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CONDO DEVELOPERS AND FIDUCIARY DUTIES: AN UNLIKELY PAIRING?

Alisa M. Levin^{* 1}

INTRODUCTION

There comes a time when many consumers consider purchasing real estate. Whether eyeing some real property “candy” down the street, enjoying a neighbor’s summer backyard party, or trading up from studio apartments to trendy downtown condos, we are all exposed to different types of realty on a daily basis. We all live somewhere, and we all know someone who has had experiences with purchasing real estate. In terms of size, affordability and convenience, the condominium is an increasingly popular option. With more frequency, we all may know someone who has purchased a condominium, only to subsequently experience buyer’s remorse. This article examines some issues that create this after-the-fact regret and discusses what can be done to avoid it.

Condominiums are often located in central areas that are historically more expensive, allowing purchasers to buy in areas that they might not otherwise be able to afford. However, like any real estate, a condominium can come with a number of issues apart from other types of real estate ventures. When prospective purchasers (and their attorneys) are evaluating the feasibility of a particular project, or in the alternative, extricating themselves from one gone bad, the developer’s “fiduciary duty” must be considered.

The condominium developer – the party who builds the condominium or initially converts it from its prior state, and who is typically the party responsible for initial sales – has various important and ongoing fiduciary duties. Even after the first unit owners have

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closed or after turnover when the owners collectively have assumed the responsibility of ongoing maintenance of common areas within the development, issues can arise involving the developer's continuing obligations.

Part I of this Article will provide a history of condominium creation and explain their trajectory in the United States. Parts II and III will examine a condominium developer's fiduciary duties and various ways in which a developer can be liable to incoming purchasers or condominium unit owners. Part IV provides an overview of developer beginnings and various issues that may arise before a sale takes place. Part V explores some common legal actions against developers. Part VI deals with a uniform law relating to vacant real estate, which is very common in connection with developer purchases. Part VII looks at various defenses a developer might assert in response to legal action. Parts VIII and IX explore the Restatement (Third) of Property ("Restatement") and the Uniform Common Interest Community Act, which offer jurisdictions methods by which to codify condominium laws. While not an examination of every scenario affecting condominium owners or developers, the sum of this article's parts is intended to provide a starting point for more critical examination of the issues that affect the parties to condominium transactions and to highlight pathways for positive change.

I. A BRIEF HISTORY OF CONDOMINIUMS

Most community associations, such as condominiums and cooperatives, are created by a developer rather than through direct agreement of neighboring property owners.² The developer typically executes and records a declaration of covenants together with by-laws, which serve as the governing documents of the community association and which bind every unit owner upon purchase.³ The governing documents empower the association board to manage the association and impose restrictions on owners while overseeing association affairs, and provide provisions for amendment and the exercise of power, both of which are tantamount to a community constitution.⁴ While in some cases a copy of this "constitution" is delivered before purchase so that the prospective buyer can

² Russell Zuckerman, *Using Good Judicial Judgment: Dispensing with the Business Judgment Rule in Mixed-Use Community Association Disputes*, 81 *TEMPLE L. REV.* 927, 935 (2008).

³ *Id.*

⁴ *Id.*

investigate the health of the community, usually a copy is delivered no later than closing. These governing documents serve as the rulebook for the particular condominium community. In many instances, homeownership in community associations is more popular because it is generally cheaper and offers the unit owners the ability to dispense with typical obligations of homeownership, including some maintenance and repair.⁵

Regulation of condominium ownership in early years was first formally outlined in the Code Napoleon of 1804, Article 664, which addressed separate ownership of floors and maintenance and repair issues relating to common elements.⁶ Article 664 provided in part that:

When the different stories of a home belong to different proprietors, if the titles of the property do not regulate the mode of reparations and reconstructions, they must be made in manner following: The main walls and the roof are at the charge of all the proprietors, each in proportion to the value of the story belonging to him. The proprietor of the first story erects the staircase which conducts to it; the proprietor of the second story carries the stairs from where the former ends to his apartments; and so of the rest.⁷

In the 1920s, France, Belgium, Italy, the Netherlands, Germany and others started to pass legislation designed to clarify the rights and duties of flat owners, focusing on their responsibilities for common parts of the building.⁸

The model for United States condominium law came not from Europe, but from Puerto Rico.⁹ In the 1950s, a housing shortage – combined with the high cost of real estate and a shortage of available land – led to the passage of the Horizontal Property Act in Puerto Rico.¹⁰ Following the passage of that act and the United States' recognition of the condominium form of ownership in the 1961

⁵ *Id.*

⁶ Donna S. Bennett, *Condominium Homeownership in the United States: A Selected Annotated Bibliography of Legal Sources* 1 (Jan. 22, 2010), available at <http://ssrn.com/abstract=1493368>.

⁷ *Id.* (citing Code Civil de Francais (the Code Napoleon) §664 (1804); J. Leyser, *Ownership of Flats – A Comparative Study*, 7 Int'l L & Comp. L.Q. 33 (1958)).

⁸ *Id.* at 2 (citing J. Leyser, *Ownership of Flats – A Comparative Study*, 7 INT'L & COMP. L.Q. 33, 35 (1958)).

⁹ *Id.* at 4.

¹⁰ *Id.*

National Housing Act, condominiums sprung up all over America and legislative bodies began passing laws regulating them.¹¹

Noted as early as 1976, an apt reflection on the wry humor that regrettably is part of current condominium development is the axiom that "upon turnover of the association to the unit owners, the first three things they do are raise the assessment, fire the manager and sue the developer."¹² This common situation is an unfortunate testament to the failure of many of the players in the game to understand the responsibilities that are vested with the initial project developer and the resultant issues that unit owners and condominium and community associations inherit. Where each player in the real estate closing process simply looks at what is in front of him with an eye toward closing the present file just to get to the next, a lot can be missed, creating problems for all involved.

In taking a birds-eye view of a typical condominium transaction, a multitude of individuals impact a project, including the developer, purchaser, architect, engineer, realtor/broker, inspector, municipal building department employee, attorney, title agent, insurance agent and lender. Where any one of these parties in a transaction fails to do his or her job or abrogates a defined duty, the purchaser can be caught in the crosshairs.

One party who has the capacity to cover many of the bases in problem-avoidance is the developer. When the developer hits his mark, tends to his many obligations, and delivers a well-built (or well-rehabbed) and stable condominium project, his job is usually done. Conversely, the developer may breach his obligations where his bottom line is more important than the whole of the project, causing his failure to (1) appreciate matters dependent upon his sound judgment, (2) respect and comply with his duties to the eventual consumers of his condominiums, and/or (3) be honest.

II. THE FIDUCIARY DUTY

A. How Fiduciary Duties Arise and the Condominium Life Cycle

Fiduciary duties arise from both the common law of a particular jurisdiction and through legal instruments that are created or drafted by the developer or its counsel in response to certain

¹¹ *Id.* at 6 (citing John E. Cribbet, *Condominium-Homeownership for Megalopolis?*, 61 MICH. L. REV. 1213, 1218 (1963)).

¹² Wayne S. Hyatt & James B. Rhoads, *Concepts of Liability in the Development and Administration of Condominium and Homeowner Associations*, 12 WAKE FOREST L. REV. 915, 916 (1976).

responsibilities of the parties that are inherent in the transaction. This section examines how the duties arise, what instruments impart the duties, how the instruments can create contractual obligations, and how they all can affect the community.

In a typical scenario, a developer or his agents advertise a condominium as being for sale or upcoming. A prospective purchaser finds the unit and makes a decision to invest in and purchase the real estate. It is unusual that in the first instance a purchaser views the developer as a fiduciary or someone upon whom he or she is completely dependent. Oftentimes a developer can only sell a small portion of the whole project before it is completed, opening the door for problems in completing the project and with attracting buyers. An incoming purchaser in an incomplete project faces both uncertainty about whether a developer can and will finish the project, and whether or not resale is possible if the developer cannot or does not finish.

In the United States, there is a clear difference of opinion as to whether a developer has to deliver a completed and nearly perfect product before the sale. While some jurisdictions require completion prior to closing, others allow a developer to close either pre-construction or with some unfinished major items, essentially closing deals with a promise that he'll "get to it." This divergence is one of the major issues that needs to be addressed by standardization. Where the law in one jurisdiction requires completion of real estate before sale and another jurisdiction does not address completion or only theoretically requires it and/or issuance of a "certificate of completion," the issue of requirement on one hand and enforcement on the other can create issues that developers are eager to avoid. The failure to finish a project touches upon fiduciary duties because so much of the obligation to finish is essentially the benefit that goes to the purchasers, regardless of whether there is financial risk to the developer's entity in doing so. Because it is advantageous to a developer to sell units before they are complete (thus financing the project through the sales rather than "pre-paying for the work") the risk shifts to the buyers to finance the project. This risk-shift is but one essence of the fiduciary duty and it requires focus toward the questions of where and when the duty begins. The laws and court decisions regarding developer duties and obligations coming out of different jurisdictions can obviously be very diverse, and the differences can have far-reaching consequences to developers and unit purchasers alike.

As condominiums have become a more popular option for consumers, much scrutiny has been focused on the developer and his

obligations to his prospective purchasers during the condominium lifecycle. A condominium lifecycle is composed of three phases: (1) pre-contract; (2) contract; and (3) post-closing. In the pre-contract and contract phases, the purchaser's most important job is to document the particulars of the transaction so that in the post-closing phase the agreements define the developer's duties with particularity. Additionally, prospective purchasers in every instance should hire an attorney for the pre-contract and contract phases and a licensed and bonded professional inspector to identify and document any issues with the real estate that may impact the unit or common-areas.

