Third Inter-collegiate Negotiation Competition Problem

1. Red Industries, Ltd. ("Red") is a maker of steel and automobiles in Negoland. Negoland is an Asian country with a population of 60 million and an area of 700,000 square kilometers. The capital is Nego-nego. Its climate is generally mild. The average gross national income per person is around $15,000 and its economy is comparatively stable. Negoland is comparatively rich in mineral resources. It focused on export of those resources, but recently is also developing advanced industries. Red is one of the key companies responsible for Negoland's advanced industry.
   Red was formed in 1900 as a state enterprise. Until that time, Negoland had depended on importation for arms; thus, Red's formation was an important aspect of state policy for the development of a domestic arms industry. Red manufactured tanks, machine guns, shells, and so forth. Subsequently, Red was privatized and converted to non-military industries following losing the war in 1940. Red matured focusing on two main divisions—steel goods and automobiles. In addition, reflecting its formation originally as an armaments company, Red still maintains a military relations division for tanks, shells, etc. Red's basic corporate information is contained in Attachment 1.

2. Blue Materials, Inc. ("Blue") is a producer of machines and non-steel products in Arbitria. Arbitria is a European country with a population of 50 million and an area of 400,000 square meters. For a country situated in the north, it has a comparatively mild climate due to a warm current. Arbitria is a highly developed industrialized country that has an open, export driven economy. It is also favored with natural resources. It is close to the important European market and has a highly developed economy. Its average gross national income per person is around $40,000 and its living standard, life expectancy, and populations' health are all among the highest in the world.
   Blue was formed in 1890 by the locally famous industrialist Mr. Herlock. Initially, the company focused on basic materials such as non-steel metal. Subsequently, riding the development of Arbitria's economy, it expanded and diversified into metal production, aluminum can manufacturing, automobile and motorbike parts, and semi-conductor and electrical parts. Recently, it entered the energy and environmental sectors. In particular, Blue recently has been doing research and developing on fuel cells and hydrogen retaining alloys, but nothing useable has been produced yet. In addition, Blue has also been a distributor of imported foreign cars since its founding, as Mr. Herlock was a famous automobile aficionado. Blue's import car sales division is the fully

owned subsidiary Herlock Auto, Inc. which primarily focuses on Japanese and European car makers. The president of Herlock Auto is the son of Mr. Herlock (the founder of Blue), who is also a director of Blue. Blue's basic corporate information is contained in Attachment 2.

3. Since 2003, Red has been concentrating on developing a new passenger car to address its auto division's poor performance. The concept of the development is a family car that greatly exceeds the current standards for all fuel efficiency, comfort, and handling. However, to construct the new car that Red envisions, it is necessary for the suspension and engine materials to just surpass current quality. Given this, Red's eye has been caught predominately by Blue, with its world-class technical powers in automotive parts. In 2004 spring, employees of Red visited Blue on a number of occasions and requested supply in top quality suspension and engine parts for the new car from Blue. As for Blue, presently due to the poor economy in Country N, which has been the main export market for Blue's auto part, the sales of Blue's auto parts have reached their limit. Because Blue was just looking into new products, it is considering Red's proposal with deep interest. Indeed, the car Red plans would be epoch-making surpassing all present comparative international standards. Thus, if Red succeeds in developing the car according to plan, it looks like it has a strong chance of being highly competitive in the world family car market.
Moreover, according to Red's development staff, if Blue's patented electric technology is used, they may confirm a way to lift the new car's fuel efficiency another level. Therefore, Red recently added to its proposal a request to license the relevant patent.

4. As for Blue, it has not done business in Negoland including with Red before, but it is interested in the strong potential of this plan and it had decided essentially to respond to the offer. However, Blue has the following two conditions. First, because it will have to make the engine and suspension parts especially for Red, it believes a guaranty of substantial amount of orders is necessary. Thus, Blue wants a five year promise that Red will exclusively import the new car's suspension and engine parts from Blue and purchase at least an established amount from Blue each year. Second, Blue believes that with the new car's planned attributes it might be competitive in Arbitria, thanks to Blue's supply of top quality parts and the latest electronic technology,. Thus, Blue wants its subsidiary Herlock Auto, Inc. to import the cars. Arbitria's economy is doing well and the demand for passengers cars is healthy,

but the performance of Herlock Auto has been poor in the absence of a main product. However, if Blue can accept the new car this time as a main product of Herlock Auto, they expect its sales will increase appropriately in the future. Therefore, Blue wants Herlock Auto to become the import dealer of the new cars in Arbitria.

The patent that Red hopes to license has a very high reputation internationally and normally Blue would want at least ¥100,000,000 up front and a license fee around 0.5% on all product sales. However, if they were able to get the above two conditions, they would agree at this time to an upfront fee of only ¥10,000,000 without additional license fee based on product sales, along with the offer on the engine and suspension parts. In July 2004, the information above was passed on to the Red executives who had visited Blue.

5. Red accepted all of Blue's conditions as outlined above. First, Red believed that no company other than Blue presently is able to supply the necessary quality of parts to Red. Furthermore, it will be no problem for Red to purchase all the parts from Blue, as the minimum quantity for purchase that Blue wanted is appropriate in light of Red's planned production. Second, Red's passenger car sales are 60% domestic, 20% in Asia, 15% in Africa and America, and currently Europe accounts for barely 5%. Red is thinking it wants to expand its sales in the European market and it hopes that if its brand value is able to pick up in Arbitria then this will have a positive effect on the whole of the European market. As for Herlock Auto's actual ability to sell the cars, it is a bit of an unknown quantity. However, Red was concerned that its entire proposal including the license and parts supply aspects would be rejected if they turned down this item. In addition, because Red did not know any other more appropriate seller in Arbitria, it decided to accept this point of Blue's proposal too. Moreover, Red could not manufacture its new car at this time without Blue's patent. Yet, if they had to pay a high fee for the license, it would raise the price of the new car. Because Red intended to purchase all of the engine and suspension parts from Blue anyway, Blue's suggestion of a low license fee was particularly appreciated.

