

EXAM

Instructions

DO NOT GO BEYOND THIS PAGE UNTIL YOU ARE TOLD TO BEGIN.

THIS EXAM WILL LAST 3 HOURS. Part I is a CLOSED BOOK EXAM. It will last **90 minutes**. After 90 minutes I will collect all of the exams. If you finish ahead of time you may read Part II (Question 3) and make notes but you may not begin writing your answer to it.

Part II is a modified OPEN BOOK exam. It will last from 90 minutes. You may use any notes you have made yourself, your textbook, the statutory supplement (West's Commercial Law Statutes) and any outlines that I have distributed to you. **YOU MAY NOT** use any commercially printed outlines, hornbooks, treatises, articles, etc., except that you may use up to 50 pages photocopied from such materials.

While waiting for the exam to begin, be sure that you have written your EXAM NUMBER on each bluebook, that you have read these instructions, and that you are otherwise ready to begin. For each of the questions, **START A NEW BLUEBOOK**.

POINTS are assigned based upon the rough number of minutes it should take to complete each section. The division is as follows:

Part I	Question 1:	70 points
	Question 2:	15 points
Part II	Question 3:	85 points
	=====	
	TOTAL	170 points

For purposes of this exam, assume that you and your clients are located in the State of Linden, and that Linden has adopted all of the Uniform Acts (including the Uniform Consumer Sales Practices Act and the Uniform Consumer Credit Code) that are contained in your statutory supplement.

PLEASE DOUBLE-SPACE YOUR ANSWERS. Label the bluebooks "Question 1, Book 1"; "Question 1, Book 2"; "Question 2, Book 1"; etc.

GOOD LUCK!

MERRY CHRISTMAS! HAPPY HOLIDAYS!

PART ONE: CLOSED BOOK

QUESTION 1 (70 points)

You are a new associate in a law firm that has been contacted by five individuals (hereinafter "plaintiffs") who are seeking advice based on the following facts.

After coming to the United States in the 1960s to study at the Philadelphia College of Art, Amrit Desai formed the Kripalu Yoga Ashram, a small intentional living community, sometime in 1974. Desai appointed himself as the Kripalu Ashram's "guru," or spiritual leader. The ashram included approximately twenty resident members and operated a small public center for the purpose of teaching yoga. In the late 1970s, Desai's ashram became a Linden nonprofit charitable corporation called the Kripalu Yoga Fellowship ("KYF").

In 1983, KYF moved to a 350-acre site in Springfield, Linden. KYF began to operate a large-scale retreat center for holistic health and education at the Springfield site, which contained several large facilities that housed up to 500 people. Over 15,000 paying guests per year visited KYF "to relax, take yoga classes, meditate, have massages, and otherwise take a break from the routine of their daily lives." Approximately 250 resident members of the ashram (including the plaintiffs) operated the facility, working for room and board and a small monthly stipend in exchange for the opportunity to live at the Kripalu Ashram as Desai's "disciples."

Plaintiffs allege that the resident members, paying guests, and KYF donors were attracted to the facility precisely because of Desai's presence. Desai's picture hung throughout the facilities, his videos ran continuously in the public areas, and his books, tapes, and other items were offered for sale by KYF.

Publicly, Desai claimed to be an authentic guru—a "teacher and object of veneration" who attains his status in part through several forms of abstinence, including refraining from sexual activity and material pursuits. Desai outwardly professed to live the proper life of an authentic guru, which he identified as demanding "honesty, selfless devotion to the well-being of his followers," and "absolute personal trust" between guru and followers, in addition to celibacy and commitment to a non-material, physically and financially simple lifestyle. As resident guru at KYF, he conducted a combination of life counseling, spiritual leadership, and health and educational services.

