Professor DeWolf | Consumer Law
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# SAMPLE ANSWER TO EXAM

## QUESTION 1

> This case is based upon *Dushkin v. Desai,* 18 F.Supp.2d 117 (D.Mass. 1998), in which the court denied the defendant's motion to dismiss claims for common-law fraud and violation of consumer protection statute.

There are a variety of theories that might be used to obtain redress from Desai. Also, a variety of remedies should be considered.

Liability Theories

*Fraud*. The first possibility for recovery would be on a theory of fraudulent misrepresentation, or deceit. In order to establish fraud, the plaintiffs would have to show (1) a false representation of fact; (2) that was made with *scienter*--knowledge of its falsity; (3) with an intent to produce reliance by the plaintiffs; which (4) did in fact produce justifiable reliance; and (5) resulted in damage to the plaintiffs. Desai certainly made false representations about his personal holiness, but there is a mixture of religious belief along with the statements of fact. On the issue of it is a little difficult to determine whether they were representations of fact. Certainly he knew he was a hypocrite. The statements were certainly designed to produce reliance and did produce justifiable reliance, and they led to the plaintiffs' damage. All of these factors seem to be relatively well established.

As will be discussed later, fraud allows the recovery of punitive damages in egregious cases, so it has advantages as a liability theory.

*Consumer Deception*. The second theory that could be used would be a violation of the state consumer protection act, or UDAP statute ("Unfair or Deceptive Acts or Practices"). Most states have enacted the equivalent of the Washington CPA, and permit plaintiffs to recover either where they have been deceived or where the defendant has committed an unfair trade practice. One immediate issue is whether this is a transaction that took place in the area of commercial trade. Certainly not every religious leader is subject to consumer fraud claims, even if he turns out to be a hypocrite or even a charlatan. But the transactions in this case do seem to be commercial in nature and certainly drew from the wider population to obtain benefits. One big issue is whether the plaintiffs will have to meet the more difficult standard established in the *Cliffdale Associates* case of showing that the deception was one that would deceive a "reasonable consumer." The defendant might argue that the plaintiffs would be unreasonable to rely so heavily on the claims of a single individual, but in fact it doesn't appear to be all that unreasonable. Older CPA cases permit a consumer to recover if the practice has a *tendency* to deceive. Hopefully that will be closer to the standard that is used in this jurisdiction.

Another problem that concerns me is that a lot of time passed between the first notice that Desai had a problem and the time that this case is brought. I hope there are no statute of limitations issues to worry about. Finally, in addition to the deception theory, we could claim that Desai's practice of taking vulnerable disciplines and encouraging major dependence while cynically fleecing them of their money is an unfair trade practice. I don't think this aspect would be too difficult to prove (aside from the religious liberty and/or statute of limitations issues inherent in the other claims).

Remedies

As part of considering the fraud and consumer protection claims, I would investigate the advisability of initiating a class action on behalf of all of Desai's victims. A class action can be certified if (1) the class is so numerous that joinder is impractical; (2) there is a preponderance of common questions of law and/or fact; (3) the class representative is capable of representing the interests of the class; and (4) the claims and defenses of the class representative are typical of the class as a whole.

I would be concerned about a class action in terms of the burden on our plaintiffs (and on our firm if we initated a class certification proceeding), and I would only do it if Desai had almost unlimited resources. Otherwise, the same pie would have to be shared with a lot of other people. It would probably be better to initiate individual suits on behalf of the plaintiffs and anyone else who decides to join the suit.

We could certainly claim the actual damages suffered by the false representations, and in addition seek punitive damages for the egregious conduct of the defendant. Under the consumer protection act there are usually some kind of treble damages or penalties, and in addition attorney fees can be recovered.

### Question 2

There are advantages and disadvantages to this proposal. First, some history is in order. The Rule of 78s was initiated in the era before computers or even calculators were commonly used, and it was a crude but effective way of providing an approximation of the rebate in interest to which a borrower was entitled.

The advantage of getting rid of the Rule is that it would result in more accurate calculation of the amount of principal that has already been paid, and a reduction for the interest that has not yet been accrued. It would mean that consumers obtain a bigger deduction (or rebate) when they prepay a loan, and that in turn might mean that consumers would be more inclined to pay off loans early. As it is, most loans are paid before maturity anyway, so it could result in a substantial saving. It might even encourage more borrowing, which could stimulate the economy. Abolishing the Rule on a federal level would provide uniformity in the economy.

The disadvantages include the fact that it would cost lenders something to switch over to a new system. It would also mean that the extra bonus they get when loans are prepaid would have to be compensated for in higher nominal interest rates. It would hurt people who pay their loans per the original agreement. It also is somewhat offensive to those who are true believers in market rates and a decentralized system of government.

### Question 3

> This case is based upon *United Companies Lending Corp. v. Sargeant*, 20 F.Supp.2d 192 (D.Mass. 1998), in which the court held that the regulation was valid and that the loans could constitute an unfair or deceptive practice.

Ms. Sargent has a variety of different angles of attack. She might look at a claim based upon arguing that the loan was usurious, but I doubt there would be much utility in that route. For one thing, the nominal loan rate was less than 18%, which is below the ceiling that most states have for loans. (Although, if the broker's fees are added to adjust the APR upward, it could exceed 18%). Another problem is that many lenders are able to take advantage of better lending rates by structuring their loans as out-of-state lenders, which United may be.