6. Both companies proceeded according to this intent, and in September 2004, Blue and Red entered into the Memorandum of Understanding (Attachment 3) and concluded the License Agreement (Attachment 4). They also began development of the new car and manufacturing of the parts. Three months following this in December 2004, they completed the sample test parts, and in April 2005, they completed the test automobile. The match of Blue's parts

and electronic technology with Red's passenger car was outstanding, and the new car was the high performance vehicle for which they had hoped. It was decided to give the new car the product number X-1001. X-1001 passed each of the various tests and it was decided to begin sales in January 2007 at the base price of ¥1,800,000. Moreover, it was decided to begin sales at the same time not only in Negoland, but also in the Asian and American markets and even in Arbitria.

In June 2005, Red and Blue turn seriously toward production and sales. They enter the distributor agreement (Attachment 5) and the Supply Agreement (Attachment 6). When they are negotiating the distributor agreement two points become problems between Red and Blue. First are the requirements of Blue from Red. Red insists on a reservation for a right to terminate the distributor agreement in the event Herlock Auto's actual sales in Arbitria fail for two consecutive years to meet the minimum number of annual car sales. This is because if Red gives Herlock Auto an exclusive distributorship and Herlock Auto cannot move the expected amount, Red needs to maintain room to select another distributor. Red threatens that if this condition is not included in the contract it cannot conclude the agreement. Because Blue's legal department itself also notes that inclusion of such clauses in distributor agreements is not uncommon, Blue concedes this point. The minimum number of cars proposed by Red is 8,000 per year, but after negotiation the parties agree to 5,000.

On the other hand, Blue had an additional request of Red. According to investigation of the market done by Blue, there is robust domestic demand in Arbitria for family cars. However, comparing the domestic and foreign makers, domestic makers win an overwhelming share. The first reason for this, it is thought, is that Yellow Motors, a domestic maker, manufactures a superior and internationally competitive passenger car. However, it seems that in contrast to many other countries, in Arbitria people drive on the left side of the road, thus, cars normally driven domestically are right-hand-drive and most people tend to pass on imported cars with left-hand-drive. Therefore, Blue requests that a right-hand-drive car be manufactured for the Arbitria market. However, Red complains that to manufacture right-hand-drives, for Arbitria where the sales environment is not even proven, is a burden beyond what it wants to undertake. Furthermore, Red has not heard similar complaints from its Japanese distributor where people also drive on the left side of the road. Red's view of the situation is that, if the promotion is effective, the car will be sufficiently competitive regardless of the right/left-hand-drive issue considering the high potential of the new car. At this point the negotiator for Red states: “What if we include such clause in the contract as Red will promise to sincerely consider Blue’s request which is reasonable to increase sales in Arbitria If the adjustments will increase sales in Abritria then, limited to it being within our costs, Red would naturally look at doing these adjustments.” Blue accepts this proposal.

7. The new car exceeded expectations. From the start, sales in Negoland set records with 5,000 car sales a month after release, even though the expectation was around 3,000 per month. In Asia and America as well, the orders exceeded expectations by 30%-50% in both markets and production cannot meet the demands.
In Arbitria too, since its release in January 2007 it has performed well, but the sales thereafter began to decline. The car set a record of 500 cars per month for the three months after release, but following that it has been around the 300 cars per month level. At this rate, Blue will not clear its minimum sales figure. According to the sales staff on site, there are lots of people who have heard about the car’s high performance and visited the showroom, but many of these people give up buying one saying that they would have bought one if it came in a right-hand-drive model. Further, fueling this sentiment a well-known critic from Arbitria wrote an article in a car magazine that noted the fuel efficiency and comfort are incomparable, but the left-hand-drive of this car is difficult to handle especially on Arbitria roads. In fact, sales of the right-hand-drive have been near what Herlock Auto headquarters hoped for.
To overcome this difficulty, in April 2007 Blue requested Red quickly investigate selling right-hand-drives. However, Red responded: “We must first consider meeting the increased production demand from Negoland. Thus, we don’t have the room to satisfy the demand for a right-handed-drive.” In fact, at present the maximum production capacity is at the 6,000 cars per month level, but excluding Arbitria, orders alone are above 10,000 cars per month and the factory is working round the clock. Based on its understanding during contracting, Blue again requested that Red produce a car for Arbitria urgently. However, Red replied again that it was impossible to immediately start the production of a right-handed-drive. Red added that since the left-handed-drive was selling sufficiently in Japan, it hoped Blue might reconsider its sales strategy in light of the Japanese example and endeavor to lift its sales.

8. Despite Herlock Auto’s efforts, its sales from January to December 2007 ended up being 4,000 cars. In December 2007, at a conference for all of its foreign

and domestic distributors at Red's headquarters, Herlock Auto's representative requested production of a right-hand-drive model again. However, Red replied: "We don't ignore the situation in Abitria, but presently we are refitting a factory set up for a different model to fit the new car and that should be completed by the summer of 2008. Thus, we might have the room to produce a right-hand-drive then. Until that time, please be patient. In the interim, we hope you will use your best business efforts to increase your sales of the left-hand-drive model." Inquiring of its distributors outside Arbitria, it seems that they have been able to sell actually twice their established minimum amounts from the start. Herlock Auto, in order to remove customers' mental barrier to the left-hand drive model, have used their best business efforts by giving a sufficient opportunity of test-drive and giving free seminars on left-hand-drives for prospective buyers. However, sales have not taken off and have stopped at the 200 cars per month level.

In July 2008, the new factory was completed, but production of a right-hand-drive did not begin. At this point, the manufacturing situation allowed for production of 13,000 cars per month to 12,000 monthly orders. Therefore, it was possible to allot 1,000 cars as right-hand-drives, but to do this would incur costs in refiguring the line and Red was expecting orders to increase at the end of the year by 2,000 cars per month. Blue probed Red and Red replied: "We have completed the new factory, but just as before we are still at our limit of orders for the other countries. Moreover, it will cost us to reform the line so that it can build right-hand-drive cars, so we would have to raise the price of the right-hand-drive model to the ¥2,200,000 level correspondingly. Given all of this, we don't seem to have the capacity to manufacture the right-hand-drive car."

