

FINAL EXAMINATION

CONTRACTS

HOUSE OF RUSSELL

INSTRUCTIONS:

- DEADLINE:** This is a 75-hour examination. You may begin the exam at any time after you receive the exam via email around 10 am on Monday, May 11, 2015. You must submit your answers by 1 pm on Thursday, May 14, 2015. **If you turn in your answers after 1 pm on May 14, then you will receive an F for your Contracts grade. NO EXCUSES.**
- TURNING IN YOUR ANSWERS:** Turn in your answer by sending the file to registrar@law.du.edu. It's a good idea to send your answer with either a send receipt or a delivery receipt. As well, send yourself a copy of the message that you send to the registrar. This will verify the fact and time of sending your answer. **DO NOT SEND A COPY OF YOUR ANSWER TO PROFESSOR RUSSELL; YOU VIOLATE THE HONOR CODE IF YOU SEND A COPY OF YOUR ANSWER TO PROFESSOR RUSSELL.** In the subject line of your email, put the following text: "Russell-Contracts-[exam number]" where [exam number] is your exam number. Name the file that contains your answer using the same convention: Russell-Contracts-[exam number]. If you have technical problems turning in your answer, please contact the registrar. **Do NOT contact Professor Russell with difficulties related to exam submission.**
- OPEN-BOOK:** This is an open-book, take-home examination. Your answer must be of your own composition. You may work on this examination wherever you wish, and you may consult any written material that you wish. However, you violate the Honor Code if you discuss, show, or distribute this examination or your answers to anyone at all before 1 pm on Thursday, May 14. Be cautious, for example, about posting anything on

Facebook that anyone might think is a request for assistance. Once the exam starts, you may not discuss it with anyone at all before the examination ends at 1 pm on May 14, 2015.

4. **EXAM NUMBER:** Please put your exam number on each page. The easiest way to do this is to put the exam number in a header on each page. **Do not put your name anywhere on the exam.** You should name the file Russell-Contracts-[Exam Number]

5. **LENGTH:** This examination consists of one question. You may use no more than 2,500 words to answer the question. Reducing your answers to this word limit will be one of the challenges of this examination. **Include the word count at the end of your answer.**

6. **SPACING:** Please double-space your answers. Avoid miniature fonts, okay?

7. **HOW TO ANSWER:** In answering, use judgment and common sense. Be organized. Emphasize the issues that are most important. Do not spend too much time on easy or trivial issues at the expense of harder ones. If you do not know relevant facts or relevant legal doctrine, indicate what you do not know and why you need to know it. You must connect your knowledge of law with the facts before you. Avoid wasting time with lengthy and abstract summaries of general legal doctrine. Discuss all plausible lines of analysis. Do not ignore lines of analysis simply because you think that a court would resolve an ambiguous question one way rather than another. **Starting the exam with a long list of general points is a waste of time.**

8. **JURISDICTION:** The laws of the 51st state of the union apply to all the issues in this examination. This state has adopted the Uniform Commercial Code. The 51st state is NOT Colorado.

9. **CONCISION:** Quality, not quantity is desired. Think through your answer before you begin to write. You have a lot of time to write and edit your answer. You will earn a better grade by being thorough and concise. And, of course, well-organized answers will be the best answers that earn the highest grades.

10. **EXPERTISE:** Please note that sometimes House of Russell exams deal with subject matter about which some of you may have expertise. You have to accept the exam's presentation as true. For example, if there is lava in the exam, the exam indicates that lava is 1,500 degrees Fahrenheit, but you happen to know that lava is much hotter, then you should put aside your superior knowledge and accept the lava as being the temperature that the exam says it is. Typically, House of Russell exams try to simplify some issues by mashing down the science just a bit.

11. **KEEP A COPY:** You should feel free, of course, to keep a copy of the exam. Please keep your answer also.

12. **CHEATING:** If, in preparing for this examination you have violated the Honor Code, or if, during this examination, you violate the Honor Code, the best course of action is for you to report to the Dean of Students immediately after this examination ends.

13. **GOOD LUCK:** Good luck and have a great summer.

