

THE UNIVERSITY OF
NEW SOUTH WALES



FACULTY OF LAW

LAWS 1072 CONTRACTS 2
FINAL EXAMINATION SESSION 2, 2006

TIME ALLOWED: TWO hours, plus 10 minutes reading time. You may begin writing at any 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 3 pages including this instruction page. Please check that you have all pages. You may retain this paper.

**ANSWERS MUST BE WRITTEN IN INK.
EXCEPT WHERE THEY ARE EXPRESSLY
REQUIRED, PENCILS MAY BE USED
ONLY FOR DRAWING, SKETCHING
OR GRAPHICAL WORK**

FACTS

Arnold and Zena, who although not married have been living together for two years, have long wanted to open a music shop specialising in jazz recordings. Arnold is a keen and very accomplished saxophonist with an encyclopaedic knowledge of jazz and Zena has extensive retail experience including five years as manager of a clothing boutique. They look round for suitable premises and find a small shop in an arcade the central business district of Sydney. The owners are the trustees of an obscure charitable trust, the Uptight Trust. Arnold and Zena form a company wholly owned by them, AZ Jazz Pty Ltd, for the purposes of trading. The rent is very reasonable and A and Z sign as directors of AZ Jazz Pty Ltd a lease in standard form and move in.

In order to finance the fitting out of the shop and the purchase of stock, Zena, who is the business brain of the family, approaches the Friendly Bank. She speaks with Eager, a senior loan officer, who is very helpful and offers to lend \$250,000, \$50,000 more than Zena asks for, to AZ Jazz Pty Ltd. The bank, however, insists on security and asks for a mortgage over Arnold and Zena's jointly owned (as joint tenants) Glebe terrace house, which is presently unencumbered (that is, no money is owing on it). Further, because this is a business loan to a company with few assets the Bank requires Arnold and Zena to give their personal guarantee. Zena says "I don't think Arnold will be very keen about that". Eager says "Don't worry, just send him in and I'll get him to sign".

Arnold visits the Bank. Eager tells him that the personal guarantee is just a formality and the Bank never tries to enforce them anyway. He points out that the house is valued at \$500,000 and the loan is only for \$250,000, so the Bank has more than adequate security. "This personal guarantee thing is just the Bank being a bank" he says. Reassured, Arnold signs the personal guarantee under which he and Zena have joint and several liability (if one can't pay the other is liable for the lot). He does not however sign the mortgage (which Zena has already signed on behalf of her self only). Eager, by the way, gets a performance bonus of \$5000 for securing the business.

AZ Jazz opens, and for a while does well. The shop is right opposite the Just Jazz restaurant, a major Sydney jazz venue. AZ Jazz Pty Ltd orders some state of the art sound and video equipment for demonstrator use in the store from Megasound Ltd.

Unfortunately (except for the lawyers) things go sour. First the Megasound equipment turns out to be unsuitable despite representations to the contrary by their salespersons. Several customers have complained of becoming deaf after listening to jazz played through headphones provided by Megasound and one customer has sued the shop for \$100,000, alleging music-induced deafness. This is a serious matter for the customer, who is a piano-tuner and dependent on her hearing for a living. Arnold, who as merchandise manager is in charge of stock, has the instincts of a collector rather than a dealer, and manages to buy far too much, and the overdraft loan is soon at \$600,000 (the Bank has simply ignored the breach of the \$250,000 limit). AZ Jazz Pty Ltd gets behind in the rent and is \$100,000 in arrears.

Zena approaches the landlord, the trustees of the Uptight Trust. They agree not to exercise their power to evict for non-payment of rent if AZ Pty Ltd agrees to recommence

paying rent and agrees to a schedule for paying the arrears. The Bank however is not so accommodating and demands immediate payment of the entire loan.

A few days after speaking with the trustees Zena gets a phone call from their secretary. It seems that the trustees were unaware that AZ Jazz Pty Ltd (despite the name) was selling music. The Uptight Trust was founded by an eccentric millionaire who believed that all modern music was the work of the devil and the trust is prevented for renting to anyone connected with the sale of such music, especially jazz. The trustees therefore regard the lease as void on the ground that they were mistaken as to their power to enter into it. Nevertheless they demand immediate payment of all the rent overdue, due now, or payable in the future under the lease.

By now Arnold and Zena are convinced they need a lawyer and you are consulted.

QUESTION.

Advise Arnold and Zena