



**LAWS1072 – Contracts 2**  
**FINAL EXAMINATION - Session 2 2005**

**TIME ALLOWED:** 3 hours, plus 10 minutes reading time.

**EXAMINATION CONDITIONS:** This is an open book examination. You may bring any printed or handwritten materials into the examination room.

The examination consists of ONE question only. It carries 50% of the total assessment for this course.

**OTHER INSTRUCTIONS:**

1. YOUR NAME, STUDENT NUMBER and TEACHER'S NAME must be written on the front of each examination booklet you use.
2. You should assume that the laws of New South Wales and the Commonwealth of Australia apply to the facts but you may cite persuasive authorities from other jurisdictions. Full citations are not required.
3. You should allow yourself time to plan your answer, using appropriate headings and sub-headings. If you wish, you may write your plan in your answer book. You must write your answer legibly and in ink.
4. This paper consists of 4 pages including this instruction page. Please check that you have all pages. You may retain this paper.

## QUESTION

Larry Backtorque (Larry) is a motor mechanic with 20 years experience who has long dreamed of opening his own business. Now it seems he can make his dreams come true. On the recent death of a distant relative Larry inherited \$500,000 which according to his accountant Snipe is enough, with some bank borrowings, to start on a sound financial basis. Snipe prepares Larry a business plan which shows the business earning after one year a profit of \$250,000 a year before tax on a turnover of \$1 million. Larry, though he has long supervised staff, has had no experience of actually running a business and points this out to Snipe. Snipe replies "Don't worry, I'll look after administration and finance. You just concentrate on the cars and customers."

Snipe applies on Larry's behalf to Big Bank Ltd (Big Bank), who agree to lend on overdraft to a limit of \$200,000. Larry finds suitable workshop premises in Kensington and negotiates with the landlord, Mean Corp Ltd (Mean Corp), for a lease. Mean Corp grants him a lease of the premises for three years at \$5000 a month payable in advance. He hires staff, fits out the premises as an automotive workshop, and opens up for business.

For the first few months things go well, but then, due to trouble in the Middle East and increased world demand, petrol prices shoot up to \$2.80 a litre. As Larry specializes in servicing and repairing imported sports cars, business drops off alarmingly. He lays off most of his staff and delays paying his rent. Mean Corp presses for payment of the rent. Larry has a conversation with Mr Nice of Mean Corp.

Nice: Well, I'm sorry to see you are behind – you've been a good tenant up to now. Can you see your way to at least paying some of it by next week?

Larry: Well, only if I can get my remaining staff to take their holidays – that's cheaper for me than to have them working.

Nice: Why don't you do that? If you pay 50% of the amount overdue by next Friday we won't take any immediate action and we will review the situation at the end of the month.

Larry sends the rest of his staff off on holiday and pays the 50%. As a result business drops even further. Even so, by the end of the month he has enough to pay the remaining 50% of the rent and the next month's rent. However Mr Nice has also gone on leave and Ms Nasty is in his place. Larry visits Mean Corp's office.

Larry: I've got bank cheques here for the rest of last month's rent and this month – I'm pretty well at break-even point.

Nasty: That's good to hear, let me take those (Larry hands over the bank cheques). However you are in breach of the lease and I'm going to have to give you this notice to quit.

Larry: (shocked) You can't do that, I've just paid you.

Nasty: Oh yes we can. Now get out, or do you want me to call security?

Larry has sufficient presence of mind to call the bank as soon as he walks out of Nasty's office and instruct it to cancel the cheques, telling Big Bank they have been stolen.

Larry has also ordered some sophisticated electronic car testing equipment from Japan. The salesperson told him that the equipment was calibrated to test the car's anti-pollution devices to Australian levels, that is, those required by Australian law. He gave Larry a brochure which states that Australian pollution levels for car exhausts are the same as Japan's. Larry has already paid 10% as a deposit, but the equipment has not been dispatched. He e-mails the Japanese supplier Motocorp Ltd (Motocorp) to cancel it. That company replies that it is too late to cancel and it will be delivering the goods next week.

It seems also that Snipe concealed the fact that Big Bank wanted a personal guarantee from Larry's wife Susan for the loan to Larry. Susan operates her own hairdressing salon. Unbeknown to Larry, Snipe got Susan to sign the guarantee for "all moneys" lent to Larry, by telling her it was a "mere formality" and that Big Bank never enforces personal guarantees against spouses unless it suspects that the borrower had deliberately transferred assets to the spouse to avoid liability. Unbeknown to both Larry and Susan, Snipe received an extension of his own loan from Big Bank a day after Big Bank approved the loan to Larry. Big Bank told Snipe that they really appreciated his efforts to bring in new business.

It also appears that the lease Larry has signed is for the wrong land. The correct site was Lot 3, Deposited Plan 123456. The lease documents show Lot 4, DP123456, which does not exist. This has come about as a result of an error in the Plan by the surveyor who prepared it many years ago and was only discovered when an adjacent block was subdivided after Larry signed his lease.

To conclude:

1. Mean Corp has issued Larry with a notice to quit, and is suing him in respect of the bank cheques, and in respect of all rent due under the lease. The lease provides that in the event of a default in payment of rent by the lessee all the rent due in respect of the remainder of the term becomes immediately due and payable.

2. Big Bank is calling in the loan (which is on demand) and demanding that if Larry doesn't pay they will call upon Susan to honour her guarantee. The amount currently owing is \$300,000, \$100,000 over the agreed overdraft limit.

3. Motocorp is still intent on delivering the equipment Larry no longer wants and have already sent a pro forma invoice for the balance of the purchase price. Larry has discovered that permitted car exhaust emissions in Australia are much lower than Japan and that the equipment cannot be used to monitor exhaust emissions to Australian requirements

4. Snipe is always out when Larry calls.

On the good side, Nippon Sport Australia Ltd, an importer of small sports cars, have appointed Larry an official service centre which is estimated to bring in new business amounting to at least \$4 million year. This of course is contingent on Larry remaining in business.

Advise Larry and Susan.