Das Franchise (франшиза)

Your client is Jim Bizowner. The news story below, which has just run in the newspaper, concerns one of several issues for which he needs your help. Mr. Bizowner has talked with your boss, Amy Partner, in the small, business boutique law firm in which you work.

Two Newstate cafés defect from Daz Bog, emerge as Genessee Coffee

By Alicia Wallace, The Newstate Post

Two Newstate coffee shops have defected from Daz Bog Coffee.

After closing Tuesday night as franchise locations for the Russian-themed company, the coffee shops at 110 16th St. and 1200 Clayton St. reopened Wednesday morning as Genessee Coffee stores.

Under the cover of night, workers removed the red-and-black Daz Bog signs, tiled and painted over the Newstate-based firm's signature Russian-language writing on the walls, and replaced the menu boards to reflect an all-local lineup of food and coffee.

Now filling the pastry cases are baked goods from Newstate's City Bakery, and the coffee beans are from local roasters Corvus and Novo.

“Financially, it was impossible for us to go any longer, so we decided to debrand and rebrand and face the consequences,” said Jim Bizowner, a Daz Bog franchisee who owned the two locations with his late son, Brian, since January 2013. “We told the franchisor that we were going to do it. We called their bluff.”

“I started these locations two years ago with my son,” Bizowner said. “We put our heart and soul into these stores. It doesn't matter how hard you work; under the Daz Bog system, you just can't succeed.”

How long the coffee shops will remain Genessee Coffee locations remains to be seen.

Daz Bog president and chief operating officer Leonid Fyodorov said Wednesday the company plans to take “immediate possession” of the store locations.

“We were surprised to see our former franchisee Jim Bizowner step outside of the legal process and violate the franchise agreement with us by rebranding our two Daz Bog stores in violation of Daz Bog's rights,” Fyodorov said in a prepared statement. Said Fyodorov: “Daz Bog takes these matters very seriously and we intend to use all available legal resources and processes to appropriately resolve these disputes. Due to the unfortunate breach of his obligations as a franchisee, Daz Bog has terminated Bizowner’s Franchise Agreements and given notice to the landlords of our intent to take immediate possession of the store locations.”

Bizowner claims the franchisor engages in unfair business practices, including overcharging its franchisees for goods. “Daz Bog charges franchisees prices that

are considerably higher than industry standards for products that must be purchased from Daz Bog," said Bizowner.

Bruce Van Zandt, a morning regular at the 110 16th St. coffee shop for nearly 10 years, has seen the location change from a Diedrich Coffee to a Daz Bog and now to a Genessee. The location and the friendly staff, including longtime barista Megan Lamothe, are what keep him coming back, he said. "This is a great transition for me," he said, noting the small-batch coffees. "I love it."

[End of article.]

Bizowner has described to your boss the details of his entering into the contract with Fyodorov to form two Daz Bog franchises. Bizowner, who previously had managed a boat dealership, was experienced in business although he was not someone ordinarily thought of as "savvy."

Bizowner approached Daz Bog after reading about franchise possibilities on the Daz Bog web site. Bizowner felt that he met Daz Bog's expectations: he was a team player and a people person who was attentive to detail and enthusiastic. He also met the financial qualifications because he had more than \$200,000 in cash and otherwise met the financial qualifications.

In June of 2012, Fyodorov, the CEO and owner of Daz Bog, received email from Bizowner saying that Bizowner was interested in becoming a Daz Bog franchisee. Fyodorov believed strongly that next to personal and financial qualifications, enthusiasm is a key success factor. For that reason, Fyodorov looks

for people who exhibit a high level of enthusiasm and who are motivated to succeed. Building a successful business takes dedication and hard work, and Fyodorov believes the key to success is the energy and enthusiasm of the business's leadership.

Bizowner has told your boss that when he first met in person with Mr Fyodorov, Fyodorov told Bizowner that "I have got unique opportunities in Newstate for two new Daz Bog stores." Bizowner claims that Fyodorov showed him a document that included combined weekly gross sales figures for the two stores, ascending each week, starting from \$5,000 and progressing by increments of \$1,000 to \$14,000 weekly combined profit for the two coffee stores. Underneath these figures were expected expenses and net figures for profits generated relative to sales achieved. Fyodorov described the document as a "pro forma expenditure statement." Although Fyodorov showed the document to Bizowner, Fyodorov did not give Bizowner a copy. Bizowner is adamant that Fyodorov used this document to show the sales figures that Bizowner could expect once he opened the stores and that the figures in the document showed the profit that Bizowner could expect from operating two coffee franchises.