Herlock Auto conducted a survey of its customers who came to the showroom from July to September 2008. They then reported the results of that survey to Red in a letter in October 2008(Attachment 7). Red confirmed receipt of the letter and that they were investigating the situation, but nothing was heard again on the matter following this.

9. Around December 2008, an event arose that impacted the Red and Blue's relationship. Sales of the new car were going well and it looked like this would continue for years to come. Then, Red received a proposal from Brown Company, a maker of auto parts in the newly industrialized Country C. Focusing on the new car's strong showing, Brown proposed a supply contract for the new car's engine and suspension parts. Brown proposed that it would use different technology than Blue, but it could produce the same quality and

functionality as Blue and supply it at a 30% discounted price. An employee of Red visited Brown's factory to confirm that the quality was the same level as Blue's. Because the supply agreement with Blue contained a provision that provided Red could not purchase parts from another company during its 5-year term, Red's director of planning who was negotiating with Brown discussed the matter with his legal department. In doing this, the legal department confirmed the situation with an outside lawyer who responded that a Supreme Court decision from exactly one year ago held: "A contract that prohibits purchasing goods from another party for a term of 3 years or more is invalid, regardless of whether it actually has an anti-competitive effect, because this is per se illegal under the anti-monopoly law. It would also be the same for a contract that stipulates a minimum purchase amount from one company, because this in effect prevents the buyer from purchasing from another company." Under the standard established by this judgment, it was clear that in Negoland clause 3 of the parts supply agreement was contrary to Negoland's anti-monopoly law and invalid. Red's legal department had not been aware of the decision because they had not had opportunity to handle a purchase contract similar to this.

For now, there is no fear that this has been reported to the authority in charge of the anti-monopoly law, but if Brown complains, it is possible that Red may receive an advisory from the authority to abolish such anti-competitive agreement (Note, considering the reality of law enforcement in Negoland, Red's executives or employees will not be punished but Red will be fined about five million yen, even if Red does not follow such advisory) In addition, Red is thinking that because Brown's price is cheaper if possible it would like to purchase the parts from Brown. Nonetheless, though it might be okay if Red stops purchasing parts from Blue, Blue's patent for electric technology is an essential element of the new car, thus, it must maintain that license.

According to Red's research, development of alternative technology not dependent on Blue's patent is possible in 2 years, but until then Red must continue using Blue's patent. Red's legal department has looked into this point. Because the license agreement period is until September 2010 and causes for termination are limited to completion of the term or the insolvency of Red, they concluded that it is possible to maintain the license under the current conditions even if they stop purchasing Blue's parts.

Furthermore, regarding the dealership agreement, Blue's subsidiary Herlock Auto has been concerned about the right-hand-drive and not expanded its sales; thus, it is certain that Herlock Auto will fail to meet its minimum annual sales amount for two consecutive years. Just as all of this was happening, Red was approached by another auto import dealer in Arbitria. Therefore, within Red, there is a opinion recommending to take a hard-line by canceling the dealership agreement for failure to meet the minimum annual sales amounts for two consecutive years.

10. At the December 2008 distributors meeting, Red's executive officer in charge implicitly criticized Herlock Auto by remarking: "There is a company which is not sufficiently trying to get customers to understand the superior characteristics of the new car. Therefore, for two consecutive years the company has failed to meet the minimum sales figure." Wanting his say, the president of Herlock Auto responded with the following criticism: "It is disappointing that our company's sales have fallen short of the target. However, the reason is Red has not upheld its original promise and has taken an extremely insincere and neglectful attitude towards our situation with no attempt to understand the Arbitria market. Our company repeatedly stressed the strong demand for the right-hand-drive car in the Arbitria market and explained that if a right-hand-drive model was introduced we would produce results substantially above our target. We expected that there are a strong demand for the right-hand-drive model in Arbitria. At the time of signing the distributor contract, our company made this clear to Red and the responsible person at Red explained that as long as it could be done from a costs perspective, Red would make the adjustments to the car. Even in the contract, that gist was stipulated. It was because of that, that we felt comfortable concluding the distributor agreement. Red is a liar, as it goes on about this and that and doesn't try to satisfy its promises. As Red has taken this kind of posture, we must take the position considering switching to another company's cars." With this statement, the meeting went into an uproar and Red's executives flew into a rage. After this, there was no chance to repair the relationship between Red and Herlock Auto before 2009. In the end, Herlock Auto's number of cars sold for January to December 2008 was 3,500 falling far short of its minimum number of car sales for the second consecutive year.

11. On January 15, 2009, Red sent notice to Blue that it terminated the distributor agreement with Herlock Auto for failing to meet its minimum sales figure for two consecutive years. Further, it sent notice to Blue along the lines that from now on it would purchase parts from Brown. At that point, Red explained that clause 3 of the parts supply contract was void as a violation of Negoland anti-monopoly law. Responding to this, Blue filed for arbitration claiming (1) Red's cancellation of the distributor agreement was ineffective, and, therefore,

Blue demanded compensation for damages to Blue and its subsidiary Herlock Auto due to Red's breach of the distributor contract; (2) Purchasing parts from Brown is a violation of the parts supply agreement, and, therefore, Red is prohibited to purchase any parts from any other company than Blue prior to the end of May 2010. Red must purchase the parts of minimum quantity as agreed in the parts supply agreement, too. If the specific performance of such contractual obligations may not be ordered, Red should pay damages; (3) Assuming that the cancellation of the distributor contract is effective and that clause 3 of the parts supply agreement is void, Blue demands that Red pay an appropriate license fee for the license agreement.

Concerning the first claim, Blue submits that it could not meet the minimum sales amount, because Red continued inappropriately to deny supply of right-hand-drive cars. Therefore, it cannot accept the contract being terminated for this reason. Regarding the second claim, Blue argues that pursuant to Arbitria law clause 3 of the parts supply agreement is legal, thus, it cannot accept Red avoiding its obligation unilaterally based on the unlawfulness under Negoland law. Regarding the third claim, Blue argues that the license fee was premised on the execution of the license agreement as a part of a whole with the parts supply agreement and distributor agreement. Thus, if the distributor agreement is terminated and the promise to purchase parts continuously has no effect, then the license fee should be adjusted retrospectively, and Red should pay license fee at the same standard as applied to other licensees, that is, ¥100,000,000 up front and 0.5% of total sales amount of X-1001 from the beginning of the period of this license agreement retrospectively.

