I. GOALS

1. Blue Inc. ('Blue') seeks to facilitate the acquisition of Red Corp. ('Red')'s chocolate division on terms favourable to Blue's commercial interest. Successful acquisition necessitates a mutually beneficial outcome for both parties to promote a collaborative future business relationship. However, as Blue is accountable to its shareholders, we may be unable to compromise on particular issues. In the event that an agreement cannot be reached, we intend to postpone the finalisation of the details of certain issues to a later date if necessary to continue our positive relationship with Red.

2. Blue will strive to achieve a written agreement to govern the acquisition and resolve any outstanding issues of contention. Our goal is to include the following features in the written agreement:

a. Blue's acquisition of Red Chocolate by April 2015;
b. The maximum purchase price being US$100 million with potential offsets in the price depending on concessions made in other aspects in the agreement;
c. The retention of Chen as director of R&D and either the removal or reduction in salary and title of Sullivan;
d. The limitation of Blue's liability and exposure to risk in the event that the land is contaminated, either by way of a written assurance that there is no contamination of the land and/or agreement to share the cost of cleanup;
e. A guarantee from Red, to the best of its knowledge, that Red Chocolate has not traded directly or indirectly with Zeta in contravention of Arbitrian law; and
f. The reduction of the breakup fee to a maximum fixed amount of US$1 million.

3. Blue will propose an agenda at the commencement of the negotiation reflecting our prioritisation of issues and to ensure the efficient use of time in the negotiation.

II. STRATEGY

A. ACQUISITION OF RED CHOCOLATE

4. Successful acquisition of Red Chocolate for Blue is vital for the following reasons:

a. Chocolate will complement Red's existing confectionary division, and will enable Blue to provide a full range of confectionary [*Record, para. 45*];
b. Chocolate is a highly desirable industry sector and is immensely popular with a strong customer base internationally [*Confidential Information ('CI'), 1*]; and
c. The popularity of Red chocolate's products in Arbitria looks likely to increase [*CI, 2*].

5. Given the highly beneficial potential outcomes from Blue acquiring Red's chocolate division, Blue is willing to make various concessions as outlined below. However, Blue will only agree to the acquisition insofar as it will not expose Blue to unprofitable risks and liabilities. As a BATNA, Blue will postpone negotiations and endeavour to maintain a working relationship with Red on this issue. However, due to production deadlines, this deal must be finalised by April 2015 [*CI, 1*].

B. PURCHASE PRICE

6. Given the integral nature of Red Chocolate's purchase price, failure to reach an agreement on this issue will mean that it is unlikely that the acquisition will occur. Red's valuation of Red Chocolate was significantly higher than Blue's initial offer due to the potential for synergies [*Record, para. 48*]. In light of this, we are willing to increase our starting offer of $70 million in the following ways:

7. **B1.** As synergies require initial upfront capital to be realised and the effects of synergies are uncertain, we will provide the option of contingent payments to Red based on the Chocolate division's performance in the first few years. This type of arrangement has precedent in our relationship with Red and will be familiar to Red as a commercially sensible option [*Record, Exhibit 5*].

8. **B2.** However, if Red requires an upfront increase in the purchase price, we will increase our offer to take into account Red's belief that there will be synergies, if Red will bear future risks. Our highest offer will be $100 million. However, should Red be willing to absorb the risk for environmental contamination, we are willing to increase this to $105 million [*CI, 2*].

C. OFFICERS

9. Blue will prioritise retaining Chen as Director in charge of R+D due to her contribution to the corporate value of Red Chocolate [*Record, para. 49*]. Blue will not keep Sullivan in his current position of CEO as it is intending to replace him with one of Blue's outstanding sales staff [*Record, para. 49*]. The retention of Chen as director in charge of R+D is a key objective. Therefore, given Red's insistence for Blue to keep Sullivan, Blue is prepared to hire Sullivan as a sales advisor or manager for a maximum period of three years [*CI, 3*] in order to retain Chen and ensure the overall acquisition of Red Chocolate:

10. **C1.** However his salary should be reduced to US$700,000 to reflect the average salary of advisors and managers within Blue group [*CI, 3*].

11. **C2.** Alternatively, Blue may retain Sullivan's current salary of US$1 million if Red is willing to share the cost of his continued employment [*CI, 3*]. Blue will accept this contribution through a variety of means, not necessarily monetary. Thus, Blue will initially propose retaining Sullivan for a one-year term subject to annual review of his performance at a salary of US$700,000 per annum. If Red rejects this initial offer, Blue will re-negotiate Sullivan's term (up to three years) and explore cost-sharing options for his salary.