Bizowner says he has a clear memory of Fyodorov saying to him "you can expect sales of \$11,000/\$12,000 per week, but it will take a good 3 months and then you will be right after that. The first month will be a hit and then it will die down a bit." Fyodorov then showed him the document and pointed to the columns headed "Weekly Sales." Bizowner recalls Fyodorov saying, "this is what you'll be doing in the first week, the second week etc." Mr Bizowner says he was excited by

these figures, and that these figures were the reason he decided to become a franchisee.

During the late summer of 2012, Bizowner continued to have discussions with Fyodorov. Bizowner learned that he would have to pay a \$25,000, nonrefundable franchise fee for each of the two Daz Bog franchise stores that he wanted to start. Initially, Fyodorov told Bizowner that he should expect to make an initial investment of \$187,000 for each coffee store. In the fall of 2012, though, he learned that \$187,000 at the low end of initial investment in a franchise and that the franchisor recommended \$269,000 as a median amount that franchisees should invest with \$376,000 being the high end for initial investment in a franchise.

In November of 2012, Fyodorov telephoned Bizowner and requested \$25,000 or one-half of the total deposit needed for two franchises. Fyodorov was anxious to get Bizowner's agreement, Bizowner recalls Fyodorov saying "I have shown you the weekly forecast figures for what the two coffee stores should be doing—you are losing money every week that you are not in the coffee business! I have shown you how much you can make." Bizowner believes that Fyodorov will deny having said this.

In December of 2012, Bizowner decided to pull the trigger and commit to two Daz Bog Franchises. He knew that he would not get the holiday revenue for 2012, but in light of the figures that Fyodorov had shown him, he felt very confident that he would soon be making substantial amounts of money. He paid Fyodorov a total of \$50,000 for the franchise fees—\$25,000 for each store. In effect, payment of this fee got him into the Daz Bog business. Once he opened his

businesses, which he expected to do in April of 2013, Bizowner would pay 6 percent of his gross revenue each month to Daz Bog as a royalty.

Bizowner opened both of his coffee shops on April 4, 2013. He had invested \$400,000 in the shops—some funds he borrowed and some came from his cash reserves. As with any coffee shop, he sold coffee drinks, other beverages, food, cups, coffee paraphernalia, and beans. As predicted, there was a good deal of customer interest when he first opened after which business fell off somewhat and then climbed back. However, by late July of 2013, Bizowner could see that the projections that Fyodorov had shown him were far above his actual gross revenues for the two stores.

Bizowner had good staff in both coffee shops, and he worked nearly round the clock. Even so, after Christmas of 2013, he had not come anywhere near the \$14,000 per week that Fyodorov had projected. His biggest week was only \$7,000 total for the two stores, and after paying all his employees and expenses, he found that he was barely making money.

In January of 2014, he confronted Fyodorov about the fact that the figures that Fyodorov had suggested were apparently unobtainable. Fyodorov denied that he had ever given Bizowner projected sales figures. Fyodorov emphasized that it was company policy never to give prospective franchisees any projected sales figures. He said that there was no doubt that this was company policy. Fyodorov implied that maybe he had made a mistake in thinking that Bizowner had what it took to be a Daz Bog franchisee. Bizowner was downhearted.

When he signed the franchise deal, Bizowner did not understand a different cost that he would face as a franchisee. In addition to requiring the franchise fee and a 6 percent royalty on his gross revenue, Bizowner also had to buy most of his supplies—beans, cups, sugar packets, utensils, filters, for instance—from Daz Bog. The markup on these supplies was very high— 68 percent mark-up on cold cups and a 41 percent mark-up on coffee filters, for example. These prices were far higher than what franchisees would pay if they bought directly from suppliers.