Another avenue would be TILA (the Truth in Lending Act). This is primarily directed at disclosure. Not all the facts are given, but there may have been some omissions in terms of disclosing all of the fees that were being charged to her. In addition, there is no mention of the mandatory 3-day rescission window that she should have had available. However, that may simply be an omission in the recitation of facts. It's likely that the lender was conscious of these requirements.

The better argument is that the loan is unconscionable. This claim can be made in two forms: first, that the loan was *procedurally* unconscionable. That is, S was not told enough to make a fully informed decision. In particular, she wasn't told (as the court required in *Besta*) that the loan she was entering into was going to leave her worse off than her previous mortgage. Although she got some limited cash benefits from the new loan, the huge fees that she was paying off the top drastically reduced the equity that she had in her house. Most refinance loans are done either to get new money or to come up with more favorable loan terms. S got neither out of this deal. (She would have been better off signing up for a credit card with 22% interest than paying $23,000 in broker's fees.) Unless she was told that she was better off standing pat, she may have been dealt with in an unconscionable way.

Second, she may claim that the loans are *substantively* unconscionable. To succeed on this theory she would need to show that the loans are so high as to shock the conscience of the court. One test for substantive unconscionability was found in *Jones v. Star*, where the court found a loan rate that was 200-300% higher than ordinary consumer rates to be unconscionable. Another indicator in this case is that the commissions paid to the lender ($23K) actually exceed the amount of benefit she would receive from the loan ($20.5K). I think the case for substantive unconscionability would be pretty good.

*Remedies.* If Sargeant were interested only in defeating the claims against her, she could use the unconscionability argument as a shield. But this would be of limited use. She would probably want a more aggressive approach. One way to achieve this would be to ask for *rescission* of the loan contract. This would require her to repay the loan amount, but would not entitle the lender to commissions and might permit Sargeant to repay the principal without any interest. One way to ask for rescission would be from the automatic 3-day "cooling off" remedy that attaches to any consumer loan. Although obviously more than three days have passed, Sargeant could argue that the inadequate disclosure in effect delayed the commencement of her three-day waiting period. Alternatively, Sargeant could argue that she is entitled to remedies under the state consumer protection act, or UDAP. The UDAP is generous in setting a relatively low threshold for liability (an unfair or deceptive act or practice) and it allows the successful plaintiff to recover not only damages but also attorney fees, and potentially a penalty or civil fine. Depending upon how many other victims of this practice we might be able to identify, Sargeant could consider a class action. Class actions require that the trial court find (1) the class is so numerous that joinder is impractical; (2) there is a preponderance of common questions of law and/or fact; (3) the claims and defenses of the class representative are typical of the class as a whole, and (4) the class representative has the ability to represent the interests of the class.

# CHECKLIST

## QUESTION 1

- ☐ Liability theories
- ☐ Elements of Fraud:
  - ☐ False representation;
    - ☐ statements *of fact*?
  - ☐ Scienter
  - ☐ Intent to produce reliance by π;
  - ☐ Justifiable Reliance by π;
  - ☐ π's damage from reliance
- ☐ Consumer Protection violation
- ☐ Does it affect "public" interest?
- ☐ Deception theory
- ☐ Did *Cliffdale* raise the bar?
- ☐ UDAP test: *tendency* to deceive
- ☐ Is passage of time a problem?
- ☐ What about *unfairness* theory
- ☐ Remedies
- ☐ Class action
  - ☐ numerosity
  - ☐ common questions
  - ☐ class representation OK
  - ☐ burden on class representatives
  - ☐ does he have the money?
- ☐ individual suits
- ☐ damages
- ☐ Punitive damages?
- ☐ penalties
- ☐ attorney fees
- ☐
- ☐
- ☐

## QUESTION 2

- ☐ History: used as a convenience.
- ☐ Benefits of outlawing:
  - ☐ more accurate (less deceptive)
  - ☐ Consumers get money back
  - ☐ most loans are refinanced
  - ☐ would it encourage refinance?
- ☐ Detriments of outlawing
- ☐ benefits only early payoffs
- ☐ would hurt those paying entire term
- ☐ probably be reflected in higher initial rates
- ☐ federalism issue

## QUESTION 3

- ☐ Usury?
- ☐ Probably not above 18%;
- ☐ But with additional "points," may be
- ☐ Interstate restrictions

- ☐ TILA remedies?
- ☐ Doesn't look spectacular

- ☐ Unconscionability: Procedural
- ☐ *Besta*: unconscionable not to disclose
- ☐ Was she worse off?
- ☐ She got benefits, but paid a lot more
- ☐ compare to simply borrowing the money

- ☐ Substantive unconscionability
- ☐ Higher than other loans
- ☐ *Jones v. Star*, etc. use 200% - 300%
- ☐ Total commissions ($23,000) exceed her benefit ($20,500)

- ☐ Remedial Issues
- ☐ Unconscionability as a Shield
- ☐ Rescission
- ☐ Was 3-day right to rescind protected?
- ☐ UDAP remedies as a sword
- ☐ class action?
- ☐ penalties, attorney fees, etc.

EXAM # ____________