CHOCOLATE CASE

On 10 December 2013, Red Corp. ("**Red**") and Blue Inc. ("**Blue**") signed a chocolate sales contract ("**CSC**") under which Blue agreed to import chocolate manufactured by Red, for sale in leading department stores in Arbitria [Record ("R") ¶29, p. 12]. The Parties agree that applicable substantive law governing the CSC is the UNIDROIT Principles of International Commercial Contracts 2010 ("**UNIDROIT**"). There have been various complications with performance under the CSC. This resulted in some significant modifications to the contract, providing for a change from cargo ship to air freight and a different risk allocation. Blue discharged its obligations, but Red failed to deliver part of the shipment. As a result, Blue was forced to pay penalties to the department stores. Two issues arise in this dispute, both concerning the allocation of cost and risk between the Parties. Blue submits that Red is liable to reimburse Blue for the penalties (**I**), and Red is responsible for the costs of air freight (**II**).

I RED MUST REIMBURSE BLUE US$1 MILLION FOR THE PENALTIES

The Parties expressly stipulate in the written agreement that time is of the essence [Art. 3(3) CSC]. Red was under an obligation to ship the goods on 10 January 2014 in order to ensure delivery of the shipment by 31 January 2014, or bear the consequences for breach of the CSC including the penalties and costs.

A. RED BREACHED ITS DUTY TO ACHIEVE A SPECIFIC RESULT

Red's contractual obligation to ship the goods "by January 10" [Art. 3(2) CSC] constitutes a duty to achieve a specific result [Art. 5.1.4(1) *UNIDROIT*]. This did not occur. Red therefore breached the CSC on 10 January 2010 non-performance of this obligation [Art. 7.1.1 *UNIDROIT*] giving Blue a right to avoid the contract [Art. 3.2.4 *UNIDROIT*]. Further, Red was actually in breach of the CSC earlier, when it became impossible for it to load the goods onto the scheduled ship by 10 January. It takes "two full days at least from the receipt of the letter of credit to the completion of loading" [*R* ¶31, p. 13]. Red did not even 'press' Negoland Bank to issue the letter of credit until 9 January 2014. Therefore, as at 8 January, Blue had a right to terminate the contract for anticipatory non-performance since is was impossible for Red to fulfil its specific obligation [Art. 7.3.3 *UNIDROIT; UNIDROIT Commentary*].

B. RED CANNOT RELY ON NEGOLAND BANK'S DELAY TO ESCAPE RESPONSIBILITY

It is irrelevant that the delay was partly due to error by Negoland Bank, or that businesses were closed for the holiday season. Blue informed Red on 19 December 2013 that it had requested that Arbitria Bank issue the letter of credit, and that it would arrive at Negoland Bank "in two to three days" [*R* ¶30, p. 13]. Red then neglected the matter until 7 January 2014, when it finally discovered that the letter of credit had not been advised. Red had ample time during this period to inquire about the status of the letter of credit and to follow up with Negoland Bank, but failed to do so. Even after discovering the delay, Red waited two days before 'pressing' Negoland Bank to issue the letter of credit. This constitutes a failure to cooperate with Blue in the performance of its obligations [Art. 5.1.3 *UNIDROIT*] and a general failure to act in good faith and fair dealing [Art. 1.7 *UNIDROIT*], and Red cannot rely on the delay at Negoland Bank to excuse its non-performance.

C. BLUE ALLOWED RED ADDITIONAL TIME TO PERFORM

After learning of the error by Negoland Bank, Red waited four days until 11 January 2014 before contacting Blue to inform it of the situation [*R* ¶32, p. 14] – Red waited until it had already breached Art. 3(2) CSC. Nonetheless, Blue acted in good faith [Art. 1.7 *UNIDROIT*] by allowing Red additional time to perform its obligations of shipment and delivery [Art. 7.1.5 *UNIDROIT*]. As timely delivery of the goods was a fundamental part of the contract, the effect of this extension was that Blue would not pursue termination or other remedies during the additional period for performance, but if Red failed to meet its revised obligations then Blue would have access to the usual remedies for non-performance [*UNIDROIT Commentary,* Art. 7.1.5].

This modification was effected by the conversation between Swan and Emerald on 11 January 2014, who were acting as agents for Red and Blue respectively, with authority to bind their employers [*R* ¶32, p. 14]. This directly affected the legal relations between the Parties [Art. 2.2.3 *UNIDROIT*] creating a modified agreement ("**Modified CSC**").

Red cannot rely on Art. 9 CSC to deny the effect of the Modified CSC. Although this clause seems to require amendments to be in writing, Red's conduct was such as to purportedly amend the contract. Red is therefore precluded from asserting this clause because Blue has relied on the conduct of Red in its subsequent actions [Art. 2.1.18 *UNIDROIT,* as applied in *GEC Marconi Systems Pty Ltd. v BHP Information Technology Pty Ltd. and Others* [2003] FCA 50]. Blue accepted a different form of delivery, payment and risk allocation from that agreed in the initial CSC in reliance on the oral modifications agreed by Swan.

D. RED BORE THE COST AND RISK FOR DELIVERY UNDER THE MODIFIED CSC

Under the initial CSC, the Parties agreed on trade terms of CFR (Incoterms 2010) [Art. 3(1) CSC]. However, this Incoterm is only applicable to carriage by sea and inland waterways [ICC Guide to Incoterms ® 2010 CFR]. When the Parties agreed on air freight, CFR could no longer apply. It is clear from the discussion between Swan and Emerald that the Parties objectively intended [Arts. 4.1, 4.3 *UNIDROIT*] for Red to bear the cost and risk of sending the chocolate by air freight. Emerald told Red that it "should deal with this trouble on [its] responsibility", and Red did not contest this [*R* ¶32, p. 14].