After talking with other Daz Bog franchisees in early 2015, Bizowner learned that a number of franchisees had failed; that nearly every franchisee thought that Daz Bog’s requiring franchisees to purchase supplies at huge markups was both ridiculous and highly unusual in the business; and that everyone to whom he mentioned the financial projections that Fyodor showed him thought that the projected profits were unrealistically high and that Fyodor had lied to Bizowner when he suggested that Bizowner might have sales revenue as high as \$14,000 per week. No other franchisee had heard of or had obtained sales figures that high.

After talking with these other owners, Bizowner resolved to do something. And last week, he made the bold move of stepping away from the franchise and has rebranded his stores as Genessee Coffee.

Bizowner provided sections of the contract that he thought might be relevant to Ms. Partner, as follows:

Paragraph 13. Liquidated Damages.

Upon the Franchisee’s breach of this agreement or the Franchisor’s termination of this agreement for good cause, the Franchisee shall pay to the Franchisor within 30 days of the date of the termination, as liquidated damages for the premature termination of this

agreement and not as a penalty, an amount equal to 3 ½ times the continuing royalty fees payable to the Franchisor in respect to the last 12 months' of the Franchised Business's active operations or for the entire period the Franchised Business has been open for business, whichever is the shorter period.

Paragraph 14. Gross Sales.

"Gross Sales" means:

- (a) all revenue derived from the sale, at regular selling prices before any discounts or allowances, of any food, merchandise, and services, from the Store;
- (b) all income of every kind and nature related to the Store, Franchise, or Marks, even if derived from sales or activities not permitted by this Agreement;
- (c) the fair value of any non-monetary consideration received by Franchisee for any food, merchandise, and services, from the Shop, which are bartered, traded or otherwise exchanged by Franchisee for valuable goods or services; and
- (d) all proceeds of any business interruption insurance policies related to the Store or Franchise.

Specifically excluded from "Gross Sales" are:

- (i) the incidental sale of gift cards (or any similar redemption device), if authorized by Daz Bog; provided however that goods and services purchased with gift cards (or any similar redemption device) shall be included in Gross Sales, to the same extent as if paid for with cash;
- (ii) sales taxes, excise taxes, or other taxes added to the selling price of any item or service, if actually collected from customers and transmitted to a governmental taxing authority; provided however any tax rebate, allowance, or discount shall be part of Gross Sales to the extent received, taken, or realized by Franchisee;
- (iii) any extraordinary sale of equipment or fixtures used in the Store.

Paragraph 15. Franchisor Disclosure.

Franchisor does not provide projections on earnings. The franchisor does not give earnings information about a Daz Bog franchise. Earnings may vary between franchises. The franchisor cannot estimate earnings for a particular franchise. Like any business, risk is involved and no representation or guarantee (whether oral, written or implied) can be or has been given in relation to the store's success, profit, or potential turnover.

Paragraph 16. Legal Advice and Risk.

Franchisor recommends that Franchisee obtains legal advice in respect of this document and the Related Documents and Franchisee acknowledges such recommendation and that Franchisee has had the opportunity to obtain such advice. Franchisee acknowledges that Franchisee has conducted an independent investigation of the business and the Franchised Business and recognizes that:

(a) the Franchised Business involves business risks that make the success of the Franchised Business largely dependent on Franchisee's business abilities; and
(b) although Franchisor has used its best endeavors to ensure that the Franchise site is satisfactory for the operation of the Franchise Business, Franchisee shall make no claim against Franchisor as a consequence of the location of the Franchise Site proving to be unsatisfactory for the conduct of the Franchise Business.

Paragraph 17. Entire Agreement and Acknowledgement.

This document together with any Related Document contains the entire agreement and understanding of the parties with respect to the Franchised Business and the Business. There are no representations, undertakings, agreements, terms or conditions not contained or referred to herein or in the Related Documents. This document supersedes and extinguishes any prior written agreement between the parties or any of them relating to the location of the Franchise Site. Franchisee confirms and acknowledges that prior to having executed this document Franchisee has read the provisions of this document carefully.

Breaking up the franchise relationship has opened a variety of other questions. Bizowner asked Ms. Partner about three in particular.