Plaintiffs characterize Desai as cultivating in his followers an intense emotional dependence. The plaintiffs, as "disciples," were told to identify themselves and their well-being with Desai's personality and integrity, and to regard Desai as the most important person in their lives. Desai deemed himself the plaintiffs' "personal life counselor," and frequently offered guidance with respect to the most intimate aspects of the plaintiffs' personal lives. Plaintiffs state that over many years, each of them developed a "close and deeply personal relationship" with Desai.

Plaintiffs claim that during their years at the ashram they strove to emulate Desai's professed lifestyle, in that they endeavored to be celibate or chaste, honest, selfless, and devoted to the well-being of others, within the framework of a simple, non-material way of life. In addition, on numerous occasions, Desai allegedly urged the plaintiffs to donate literally all of their possessions to KYF. One plaintiff claims to have donated more than \$30,000, and another more than \$100,000 in earnings to KYF upon Desai's instruction.

Behind his carefully cultivated image, plaintiffs charge, Desai was in fact a fraud. Plaintiffs allege that, from the 1970s until 1994, KYF entered into a series of lucrative contractual relationships with Desai, the purpose of which was "to induce Desai to remain physically present at KYF, teaching yoga courses, meeting with guests and visitors, serving as advisor, mentor and exemplar to the residents," and performing the role of guru at KYF. In exchange, Desai, as an independent contractor, received an annual fee, free housing, free transportation (both domestic and international), a percentage of the proceeds from literature, video, and audiotape sales, and free sponsorship of Desai's seminars throughout the world, all revenue from which he retained. Plaintiffs aver that Desai secretly received payments and benefits from KYF totaling many

hundreds of thousands of dollars.

Moreover, between 1974 and 1994, Desai engaged in a series of secret sexual relationships with several female "disciples" in the KYF community (none of whom has expressed interest in making any claim against Desai). Plaintiffs assert that these relationships, like his material self-enrichment, were deliberately concealed by Desai in order to preserve his reputation as a true and authentic guru. In 1985, a woman apparently revealed to KYF officers and directors that Desai had had abusive sexual relations with her. Desai accused the woman of deceit and mental illness, and "prevailed on KYF and its residents and members, including each of the plaintiffs, to ostracize, expel, or otherwise usher her out of the KYF community." In 1994, another woman brought similar accusations against Desai, at which time he publicly admitted to some past sexual activities. In an audiotaped statement, Desai apologized for his behavior and acknowledged that it had caused his disciples much emotional pain and suffering. KYF ended its contractual relationship with Desai, who moved to Florida. The Kripalu Ashram still operates in Springfield, but without any connection to Desai.

Plaintiffs want to know what legal remedies, if any, they have against Desai. (Please limit yourself to the remedies that have been covered in this class.)

QUESTION 2 (15 points)

You are a legislative aide to United States Senator Jefferson, who is a member of the Senate Judiciary Committee. The Senate is considering new consumer legislation, and you have been assigned to evaluate a staff proposal that would prohibit the use of the "Rule of 78s" in calculating refunds for the prepayment of loans. Please provide an analysis of whether such a proposal would be beneficial or detrimental to the interests of consumers.

PART II: OPEN BOOK

QUESTION 3 (85 points)

United Companies Lending Corporation ("United") makes, sells, and services refinancing, first lien residential mortgage loans which are used primarily for debt consolidation, home improvement, or major household purchases. United is licensed to do business in Linden as a mortgage lender. United operates in the subprime market making loans to consumers who have a higher credit risk than borrowers in the prime market.

Subprime loans are more costly to the lender to originate, sell, and service than traditional "A credit" loans. In the subprime market, the lenders evaluate the credit-worthiness of a borrower "by establishing various risk classifications with associated pricing parameters." There is no standard set of credit risk assessment criteria as exists in the prime market. The subprime market typically takes into consideration a potential borrower's 1) credit history; 2) the household debt-to-income ratio if the loan is approved; and 3) the combined loan-to-value ratio for home equity loan and other mortgage debt on the property. "Standards vary, however, within the subprime market, and different lenders may assign different weights for each of these factors, for a given credit grade. (One firm's 'B' loans may look like another firm's 'C' loans.)"