B. Condominium Instruments

While the fiduciary obligations of the developer are inherent in the transaction, they are sometimes outlined in greater detail in the condominium instruments or in the related law of condominiums within the particular jurisdiction of the property. Under some authorities, a developer may have a fiduciary duty to a condominium association in the following scenarios: (1) "where it and its employees controlled the association initially"¹³ and (2) "where such owners' association's initial directors fail to exercise their supervisory and managerial responsibilities and act with a conflict of interest, they abdicate their obligations as initial directors."¹⁴ In the latter situation, the developer can be "individually liable for breach of [its] basic fiduciary duties of acting in good faith and exercising the basic duties of good management."¹⁵ Such abdications of duty, intentional or otherwise, may arise out of the conflict of interest inherent when one person or entity does too much and assumes roles that fundamentally oppose one another. Since a real estate developer often wears a multitude of hats, acting as builder, vendor, promoter, designer, and/or general contractor, conflicts of interest normally appear which can lead to breaches of fiduciary duties.

When the developer gets past the purchase of the real estate and "develops" the property, its next task is selling the property units to a new condominium association that will eventually manage itself. The selling developer hopes not only to cover costs, but to make money through the sales. As a starting point in most states, the developer formally creates the new association and becomes the

¹³ 31 C.J.S. *Estates* §261 (2011) (citing *Raven's Cove Townhomes, Inc. v. Knappe Dev. Co.*, 171 Cal. Rptr. 334 (Cal. Ct. App. 1981); *Governors Grove Condo. Ass'n, Inc. v. Hill Dev. Corp.*, 414 A.2d 1177 (Conn. Super. Ct. 1980)).

¹⁴ *Id.* (citing *Raven's Cove Townhomes, Inc.*, 171 Cal. Rptr. at 334).

¹⁵ *Id.*

“initial board,” starting the clock on its duties. When unit-owners become members of the association, they form a board of directors, taking over the management duties from the developer. However, this management takeover does not remove all of the developer’s duties, as discussed further below.

“The fiduciary duty of an association board consists of three elements: (1) the duty of loyalty; (2) the duty to treat all unit owners fairly and evenly; and (3) the duty of care.”¹⁶ The duty of loyalty requires that board members act for the benefit of the association and not out of personal self-interest.¹⁷ The developer who sits on an association’s board of directors has all of the concomitant responsibility and potential liability of any other member (i.e. unit owner), and in such cases the effect may be that the developer has two distinct and separate loyalties: (1) the operation of the association; and (2) the development and marketing of the project.¹⁸ This dual role is what so often creates a conflict of interest, for some decisions benefit one loyalty at the expense of the other.¹⁹

Commonly serving as directors of condominium associations, developers have a fiduciary responsibility to exercise ordinary care in performing their duties and are required to act reasonably and in good faith.²⁰ A “fiduciary” is one who transacts business or handles money or property for the benefit of another person to whom he stands in a relation implying and necessitating great confidence, trust, and a high degree of good faith.²¹ When the developer is required to act in good faith and for the benefit of others, a line of demarcation separating the developer as a businessperson out for profit and a functioning member of the condominium association is formed. The line is established at the moment the declaration documents are recorded and survives the closings of all units until the property is turned over to unit owners.

C. Contractual Duties

Parties to real estate transactions often do not utilize the services of legal counsel because it is not the standard practice in

¹⁶ Zuckerman, *supra* note 2, at 940 (citing Vincent Di Lorenzo, New York Condominium and Cooperative Law § 12:3, at 217-19 (2d ed. 1995, supp. 2007-2008)).

¹⁷ *Id.*

¹⁸ Hyatt & Rhoads, *supra* note 12, at 973.

¹⁹ *Id.*

²⁰ See generally 31 C.J.S. *Estates* § 261 (2011).

²¹ *Id.* (citing *Caprer v. Nussbaum*, 825 N.Y.S.2d 55 (N.Y. App. Div. 2006)).

their jurisdiction. Instead, these parties use a title company, relying on the information provided by the title agent or mortgage loan officer. However, legal counsel – which can normally be procured for a relatively minimal cost – is an absolute necessity for all real estate transactions, including condominium transactions, because the typical real estate purchaser is less concerned with what the documents say and more concerned with when he can get the keys to his new unit. Excitement can easily take over, so the buyer is usually not in the best position to examine issues involving the obligations of the developer and the association. The buyer's counsel is, in addition to the title agent and lender, one of the best parties to ensure appropriate legal compliance.

In many typical construction contracts, the contractor and owner decide who will bear the burden if something happens before or after completion of the project. However, in residential transactions, this contractual language is scarcely used. Because contracts for condominiums are often standardized forms drafted by the developer's counsel, the inclusion of risk-of-loss provisions can be difficult to negotiate. Nevertheless, language which clearly spells out the developer's pre- and post-closing obligations and fiduciary duties should be present in all condominium purchase and sale contracts, a further illustration of why enlisting the services of an attorney is important to any condominium purchaser.

Because the tradition of *caveat emptor* ("let the buyer beware") has been so ingrained in the law, buyers of condominiums have found themselves in a quandary when their purchases go awry or the condominium product does not turn out to be what was contracted for. For a builder or developer engaged in the business of selling real estate, the construction and/or sale of real estate is a daily event. For the buyer, the purchase of real estate is a significant and unique transaction. In many instances, it is the most important transaction of a lifetime. Thus, when problems arise and legal action is instituted, it can be a slap in the face when a unit owner's (or association's) claim is rejected based upon the old rule of *caveat emptor*. As such, it is important not only that the purchaser, his attorney, and his inspector engage in some very calculated pre-closing due-diligence, but that the contractual language reflect the inherent risk in the transaction.

One way to address these common issues is to standardize the inspection period of real estate so that the buyer has a fair opportunity to terminate the contract if the condition of the premises is not on par with the parties' agreement or understanding. Certain form contracts provide for an inspection period at or near the time of contracting,

while others provide for an inspection at or near the time of closing. The applicable time frame should depend on whether the condominium is a new construction, resale, or rehabbed property, as the buyer will need an opportunity to inspect the property both near the time of contracting and before closing. Where the only provided inspection window is just before closing, the buyer has usually already given up their primary residence, set up utilities and otherwise prepared to move. This influences the buyer's willingness to move forward with a transaction even when faced with issues identified in an inspection. Thus, the inclusion of contract language protecting the buyer from being backed into such a corner just before closing is essential.

Applying the rule of *caveat emptor* against an inexperienced buyer and in favor of a wily and experienced developer has been called a "manifest denial of justice."²² Indeed, it is a manifest denial of justice when after purchasing a home and obligating oneself to the transaction of a lifetime, code violations and plumbing disasters (for example) force the purchaser to fund considerable repairs without recourse. However, the reality is that these "manifest denials of justice" do occur. As such, a condominium buyer must be able to rely on the builder or developer who sells him a house.²³ Some courts suggest that implied warranties will "inhibit the unscrupulous, fly-by-night, or unskilled builder and '...discourage much of the sloppy work and jerry building that has become perceptible over the years.'"²⁴ Unfortunately, this pro-buyer line of thinking has in recent years been replaced with a more hard-line approach, allowing an unfair burden to be shouldered by buyers, who are ill-prepared to take on hurdles of bad construction, underfunded condominium and community associations, and market fluctuations.

D. Community Association

For condominium unit owners, membership in the condominium or community association (usually an interest proportionate to one's percentage of ownership in the property as a whole) is a requirement. Functioning as a "mini-government," the association almost always provides its members utility services, maintenance, street and common area lighting, refuse removal, water, insurance, and even storage.²⁵ All of these functions are financed

²² *Bethlahmy v. Bechtel*, 415 P.2d 698, 710 (Idaho 1966).

²³ *Tavares v. Horstman*, 542 P.2d 1275, 1279 (Wyo. 1975).

²⁴ *Capra v. Smith*, 372 So. 2d 321, 323 (Ala. 1979).

²⁵ *Hyatt & Rhoads*, *supra* note 12, at 918.

through the assessments or taxes levied upon the members of the community by the board of directors or other similar body.²⁶ As in any business, the officers and directors of that governing body must then concern themselves with details such as finances, asset and property management, taxation, insurance, and employee relations, among other things.²⁷ Where a developer becomes involved in structuring and initially running these governing boards, liability can (as it well should) arise when the developer has abandoned or failed to fully honor his fiduciary duties to the project, the association, and its members.

As a result of these considerations then, it is important for sellers, purchasers, counsel, lenders, title companies and developers alike (not to mention the judges, juries, and legislatures), to understand and create a system of uniform applications and systems for the conveyance of condominiums. This system should focus on avoiding the pitfalls that can and do often accompany these kinds of transactions. The rest of this article outlines developer liability in condominium transactions for fiduciary duty violations and suggests ways in which these violations can be lessened through stricter, more uniform legislative and municipal guidelines.