Further, Blue was to "pay the price by remittance to [Red's] bank account after the receipt of the goods" [*R* ¶32, p. 14], indicating that the Parties agreed for Red to be responsible for the risk of the goods until they were delivered to Blue. This is supported by the subsequent conduct of the Parties – Blue paid Red for the first batch of chocolate only "after Blue's receipt of the goods" [*R* ¶33, p. 15]. Red's failure to purchase insurance for the goods during air freight should not absolve Red of liability for its failure to deliver the second batch.

E. RED CANNOT RELY ON FORCE MAJEURE TO EXCUSE ITS NON-PERFORMANCE

Red may seek to rely on the force majeure clause contained in either Art. 6 CSC [*R* Exhibit 6, p. 38] or Art. 7.1.7 *UNIDROIT* to escape liability for its failure to deliver the second shipment. However, the specifically agreed force majeure clause is narrower in application than Art. 7.1.7 *UNIDROIT*. The Art. 6 CSC provisions will apply exclusively, because the Parties are at liberty to modify the application of the UNIDROIT Principles [Art. 1.5. *UNIDROIT*] and specific terms in principle override general terms [e.g. Art. 2.1.21 *UNIDROIT*]. This understanding is supplemented by cases such as *YPFB Andina S/A v UNIVEN Petrocquimica Ltd* (Brazil 08/15/2012) where parties successfully relied on a force majeure clause in situations involving unforeseeable regulatory and policy change issued by a government body. The effect of Art. 6 therefore displaces the presumption that natural disasters (as defined in section 3[e] of the *ICC Force Majeure Clause 2003*) fall under the scope of Article 6 [*R* Exhibit 6, p. 38].

In addition, mechanical failure and lightning strikes do not constitute a wholly unforeseeable supervening disaster that meets the definition of a force majeure event. This is a very high threshold, as confirmed in *Kangwei Pharmaceutical v Asia Pharmaceutical* [2012, Supreme People's Court of the People's Republic of China], where the tribunal found that the SARS epidemic could not constitute a force majeure event. In contrast to these examples, mechanical failings lightning strikes are common natural occurrences and Red could have reasonably acted by obtaining insurance against such types of loss to prevent the consequences of non-performance. The underlying principle of *pacta sunt servanda* must apply [Art. 1.3 *UNIDROIT*]; Red cannot rely on force majeure as an excuse for its non-performance.

F. RED CANNOT RELY ON NEGOLAND PRECEDENT TO EXCUSE ITS NON-PERFORMANCE

Red claims they have performed their obligations under the CSC in accordance with Negoland legal precedent [*R* Exhibit 9, p. 41] by not shipping the goods until the letter of credit had been advised. However, as both parties consented to be governed by the UNIDROIT Principles, mere observance of domestic law will not allow Red to escape liability under the arbiter of international law and business practice. In *Fortis Bank and Stemcor UK Limited v Indian Overseas Bank* [2010] EWCA Civ 58, the English Court of Appeal adopted a purposive approach to the interpretation of the Uniform Customs and Practice for Documentary Credits ("**UCP 600**"). This decision reflects a standardisation of international banking practice that is not affected by the observance of domestic legal norms. In any event, by failing to take prompt action once the delay had been discovered [*R* ¶31, p. 13], Red's actions were the ultimate cause of the non-performance, regardless of Red's compliance with domestic Negoland law.

G. BLUE IS ENTITLED TO DAMAGES IN COMPENSATION FOR THE LOSS SUFFERED

Red's non-performance has resulted in loss to Blue in the form of penalties paid to the department stores. Blue has a right to damages for non-performance and full compensation for the losses suffered [Arts. 7.4.1, 7.4.2 *UNIDROIT*]. This type of loss to Blue was a foreseeable result of delay – indeed at the time of contracting Red knew of the penalties [*R* ¶32, p. 14]. Therefore, the penalties were a certain and foreseeable result of non-performance [Art. 7.4.4 *UNIDROIT*].

Conclusion: Ultimately, Red failed to deliver the goods to Blue as required under the CSC and the Modified CSC. Red is responsible for the losses arising in consequence of this non-performance, namely the penalties Blue was forced to pay to the department stores. Red cannot rely on later supervening events to resile from its obligations under the contract.

II BLUE IS UNDER NO OBLIGATION TO PAY RED FOR THE SECOND BATCH OF CHOCOLATE OR FOR THE COST OF THE AIR FREIGHT

A. RED BEARS THE COST OF THE AIR FREIGHT UNDER THE MODIFIED CSC

During the relevant telephone conversation on 11 January 2014 [*R* ¶32, p. 14]: (i) Swan first suggested the use of air cargo, and had already attained a quote; (ii) Emerald consistently maintained that rectification of the breach was Red's responsibility; (iii) Swan stated that 'in order to meet the delivery date to the department stores, we need to use air cargo, but the air freight would cost US$500,000'; (iv) Emerald suggested Red may prefer to pay the air freight rather than US$2 million in penalties; and (v) Swan clearly agreed to this. Therefore under the Modified CSC, Red bore the additional cost of air freight.