Subprime loans have higher securitization costs associated with the sale of these loans on the private secondary market compared to loans in the prime market because they are "nonconforming" loans. United loans are also sold "with recourse" in the event of a default by the borrower. As a result of these terms, the risk to the lender on a subprime loan is substantially higher than on a prime loan. "Due to the higher risks and costs associated with subprime loans, the total cost of such loans to the borrower—as reflected in the Annual Percentage Rate ("APR")—is generally higher than the cost of loans by traditional lenders such as banks. Such costs typically include interest, origination fees or 'points'¹ and other fees associated with the closing of the loan."

Daisy Sargeant ("Sargeant") is the owner of a New England triple-decker in Dorchester, Linden. She resides on the second floor and rents out the first floor and third floor apartments for \$600.00 per month each. Desiring to make improvements to the interior and the exterior of the house, she responded to an advertisement in the Springfield Herald regarding the availability of loans. She contacted the toll-free number in the advertisement and received a mortgage application. The advertisement was placed by a Bigstate-based mortgage broker, John P. McIntyre ("McIntyre"). McIntyre referred Sargeant's name to David Richard ("Richard"), a United mortgage loan originator located at the Warwick, Nextstate office. Richard contacted Sargeant. Richard is the United agent with whom Sargeant dealt in obtaining the mortgage loan at issue.

On August 9, 1995, Sargeant completed the loan application and executed disclosure documents related to the loan. Sargeant was classified as a "C" borrower by United. On August 23, 1995, United approved Sargeant's loan. A title search disclosed an undischarged mortgage on the property, however, as well as unpaid real estate taxes. McIntyre then negotiated with the lien holder who agreed to accept \$5000 as payment in full. United reapproved the loan, and the closing was held in Warwick, Nextstate, on September 29, 1995.

(In 1995, the period when the loan transaction took place, the majority of subprime lenders did not charge ten points on loans but rather charged five points or less. The payment of points can result in a lower contract rate, but the payment of points does increase the annual percentage rate or the effective rate of interest. This is so because the debt service is based on the face amount of the loan rather than on the net amount of the loan or the amount actually received by

¹One "point" means one percent of the total loan amount, which is payable at the time the loan is funded. Thus, charging five "points" on a \$100,000 loan means that the borrower pays a one-time fee of \$5,000 to the lender—in addition to whatever periodic interest rate is charged based on the amount of the principal that is still outstanding.

the buyer. Thus, points have the effect of reducing the amount of money advanced by the lender while raising the effective interest rate.)

Sargeant thus obtained a loan from United for \$134,700. The mortgage had an adjustable interest rate with an initial rate of interest of 10.99%. The loan provided that the rate could be adjusted upward one percent every six months with a maximum interest rate of 16.99%. The initial annual percentage rate charged on the mortgage was 13.556%. The loan proceeds were disbursed as follows: \$15,681 was applied to the home improvements upon their completion; \$4,910 was applied to pay off credit card debt; and \$93,000 was applied to two prior mortgages on her residence.² According to the settlement statement, Sargeant was assessed a brokerage fee payable to United in the sum of \$13,461.40. Sargeant was also charged a broker's fee in the amount of \$4,150 made payable to McIntyre. Her total closing costs and fees equaled \$23,029.87. Her initial mortgage payments were \$1,281. Her previous mortgage payments were \$956 per month.

Sargeant fell behind in the repayment of her loan and United initiated foreclosure proceedings against her. Sargeant has come to your office for advice. Please prepare an analysis of the likelihood that Sargeant will be successful and the remedies to which she is potentially entitled.

²One of the mortgages totaled \$88,000 to AFSCI and the other totaled \$5,000 to Foremost Servicing Company, Inc. Sargeant claims that she was not making any payments in connection with the \$5,000 mortgage and alleges that she did not have any obligation to do so.