D. REPRESENTATIONS AND WARRANTIES ABOUT THE FACTORY SITE

12. While acquisition of the factory site is critical to Blue operating the chocolate business, Blue is uncomfortable with accepting the risk that the land is potentially contaminated and may require cleanup at a significant cost. There are several options with respect to this issue:

13. **D1.** Ideally, Blue would like to secure representations from Red that it will:
    a. survey the land again for contamination before the acquisition is finalised;
    b. bear this cost; and
    c. agree to bear between 50% to 100% of the cost of cleanup if contamination is found, either now or in subsequent searches by Blue. This is dependent on the concessions it makes.

14. **D2.** We recognise that Red may reject this arrangement, as it was not responsible for potential contamination of the land and clean up may cost up to $30 million [*Record, para. 50*]. Therefore, we will propose that Red join Blue in cleaning up the land if any contamination is found, citing the potential harm to its reputation as a responsible corporate citizen. We will emphasise the good faith nature of these negotiations and the imperative to collaboratively clean up the land in accordance with Negoland laws as opposed to Blue's commercial self-interest. This partnership could involve lowering Red's contribution to 50% [*CI, 3*]. However, this is the largest concession Blue will make.

15. **D3.** Blue may also offer to limit the time period of Red's responsibilities under any of these options. Concessions in this area will only be provided in exchange to secure favourable agreement elsewhere, such as Red agreeing to survey the land again now. We are also willing to grant Red certain advantages if it provides generous concessions on this issue, such as a higher purchase price.

E. DEALINGS WITH ZETA

16. Blue is bound by Arbitria's strict trade sanctions, which operate to prevent Blue from dealing directly with Zeta related parties, extending to indirect trade [*Record, para. 51*]. As Red

Corp is based in Negoland, neither Red Corp nor Red Chocolate operates with such restrictions. Blue seeks a representation that neither Red Corp nor Red Chocolate is affected by the regulations, as any prohibited transactions will result in culpability for substantial fines and must cease immediately [*Record, para. 51*]. Blue will negotiate this issue with the understanding that these regulations are highly onerous for Red.

17. In the unlikely case that the acquisition of Red Chocolate is terminated due to Red Corp or Red Chocolate's dealings with Zeta, the break up fee may become payable [*infra, Section F*].

18. **E1.** Blue must perform diligent inquiry into Red Corp's dealings with Zeta [*Record, para. 51*]. Ideally, Blue will be able to secure a clear representation from Red to the effect that Red Corp does not trade directly or indirectly with Zeta related parties. If this is not possible, Blue will request a representation that at the date of the contract, neither direct or indirect dealings with Zeta are ongoing to the best of its knowledge [*CI, 4*]. This will constitute diligent inquiry as required by Arbitrian law. Thus, Blue will avoid financial penalties for this transaction if Red is found to be a Zeta related party.

19. **E2.** Blue has negotiated a six month grace period from the Arbitrian government with regards to Red Chocolate's dealings with Zeta after the takeover [*CI, 4*]. Thus, Blue can make diligent inquiry and immediately discontinue all transactions between Red Chocolate and all Zeta related corporations, including indirect trade during this period. This is a significant offer from Blue, and will cost US$1 million [*CI, 4*]. Blue will use this concession as leverage to secure more important concessions from Red, particularly in respect of the purchase price.

F. BREAKUP FEE

20. Red has suggested the inclusion of a breakup fee provision requiring Blue to pay a fee equivalent to 3 percent of the sales price in the event of the termination to the Agreement for reasons not attributable to Red [*Record, para. 52*]. However, Blue believes the breakup fee is too high and not customary for such agreements [*Record, para. 52*]. Initially Blue will refute the breakup fee forthright, however Blue is willing to agree to a maximum breakup fee of US$1 million in exchange for concessions by Red in other aspects of the negotiations.

21. Further, Blue may seek a written clarification of the phrase ‘for reasons not attributable to Red Corp’ to include termination of the Agreement if it is determined during the acquisition period that Red has engaged in direct or indirect trading with Zeta in contravention of Arbitrian law outlined above. Blue’s agreement to a breakup fee at a fixed price of US$1 million can maximize Blue’s interests by demonstrating good faith through its conciliatory approach whilst operating as a bargaining tool to assist with the resolution of other issues.