Regarding all of this Red submits as follows. Concerning the first claim, Red argues that it was plainly effective under the contract to terminate the agreement. Regarding the second claim, Red argues that clause 3 of the part supply contract is void because Negoland's anti-monopoly law should be applied to this case as the "mandatory rules which claim application irrespective of which law is applicable to the contract" in Comment 3 of Article 1.4 of UNIDROIT principles. Even assuming that Red's purchasing from Brown conflict with clause 3 of the parts supply contract, the arbitral tribunal should not prohibit such purchase from Brown nor compel Red to purchase the parts from Blue. Regarding the third claim, Red argues that because there is no provision for adjustment of the license fee in the license agreement, it is unnecessary to adjust the license fee.

Round A (Arbitration)

This arbitration will proceed pursuant to the UNCITRAL Arbitration Rules. Preceding this hearing the arbitrators have requested to submit a memorandum which expands the parties' claim and reasons on the three points below by a day designated in a separate clause.

1. The effectiveness of Red's termination of the distributors agreement;
2. Whether Negoland's anti-monopoly law should be applied to this case as the "mandatory rules which claim application irrespective of which law is applicable to the contract" in Comment 3 of Article 1.4 of UNIDROIT principles, so that the Clause 3 of the parts supply agreement must be found void. Assuming that there is no such application, whether the arbitral tribunal should order Red not to purchase parts from Brown but to purchase parts in the minimum quantity designated in the contract with Blue. Assuming that Negoland's anti-monopoly law is not applied and the arbitral tribunal does not order Red to purchase parts from Blue, for which loss Blue should be compensated (Note: it is unnecessary to calculate the amount, rather it is enough to itemize the losses to be compensated); and
3. Whether the tribunal should order Red to pay ¥100,000,000 up front and 0.5% of the total sales amount of X-1001 from the beginning of the period of this license agreement retrospectively.

At the arbitration on November 20, a hearing on the above points will be held with first Blue and then Red to give oral arguments for 15 minutes each. Further, on the day of the hearing, both parties may make arguments which are not mentioned in their preliminary documentary submissions.

In addition, though Blue and Herlock Auto have separate legal personality, Herlock is a wholly owned subsidiary of Blue. Therefore, for these arbitration proceedings, the parties and arbitrators have agreed to treat jointly the dispute concerning the license agreement and parts supply agreement with Blue and the dispute regarding the distributor agreement in which Herlock Auto is a party.

Round B (Negotiation)

The time has reverted to 2004. All of the various events from Round A (from section 3 on) have not happened and we begin a new story.

1. As a means to break through the automotive division slump, Red is presently aiming to develop an environmentally friendly car that captures the world's attention. Basically, the idea is to develop a fuel cell car powered by fuel cells using hydrogen.
Red has consistently committed a sufficient budget to research for environmental policy in its automotive department. Particularly until the first part of 2000, Red was conducting the most advanced research on fuel cell cars in line with Japanese and American makers' research. In 2001, they even produced a test car. At that time, the problem was the price, weight, and size of the fuel cells and actual application was a long way off. After that, the research budget was cut due to the automotive division slump. There have not been any eye-catching results but research is continuing.
Added to this background, recently there has been a remarkable increase in the interest in the environment in Negoland; this is the reason Red is focusing on developing the fuel cell car. If it can succeed in making an environmentally friendly car, Red dreams its current low market share around the 5% level will rise to near 20%.

2. Blue in recent years has put its energy into the environmental business, for example, development and manufacture of environmentally improved ceramics, consulting regarding recycling plants, surveys of contaminated soil and removal of contamination, development of fuel cells, and so forth. Recently, in Arbitria a Contaminated Soil Policy Act was enacted with basically the same contents as the law effected in Japan in 2002. At the termination of use of facilities for the disposal and manufacturing of toxic substances, the owner of land or premises has an obligation to have property with possible contaminated soil investigated by a government designated survey institution to determine whether or not it is polluted. In case there is contamination, the owner has an obligation to remove it. Blue has been designated an official survey institution. In addition, Blue has achieved results from its development of fuel cells and it has tied up with Black Company, a large automobile maker in Arbitria, to develop a fuel cell car. Blue's fuel cells were also put into the fuel cell cars which Black started to sell in 2003, but in 2003 there was an incident where one of Blue's fuel cells exploded, injuring around 50 of Black's

employees. Assigning responsibility between the companies has given rise to difficulty and Blue has ended its cooperative relationship with Black on the development of the fuel cell cars. However, Blue and Black continue as before to transact in other areas such as supply of automobile parts.

3. Exactly at the same time Blue was ending its collaboration with Black, Red proposed cooperating on the development of fuel cell vehicles with Blue. Red made a definite proposal: According to Red, it seems each bus company in Negoland plans to covert its domestic bus lines to fuel cell vehicles as part of the national environmental environmental policy. Negoland's other automobile makers manufactures passenger cars, and there is only one other company than Red that manufactures large buses. Therefore, Red proposes setting up a joint venture company with Blue to specialize in the development of fuel cell cars in Negoland and then manufacture fuel cell vehicles for the domestic bus routes in Negoland. Red was thinking that it could incorporate Blue's fuel cells, which were of the highest technological standard, into its buses. In the case of bus routes, because the routes are set and comparatively large hydrogen tanks can be carried on buses, it is easy to address what has been the largest obstacle to fuel cell cars by setting up hydrogen filling stations on the route. Red and Blue's technicians believe that in a year they should be able to develop sufficiently a practically possible bus and do the other related preparations. As such, basic discussions regarding setting up a joint venture have begun.