That the cost falls to Red is supported by Art. 7.1.4 *UNIDROIT*, which provides that where a party is guilty of non-performance but is able to 'cure' its non-performance, it does so at its own expense. This reinforces the general obligations of good faith and fair dealing [Art. 1.7 *UNIDROIT*] – Red cannot now ask Blue to pay for the costs of rectifying Red's non-performance, particularly when Blue has already accommodated Red by allowing additional time to perform.

i. Red cannot rely on Art. 5 CSC to avoid liability for the cost of the air freight

Red may argue that Blue is responsible for the increased costs of delivery under Art. 5 CSC. However, this is invalid for two reasons. First, this clause must be construed to apply where, by no fault of the Parties, the Seller's costs of performing its obligations increases [Arts. 1.7, 4.1-4.3 *UNIDROIT*]. Here, the increased air freight costs are purely due to Red's initial breach in failing to ship the goods by 10 January 2014. Therefore, this is not a situation to which Art. 5 CSC can apply.

Second, even if Art. 5 CSC did apply, it would not operate to place the costs of the air freight on Blue. The clause is limited to 'reasonable costs'. Here, the cost of air cargo is <u>five times</u> the cost of shipping freight [*R* ¶32, p. 14]. It cannot be said that this increased cost is reasonable; therefore Blue is not liable.

ii. Red cannot rely on Hardship to avoid liability

Red may seek to rely on the hardship provisions in the UNIDROIT Principles. The fact the performance become more onerous for Red does not absolve the need to perform its obligations [Art. 6.2.1 *UNIDROIT*]. Further, the essential elements required for Red's reliance on Art. 6.2.2 *UNIDROIT* are not met. First, there was no fundamental change in the equilibrium of the contract. Reliance on hardship requires substantial or fundamental changes of such magnitude as, for example, the complete devaluation of one party's benefit as a result of changing state borders [*Arbitral Award SG 126/90, 1990*]. A mere increased cost does not satisfy this criterion. Second, Red could reasonably have taken into account the shipping/loading schedule at the time of the conclusion of the contract [Art. 6.6.2(b) *UNIDROIT*]. The contractual deadlines for the letter of credit and shipping were structured to allow both parties ample opportunity to perform their respective roles [*R* ¶29 p. 12]. Third, the events resulting in increased costs were within Red's control [Art. 6.2.2(c) *UNIDROIT*; *Arbitral Award ARB/03/15, 2011*]. Red selected Negoland Bank, contrary to Blue's advice [*R* ¶29 pp. 12 – 13]. Further, as a company which has actively engaged in international trade since 1990 [*R* ¶4 p. 3], Red would have known that it took two full days from the receipt of the letter of credit to the completion of loading [*R* ¶31 p. 13]. It was unreasonable for Red to wait so long to contact Negoland Bank about the letter of credit. This was the true cause of the increased cost; Red cannot rely on hardship as an excuse.

B. BLUE IS NOT OBLIGATED TO PAY RED FOR GOODS WHICH WERE NOT DELIVERED

i. Partial performance was allowed under the Modified CSC

Although the original CSC prohibited partial shipment [Art. 3(4) CSC], the Modified CSC allowed this for reasons of practical necessity [*R* ¶32, p. 14]. Therefore, Blue was justified in accepting and paying for the first chocolate shipment, but withholding payment for the second. This is also compliant with Blue's obligations to mitigate loss suffered under Art. 7.4.8 *UNIDROIT*, since accepting the first batch of chocolate mitigated Blue's liability to the department stores for damages.

ii. Blue is entitled to withhold payment for the second shipment of chocolate

Under the Modified CSC, payment by Blue was to be done immediately after delivery of the goods by Red. Blue is entitled to withhold performance until Red has delivered the goods [Art. 7.1.3(2) *UNIDROIT*]. Since the second batch of chocolate has been destroyed and is irreplaceable [*R* ¶33, p. 15], Red has no basis on which to ask Blue to pay for goods which it has not, and never will, receive.

Conclusion: Red failed to fulfil its obligation to ship the goods by 10 January 2014 as required under the CSC. Blue acted in good faith by allowing Red additional time and negotiating the Modified CSC, but Red is responsible for the costs of its non-performance. Blue need not pay for goods that is never received.

M&A CASE

Pursuant to the Stock Purchase Agreement ("**SPA**") dated 15 December 2012, Red agreed to acquire Blue Drink, formerly a subsidiary of Blue. Since then, three disputes have arisen between the Parties in relation to the SPA. Blue submits that the representation and warranties given by Blue under Art. 4 SPA were correct and not misleading (**III**); that Blue did not violate the non-competition clause in Art. 9 SPA by investing in Arbitria Coffee (**IV**); and Red is required to compensate Blue for its commercially nonsensical and contractually wrongful actions by paying the Additional Purchase Price pursuant to Art. 2.2 SPA (**V**).

III THE REPRESENTATIONS AND WARRANTIES MADE BY BLUE WERE CORRECT

Red alleges that Blue made misrepresentations with respect to Art. 4 SPA [*R* Exhibit 14, p. 46]. Red may seek to rely on paragraphs (xii), (xiii) or (xiv) of Art. 4(1) SPA to substantiate this claim. However, the evidence shows that Blue made full and frank disclosure to Red during the negotiation of the SPA, allowing Red to carry out its required due diligence to its satisfaction [*R* ¶19, p. 7], and the representations made in Art. 4 were correct as at the conclusion of the SPA.