Facing these issues and potential liability, developers, buyers and courts alike question when the fiduciary duty begins. Unfortunately, however, there is not a clear-cut answer due to the different ways states treat condominium law and enforcement. While various courts have held that the developer's fiduciary duty starts when the developer begins creating the condominiums and the association and not when the first sale takes place,²⁸ there are few judicial opinions that offer cogent analysis on when the duty begins and ends. Given that judicial opinions are typically shaped by the attorneys arguing cases and offering briefs before the various courts, questions about real estate developers are hardly uniform. This is one specific place where change is needed. Where laws are not similar, courts cannot ultimately craft a body of law that outlines prudent methods of conflict resolution.

III. DEVELOPER LIABILITY

A developer's potential liability does not suddenly end once it relinquishes control of the condominium or community association to

²⁶ *Id.*

²⁷ *Id.* at 919.

²⁸ *Id.* at 975.

the members.²⁹ In many cases, problems allegedly caused by the developer's pre-closing acts or omissions are often not ascertained until well after the time that control of the owner's association passes to the owners.³⁰ Unit owners and prospective purchasers must understand that in the case of a condominium development – whether a new build or rehabbed property – the developer maintains control until a certain number of units have been sold. Therefore, the issue of control is paramount in terms of understanding and eyeing breaches of a fiduciary duty.

Developer liability can arise from actions taken in the pre-closing or post-closing periods. If a developer assumes the role of builder, he is potentially liable for construction defects in the same manner as any other builder.³¹ Historically, the doctrine of *caveat emptor* has led to the purchaser's assumption of all of the risk in real estate transactions while also placing the duty of inspection and knowledge squarely on their shoulders.³² However, the idea that a purchaser must bear all that risk is slowly evaporating. Developers are slowly being held more responsible for violations of their obligations to purchasers.

Who then, is or should be responsible to lead the project after someone purchases a condominium? The short answer is the condominium board in cases where the developer cannot or refuses to do so. The board is a group of unit owners that is called upon to manage the property as a whole, including all common areas. But before all units have been sold, the developer still owns part of the property. The developer typically assumes the role of board member directly or through appointed agents. Consequently, duties held by the board members are tied to duties that flow from the developer to unit owners. A developer-controlled board, as any other homeowner association board, then owes a fiduciary duty to unit owners, although the duty arises from a different origin.³³

²⁹ Richard E. Kennedy & Ellen H. de Haan, *Litigation Involving the Developer, Homeowners' Associations, and Lenders*, 39 REAL PROP. PROB. & TR. J. 1, 2 (2004).

³⁰ *Id.* at 2-3.

³¹ *Id.* at 3.

³² *Id.*

³³ Kennedy & de Haan, *supra* note 29, at 24; see also Robert N. Sandgrund & Joseph F. Smith, *When the Developer Controls the Homeowner Association Board: The Benevolent Dictator?*, 31 COLO. LAW 91, 93 (2002).

A. The Origins of the Fiduciary Duty in Relation to the Developer's Potential Liability

While courts and academics often agree about this concept in general, what is less clear is where the duty originates. The duty's origin matters because our laws must be crafted with the practical realities of the real estate end-user in mind. If the players in the process (the lender, realtor, title company and building inspector) understand the fiduciary duty, the process will be streamlined and will help to ensure a lower likelihood of developer-caused issues. If no condominium could be sold without the benefit of a municipally-mandated inspection geared toward purchaser protection and complete or finished real estate, fiduciary duty breach issues would arise far less frequently.

In some situations, the duty attaches once the condominium project is initiated or created through the filing of the declaration. In others, it applies after the sale of a particular unit. Corporate law has historically been the starting point of fiduciary duty law as applied to real estate, but when the developer controls the condominium or community association, the strict scrutiny of trust law (rather than the business judgment rules of corporate law) may be applied to the developer-appointed officers and directors.³⁴ The association retains the features of a trust while the developer controls it: "The developer has dominion and control over the association (trust property), to carry out the general plan of development (the settlor's instructions), for the benefit of the association's present and future members (the beneficiaries)."³⁵ In most cases, the association's creator is also its controller and is not subject to any direction from its members.³⁶ Since the developer and its appointed officers and directors could easily take advantage of their members under this structure, courts now subject them to the same rigidly defined duties, high standards of conduct, and strict scrutiny applied to trustees under the general principles of trust law.³⁷

How should we differentiate the duty originating in corporate law from its counterpart in trust law? There is enough overlap that a dividing line is unnecessary. In general, developer-appointed members of the board must act with the utmost good faith, for the

³⁴ Kennedy & de Haan, *supra* note 29, at 24.

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* (citing Wayne S. Hyatt & Jo Anne P. Stubblefield, *The Identity Crisis of Community Associations: In Search of The Appropriate Analogy*, 27 REAL PROP. PROB. & TR. J. 589, 633 (1993)).

sole good of the beneficiaries of the board's governance, and they are required to deal with the unit owners impartially.³⁸ In most jurisdictions, where the developer's units remain unsold, the developer must assume the rights and obligations of a unit owner. In the capacity as owner of unsold condominium interests, the developer must pay common expenses attaching to those interests, from the date the declaration is filed or recorded, even if the construction of the units and the appurtenant common elements subject to those interests has not started or is not complete.³⁹ Most states and cities where condominiums and common interest communities are found have statutes and laws that affect development, ownership and maintenance of these units, and specific statutes that make mention of developer obligations.

For example, South Carolina courts have recognized that a developer stands in a fiduciary relationship with unit owners prior to the creation of the association and the conveyance of common areas to the association.⁴⁰ There, courts have held that because a purchaser reposes special confidence in a developer, the latter, in good conscience, is bound to act in good faith and with due regard to the former's interests.⁴¹ Where that special confidence is or should be obvious because of the trust needed to complete a transaction, it should be automatically imputed to the developer and his agents, and affirmed by the legislature and courts. Further, South Carolina courts have held that where a developer fails to maintain common areas and to establish a sufficient fund to maintain those areas until assessments were adequate, the developer has breached his fiduciary duty toward the owners and the association.⁴² It could therefore be said that the South Carolina legislature sees the fiduciary duty arising before, rather than after the sale. This question is one that should be asked by our legislators and included in the applicable provisions of law. Legislators and courts are strongly encouraged to define the law's source when drafting and analyzing it for general application and to clearly explain where a concept comes from and elaborate when a fiduciary duty is recognized.

³⁸ Sandgrund & Smith, *supra* note 33, at 93.

³⁹ 16 OHIO JUR. 3d *Condominiums, Etc.* § 13 (2011).

⁴⁰ Constance R. Boken, *Developer's Fiduciary Duty to Condominium Associations*, 45 S.C. L. REV. 195, 197-98 (1993).

⁴¹ *Id.* at 197 (citing *Island Car Wash, Inc. v. Norris, III & Rhodes*, 358 S.E. 2d 150 (S.C. Ct. App. 1987)).

⁴² *Id.* at 198, (citing *Goddard v. Fairways Dev. Gen. P'ship*, 426 S.E.2d 828, 832 (S.C. Ct. App. 1993)).

B. The Developer's Liabilities as Initial Officer of the Association

This moves the discussion to homeowners' associations and their directors. In layman's terms, the developer as the initial creator of the association has an obligation to dot his I's and cross his T's (vis-à-vis the building or project as a whole and the bank account belonging to the master association). A fiduciary relationship may arise from the nature of the business relationship between the developer and the unit owners or the nature of the control relationship.⁴³ In a situation where the developer (or his agent) is in complete control of the association, or in the case where the incoming unit owners are not interested in managing the association as a whole, there may be more scrutiny by courts if a given situation ends up in court.⁴⁴ "The principles of fiduciary duty established with business corporations 'may exist for holding those exercising actual control over the group's affairs to a duty not to use their power in such a way as to harm unnecessarily, a substantial interest of a dominated faction.'"⁴⁵

In most jurisdictions it is well established that absent fraud, self-dealing and betrayal of trust, directors of condominium associations (including those that are developer-appointed), are not personally liable for the decisions they make. Often, the association has master insurance covering acts or omissions by the board or its individual members. Although most master building policies do not state whether the insurance coverage can be used only on a forward basis (i.e. in favor of the unit-owner board). Similarly, one does not know if it applies to any director (rather than just some directors or those included by vote), thus including the initial director/developer entity in its coverage. It is important to consider that there may not be uniform coverage or indemnity obligations in connection with the policy of insurance and it also matters greatly in the event of a breach of duty, if a breach is allocated to a developer board, or a unit-owner board.