4. In October 2004, the first main meeting was held and a wide-ranging discussion was made. From this, the parties agreed that they will aim to establish a joint venture company in Negoland with 50% capital from each party in April 2005 and the details regarding what is needed for manufacturing of the fuel cell bus are to be filled in later. Discussion regarding the details is to continue at a second meeting in November. At the second meeting the points below in particular will be debated and it is planned that a "letter of intent" will be drafted. In addition, because both presidents will attend, there will be a wide discussion as to both companies' cooperation beyond establishing the joint venture. Negoland's corporate law is essentially the same as Japan's.

Details to be discussed include:

(1) Joint company's structure;
(2) Joint company's name;
(3) Joint company's key executives;

(4) The rules for making corporate decisions;
(5) The substance of the joint company's business; and
(6) The means for exchanging technical information.

5. During the time all of this was going on, on November 10 it was reported in Negoland newspaper that Black was aiming for Red's fuel cell technology and was investigating proposing a joint operation. If the article is to be believed, after ending its cooperation with Blue, Black was putting together a new joint project on the fuel cells with Orange Company. However, by including Red's fuel cells technology, which was superior to its own and by picking up the pace of the development of a practical fuel cell car, Black wanted to take over the route bus business in Negoland.

(Attachment 1)

Red's Basic Corporate Information (as of November 2004)

Corporate Name:	Red Industries, Ltd.
Established:	November 3, 1900
Headquarters:	Negonego, Negoland
Factories, Branches:	In Negoland, 4 factories and 5 branch/sales offices. In New York and Singapore there are subsidiaries for sales in America and Asia.
Employees:	20,000 approximately

Results (in hundred thousands yen)

	Sales	Operating Profits	Pre-Tax Profits
2000	800,000	16,000	4,000
2001	1,000,000	24,000	6,000
2002	750,000	(20,000)	(5,000)
2003	650,000	(28,000)	(6,000)

Sales by Industry (in hundred thousands yen)

	Steel Goods	Auto	Military
2000	350,000	350,000	100,000
2001	450,000	450,000	100,000
2002	350,000	300,000	100,000
2003	350,000	200,000	100,000

Notes: From 2001 to 2002, a series of defects being found in the company's passenger cars resulted in frequent recalls. This was widely reported in Negoland and is related to the drop in the passenger car division's sales after 2002. The decline in income in 2002 and 2003 is due to the costs related to the recall plus the decreased sales of the auto division. In 2004, the recall obligations are winding up but the sales of the auto division have not recovered to normal level. The steel goods and military divisions were steady, but overall results were influenced by the auto division's poor performance. Profit predictions are for the company to finally return to profitability.

(Attachment 2)
Blue’s Basic Corporate Information (as of November 2004)

Corporate Name:	Blue Materials, Inc.
Established:	May 3, 1890
Headquarters:	Arbarb, Arbitria
Factories, Branches:	In Arbitria, 10 factories and 3 branch offices. Additionally, overseas there are 8 manufacturing bases and sales offices for the company’s products.
Employees:	10,000

Results (in hundred thousands yen)

	Sales	Operating Profits	Pre-Tax Profits
2000	900,000	20,000	(25,000)
2001	1,000,000	40,000	10,000
2002	1,100,000	50,000	20,000
2003	1,000,000	40,000	15,000

Sales by Industry (in hundred thousands yen)

	Non-steel	Semiconductors & Electric Parts	Auto Parts	Other
2000	300,000	300,000	250,000	50,000
2001	400,000	300,000	200,000	100,000
2002	450,000	300,000	200,000	150,000
2003	400,000	250,000	180,000	170,000

Notes: In 2000 due to a failure of foreign investment, pre-tax profits resulted in a loss, but following that the results have shown a firm improvement pushed by the increased supply of aluminum related goods. The automotive parts division has done poorly due to the poor economy in Country N, which is the main destination for deliveries, but steady increases are shown in the other category mainly due to the environmental business.

（Attachment 3）

MEMORANDUM OF UNDERSTANDING

This Memorandum expresses our mutual intent of Red Industries, Ltd. (“Red”) and Blue Materials, Inc. (“Blue) to cooperate Red’s project (“Project”) to produce the new car (the “Car”) which Red has been developing.
Red requested Blue to provide the parts of engine and suspension of the Car with the quality specified by Red and to grant the licenses of the patents for the control mechanism held by Blue. Blue accepted Red’s request and both parties intend to negotiate and conclude final binding contracts (the “Definitive Agreements”) with respect to the matters set forth below.

1. Blue will provide the parts of engine and suspension of the Car as requested by Red. Red will promise to purchase more than the minimum amount of the parts which is mutually agreed by the parties and will not purchase the parts from other companies than Blue at least for five years from the first purchase of the parts.
2. Blue will grant Red with the licenses of the patents of the control mechanism. Red shall pay ¥10,000,000 for up-front royalty at signing and no running royalty is required.
3. Red will appoint Herlock Auto, Inc., the subsidiary of Blue as the sole distributor of the Car in Arbitria.
4. Red and Blue will keep each other’s confidential information strictly secret and will not reveal the existence of this memorandum to any third party without the other party's approval in advance.
5. This memorandum represents the good faith intentions of the parties to proceed with the Project but is not legally binding and creates no legal obligations on either party. Its sole purpose is to set out the principles on which the parties intend in good faith to negotiate the Definitive Agreements.

Dated: September 24, 2004

Red Industries, Ltd.

Blue Materials, Inc.

（Attachment 4）

PATENT LICENSE AGREEMENT

THIS AGREEMENT is made and entered into by and between Red Industries, Ltd., a corporation of Negoland (“Red”), and Blue Corporation, a corporation of Arbitria (“Blue”), as of the 27th September, 2004

WITNESSETH

WHEREAS, Blue owns patents in certain countries of the world with respect to Licensed Technology (defined below); and
WHEREAS, Red desires to acquire license under such Blue's patent; and
WHEREAS, as a part of the mutual cooperation to manufacture the new car mentioned in the Memorandum of Understanding between Red and Blue dated _______________, Blue is willing to grant such license to Red.

NOW, THEREFORE, in consideration of the mutual covenants and premises contained herein, the parties hereto agree as follows:

Section 1. DEFINITIONS

1.1 "Licensed Technology" shall mean the control mechanism as specified in the Attachment 1.