A. BLUE DID NOT VIOLATE ART. 4(1)(XII) SPA

Any representations made by Blue only extend to the Closing Date of the SPA [Art. 4(1) SPA]. As of 15 December 2012, there were no claims, actions, suits or legal administrative proceedings or investigation against Blue Drink. The evidence shows only that (i) Blue conducted four weeks of rigorous tests on Blue Slim [*R* ¶39, p.18] and found no evidence of stomach problems; (ii) Blue may rely on the decision of the Arbitrian Ministry Health and Welfare to confirm Blue Slim as a Designated Health Food [*R* ¶9, p. 4] until such status is validly revoked; (iii) the Ministry merely notified Blue Drink of its receipt of the complaints and intention to closely monitor the situation, but did not initiate any formal 'investigation' [*R* Exhibit 13, p. 45]. Moreover, the discretionary power of the Ministry [*R* Exhibit 13, p. 45] means that any change of Ministry policy after the Closing Date is beyond the scope of representations and outside Blue's power.

In addition, the Ministry's monitoring does not breach Art. 4(1)(xii) since this representation must be interpreted in accordance with the Parties' common intention. This may be determined by reference to their preliminary negotiations [Art. 4.3(a) *UNIDROIT*]. This includes the meeting on 15 October 2012 in which Red CEO Pat Red concludes that Red "didn't find any issue that [stood] in our way" [*R* ¶19, p. 8], regardless of the Ministry's monitoring being included in Red's due diligence report [*R* Exhibit 13, p. 45]. Blue's representation in Art. 4(1)(xii) was truthful and not in breach of its contractual representations.

B. BLUE IS NOT IN VIOLATION OF ART. 4(1)(XIII) SPA

As at December 15 2012, there had been no adverse change in the condition, financial or otherwise, of Blue Drink, its business or assets, and no such change was threatened to Blue Drink. The references to the due diligence carried out by Red during negotiations support the Parties' mutual intention that Art. 4(1)(xiii) refers to serious or at least substantive threats of adverse change. The Delaware Court of Chancery in *Hexion Specialty Chemicals,Inc. v. Huntsman Corp* (Del. Ch., C.A. No. 3841-VCL) offers a useful definition of 'adverse change' as "… the occurrence of unknown events that substantially threaten the overall earning potential of the target in a durationally-significant manner.' On the evidence, (i) Blue Drink performed equally well between 2011 and 2012 [*R* p. 25]; (ii) the rigorous testing by Blue produced no scientific evidence to support the complaints; and (iii) even if the complaints made to the Ministry were to be taken into account, these few complaints would not 'substantially threaten the overall earning potential' of Blue Drink, as the complaint does not bar Red from continuing to sell the product. The interpretation of both common intention of the parties and the literal meaning of the language used [Arts. 4.1, 4.3 *UNIDROIT*] support the representation that no adverse change or threat thereof existed. Both commercially sophisticated Parties relied on their mutual knowledge of the due diligence and the results of Blue Drink's internal tests in entering the SPA and, therefore, in their understanding of its provisions.

C. BLUE DID NOT VIOLATE ART. 4(1)(XIV) SPA

Finally, as explained above, Red received full disclosure from Blue in the form of information and documents furnished during the due diligence process. Blue provided Red with all information requested in the list after the 16 January 2012 meeting [*R* ¶16, p. 7]. The Due Diligence Report clearly and accurately states the status of Blue Slim [*R* Exhibit 13, p. 45]. As such, Blue is not in breach of its disclosure obligations and representations under Art. 4 SPA.

D. EVEN IF THE TRIBUNAL FINDS THAT BLUE BREACHED ART. 4 SPA, THE AMOUNT OF DAMAGES (US$30.5 MILLION) SHOULD BE REDUCED

Under the UNIDROIT Principles, the breaching party is only liable for harm which it foresaw or could reasonably have foreseen at conclusion of the contract [Art. 7.4.4 *UNIDROIT*]. Such harm must be a direct consequence of non-performance, that requires a "sufficient causal link between the non-performance and the harm" [*UNIDROIT Commentary,* Art. 7.4.3]. Red claims that the loss of sales caused lost profit at least US$30 million. However, the loss of sales may be attributable to other factors such as imprudent business decisions [*R* ¶35, p.15], appointment of an inexperienced manager to handle the sales [*R* ¶35, p.15], poor management in sales [*R* ¶35, p.15], and inability to craft a drink that suits the preferences of Negoland Consumers [*R* ¶35, p.15]. These factors could not reasonably have been foreseeable by Blue at the time of the conclusion of the SPA, and broke the casual link between the non-performance and the harm. As a consequence, Blue is not liable for the full amount of US$30.5 million, even if the Tribunal finds that Blue breached its representations and warranties under Art. 4 SPA.

Conclusion: When negotiating and concluding the SPA, Blue made full disclosure to Red regarding the state of Blue Drink, and Red was satisfied with its due diligence findings. The representations made by Blue in Art. 4 SPA were correct, and Blue is not liable to Red in damages for misrepresentation.

IV BLUE INC. IS NOT IN VIOLATION OF ART. 9 OF THE SPA AND IS NOT OBLIGATED TO REVOKE ITS INVESTMENT IN ARBITRIA COFFEE

Blue is not in violation of Art. 9(1) SPA; Blue does not exercise direct or indirect control of Arbitria Coffee by virtue of its US$5 million investment, nor did Blue induce Mr. Bob Orange's ("**Orange**") termination of employment with Red. Blue is not liable to pay damages of US$500,000 under Art. 9(2) SPA, nor is Blue obligated to revoke its US$5 million investment in Arbitria Coffee.