Similarly, the Uniform Condominium Act (the "Act") originally drafted to try to create a nationwide system for condominium administration to be adopted state-by-state, reflects provisions that impose a different standard of care for developer-boards than unit-owner boards, holding the former to a higher standard.⁴⁶ Section 3-103 of the Act provides that "higher standards

⁴³ Hyatt & Rhoads, *supra* note 12, at 923.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ Uniform Condominium Act, §3-103(a)(1980).

for appointed board members is imposed, because the board is vested with great power over the property interests of unit owners and great potential for conflicts of interest exist between owners and developers.”⁴⁷

C. Unit Owners as Elected Officers of the Association and Their Relationship to the Developer

On the other hand, elected-directors, who are voted in after the control of the association has shifted to the unit owners, have much less potential for experiencing a conflict of interest with other unit owners or the association.⁴⁸ This may be because elected unit owners are community-oriented as opposed to the inwardly-focused developer-board interest. The conflict of interest may typically be found on the developer’s side, where a higher standard is imposed, rather than on the unit owner’s side. If an incoming unit owner would assume the responsibility of board service and be held to a higher standard of care than the developer (including a fiduciary duty and the potential exposure to personal liability), it would conceivably be difficult to find anyone to serve as an association director or officer.⁴⁹

Although the nationwide perspective on condos is similar in theory, the issue and point is that the lack of uniformity in defining standards and in putting avoidance measures in place (which can help to avoid fiduciary duty issues in condo developments) can cause unit-owners and prospective purchases to be unsure of how to protect themselves from developer problems. The issues are not limited to the pre-contract or post-closing timelines. Indeed, some courts have held that developers are in breach of fiduciary duties to owners’ associations where they fail to turn over the property in good condition and they fail to provide enough funds in association accounts to remedy any problematic conditions.⁵⁰ This would fall into the post-closing/pre-turnover period when it is often difficult to determine who should be in charge. The myriad of issues that can arise include control of financial accounts, tax returns, maintenance, collection of assessments, and building and capital improvement issues, among others. It can also leave a gap filled by the ever-present fiduciary duty obligation held by the developer. This imposes the duties of omnipresence and ever-mindfulness over the state of the

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ Lisa M Pardon, *Advising Developers in Operating Community Associations*, 77 WIS. LAW. 12, 52 (2004).

union (even while that same developer may be in the process of preparing his exit scheme).

When evaluating the acts and omissions of developers, counsel should be aware of the possible legal claims that can be levied, and the avenues through which they may arise. "A breach of fiduciary duty cause of action may involve, among other things, the following: (a) conflict of interest allegation; (b) failure to properly determine an operating budget (such as an attempt to secure sales by understating the reserve and operating costs); (c) failure to fund and maintain an adequate reserve account; or (d) failure to enforce the association's [declaration, by-laws] or regulations."⁵¹ The types of problems that can arise are as numerous and varied as the condominiums they involve. Most problems, while involving the developer in general, start with the common interest community's financial health.

D. Budgetary Issues Affecting the Developer

One of the major reasons that condominiums are attractive options for many people is that they are perceived as cheaper than single-family living. While true in some cases, what may be more accurate, is that where the community is operating in the black and is well-managed and well-funded, problems are less likely than where the opposite is true. Where a developer fails to fund reserves, implement an operating budget, or insists upon timely payment of assessments when there are acts or omissions that constitute abandonment of the traditional rules, those failures may result in disastrous consequences.

This is especially true where the common areas of a building are in a state of disrepair. Reserves, as they are known, are forced savings for inevitable repairs or replacement of major items such as roofs, exterior siding, furniture, fencing, pool resurfacing, driveway, walkway repair, etc.⁵² The idea that "things come up" is an accepted adage for anyone owning real estate. A lesser recognized concept though, is that "things will come up and those things result in a special assessment." New condo buyers rarely approach the concept of an unknown assessment without some trepidation. What will it be for? How much will I have to pay and for how long? How much time will I have to come up with the money? All are common questions,

⁵¹ THOMAS E. MILLER & RACHEL M. MILLER, *HANDLING CONSTRUCTION DEFECT CLAIMS: WESTERN STATES* 162-163 (3d ed. 1999) (citing *Raven's Cove Townhomes, Inc. v. Knappe Dev. Co.*, 171 Cal. Rptr. 334 (Cal. Ct. App. 1981)).

⁵² *Id.* at 165.

but yet one can rarely see into the future. This makes developer responsibility at the pre- and post-contract stages key to making a determination as to whether or not breaches of a fiduciary nature are possible and whether those breaches are more likely or not to result in special assessments to the owners.

Tensions will mount when a developer or other real estate vendor commits fraud, abandons its obligations, and fails to fulfill contractual and statutory duties to unit-owners. This scenario in condominium living, however, is becoming increasingly commonplace. The focus on the various operating principles and the participation of the other individuals involved in the closing of the transaction leaves quite a bit to be examined.

The idea of who has to be the “first responsible” in terms of condominium development is a key issue. This should be evaluated more stringently by lenders, title companies, courts, legislators, and all involved. If municipalities and title companies were properly watching, no closings would take place where a condominium had major or minor problems. The developers would have to do better where “better” is key to closing deals.

In a state that could call itself a leader in condominium law and statutory codification of developer and board duties, California (through its Civil Code), requires a condominium association’s board (in certain circumstances) to review condominium financials quarterly. Although this is uncommon in many states, it represents an advanced and unit-owner friendly attitude toward common interest communities. These requirements, while not only considered by many to be forward thinking, and are often rebuked by others as too strict, in terms of pre or post-sale requirements in condominium projects. Like many other states, California has adopted the fiduciary concept, and it has been explored *ad nauseum* in its many condo-related reported decisions. The overarching issue or question that arises then, is what is too strict versus what is too lax when examining the health of a condominium project, and when is it appropriate to have that health exam. Arguably, such a review would be better placed before any closings and before any issues can be passed along to unit owners and associations, while the developer still has control and clear responsibility.

E. Inspection and Reporting Obligations of the Developer

Many actions brought by unit owners against a homeowners’ association are for property damages arising from an assertion that the association failed to repair and maintain the common areas,

causing damage to units.⁵³ To the extent that a declarant-developer fails to timely investigate, or fails to timely pursue viable claims against those responsible for the construction defects, liability may attach for its breach of fiduciary duty and negligence.⁵⁴ Similarly, issues can arise where the developer denies that the problem existed during his tenure. Because of this, increasingly, condominium conversions are particularly fertile ground for developer problems because there is ample room for over or underestimating useful life of existing building components and the negligent repair or replacement of necessary building components (such as electrical or mechanical or plumbing systems).⁵⁵

Although it is still the purchaser's responsibility to inspect (and utilize the services of a licensed inspector where appropriate), the developer is still responsible for being aware of the conditions of all building and system components, so that disclosure can be made to the prospective buyer. In these scenarios, it is incumbent on developers to make it clear to prospective buyers what specific building components they have touched, improved, remodeled, installed, etc. in conversion or rehab scenarios. Likewise, an incoming purchaser should not assume that everything is new, code-compliant, or rehabbed, and should solicit the services of a licensed home inspector who examines both the particular unit, and the common areas that are equally owned by all unit owners. Where too many assumptions are competing with one another, the recipe for misinformation and failure to investigate can lead to many common area problems, many of which have their origins in breach of fiduciary duties. Also, where a five hundred dollar inspection could reveal whether or not a statement of condition as to a building component or system was true or untrue, the penny saved could be the penny earned in terms of avoiding a transaction altogether where it is apparent that the building's condition is not truly what is or was represented at the pre-contract or contract phase. It is not uncommon for a seller of real estate to misstate or try to lessen the impact of an issue, in order to secure a sale. As such, it is critical that the buyer take on and fully appreciate what information can be made available before the mortgage is executed and the closing finalized, rather than through the hindsight that comes after a problem (or ten) is identified. This can have the impact of avoiding a purchase where a large common area issue is found or identified after closing which, in order

⁵³ Kennedy & de Haan, *supra* note 29, at 29.

⁵⁴ Sandgrund & Smith, *supra* note 33, at 94.

⁵⁵ MILLER & MILLER, *supra* note 51, at 168.

to repair, will require a special assessment to be levied against the owners.

As a matter of pre-sale or pre-contract (or even post-closing) due diligence, not only must an incoming unit-owner board carefully review the budget when it is first handed down by the developer, incoming purchasers should be suspect where no property report or engineer's report exists or is provided by the developer that explains the condition of all units and common areas. This is because a corresponding breach of fiduciary duty may be found where the developer fails to inform himself of the existing state of the building and its major components, instead assuming the code-compliance of each, or failing to ascertain the remaining useful life (even in situations where the original components are not initially in need of repair or replacement).

In some jurisdictions, there are minimum requirements for determining when the existence or preparation of a "property report" (or another similar type report) is called for and when it must be provided to prospective purchasers, although not all jurisdictions impose this requirement. This is one area where significant nationwide agreement and uniformity is necessary. Specifically, developer parties who sell condominiums should be required to invest in a professional's independent report, so that there can never be any argument that the developer was unaware of a particular issue. Such a requirement could be enforced through the local building department, along with the title company and attorney who assist in closing the transaction. If the concept of a property report became a standard in transactions of this type, then the likelihood of selling "less than" real estate would decrease, because the seller would not be able to claim that something was unknown or undiscovered.

Also, where a municipality fails to require the developer to make himself aware of the actual condition of the building, then it is all too simple for a developer to refuse to do it – thus creating the first defense in failure to disclose cases (i.e. "what I didn't see, I couldn't disclose to a buyer"). Since most disclosure requirements under the law go to actual knowledge, where a developer or vendor doesn't know about an adverse condition, then the issue of intentional conduct makes way for negligent conduct. However, where there is an affirmative obligation and a defined list of typical building and system components (i.e. roof, masonry, electrical, HVAC, etc.), and that list is uniform and it becomes a standard in the industry – and indeed a standard in every jurisdiction - then no excuse can be offered by a developer in any case, for the failure to affirmatively know, inspect, and report on the state of a particular parcel of real

estate. All too common is the “head in the sand” syndrome coupled with exculpatory language in a contract which proclaims that what the builder didn’t touch, he doesn’t warrant.