1.2 "Licensed Patent” shall mean all the patents issued under the following patent applications and their divisions, continuations and continuation-in-parts, and all reissues of any of the foregoing patents.

1.3 “Licensed Territory" shall mean the countries in which Licensed Patents are in existence.

1.4 “Car” shall mean the car which will be produced by Red and specified with the products No. X-1001.

Section 2. GRANTS OF LICENSES

2.1 Blue hereby grants for the term of this Agreement to Red, subject to the conditions under this Agreement, a non-exclusive and non-transferable license, without the right to sublicense, under Licensed Patents to use Licensed Technology in the Licensed

Territory.

2.2 Red is allowed to use the Licensed Technology only for the purpose of its production of the Car, and is prohibited to use the Licensed Technology for any other purpose.

Section 3. LICENSES FEE

3.1 In consideration of the license set forth in Section 2 above, Red shall pay ¥10,000,000 for the upfront royalty within 30 days after the date of this Agreement.

3.2 No running royalty shall be charged.

Section 4. TERM AND TERMINATION

4.1 This Agreement shall become effective on the date of this Agreement and shall, unless earlier terminated pursuant to Sections 4.2 or 4.3 below, continue until the sixth anniversary of the date of this Agreement.

4.2 In the event of a breach of this Agreement by one party hereto, and if such breach is not corrected within ninety (90) days after written notice complaining thereof is received by such party, the other party may terminate this Agreement forthwith by written notice to that effect to such party.

4.3 Blue shall also have the right to terminate this Agreement forthwith by giving written notice of termination to Red at any time, upon or after:

(a) the filing by Red of a petition in bankruptcy or insolvency; or
(b) any adjudication that Red is bankrupt or insolvent; or
(c) the filing by Red of any legal action or document seeking reorganization, readjustment or arrangement of Red's business under any law relating to bankruptcy or insolvency; or
(d) the appointment of receiver for all or substantially all of the property of Red; or
(e) the institution of any proceedings for the liquidation or winding up of Red's business or for the termination of its corporate charter; or
(f) the assignment to third party of all or substantially all of the assets of Red; or
(g) important change in controlling ownership of Red; or
(h) any activity or assistance by Red of challenging the validity of any Licensed Patents or restricting the scope thereof.

4.4 In the event of termination of this Agreement by Blue pursuant to Sections 4.2 or 4.3 above, the licenses granted hereunder to Red shall automatically terminate when Red has received or is deemed to have received such termination notice hereunder.

Section 5. NEW PATENTS

A new patent derived from any improvement over inventions covered by the Licensed Patents:
(i) is owned by Blue and the non-exclusive license shall be granted to Red at a reasonable royalty, if invention is made solely by Blue. Detailed terms and conditions for such license shall be separately agreed upon between the parties.
(ii) is owned by Red and the non-exclusive license shall be granted to Blue at a reasonable royalty, if invention is made solely by Red. Detailed terms and conditions for such license shall be separately agreed upon between the parties. However, the non-exclusive license for a patent for which the invention is made within five years after the date of this Agreement shall be royalty free.
(iii) is owned jointly by Red and Blue, if invention is made by Red and Blue. Each party shall be free to practice and use such jointly owned patent on a world-wide, non-exclusive basis without accounting to and royalty-free to the-other party. Each party shall be free to license jointly owned patent to their subsidiaries but licenses to third parties may be granted only upon the other party's prior consent, which may not be unreasonably withheld.

Section 6. MISCELLANEOUS

6.1 The parties hereto shall keep the terms and conditions of this Agreement (except the existence of this Agreement) confidential and shall not divulge the same or any part thereof to any third party except:
(i) with the prior written consent of the other party; or
(ii) to any governmental body having jurisdiction to request and to read the same; or
(iii) as otherwise may be required by law or legal process; or
(iv) to legal counsel representing either party; or
(v) as required for review by the competent authorities of the Negoland or the Arbitria Government.

6.2 The construction and performance of this Agreement shall be governed by and shall be subject to UNIDROIT principles of International Commercial Contracts.

6.3 The parties hereto shall use their best efforts to resolve by mutual agreement any disputes, controversies or differences which may arise from, under, out of or in connection with this Agreement. If any such disputes, controversies or differences cannot be settled between the parties hereto, they shall be finally settled by arbitration in Tokyo, Japan under the UNCITRAL Arbitration Rules and by two (2) arbitrators appointed in accordance with the said Rules. The award rendered by the arbitrators shall be final and binding upon the parties hereto. Judgment upon the award may be entered into any court having jurisdiction thereof.

6.4 Any failure of either party to enforce, at any time or for any period of time, any of the provisions of this Agreement shall not be construed as a waiver of such provisions or of the right of such party thereafter to enforce such provisions.

6.5 If any term, clause or provision of this Agreement shall be judged by the competent authority to be invalid, the validity of any other term, clause or provision shall not be affected; and such invalid term, clause or provision shall be deemed deleted from this Agreement.

6.6 All notices required or permitted to be given hereunder shall be sent in writing by certified or registered airmail, or facsimile (with a confirmation letter thereof) to the address specified in the attachment or to such changed address as may have been previously specified in writing by the addressed party. Unless otherwise proven, each such notice given by either party hereto shall be deemed to have been received by the other party on the fourteenth (14th) day following the mailing date or on the second (2nd) day following the facsimile date.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed in duplicate on the date first above written.

Red Industries, Ltd.	Blue Materials, Inc.
____________________________	____________________________

（Attachment 5）

AGREEMENT

This AGREEMENT is made as of this 1st day of June, 2005 by and between Red Industries, Ltd, a corporation organized and existing under the laws of Negoland (hereinafter called "RED") and Hurlock Auto, Inc., a corporation organized and existing under the laws of Arbitria (hereinafter called "DISTRIBUTOR")

WITNESSETH:

1. Appointment

RED hereby appoints DISTRIBUTOR as its exclusive distributor for the sale of the Car No. X-1001 (hereinafter called "PRODUCTS") in Arbitria (hereinafter called "TERRITORY"), and DISTRIBUTOR hereby accepts such appointment.