A. BLUE IS NOT IN BREACH OF ART. 9(1)(II); ARBITRIA COFFEE IS NOT AN AFFILIATE

The definition of 'affiliate' under Arbitrian law may be considered as a reasonable usage known and observed by both parties [Art. 1.9(2) *UNIDROIT Principles*]. This defines 'affiliate' as a "company on which another company may exercise substantial influence over financial and business policy decisions" [*R* ¶37, p. 18]. Blue exercises no such influence over Arbitria Coffee.

First, Blue's investment of US$5 million Arbitria Coffee shares makes Blue a mere minority shareholder, compared to Sam Jackson and his family's shares that stood at US$20 million [*R* ¶36, p. 17]. As such, Blue has limited influence over the financial and business direction of Arbitria Coffee; its shareholding does not meet the 'substantial influence' threshold of an affiliate company characterisation.

Second, the role of Blue's board member in Arbitria Coffee is nominal and indirect. Non-executive board members are frequently appoints as a symbol of a healthy commercial relationship, but by definition do not engage in the day-to-day management of a company, and have no capacity to determine the decisions or policy of the company. In any case, Blue's appointed director is completely outnumbers by the existing five directors of Arbitria Coffee [*R* ¶36, p. 18]. Therefore Blue does not meet the control threshold necessary for Arbitria Coffee to be deemed an affiliate in the relevant sense.

Third, Blue has not participated in or performed services for Arbitria Coffee. Blue's agreement to grant Arbitria Coffee a partial use of the Central Research Centre is conditional upon payment of reasonable market rent [*R* ¶36, p. 18]. As such, Blue does not have an input into the types of research conducted by Arbitria Coffee. This agreement constitutes an independent arms length transaction, to the commercial benefit of both parties. An affiliate relationship between Blue and Arbitria Coffee cannot be inferred from this agreement.

Further, the fact that Arbitria Coffee was pursuing debt financing from AbuAbu Bank is irrelevant to the characterisation of Blue's investment. There is insufficient evidence to properly compare the debt and equity financing options, and there is nothing to suggest that the equity provided by Blue was on more favourable terms than would otherwise have been available in the market, if Arbitria Coffee had pursued this option [*R* ¶36, p. 18]. Thus, Blue performed no service for Arbitria Coffee by investing.

B. ARBITRIA COFFEE IS NOT IN COMPETITION WITH RED DRINK

The consumer markets targeted by Red Drink and Arbitria Coffee are factually separate and not in direct competition with each other. This is determined by analysis of the Parties' common intention [Art. 4.1 *UNIDROIT*] during preliminary contract negotiations, Red's subsequent conduct after concluding the SPA, and the purpose of the contract as whole [Art. 4.3 *UNIDROIT*]**.**

Red acquired Blue Drink with the intention to strengthen its commercial presence in the health and weight loss market by complimenting the Spirit sportswear lines and Red's R-Choco Neo series [*R* ¶12, p. 5]. Red Drink's marketing campaigns confirms that it targets Spirit's customer base [*R* ¶22, p. 10]. On the other hand, notwithstanding the incidental benefit of weight loss, Arbitria Coffee's coffee beverage targets a general market of coffee consumers, as opposed to the primary benefit of weight loss provided by Red Slim [*R* ¶12, p. 5]. Red does not produce or sell coffee beverages; Arbitria Coffee does not engage in business similar to, or competitive with, the business of Red Drink.

C. BLUE IS NOT IN BREACH OF ART.9(1)(II) SPA

Blue is not in breach of Art. 9(1)(ii) SPA because Blue did not induce or persuade Orange to terminate his employment with Red Drink. Blue had no knowledge of Orange's resignation until later informed by Sam Jackson [*R* ¶36, p. 17] and had no input in assigning Orange to the development of diet coffee drinks. Orange's resignation from Red Drink was due to the conflict with the new CEO and inadequacy of the R&D budget. In any event, there was a two-month gap between Orange leaving Red Drink and joining Arbitria Coffee [*R* ¶¶35, 36, pp. 15, 17].

D. EVEN IF THE TRIBUNAL FINDS THAT BLUE HAS BREACHED ITS OBLIGATIONS IN ART. 9 SPA, THE QUANTUM OF AGREED DAMAGES MUST BE REDUCED

The tribunal may reduce the amount of the liquidated damages to a reasonable amount if the agreed amount is grossly excessive compared to the harm suffered by Red [Art. 7.4.13 *UNIDROIT*]. The liquidated damages of US$500,000 in Art. 9(2) SPA is grossly excessive, and would appear so to any reasonable person [*UNIDROIT Commentary,* Art. 3]. In the *Arbitral Award No.134/2002 of International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation*, the tribunal applied the test of "proportionality and conformability" in determining whether an agreed amount is reasonable. In this case, the amount is disproportionate and unreasonable because (i) the methods of calculating the liquidated damages is unclear, (ii) Red suffered no harm as a direct impact of the investment in Arbitria Coffee as it targeted different market, and (iii) there are multiple intervening factors that may have caused the financial lost of Red, such as, imprudent business decisions, poor management in sales, and Red's inability to craft a drink that is suited to the preferences of Negoland Consumers [*R* ¶35, p. 15]. Therefore, in the alternative case that Blue was in breach of Art. 9(1) SPA, Blue asks the Tribunal to reduce the quantum of damages for which it is liable.