The failure to require the developer to know something may create a scenario where if a developer doesn’t inspect the electrical system, and then doesn’t determine it should have been upgraded, that his failure is tantamount to a false representation that all electrical systems are code-compliant – when in fact, the opposite may be true. Is it acceptable that when the purchaser himself makes this discovery (i.e. that something is false when it should have been true), that a false or negligent or possibly fraudulent representation has been made by the developer/seller to the purchaser? In addition to an unequivocal “yes,” the issue is that because the typical contract cannot protect the parties from every conceivable problem that may arise (insofar as traditional tort principles are in conflict with traditional contract principles) there is a gap into which many unsuspecting purchasers fall – one where an unfulfilled promise of the “benefit of the bargain” is lost.

Apart from the necessary overhaul and suggested uniformity in these kinds of transactions, the law should simply catch up with what is happening on the street. More specifically, the legislature and the “boots on the ground” municipalities that have the capability of overseeing real estate conveyances of all kinds could and should impose requirements of knowledge, disclosure, repair and responsibility upon the seller of real estate. For example, in the greater Chicago area, some of the local village ordinances and practices are far more comprehensive than what is imposed by the City of Chicago Building Department. This, despite the fact that the latter is responsible for millions of transactions and the former is only responsible for a fraction thereof, still suggests that other than the claim by the larger entity that the task is too costly or time consuming, it shows that in some instances where a smaller community has more stringent standards relating to real estate transactions, its leadership cares more about quality rather than quantity of those transactions. Thus, the quantity over quality issue that is so prevalent in larger municipalities begs the question of how hard it could be to shift from one to the other and at what cost should that shift be avoided.

F. Does the Business Judgment Rule Protect the Developer?

“The business judgment rule is one of the most fundamental doctrines in corporate law . . . [which] is the notion that directors,

rather than shareholders or judges, manage the business affairs of a corporation.”⁵⁶ This rule operates as a presumption that directors make business decisions on an “informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.”⁵⁷ Under the rule, directors are usually free of liability due to “imprudence or honest errors of judgment” and traditionally, to overcome the presumption, a plaintiff has to “present sufficient evidence that a director, or the board as a whole, breached any one of the triads of their fiduciary duty – good faith, loyalty or due care.”⁵⁸ In the context of residential community associations, a minority of jurisdictions apply the business judgment rule with a majority using a “reasonableness” standard.⁵⁹ This is where some cogent analysis may be necessary – because a determination should be made globally, as to whether the business judgment rule is appropriate for condominium and other real estate transactions.

“To receive [the business judgment rule] protection, a board or association must not breach its fiduciary duties to the unit owners.”⁶⁰ “The business-judgment rule is generally inapplicable to boards of property owners associations . . . [because] [u]nlike a business corporate board, whose function is usually acquisition, a property owners association board is expected to protect and preserve property values.”⁶¹ Therefore, certain conduct and decisions that may be considered permissible among business persons may be impermissible for officials of a property owner association.⁶² Although traditionally considered part of the fiduciary duty trifecta as falling under the umbrella of the duty of loyalty, the “duty of good faith” can be extended to situations beyond a fiduciary obligation because most (if not all) courts will allow the implicated duty of good faith and fair dealing to be considered in relation to a claimed breach of contract.⁶³ “Where the fairness of a fiduciary transaction is challenged, the burden of proof is upon the fiduciary to prove by clear and satisfactory evidence that such transaction was fair and

⁵⁶ Zuckerman, *supra* note 2, at 930.

⁵⁷ *Id.*

⁵⁸ *Id.* (citing *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993)).

⁵⁹ *Id.* at 934 (citing *Mulligan v. Panther Valley Prop. Owners Ass’n*, 766 A.2d 1186, 1190-91 (N.J. Super. Ct. App. Div. 2001)).

⁶⁰ *Id.* at 940 (citing *Vincent Di Lorenzo, New York Condominium and Cooperative Law* § 12:3, at 217 (2d ed. 1995, supp. 2007-2008)).

⁶¹ *Unrau v. Kidron Bethel Ret. Servs, Inc.*, 27 P.3d 1 (Kan. 2001).

⁶² *Id.* (citing ROBERT G. NATELSON, *LAW OF PROPERTY OWNERS ASSOCIATIONS*, §10.3.1 (1989)).

⁶³ *See id.* at 14.

done in good faith.”⁶⁴

In analyzing what should be done and when by an association after a sale is done, a declarant-controlled board, due to its “insider” status, may be better positioned to get the declarant-developer to voluntarily address remediation of construction defects (as opposed to an elected/unit-owner-controlled board).⁶⁵

Certain developers who are most interested in cost savings may take the cheapest approach to identifying and solving any given problem, which may ultimately mean that the cheapest solution in a condominium repair scenario may turn out to be the shortest-lived solution or the gateway to an even more expensive problem down the road.⁶⁶ “In addition, they may rely on judgment of the very design professionals and subcontractors responsible for creating the defects for guidance as to their severity, the appropriate method(s) of repair and the cost.”⁶⁷ It may well be foolish for the association members to rely on the developer or his contractor for a solution to building issues, because depending on the developer’s decisions that could have been the foundation for the issues in the first place would probably not put the board of managers in a good position to pursue those responsible for their added costs.⁶⁸ When a real estate developer is just “doing his best” in terms of the project, trying to balance his profit with responsible and workmanlike practices, his judgment may not always come into play. When problems arise, however, in the fiduciary duty context, an examination of what is proper business judgment is often appropriate.

Issues arise when a unit-owner or association brings litigation against a developer, and the corporate entity is defunct, fails to defend, or refuses to produce information that could establish proper or improper business decisions. While the burden may rest with the fiduciary to prove certain decisions were fair and unimpeded by personal interests, or at an “arm’s length,” costs in litigation mount quickly. As such, while it is imperative to document carefully in pre-turnover matters, what may be more important is to carefully document before closing, and to require substantial completion if not completion itself, before closing. Indeed, where the developer has the buyer’s funds, his motivation to finish the project significantly decreases. Consequently, one key idea in changing the system is definitely to prevent and/or make illegal, pre-construction closings.

⁶⁴ *Id.* at 16 (citing *Newton v. Hornblower, Inc.*, 582 P.2d 1136 (1978)).

⁶⁵ Sandgrund & Smith, *supra* note 33, at 94.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

Where any developer is allowed to close units before his work is done, after a closing, the burden shifts unfairly to the buyer, who is almost always ill-equipped to solve problems. Eliminating the legality of closings before final finish is but one method of solving this problem, and although individual states have in many cases attempted to impose a regulatory scheme to deal with these issues, a more comprehensive system may be appropriate.

IV. CUSTOMARY ISSUES AFFECTING DEVELOPERS

A developer's life is never boring. From finding suitable real estate, to determining the feasibility of a project, and in some instances juggling acts to oversee multiple projects at once, real estate developers in general, and condominium developers specifically, face many interesting challenges. While many successfully overcome twists and turns in the road, some are less able to navigate those channels, which can impart interesting and sometimes very negative results. After a project is conceived, the developer must outline the financial roadmap, determine what work must be done to make the condominiums fit for habitation and sale, and get through the necessary construction or rehab work to realize those goals. After sales of units, but before the developer hands over all responsibility to the unit owners, he or she is basically in charge of the entire enterprise, from managing construction work to writing checks for all necessary expenses.

During the period of developer control "pre-turnover," there are many reasons why a developer might want to retain control over a development when other unit owners are there to do so. In some cases, a developer may want to oversee the finances or to avoid commencing unnecessary capital projects during the period of the developer's maintenance "guaranty".⁶⁹ Moreover, the developer can avoid litigation during the sales process, prevent unit owners from levying a special assessment to fund a litigation war-chest, maintain access to the common areas and sales office, and prevent amendment of the governing documents.⁷⁰ Many developers hold on to control by giving the false impression that they are still working, or they stall the turnover, so that they can continue to project the image that all will be completed "soon." While this is usually dangerous to believe sight unseen, it is not unusual for unit owners to hold off on taking

⁶⁹ Gary A. Poliakoff, *Transition of Control of the Community Association From the Unit Owners' Perspective*, 16 PROB. & PROP. 49, 50 (2002).

⁷⁰ *Id.*

any kind of action against a developer where the image is created that he is still there to take on and solve problems.

Unfortunately, when the developer has ultimate control over an association from its inception, his own initial budget may be the first cause of the impossibility in problem solving. Where the developer has not funded the association with enough money to do anything, it lacks the ability to survive absent a cash infusion, which is very typically funded by incoming purchasers, who are not prepared for it and who will suffer financially because of it. Like a business must have some starting cash in the register to operate, so too must an association bank account be funded in order to operate, because an expense will definitely arise. This is a key concept in developer budgeting, because where a prospective purchaser is given accurate information about financial and physical health of a condominium from the outset, responsible decisions can be made before closing as to whether or not the buyer wants to fund project completion or any necessary repairs that are, in theory, the developer's responsibility.

A. Lowballing Maintenance Fees to Attract Buyers

One issue in development and marketing of a condominium is determining what budgetary requirements are minimally necessary for the day-to-day operation and administration of the property. An "assessment" or "HOA Fee" is commonly imposed on a monthly or quarterly basis, which provides funding to the association. This assessment typically covers such necessities as: insurance, water, trash removal, snow removal and utilities. While some properties include cable or security, the main idea is that the assessment, and the initial budget which outlines it, are created and utilized for the purpose of day-to-day administration. Where the account balance is inadequate for the monthly or quarterly costs to the association, the developer has abrogated in his duty to set up a mini-corporation which is capable of the business for which it was created: the continuation of a viable property. This is similar to the concept in corporate law of "inadequate capitalization" which in that context, may lead to individual liability. Similarly if the developer does not deposit anything into the association bank account when it is opened, the association is in theory incapable of existing. An omission of this sort should be a clear factor adopted by all jurisdictions in determining a breach of the developer's fiduciary duty to the association and owners.