2. Relationship between RED and DISTRIBUTOR

The relationship between RED and DISTRIBUTOR shall not be that of a principal and an agent but shall be solely that of a seller and a buyer, and DISTRIBUTOR shall not conclude any contract or agreement or make any commitment, representation or warranty which binds RED or otherwise act in the name of or on behalf of RED, nor hold itself out as entitled so to do.

3. Terms of Sales

RED shall sell to DISTRIBUTOR and DISTRIBUTOR shall purchase from RED PRODUCTS subject to the terms and conditions to be mutually agreed upon by entering into a" CONTRACT OF SALE" in the form of RED attached hereto as Exhibit, as may be amended by RED.

Unless otherwise specifically agreed, the provisions contained in this Agreement shall govern and supersede any conflicting printed provisions contained in said form.

In case of any conflict between the provisions contained herein and any handwritten or typed terms and conditions contained in said form, the latter shall prevail.

4. Minimum Sales

DISTRIBUTOR shall sell at least 5,000 PRODUCTS to its customer in the TERRITORY for each Contract Year

The term "Contract Year" means the one (1) year period beginning on the date which the parties will mutually agree as the date to commence the sale of PRODUCTS in the TERRITORY and each one (1) year period beginning on the anniversary thereof, during the term of this Agreement..

5. Information

DISTRIBUTOR shall furnish RED, periodically and from time to time as requested by RED, with written reports with respect to the following –

(a) Monthly volume of sales of PRODUCTS in TERRITORY;
(b) Monthly inventory of PRODUCTS;
(c) Semi-annual financial statements of DISTRIBUTOR certified by a certified public accountant;
(d) Sales promotion activities for PRODUCTS in TERRITORY;
(e) Customer complaints and other claims including, without limitation, product liability claims;
(f) Changes in local laws affecting PRODUCTS, their importation, distribution or insurance; and
(g) Market information affecting sales of PRODUCTS.

6. Duties of Distributor

DISTRIBUTOR agrees to actively and diligently promote the sale of the PRODUCTS in the TERRITORY.

DISTRIBUTOR agrees to promote in the TERRITORY the names RED and the PRODUCTS.

7. Exclusive Distributorship

During the term of this Agreement or any renewal, and for so long as Distributor shall not be in default hereunder or under any CONTRACT OF SALE for PRODUCTS referred to in Clause 3 above, RED shall not sell PRODUCTS to any person or entity in TERRITORY other than DISTRIBUTOR and shall refer to DISTRIBUTOR any inquiry for PRODUCTS which RED may receive from any person or entity in TERRITORY.

8. Duties of Red

RED agrees to furnish DISTRIBUTOR with reasonable quantities of catalogs, manuals, advertising literature and other sales aids that may be available by RED.

RED further agrees to provide Distributor with reasonable support and technical assistance upon terms and conditions to be agreed upon from time to time.

RED agrees to uses its best efforts to meet the proposals and/or request by DISTRIBUTOR to increase the sale of the PRODUCTS in the TERRITORY in such manner as Red thinks appropriate as far as RED considers that such proposals/requests are commercially reasonable and shall not cause substantial cost on RED.

9. Sales in TERRITORY only

DISTRIBUTOR shall sell PRODUCTS only in TERRITORY and shall not sell or export PRODUCTS to any person or entity outside TERRITORY or to any person or entity within or without TERRITORY which DISTRIBUTOR knows or has reason to know intends to sell or export such PRODUCTS outside TERRITORY.

10. Prohibition of Assignment

Neither this Agreement nor any right or obligation hereunder shall be assigned or delegated by DISTRIBUTOR without the prior written consent of RED which may be withheld in its sole discretion.

11. Waiver

The failure of either party to enforce at any time or for any period of time any of the provisions of this Agreement shall not be construed as a waiver of such provision or the right of the party thereafter to enforce each and every such provision.

12. Effective Period

This Agreement shall be effective for a period of five (5) years commencing on the date hereof and shall thereafter be automatically extended for successive two (2) year renewal terms, unless either party gives the other a notice of termination in writing at least three (3) months prior to the expiration of the original term or any such renewal term of this Agreement. If the minimum purchase quantity for any renewal term is not agreed upon between the parties, the minimum quantity which DISTRIBUTOR shall purchase for such two (2) year period shall be the same with the minimum quantity applicable to the previous Contract Year.

13. Termination

Notwithstanding anything to the contrary contained herein, including Article 12 above, RED may terminate this Agreement at any time, without prejudice to any other rights RED may have hereunder or by law, if –

(1) DISTRIBUTOR fails to pay any money due hereunder or under any sales contract for PRODUCTS;

(2) DISTRIBUTOR fails to perform any other obligations hereunder or under any sales contract for PRODUCTS and does not cure such failure within fourteen(14) days of a notice by RED stating such failure;

(3) proceedings in insolvency or bankruptcy or winding up or any other similar proceedings are instituted by or against DISTRIBUTOR or a receiver for DISTRIBUTOR is appointed; or

(4) DISTRIBUTOR fails to meet the minimum sales as specified in section 4 of this Agreement for the consecutive two years; or

(5) there is a change in the control or management of DISTRIBUTOR which is not acceptable to RED.

Upon any such termination of this Agreement, RED may cancel any or all undelivered sales contract(s) for PRODUCTS concluded between RED and DISTRIBUTOR hereunder. DISTRIBUTOR waives any claim for compensation or damages in connection with such cancellation of undelivered sales contract(s) for PRODUCTS.

14. No Compensation for Termination

RED shall not be liable to DISTRIBUTOR under any circumstances, because of the termination of or refusal to renew this Agreement, for any compensation, reimbursement or damages including, without limitation, those on the account of the loss of prospective profit on anticipated sales or on account of expenditures, investments, leases or any type of commitments made in connection with the business of DISTRIBUTOR in any manner whatsoever. DISTRIBUTOR hereby expressly waives, to the full extent permitted by applicable law, the right to recover, and agrees not to seek to recover, any damages on account of incidental, consequential or special losses and damages.

15. Settlement of Dispute

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 in Tokyo, Japan, pursuant to the UNCITRAL Arbitration Rules and by two (2) arbitrators. The arbitration award shall be final and binding on both parties.