Conclusion: Blue did not breach the non-competition clause in Art. 9 SPA. Blue is not liable to pay Red liquidated damages amounting to $500,000 under Art. 9(2), nor is Blue obligated to revoke its US$5 million investment in Arbitria Coffee.

V RED CORP. MUST PAY BLUE INC. AN ADDITIONAL STOCK PURCHASE PRICE PURSUANT TO ART. 2.2 OF THE STOCK PURCHASE AGREEMENT, IN THE AMOUNT OF US$200 MILLION

Under Art. 2.2 of the Stock Purchase Agreement, the Parties agreed that Red would pay Blue an additional purchase price if EBITDA for 2013 or 2014 exceeded US$110 million. By engaging in nonsensical business practices and thereby suppressing EBITDA, Red has avoided the activation of this contingent payment clause. This is a breach of Red's obligations under Art. 8 of the Stock Purchase Agreement, as well as obligations of good faith and fair dealing under the UNIDROIT Principles. Red must remedy the situation by paying Blue the Additional Purchase Price that would have been owed had Red not breached its contractual obligations.

A. RED IS IN BREACH OF ART. 8 OF THE STOCK PURCHASE AGREEMENT

Red covenanted, in Art. 8 *SPA*, to "not operate, instruct, influence or exercise its voting right of [Red Drink] in such manner as may materially harm the interest of [Blue] in the additional payment". Red has done precisely this. By agreeing to a distribution agreement on financially detrimental terms, driving away the key asset to Red Drink's success, and allowing Red Slim to be stripped of its Designated Health Food status, Red has operated Red Drink in a way that has disentitled Blue from the contingent payment.

i. Red breached its negative covenant to not operate Red Drink in such a way as may materially harm Blue's interest in the contingent payment

Throughout 2013-2014, Red as the controller of Red Drink made numerous business decisions leading to Blue's non-receipt of the contingent payment. It is accepted between the parties that there were three main causes of the shortfall in EBITDA [R Exhibit 17, p. 49]. There were three corresponding instances of commercially nonsensical actions.

First, Red agreed to the Nego Drink distribution agreement which included selling the drinks wholesale at a 60% discount to standard retail price. Red knew before signing this agreement that it could have an adverse impact on the profitability of Red Drink [*R* ¶23, pp. 10-11]. Red proceeded with this agreement despite the presence of an alternative, more financially beneficial offer from Negoland Bottlers. There was no material difference between the two rival distributors; they are both leading beverage companies in Negoland [*R* ¶23, pp. 10-11] and are of the same scale [*R* ¶24, p. 11]. The terms of the two offers were identical insofar as they demanded sole distributorship and a two-year contract [*R* ¶24, p. 11]. However, Negoland Bottlers was willing to purchase the drinks at only a 50% discount to standard retail price. Although the minimum purchase volume for the Negoland Bottlers offer was slightly less than the Nego Drink offer, this was expressed to be negotiable.

Before accepting the Nego Drink offer, Red did not use an objective, transparent decision-making process. Red did not attempt to negotiate the minimum purchase quantity with Negoland Bottlers, and Pat Red explicitly ignored the opinions of his employees that there should be a competition between the two offerors [*R* ¶25, p. 11]. In fact, Pat Red made an opaque decision based on a personal relationship with the president of Nego Drink [*R* ¶25, p. 11]. Although this decision resulted in a quicker process (as opposed to the one month competition process) [*R* ¶25, p. 11], this decision cannot be said to have been an exercise of 'reasonable business judgment', and the low wholesale price resulted in lost EBITDA of US$20 million and US$15 million in 2013 and 2014 respectively [*R* Exhibit 17, p. 49].

Second, Red created a work environment so toxic that key employee Orange was driven away. Red acknowledged in the meeting on 15 October 2012 that Orange was "extremely critical to the future of Blue Drink", that the beverage market was intensely competitive, and that product innovation would be required [*R* ¶20, p. 9]. Orange was so crucial to the company that Red's offer to acquire Blue Drink was conditional on Orange agreeing to stay with the company [*R* ¶20, p. 9]. Orange became even more crucial after sales began to slow in October 2013 and Red realised it needed to develop a new flavour [*R* ¶27, pp. 11-12]. Before agreeing to the acquisition, Red repeatedly assured Blue that they would provide a budget and work environment for Orange that was <u>at least</u> as good as at Blue Drink [*R* ¶20, p. 9]. Precisely one year after these assurances were given, Red Drink appointed a CEO who was inadequately experienced and ill-suited to the position, and was not adequately informed of the commitments made regarding Orange [*R* ¶35, pp. 15-16]. The altercations between Lee and Orange made it an impossible work environment. Further, Crane's attempt to persuade Orange to withdraw his resignation was also contrary to Red's commitments. Whilst Orange was willing to stay on the condition of increased funding, Crane was inflexible and unwilling to accommodate a budget increase that was objectively verified as being reasonable [*R* ¶35, p. 16]. This resulted in an EBITDA shortfall of US$15 million in 2014.

Third, the series of events involving Orange impacted the loss of Designated Health Food status for Blue Slim since without Orange, Red Drink was unable to deal effectively with the Arbitrian Ministry of Health and Welfare. As evidenced above, Red knew that Orange was crucial to the business' success and the EBITDA of US$15 million that was lost in 2014 as a result of the status revocation [*R* Exhibit 17, p. 49] is another consequence of Red's failure to operate Red Drink in a commercially reasonable manner.