Because it is so common, developers are often accused of

“lowballing” association fees, undercharging owners and subsidizing operations to keep assessments low, and at an artificially low level, in order to attract sales.⁷¹ In many (and indeed most) jurisdictions, developers are required to disclose the annual budget to prospective purchasers pre-sale. In that there is temptation on the part of the developer to manipulate the budget to achieve the low maintenance fees, regardless of the danger and likely risk of fraud and misrepresentation, developers underestimate the costs to unit owners because they want to be competitive in the market.⁷²

In situations where the developer set the assessments too low, his intent usually is that after a certain initial sales period, the initial services previously provided by him as a way to keep costs low, will become expenses of the association. This will substantially increase the periodic common expense assessments which association members must ultimately bear (i.e. the developer sets up a “bait and switch” where he attracts buyers with a low price on the monthly assessment and then forces that assessment to be raised after he turns the association over to owners in order to cover the costs that were always there - or repairs that were always needed - but hidden through his failure to disclose them).⁷³ Although it is not a requirement in all states, some condominium statutes require developers to set aside funds reserved for the future maintenance, repair, replacement and/or preservation of the project’s common elements.⁷⁴ Not only is this a good practice, but spreading the cost of large repairs over time can have the effect of lessening burdens upon owners in relation to large assessments.⁷⁵ This is because requiring a reserve fund that is sufficiently capitalized to pay at least in part of the necessary costs of maintenance will only be necessary where there is truly work to be done. If the developer has completed all necessary work to deliver a properly built or rehabbed project, then barring unforeseen emergencies, there is little work to be done on a “new” project – thus obviating the need for financial endowment and spreading the costs to the unit owners who were never told those costs were coming.

In California, courts have required developers to not only establish a reserve fund during the period of developer control, but to account for the fund without offsets or credits for maintenance or

⁷¹ Pardon, *supra* note 50, at 15.

⁷² *Id.*

⁷³ See e.g., *Greencort Condo. Ass’n v. Greencort Partners*, No. 4045, 2005 WL 2562909 (Pa. Com. Pl. Oct. 4, 2005).

⁷⁴ Pardon, *supra* note 50, at 13.

⁷⁵ *Id.*

construction expenditures.⁷⁶ Similarly, Illinois courts have ruled that a developer has a fiduciary duty to fund reserves.⁷⁷ In jurisdictions where no property report is required, buyers purchase real estate on blind faith. Uniformity in this context is crucial, insofar as it is axiomatic that where an association is created but not funded, it will nearly always require owner funding for repair work in situations where the developer had a responsibility to convey the condominium units free from such burdens. Conversely, where such pre-development and pre-sale bank account funding requirements are not only imposed but actually met, the likelihood and impact of large-scale capital improvement projects can be more fully evaluated by the developer and the owners, which in turn, protects the purchaser. Overall, if a party selling real estate is required in all instances to know the condition of the building or property as a whole and to share that information, and the prospective owner is informed of whether the newly-formed association has the funding to make the repair before he purchases, the nature of issues arising out of the transaction would be greatly impacted.

B. Pre-Sale Requirements and Disclosure to Buyers

As an up and coming measure to head off developers who could later be accused of making material misrepresentations about real estate, some jurisdictions have introduced inspection and disclosure requirements even before a project may be offered for sale, or a building is granted approval of final inspections or green lights for sale. This is an excellent requirement and one that could prevent a significant amount of problems with real estate transactions.

In South Dakota, for example, the legislature has codified a requirement of a developer to have and obtain a final inspection and an approved report from the state's Real Estate Commission even before a condominium project or unit is put up for sale.⁷⁸ The state's Commission must approve a project and a public report on a project *before* the developer may take reservations or offers for sale.⁷⁹ The Commission is the only party that can waive the inspection, and no developer is allowed to enter into a binding contract until a copy has

⁷⁶ CHARLES T. WILLIAMS, OHIO CONDOMINIUM LAW § 34.3 (2011) (citing *PJNR, Inc. v. Dep't of Real Estate*, 230 Cal. App. 3d 1176 (Cal. App. 5th Dist. 1981)).

⁷⁷ *Id.* (citing *Bd. of Managers of Weathersfield Condo. Ass'n v. Schaumburg*, 307 Ill. App. 3d 614 (Ill. App. Ct. 1st Dist. 1999)).

⁷⁸ S.D. CODIFIED LAWS § 43-15A-17 (2011).

⁷⁹ *See id.*

been provided to a purchaser and a ten-day period has elapsed, to allow for the purchaser's review.⁸⁰ This kind of codification can go a long way toward ensuring that fraud and misrepresentation claims are avoided.

Similarly, South Dakota law contains an enforcement provision that provides for misdemeanor liability in the event of a failure to disclose pertinent information by the developer or his agents.⁸¹ South Dakota has better measures in place to avoid problems than many other states, even though it may have less than a quarter of the population of other states. This kind of forward thinking, as in California, should be adopted nationwide.

In Ohio, a developer is required to furnish a two-year warranty covering the full cost of labor and materials for any repair or replacement of roof and structural components, and mechanical, electrical, plumbing, and common service elements covering the condominium property occasioned by a defect in material or workmanship.⁸² Ohio developers are further required to provide one-year warranties for defects in materials or workmanship, commencing on the closing date.⁸³ While a longer warranty period is absolutely beneficial to the purchaser, where the warranty language is or may be allowed to contain exclusions or exculpatory language, such warranty requirements do very little to protect the consumer. Consequently, standardization of warranty language and exculpation clauses could work to prevent injustice by a contracting party who inserted language to protect a buyer in one sentence, but tried to take it away in another.

Like South Dakota, Ohio developers are also subject to extensive pre-sale disclosure requirements. Specifically, Ohio purchasers are provided information about: the developer, narrative descriptions relating to the property as a whole, construction status, financing terms offered by the developer, warranties offered for common elements and units, two-year budget projections, reports on condominium conversion (if applicable) including remaining useful life of all integral condominium components (including, *inter alia*, an estimate of repair and replacement costs projected out for five years, existence of reserve funds, the existence of management contracts, terms of encumbrances or liens of any kind, escrow details, and statements of litigation, if any).⁸⁴

⁸⁰ See *id.* §§ 43-15A-13, -19.

⁸¹ See *id.* § 43-15A-25.

⁸² 16 OHIO JUR. 3d *Condominiums, Etc.* § 14 (2011).

⁸³ *Id.*

⁸⁴ *Id.* § 17.

Despite this requirement, Ohio courts have held that a “condominium owners’ association may not maintain an action against a condominium developer for breach of fiduciary duty absent an understanding by both parties that special trust and confidence have been reposed in the developer” by the association members.⁸⁵ This is a unique twist on the law because of the unfortunate likelihood that no developer would agree to language in the contract that created such a special confidence. As a result, by the inclusion of this language in the jurisprudence, Ohio courts have possibly blocked any meaningful advance of the law in fiduciary cases involving developers.

In Michigan, a developer’s pre-sale disclosure requirements include such interesting components as the names, addresses and prior experiences with condominium projects of each developer and any management agency, real estate broker, residential builder, residential maintenance, and alteration contractor.⁸⁶ Where a project is a conversion in Michigan, developers are required to provide the following:

- (1) A statement if known, of the condition of the main components of the building, including the roofs; foundations; external and supporting walls; heating, cooling, mechanical ventilating; electrical, and plumbing systems; and structural components. If the condition of any of the components . . . is unknown, the developer shall fully disclose that fact.
- (2) A list of any outstanding building code violations or other municipal regulation violations and the dates the premises were last inspected for compliance with building and housing codes.
- (3) The year or years of completion of construction of the building or building(s) in the project.⁸⁷

These Michigan requirements impose not only an affirmative obligation on the developer’s part to inform himself of the various issues in order to comply with these disclosure requirements, but they also provide a fair amount of information that a prospective purchaser can use to fairly and honestly evaluate the viability of the condominium and its association. If this was a standard that was required everywhere, the state of condominium law would have

⁸⁵ *Belvedere Condo. Unit Owners’ Ass’n v. R.E. Roark Cos.*, 617 N.E. 2d 1075, 1083 (Ohio 1993).

⁸⁶ MICH. COMP. LAWS ANN. § 559.184a (West 2011).

⁸⁷ *Id.*

progressed significantly. If applied nationally, then a court's continued reliance on *caveat emptor* would be justified, and the burdens shouldered would reflect a greater equality between the parties. Where courts are now applying *caveat emptor*, but are not recognizing the issues involved in intentional or negligent disclosure issues, the disparity in the bargaining positions and the legal positions of the parties after a dispute has arisen is too great, which results in "manifest unjustness."