First, Bizowner wants to get rid of the cleaning service that he has used since he opened both of his Daz Bog franchises. When he opened the business, Fyodorov recommended to him that he hire Daz Cleaners, a cleaning service that specialized in cleaning restaurants, coffee shops, and bars. To say that Fyodorov recommended the service is something of a misstatement; Bizowner feels that Fyodorov demanded that he hire them. Implicit in the suggestion that he hire Daz Cleaners was the threat that if he did not do so, he would not be allowed to operate the franchise.

In any event, Daz Cleaners are expensive, and Bizowner wants to fire them. They charge \$1,500 per month to clean both stores; Bizowner could save a lot of money by having his own employees clean the stores.

Bizowner has no written contract with Daz Cleaners. Just before he opened the stores, Bizowner hired Daz Cleaners with a handshake and oral agreement to pay them \$1,500 per month. In a face-to-face conversation, he promised the owner of Daz Cleaners that they would be his cleaners for as long as he operated the stores, which was to be ten years under the original contract. They then shook hands on the deal. They have been cleaning his stores every night since he opened. Now that the franchise contract is over, he wants to save money.

Second, Bizowner is concerned about a delivery that is scheduled to arrive on Friday, May 15. For the past year, Bizowner has had a contract with a paper printing company that delivers napkins printed with the Daz Bog logo. These napkins are one of the few supplies that Bizowner has not been obliged to buy from the franchisor. The shipment arrives on the third Friday of every month and costs \$450. Because the napkins are imprinted with the Daz Bog logo, Bizowner has no use for them.

Bizowner purchased the napkins using a form that Bizowner received during franchisee training. The franchise trainer explained that the form contained fine print that said “Acceptance is expressly made conditional on assent to the additional or different terms.” Elsewhere in the fine print, the acknowledgement that Bizowner used contained a provision that “the contract includes implied warranties of merchantability and fitness for a particular purpose” and also a

provision that “the buyer will not be liable for any injuries to the seller, its staff, or agents including injuries due solely to the negligence of the buyer.”

When Bizowner had first ordered printed napkins from the napkin printer, Bizowner had telephoned the company, which was called Printers, Inc. He described what he wanted, and Printers’ salesperson took the order and said that he would send the invoice. The seller’s invoice included a disclaimer that said “no alteration of the terms of this order, whether with different or additional terms, will constitute an acceptance.” Bizowner then sent back his own form with the language mentioned above. Bizowner has been interested to see that paper forms that contradict each other have nonetheless resulted in delivery of napkins every month for 11 months. This month, however, because he no longer has any need for napkins printed with “Daz Bog,” he plans on rejecting the shipment after he tells Printers that the printed terms of their forms do not form a contract.

Third, Bizowner has a warranty claim. Last month, he agreed to purchase a new espresso machine that the seller, Espresso Machines, LLC, claimed would speed up the production of coffee using higher-capacity machines. The commercial-grade machine cost \$3,500. The design of the machines allows a barista to make six different coffee drinks simultaneously. Previously, the stores’ machines allowed only four different coffee drinks to be made at once. The Espresso Machines salesperson explained that during peak morning sales times, the new six-way machine would speed up service to the line of customers and therefore yield higher profits for the store. Bizowner agreed to purchase one of the machines for one of his stores, and he signed a contract with Espresso Machines that, he noticed last week while reviewing some paperwork, contained this

sentence on the rear of the form: **“THERE ARE NO IMPLIED OR EXPRESS WARRANTIES.”**

Here is the problem with the new coffee-making machine, which was installed last week during the night of the transition from Daz Bog to Genessee. If a barista steams milk while also making coffee, then the production of coffee stops. There seems to be some sort of mechanism in the espresso machine that diverts water from the production of coffee when the barista steams milk. Or maybe there is a defect in the design of the espresso machine’s motherboard. Because so many of his morning customers drink cappuccino—which requires steamed milk—the new machine slows the production of coffee in his store and makes the lines longer. The longer lines are costing him business and customers leave and go to competitors’ shops for coffee.

Your job is to write a memo to your boss Amy Partner in which you advise her how to advise Bizowner with regard to Daz Bog, Daz Cleaners, Printers, Inc., and Espresso Machines, LLC. Note that Newstate does NOT have a special set of statutes dealing with franchises. Note, too, that your concern is Contract law.

END OF EXAM