With respect to the materiality of the harm to Blue's interest, this is evident in the fact that EBITDA for both years did not exceed US$110 million. It is undisputed between the Parties that EBITDA would have reached US$120 million and US$125 million in 2013 and 2014 if it weren't for the three aforementioned detrimental factors [*R* Exhibit 17, p. 49]. The fact that EBITDA for 2013 was as forecasted (US$100 million) is immaterial to the loss suffered by Blue as a result of Red's actions – the relevant comparison is between EBITDA had Red not engaged in the harmful actions, and the EBITDA which actualised.

ii. Red's actions fall outside the exercise of 'reasonable business judgment'

Red cannot rely on the second part of Art. 8 of the Stock Purchase Agreement, i.e. that "[Red] may make any reasonable business judgment to operate [Red Drink] after the Closing Date", to excuse its nonsensical business practices and resulting harm to Blue. This is because, as demonstrated above, Red's conduct in relation to Red Drink was so commercially senseless that it falls outside the possible exercise of 'reasonable business judgment'. In interpreting this term, Art 4.1 *UNIDROIT* indicates that the meaning should accord with the common intention of the Parties. It is evident from the prior negotiations [Art. 4.3(a) *UNIDROIT*] that an exercise of this judgment would include "substantial initial investment" [*R* ¶19, p. 9] such as conversion of facilities and advertising expenditure – these were "reasonable investments" over which Blue did not "make a fuss", as promised by Kelly Blue on 15 October 2012 [*R* ¶19, p. 9]. The Parties did not contemplate actions such as engagement in a commercially unviable distributorship agreement or the destruction of Orange's work environment.

B. RED BREACHED ITS OBLIGATIONS OF GOOD FAITH AND FAIR DEALING

In addition to its express contractual obligations, by electing the UNIDROIT Principles as the governing law of the contract the Parties submitted themselves to an implied obligation of good faith and fair dealing, which cannot be excluded or limited by the Parties [Art. 1.7(2) *UNIDROIT*]. This is a fundamental standard of behaviour in international trade, applying to the Parties' "behaviour throughout the life of the contract, including the negotiation process" [*UNIDROIT Commentary*, Art. 1.7; *Arbitral award of 8 February 2008,* Russian Federation]. This is applicable to the present dispute in four main ways.

i. General duty of good faith and fair dealing

Red has breached the obligation to act in accordance with good faith and fair dealing in international trade, as mandated by Art. 1.7 *UNIDROIT*. Red failed to conduct itself in accordance with this standard. For example, with respect to the loss of Designated Health Food status, Blue acted in good faith by informing Red in the letter dated 20 June 2014 "[w]e are willing to extend cooperation to you as much as practically possible, if you wish to aim for re-designation" [*R* Exhibit 15, p. 47]. Not only was Red aware of the complaints before acquiring Blue Drink, and not only did Red drive away a key asset to Red Drink thereby losing its ability to deal effectively with the Arbitrian Ministry of Health and Welfare, but Red showed no interest in accepting Blue's assistance to re-obtain the status. Given these actions, Red cannot now escape its payment obligations because of the financial consequences of its own bad faith actions.

ii. Duty to not intervene with the fulfilment of a condition

Red's obligation under Art. 2.2 of the Stock Purchase Agreement is a conditional obligation within the meaning of Art. 5.3.1 *UNIDROIT*. The suspensive condition is activated if EBITDA exceeds US$110 million in either 2013 or 2014. Under Art. 5.3.3 *UNIDROIT*, a "specific application of the general rules on good faith and fair dealing" [*UNIDROIT Commentary,* Art. 5.3.3], Red cannot rely on the non-fulfilment of this condition if it prevented fulfilment of the condition by acting contrary to good faith and fair dealing. By virtue of engaging in the aforementioned nonsensical practices, Red did interfere with fulfilment of the condition, and cannot rely on this non-fulfilment to escape its obligation to pay the purchase price.

iii. Inconsistent behaviour

Red is prohibited from acting "inconsistently with an understanding it has caused [Blue] to have and upon which [Blue] reasonably has acted in reliance to its detriment" [Art. 1.8 *UNIDROIT*]. Red's actions in operating Red Drink are contrary to the commitments it made during the pre-contractual negotiations throughout 2012. Red repeatedly assured Blue that it would maintain, if not better, the working environment for Orange, and Blue relied on these assurances by asking Orange to sign the three-year commitment letter [*R* ¶20, p. 9]. Orange's agreement to sign the letter was conditional – "as long as adequate budget and work environment are provided" [*R* ¶20, p. 9]. Red acted inconsistently with these representations by hiring a new CEO, failing to inform him of these conditions, creating a toxic work environment, and refusing to provide a reasonable R&D budget [*R* ¶35, pp. 15-16]. This was to Blue's detriment, as not only did it agree to hand over a key asset of the company, but the resulting suppressed EBITDA compromised its entitlement to the contingent payment. As such, Blue is entitled to be restored to the position it would have occupied had Red not acted inconsistently with its earlier assurances.

iv. Red acted in breach of other terms of the SPA either included or implied

In addition, Red's actions constitute a breach of obligations incorporated into the SPA by the prior negotiations of the Parties. The Parties did not include a 'merger clause' in the SPA nor any other indication that "the writing completely embodies the terms on which the parties have agreed cannot be contradicted or supplemented by evidence of prior statements or agreements" [Art. 2.1.17 *UNIDROIT*]. In the absence of such a clause, extrinsic evidence supplementing the SPA is admissible [*UNIDROIT Commentary*, Art. 2.1.17]. Clear statements made during negotiations are of a sufficient form to evidence contractual agreement between the Parties [Art. 1.2 *UNIDROIT*].