In the Washington case of *Kelsey Lane Homeowners' Assoc. v. Kelsey Lane Co., Inc.*, a developer was not required to include construction defects in a pre-sale offering statement where it was established that the declarant was unaware of construction defects by virtue of his relationship with the general contractor, since neither was the agent for the other.⁸⁸ Although the developer could be held liable for misrepresentations under the Washington Condominium Act's public offering statement requirements, a declarant is not held responsible under a "should have known" standard.⁸⁹ Where actual knowledge cannot be established, it is not imputed to the developer under traditional rules of agency.⁹⁰ Also, in *Kelsey Lane*, because the association was not "formed" until the construction was completed and the defective portion was sealed within the overall project, the court found that the declarant could not have known about the defects to disclose them.⁹¹

As such, collection and analysis of key information such as a developer's date of purchase of the property and the date of recordation of a declaration of condominium, and additional information about a developer's knowledge of the property (including appraisal and inspection documents), coupled with whatever the lender knows or should know about the property and the transaction as a whole may be crucial for purposes of discovery, litigation and establishing liability in the context of proving what a developer or his agents "knew" and when they knew it. All of this information is critical for ensuring the success of not only a lawsuit but also for making decisions long before the closing table. In reality, a purchaser or condominium owner or association is not nearly as concerned with whether they sue the developer or his subcontractor, as they are with the viability of the case and the likelihood of recovery. As long as a responsible party can be identified out of the disclosure and

⁸⁸ *Kelsey Lane Homeowners Ass'n v. Kelsey Lane Co.*, 103 P.3d 1256, 1261 (Wash. Ct. App. 2005).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 1264.

knowledge requirements, the end result will be that in cases where a duty was abrogated, there would be a workable remedy under the circumstances.

C. Pre-Turnover Fiduciary Duties

Before the developer has tendered control over the building or project to the unit owners, there are still fiduciary duties held by the developer relating to the building and the finances. In some cases, the Uniform Condominium Act ("Act") has conferred a fiduciary duty on the developer, by using a statutory section imposing a fiduciary duty upon the association's governing body that the developer appoints.⁹²

Although not adopted by all states, the Act does nonetheless provide a model for jurisdictions to explore the provisions of their governing documents in relation to condominiums. Surprisingly, the Act does not provide a general fiduciary duty to purchasers.⁹³ It does provide, however, that such a duty runs from members of the governing body of an association to whomever the developer appoints.⁹⁴ The developer does not owe others a fiduciary duty in the developer/unit-owner sense. Only in the case of a developer-appointed board member vis-à-vis the unit-owner, does such a duty arise. However, it is not clear whether this means that the developer does not have a duty to his purchaser in relation to the condominium.

To analyze this from the real-world perspective, however, what must be examined within the traditional trajectory of a condominium purchase and sale transaction, the ideas that we have about the developer and the ideas that the purchaser has about the developer in terms of who does what and who is really in charge. Although the developer may be wearing the "association director hat" he is not typically thought of as a director of an association when dealing with a unit-owner. To them, he's nothing more than the developer. As such, whether through email, phone or attorney-drafted correspondence, the emphasis is usually placed on the developer as "developer" and not as the "association leader." Consequently, the Act's use of terms and its implications suggest that for jurisdictions that follow the Act, little attention may be paid to the developer's acts and omissions as a developer, rather than as an association officer or

⁹² Rick McConnell, "You Can't Always Get What You Want – But if You Try Sometimes, You Might Find, You Get What You Need": *The Search for Single Family Homeowner Protections in Missouri*, 69 UMKC L. REV. 409, 418 (2000) (citing *Randolph v. Atkinson*, 965 S.W.2d 338, 341 (Mo. Ct. App. 1998)).

⁹³ *Id.* at 419.

⁹⁴ *Id.* at 420.

director, and unfortunately, these may be very dangerous, and costly, distinctions.

In some jurisdictions, like Pennsylvania for example, a developer's fiduciary duty arises when an initial public offering document or disclosure is filed with the municipality, rather than when a declaration is filed.⁹⁵ In *Greencort Partners Condominium Ass'n v. Greencort Partners*, the court considered when a fiduciary relationship arose, before or after the filing of the condominium declaration, or when a public offering statement had been filed.⁹⁶ The holding, in conflict with the statutory language of the Pennsylvania Condominium Act,⁹⁷ provided that a condominium was created at the time a declaration was filed.⁹⁸ Like other jurisdictions, the Uniform Pennsylvania Condominium Act listed various pre-sale disclosures, delineating between new builds and conversions.⁹⁹ The issue was one of timing however, in relation to the filing of pre-sale disclosures and recordation of condominium instruments. For a court to put emphasis on the date of recordation as opposed to the date of filing the instruments, where regardless of the two dates the developer was responsible to know the condition of his own real estate before selling it, is manifestly unjust, and the wrong issues were (or may have been) put before the court.

Regardless of the law, until the owners take control, the developer is typically responsible for all aspects of the project's operations through the appointed directors.¹⁰⁰ The developer is charged with overseeing all aspects of building management, including maintenance, revenue collection and protection of the common areas.¹⁰¹ Issues come up frequently in this context because while the developer is still selling units or trying to advertise them, he is often simultaneously taking over the building as a part of the association or the manager/director of it – meaning that he voluntarily

⁹⁵ *Greencort Partners Condo. Ass'n v. Greencort Partners*, No. 4045, 2005 WL 2562909, at *3 (Pa. Com. Pl. Oct. 4, 2005).

⁹⁶ *Id.*

⁹⁷ 68 PA. CONS. STAT. § 3101 (2011).

⁹⁸ *Greencort Partners*, 2005 WL 2562909, at *7 (citing 68 PA. CONS. STAT. § 3201 (2011)).

⁹⁹ *Id.* at *12 (citing 68 PA. CONS. STAT. § 3404 (requiring pre-sale disclosures of known conditions, pertinent dates of major repair, useful life calculations, age and present condition of all building components, replacement cost assessments and listing of any outstanding and/or uncured code violations)).

¹⁰⁰ Pardon, *supra* note 50, at 12-13 (citing WIS. STAT. § 703.15(2)(c) (West 2011)).

¹⁰¹ *Id.* at 13.

takes on two different roles which are or may be in conflict with one another.¹⁰² Of course, the developer's goal is to make money on his business enterprise (which is why he is in business in the first place) but he cannot proceed on the making money side of his venture if at the same time he is depriving the buyer of the benefit of their bargain, because to do so may well result in litigation brought by unsatisfied purchasers.¹⁰³

Under section 6.20 of the Restatement (Third) of Property, the developer's role will dictate the type and kind of duty he is subject to vis-à-vis the condominium association members.¹⁰⁴ As a mere "seller" of real estate, the developer has no fiduciary obligation because he is nothing more than a seller in an arm's length transaction.¹⁰⁵ However, when a developer develops a condominium project, much a like a corporate promoter, he has certain duties of care in relation to beginning and running the project (with the foundation of that duty coming from corporate principles).¹⁰⁶ Similar to corporate law, where a promoter of a business entity cannot take any action that would prevent the entity from being operated as intended, a developer in setting up a condominium association may not prevent the association from being operational from its inception.¹⁰⁷ Some courts have held that developers have breached their duties when they have turned over to owners, control of a project that is in a state of disrepair and with under funded accounts.¹⁰⁸ The question then of whether there is a fiduciary duty toward others, possibly should be resolved under the Restatement view, by utilizing such factors as the role the developer is playing at the time, the particular activity he is engaging in, or his statements, in order to determine if any fiduciary obligations are coming into play. It begs the question of whether the developer is to announce his motivation for any given decision, and whether, even if required to, it would be done.

Having somewhat examined this question, in Illinois developers hold a fiduciary duty as directors of a not-for-profit or as

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 602 (2007).

¹⁰⁵ Pardon, *supra* note 50, at 13-14.

¹⁰⁶ *Id.* at 14; see *Duncan v. Brookview House, Inc.*, 205 S.E.2d 707 (S.C. 1974); *Rafalowski v. Old Country Rd. Inc.*, 719 A.2d 84 (Conn. Super. Ct. 1997).

¹⁰⁷ *Maercker Point Villas Condo. Ass'n v. Szymiski*, 655 N.E.2d 1192 (Ill. App. Ct. 1995).

¹⁰⁸ *Concerned Dunes W. Residents, Inc. v. Georgia-Pac. Corp.*, 562 S.E. 2d 633, 637 (S.C. 2002).

the developer-controlled board of managers.¹⁰⁹ Since Illinois courts have found that a real estate developer is a fiduciary vis-à-vis the unit-owners, courts will allow a fiduciary finding absent an analysis of the developer's role in the association.¹¹⁰ This suggests that Illinois courts see the big picture that as a developer, because a buyer naturally reposes confidence in him to develop, and adequately so, that there is an inherent fiduciary obligation flowing downstream from the developer to the buyer, simply based upon the nature of the transaction and its magnitude. Likewise, in Colorado, developers may be subject to actions for negligent misrepresentation in circumstances where people or property are harmed, or where there is a financial loss in the course and conduct of commerce.¹¹¹ Statutorily, a developer-builder is under a duty to disclose all known material facts that "in equity and good conscience should be disclosed" when marketing any kind of common interest community, including town-homes and condominiums.¹¹² Additionally, when deceptive trade practices are involved, the developer-builder may be liable to purchasers of its units under Colorado's Consumer Protection Act ("CCPA").¹¹³

However, not all jurisdictions impose broad, unfettered duty upon developers.¹¹⁴ In the case of *Belvedere Condominium Ass'n v. Roark*, the Ohio Supreme Court held that developers were not fiduciaries and recognized that the developer's right to protect its own interest in promoting its project was tempered only by the buyers' rights to employ consumer protection statutes in their favor for alleged breaches.¹¹⁵ The majority reasoned that the state legislature provided inherent statutory consumer protections, such as the association's ability to cancel developer contracts, and the phasing out of developer control over time.¹¹⁶

The dissenting opinion in *Belvedere* suggests that the majority's decision denying a fiduciary duty claim against the developer was akin to permitting the developer to engage in self-dealing with impunity, while operating the owners' association

¹⁰⁹ Eunice A. Eichelberger, 8 ILL. REAL PROP. § 43:100 (citing *Wolinsky v. Kadison*, 449 N.E.2d 151 (Ill. App. Ct. 1983)).