16. Notice

Any notice required hereunder shall be delivered in person, by registered air mail with postage fully prepaid in an envelope properly addressed or by telex, cable or fax followed by a confirmation letter by such registered air mail, to the respective party at the address as set forth in the attachment or at such different address as may be given by either party to the other by such written notice. Any such notice shall be considered to have been given when delivered in person or when dispatched by such telex, cable or fax or at the expiration of seven (7) days after the date on which a notice by such registered airmail has been posted, respectively. All notices shall be in the English language.

17. Governing Law

All questions arising out of or under this Agreement shall be governed by and construed in accordance with UNIDROIT Principles of International Commercial Contracts.

18. Entire Agreement

This Agreement is intended by the parties as the final expression and the complete and exclusive statement of the terms of the agreement between the parties with respect to the distribution of PRODUCTS and supersedes any other prior or contemporaneous written or oral agreement or understanding that the parties may have had.

19. Modification of Agreement

No modification of this Agreement shall be binding on RED or DISTRIBUTOR unless made in writing and signed on behalf of the party against which the enforcement of such modification is sought.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date and year first above written.

Hurlock Auto, Inc.	RED Industries, LTD.
By:	By:

（Attachment 6）

SUPPLY AGREEMENT

SUPPLY AGREEMENT, dated as of June 1, 2005, between Red Industries, Ltd. ("Red") and Blue Materials, Inc. ("Blue").

WHEREAS, as a part of the mutual cooperation to manufacture the new car mentioned in the Memorandum of Understanding between Red and Blue dated _______________, the parties desire that Red shall from time to time order Products (as defined below) and Blue shall deliver the Products on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual promises and agreements herein contained and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto hereby agree as follows:

1. ORDERS

(1) During the term of this Agreement, Red from time to time place orders for Products with Blue (each an "Order"). "Products" shall mean the engine and suspension parts for the newly developed car by Red as specified in the attachment in more details.

(2) Once an Order is placed by the Red, Blue shall use its commercially reasonable efforts to fill such Order as promptly as practical in accordance with the terms of such Order.

(3) Price of the Products shall be as specified in the attachment.

2. DELIVERY

(1) Blue shall deliver the Products ordered by Red on the basis of CIF, NegoNego port. The trade term, CIF as used herein shall be interpreted in accordance with INCOTERMS 2000.

(2) As a condition precedent to recovery for any claim for shortages or errors in filling an order or for the damaged or defective Products, Red must inspect the Products and make claim, if any, within fifteen (15) days after receipt of such Products.

(3) In the event Red defaults in any payment to Blue or otherwise defaults in the performance of this Agreement, Blue shall have the right, in addition to any other right or remedy, to suspend delivery of the Products ordered by Red but not yet shipped or to freely dispose of the same at Blue's discretion.

3. MINIMUM PURCHASE

(1) Red shall purchase the minimum quantity of the Products as specified in the attachment. If Red fails to purchase the minimum amount of the Product, Red shall pay to Blue the difference between the minimum quantity and the quantity actually purchased.

(2) Unless otherwise agreed by Blue in writing, Red shall purchase all engine and suspension parts which are necessary for the production of X-1001 from Blue as far as Blue can meet specification and quality requested by Red without raising the price for five years from the date of this Agreement.

4. REPRESENTATION

The parties represent and warrant each other that

(1) it has a power to enter into this Agreement and to exercise its right and perform its obligations hereunder;

(2) the obligations expressed to be assumed by it in this Agreement are legal and valid obligations binding on it in accordance with the terms hereof;

(3) it has obtained any necessary governmental permission, licenses, authorization or clearances, if any, to execute this Agreement.

5.TERM

(1) Unless sooner terminated pursuant to other provisions of this Agreement, the term of this Agreement shall be five (5) years period commencing on the date hereof. This Agreement shall be subject to automatic extension for additional two (2) years periods unless either party, with or without cause, shall give written notice of termination to the other not less than ninety (90) days prior to the end of the initial term of this Agreement or any extension thereof.

(2) If Red is in default on any payments due for a period of thirty (30) days after written notice thereof; or if Red defaults in performing any other terms or conditions of this Agreement or any individual sales contract and remains in default for a period of thirty (30) days after written notice thereof; or if Red is adjudicated a bankrupt, goes into liquidation, receivership, or trusteeship, makes a composition with its creditors or enters into any similar proceeding of that nature; or if a majority of Red's equitable ownership is transferred; or if an major change in the business operation of Red occurs, Blue will have the right to terminate this Agreement immediately upon giving written notice to Red.

6.MISCELLANEOUS

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

(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 in Tokyo, Japan, pursuant to the UNCITRAL Arbitration Rules and by two (2) arbitrators. 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 Industries, Ltd. Blue Materials, Inc.

(Attachment 7)

Hurlock Auto, Inc

Mr./Mrs. _________
President
Red Industries, Ltd.

Dear Mr./Mrs.__________,

It was nice to see you at the Distributors Conference in the last December. It is regrettable, however, that the situation between us has not been improved since then.

We made a customer survey at our showrooms from July to September. We had about 20,000 customers visited our showrooms to see X-1001, but only 500 customers actually bought. We asked the reason why other customer didn't choose X-1001. 5,000 customers kindly cooperated with the survey.

Left-hand-drive	70%	
Price	20%	
Design	20%	
Performance	3%	(Multiple Answer)

We also asked to the customers who bought other family cars if they would have bought X-1001 assuming that Right-hand-drive model of X-1001 had existed and the price is less than 2,200,000 yen.

Definitely	20%
Probably	30%
If cheaper than 2,000,000yen	20%
No	30%

I believe above result of the survey clearly shows that if you could provide Right-hand-drive model, we could easily achieve our target and drastically improve the current situation. It is also clear that customers have a room to accept small increase of price reflecting high quality of X-1001.

I strongly recommend you that you accept the above facts and take necessary steps. We should not disregard the voice from customers who have been waiting X-1001 Right-hand-drive model.

I look forward to hearing from you.

Best regards,

President