In the alternative, under the UNIDROIT Principles contractual terms can be express or implied [Art. 5.1.1 *UNIDROIT*]. In this case, the implied obligations are drawn from the nature of the SPA, the good faith and fair dealing, and commercial reasonableness [Art. 5.1.2(a), (b) and (d), Art. 4.3(d) *UNIDROIT*].

Blue submits that Red was obligated to use its best efforts maximise the profitability of Red Drink. This is supported by the inclusion of Art. 8 SPA and assurance by Red during the negotiations that it would not manipulate operating results to avoid the contingent payment [*R* ¶19, p. 9]. Without an obligation of this nature, it would have been commercially unreasonable for Blue to agree to a contingent payment structure; this is a criterion in determining the duty of best efforts [Art. 5.1.5(b) *UNIDROIT; UNIDROIT Commentary*]. As demonstrated above, Red's actions in signing an unfavourable distribution agreement, driving away a key employee and failing to maintain the Designated Health Food status were not commercially reasonable. As such, Red failed "to make such efforts as would be made by a reasonable person of the same kind in the same circumstances" [Art. 5.1.4 *UNIDROIT*].

Further, Red was obligated to provide an adequate working environment and R&D budget for Orange. This is founded on the repeated, unequivocal statements by Red during negotiations. After acknowledging the essentiality of Orange to the success of Blue Drink, Red promised to "give him the same level of work environment, at least, or a better one if possible" [*R* ¶20, p. 9]. Indeed, Blue's agreement to ask Orange to stay with the company was conditional on Red's assurance that "the R&D budget and the work environment … will not be anything less than what Blue Inc. offers now", and Orange's commitment was identically conditional [*R* ¶20, p. 9]. These discussions evidence a mutual intention by the Parties to be bound by the commitments, which Red later failed to comply with by Lee creating a volatile and negative environment, and Crane refusing to grant Orange's reasonable requests for an increased R&D budget.

C. BLUE IS ENTITLED TO DAMAGES EQUIVALENT TO THE ADDITIONAL STOCK PURCHASE PRICE IT WOULD HAVE RECEIVED IF NOT FOR RED'S WRONGFUL ACTIONS

Whether in relation to Art. 8 SPA or arising out of the operation of the UNIDROIT Principles, Red has breached its obligations under the contract. This constitutes non-performance under Art. 7.1.1 *UNIDROIT* and entitles Blue to have its situation remedied at Red's cost. In the case of interference with fulfilment of a condition under Art. 5.3.3(1) *UNIDROIT*, the available remedies are to be determined in accordance with the general rules on the remedies of performance and damages, as well as the particular circumstances of the case [*UNIDROIT Commentary*, Art. 5.3.3].

Although the breaches are in relation to non-monetary obligations, an order of performance is impossible (since Red cannot reverse the effects of its harmful business decisions) [Art. 7.2.2 *UNIDROIT*]. Therefore the appropriate remedy for the Tribunal to award is damages, pursuant to Art. 7.4.1 *UNIDROIT*. Blue is entitled to be fully compensated for the loss it incurred as a result of Red's breaches [Art. 7.4.2 *UNIDROIT*]. This includes the benefits which Blue was deprived of as a consequence of Red not properly performing the contract [*UNIDROIT Commentary,* Art. 7.4.2], namely the Additional Purchase Price owed under Art. 2.2 SPA. Blue's loss to the value of US$200 million is established with a reasonable degree of certainty [Art. 7.4.3 *UNIDROIT*], as the Parties do not dispute the figures in Exhibit 17 [*R* p. 48]. The type of loss was foreseen by the Parties [Art. 7.4.4 *UNIDROIT*]; during preliminary negotiations the Parties discussed that Red's actions could affect Blue's right to the contingent payment and this was included explicitly in Art. 8 SPA.

Conclusion: Red has avoided its obligation to pay an Additional Purchase Price by acting in breach of Art. 8 SPA and the UNIDROIT Principles. Red must place Blue in its rightful financial position.

REQUEST FOR RELIEF

Blue Inc. respectfully asks the Tribunal to find the following:

1. In relation to the Chocolate Case, that Blue:
    a. is entitled to payment from Red in the amount of US$1 million, representing the amount paid in penalties to the department stores; and
    b. is not required to pay Red US$2 million, representing the air freight costs and purchase price of the non-delivered chocolate.
2. In relation to the M&A Case, that Blue:
    a. is not in breach of the representations and warranties in the SPA, and is therefore not required to pay Red US$30 million in damages;
    b. is not in breach of the non-competition clause in the SPA, and is therefore not required to pay Red US$0.5 million in damages or revoke its investment in Arbitria Coffee; and
    c. is entitled to receive an amount of US$200 million from Red, representing the Additional Purchase Price due under the SPA.
3. That if the Tribunal finds against Blue in any respect, that the amount awarded be set off against Red's liabilities for any of the abovementioned claims pursuant to Art. 8.1.1 *UNIDROIT*.