

Problem 1

Sujit Ghosh and Patrick McAllister met in 1998 as freshmen at UC Irvine where Sujit was an economics major and Patrick majored in computer science and minored in economics. Every year, Sujit, who is not particularly mathematically inclined but who has great business ambitions, struggled with required courses in statistics and math for his major. Patrick, who is a math whiz, worked extensively with Sujit, tutoring him to help him through these courses. Indeed, in junior year, when Sujit was at risk of failing two required courses and losing the scholarship that made it possible for him to attend college, Patrick cancelled his plans with his girlfriend for Spring Break in San Diego (losing his non-refundable deposits) and stayed in the dorm with Sujit to get him ready for his finals. Sujit survived the finals, and held onto his scholarship. “I owe you,” said Sujit. “Big time. I promise. If you need something from me, just name it. I won’t forget.”

After graduation, Sujit went to work for his uncle in Los Angeles in a small but rapidly growing technology firm. A couple of shrewd (although some say lucky) decisions and stock options quickly made Sujit a rich man. Patrick, who looked on at this success with some envy, did not do so well. Superb in math and computer science, Patrick nonetheless found himself in a glut of similarly trained grads looking for work in 2002. Patrick moved around from job to job for a while and eventually decided to start up his own business, developing screening devices for the detection of explosive devices in airline baggage. Patrick developed some unique attributes in the software for the devices (which he has nicknamed “Gotchas”) and discussion of his plans for the product with security experts in the airline industry gave him great confidence that he was onto something big. What he needed, however, was capital to develop prototypes of the devices ready for testing and demonstration to potential buyers.

Patrick decided to call up Sujit and see if he might be interested in being an initial investor in Patrick’s new company. The two decided to meet for lunch at the Water Grill, Sujit pulling up rather noisily at the valet parking in his Porsche Boxster, and offering to pick up the hefty tab for their meal. At lunch, Patrick told Sujit all about his ideas for Gotcha. He had some diagrams with him and demonstrated the software in a simulation he had developed on his laptop. Sujit thought this was all pretty exciting. “Count me in, Pat. This is terrific. How would \$50,000 do? When do you need it?” Patrick says, “Great. I knew I could count on you—not only as a friend but as a businessman who’s seen the potential out there. I really appreciate this.” They shook hands, Patrick saying he will call Sujit in a few days.

Patrick left the lunch and went straight to his real estate agents' office; he signed a one-year lease for 3,000 square feet of office/commercial space near the USC campus at \$5,000 a month. He spent the following day at Office Depot and online ordering equipment, office furniture, getting phones and high speed internet services hooked up. By day three he had run up \$30,000, including his two-month deposit on the office space, on his credit cards.

Later that day he spoke to his sister Bonnie, a recent USC Law grad, about his plans. Bonnie, ever the older sister, scolded Patrick for not getting anything in writing to establish the terms of his deal with Sujit. "What if he doesn't come through with the money? You can't pay for all this stuff. And you're not going to see revenues, you're telling me, for six months at best. Get it in writing, Patrick." Bonnie drafted a document, borrowing some language from contracts she had seen in her summer job in the legal department of a local bank. In part it read, "Lender hereby covenants to convey to Borrower \$50,000, said funds to be delivered by certified check as of close of business August 1, 2005. Lender acknowledges that failure to deliver said funds as of above date will result in Borrower's default on other financial obligations and will cause substantial and material harm to Borrower's business and profitability now and in the future. In the event of default, Lender agrees to compensate borrower for all direct and consequential damages caused by said default." The document established an interest rate of 5% but did not set a date by which the funds had to be repaid.

Patrick sent the document to Sujit and followed up with a phone call. Sujit took the call on his cellphone from a cruise ship in the Mediterranean. He told Patrick his assistant had received the document and that he had instructed his assistant to sign his name to it—although he hadn't read it. When Patrick asked whether Sujit wanted him to fax the document to the ship, Sujit said, "No, no, no. It's basic, you said. I've seen hundreds of these things. We're on. Go make money, my man."

The money has not arrived. Sujit has not called and his cellphone number is no longer in service. Patrick hasn't yet tracked him down at his uncle's business. What advice can you give Patrick about his legal position at this point?