¹¹⁰ See *Glickman v. Teglia*, 902 N.E.2d 1256, 1260 (Ill. App. Ct. 2009).

¹¹¹ *Sandgrund & Smith*, *supra* note 33.

¹¹² *Id.*

¹¹³ *Id.* (citing COLO. REV. STAT. § 6-1-101, *et seq* (West 2011)).

¹¹⁴ *Pardon*, *supra* note 50, at 13 (citing *Belvedere Condo. Unit Owners' Ass'n v. R.E. Roark Cos.*, 617 N.E.2d 1075 (Ohio 1993)).

¹¹⁵ *Id.* at 14.

¹¹⁶ *Id.*

(therein disputing the Ohio legislature's intent in that regard).¹¹⁷ Justice Douglas stated in his dissent "let all who will henceforth, enter into a construction agreement with a developer-builder now be aware that they should get, carved in stone, an 'understanding' that they can have trust and confidence in their builder to be honest with them."¹¹⁸

D. Social Media Implications

In our new age of social media, internet ratings and commentary about business transactions, one need only Google, access Yelp or check Angie's List (among other web information sites in their locale) as to their particular developer. If a prospective purchaser finds any commentary, it provides good ammunition and reason to dig deeper in order to determine whether or not any given transaction is wise. If nothing is discovered or if the reports are positive, then certainly that should be more than enough to assuage fears about moving forward.

Where a developer's reputation and his customers' thoughts are freely strewn across the internet, does that then create any obligation upon a purchaser to scour the publicly available "commentary" to ascertain whether or not other people were happy with their experience? If consumers these days are posting their every thought and whim on Facebook and Twitter, then is there even any need for a uniform law to protect them from a developer's failure to disclose something important and/or material to the transaction? While today's consumer or vendee should be aware that certain information may be available publicly, there is no substitute for good governance. Also necessary, is the enactment of laws that go not only to consumer protection, but also to developer supervision, so that the developer is following the law in the first instance, rather than the latter end-solution of a consumer having a cause of action to file. While it is a good idea to run some things through the internet search engine before moving forward, the burden should not be on the consumer to have to find out the negative information on his own, when the developer is still in the best position to do the job right, sell the property in an acceptable condition, and abide by both self-imposed and legally-imposed standards and duties. If a developer were loathe to find negative commentary floating around cyberspace about him, he could then take steps to avoid the need for such a post

¹¹⁷ *Id.* (citing *Belvedere*, 617 N.E.2d at 242).

¹¹⁸ *Belvedere*, 617 N.E.2d at 291.

to be placed in the first instance by selling only completed real estate that has been duly inspected, insured and contracted for.

The failure of some courts to recognize the imbalance of power between the developer and purchaser by sanctioning the requirement of developer disclosure does not suggest the judiciary is yet moving forward as a whole. In fact, just the opposite seems true in some cases. For example, Utah does not recognize an independent duty to comply with building codes, with Utah courts holding that developers have no duty to act without negligence in the construction of homes.¹¹⁹ Utah courts have found that because a condominium association had no direct contractual relationship with the developer, builder or other party, it lacked the requisite connection for any independent duties to attach.¹²⁰ This suggests that in that particular case, the court was turning a blind eye to the obvious position of the condominium association, and taking a very strict and narrow view of what duties apply to real estate developers. Such strict and narrow viewpoints should be the exception and not the norm.

Where an association is empowered by the declarations to act on behalf of unit owners, why should a court require privity to establish a fiduciary relationship, when such a relationship is not recognized in Utah and other jurisdictions between the developer and purchaser of real estate? To discriminate because the association likely filed suit, rather than the members themselves, is to blindly ignore the real legal and equitable issues. Who is the plaintiff is not the issue, as long as the plaintiff should otherwise have standing and can establish interest and a live controversy. Refusing to protect an unsuspecting purchaser who trusted an obvious fiduciary, especially in current economic times where housing values have tanked, puts undue pressure and financial hardship onto a purchaser, who is often pushed to the brink of financial ruin when involved with a real estate transaction gone bad. The courts and legislatures can do better.

E. Insurance Implications

Regardless of whether the developer stands as a fiduciary to the owners, his appointed directors do have a common law fiduciary duty to the association as directors of a corporation.¹²¹ Condominium

¹¹⁹ Davencourt at Pilgrim's Landing Homeowners Ass'n v. Davencourt at Pilgrim's Landing LC, 221 P.3d 234, 247-48 (Utah 2009) (holding that Utah building codes do not create any independent legal duties for purposes of avoiding the economic loss rule).

¹²⁰ *Id.* at 245.

¹²¹ Pardon, *supra* note 50, at 14 (citing *Rose v. Schantz*, 201 N.W.2d 593 (Wis.

association members who act as managers or board members also have duties, and they can be breached if they do not abide by the regulations or themselves enforce them for the benefit of the entire association, which can include disclosure of misconduct by others, including the developer.¹²² The issue of developer misconduct begs the question of whether liability insurance policies (also known as "D&O" policies) would cover acts and omissions by the developer who set up the policy, if they cover the developer as the controlling "association member." It raises the issue of whether such policies are intended to be applicable only to the unit-owner elected board members rather than the developer in control of the association. When principals of the developer entity place themselves into association affairs (as is often the practice), they may be removing themselves from any corporate entity shields held by the development entity.¹²³ Consequently, where the developer acts on behalf of the association and there is no "umbrella" of a corporate shield to protect the developer from being held liable for his acts and omissions vis-à-vis the unit owners who make up the association, the question of whether or not the association insurance policies in place for directors and officer's acts and omissions actually covers the developer must be answered.

Typical condominium association D&O policies should be considered forward-looking, and thus only applicable to unit-owner members of the board and not to developer-appointed board members. In the situation where the D&O policy covers the developer as association member, the developer could force an association into financing the developer's defense on the insurance even though he may be the party at fault in the first instance. Although it seems impossible to fathom that a bad developer could force his victims to pay for his legal defense, where D&O policies do not make this clear, a developer's tender of coverage to the condo association master policy carrier could easily happen.

This idea does not appear to have been fleshed out in the case law, at least in Illinois, but if true, it should then create the impetus in the developer to self-insure for his acts and omissions (including construction negligence), which are typically excluded from a traditional commercial general liability policy held by the developer. This suggests that insurance policy drafters should be clearer as to exactly whom the said policy is designed to protect and insure. This

1972).

¹²² *Id.*

¹²³ *Id.*

also means that it is wise for incoming buyers and their counsel to request or verify evidence of a developer's insurance through a commercial general liability policy, at a minimum, so that the issue of coverage is not left looming. Where there could be a requirement in place for ensuring proper insurance coverage and a developer would not be allowed to close on unit sales without it, there would be far fewer uninsured or underinsured developers (providing a corresponding benefit for the unit owner, the insurance companies and the title agents who are closing these transactions). Although many lenders loaning money to a developer may include in their lending instruments or closing instructions an affirmative obligation to purchase, and in fact deliver appropriate insurance, many situations arise where the lender did not confirm the existence or appropriateness of the developer's insurance, which may go toward lender liability.

One question that may come up is, how long could a developer even be in control in the "typical" project? As is outlined in Wisconsin and other states, condominium laws typically clarify the developer's responsibilities during the period of their control (which is usually one to three years from the filing of the declaration or a certain time period after 75% of the units have been sold).¹²⁴ A developer, in some instances, can be charged with the failure to take action at a time when it is prudent to do so.¹²⁵ His failure to act can take many forms and often shows up in instances where the developer retains control of the association for a period of time and is unwilling or fails to make or enforce rules for fear of endangering the sales program. This, when coupled with his obvious lack of desire to engage in any dispute with unit owners, or his false sense of security that is often associated with the somewhat inappropriate notion that the developer does not have to do anything until his last unit is about to be sold, in many situations creates liability in the developer as against unit owners, which could have been prevented with better foresight and disclosure.

The principles of fiduciary duties in general, and the requirement that one subject to those duties should avoid conflicts of interest, do not automatically mandate that the developer should avoid dealing with unit owners at all; however the officers and directors of an association must clearly understand that their office is a position of trust which is not to be abused for personal advantage or

¹²⁴ Mark R. Hinkston, *Wisconsin's Revised Condominium Ownership Act*, 77 WIS. LAW. 10 (Sept. 2004).

¹²⁵ Hyatt & Rhoads, *supra* note 12, at 937.

to be exploited for any kind of personal gain or satisfaction. In fact, it should be realized that the avoidance of the appearance of abuse (by a developer) is or may be as important as avoiding the abuse itself.¹²⁶ While this concept is so often ignored in condominium transactions, the key problems can still be avoided with meticulous inspection and pre-purchase due diligence. That, along with the hopeful changes to the real estate purchase and sale rules and regulations, which are and should be followed by all of those aforementioned "players" in the real estate and condominium game, would go a long way toward meaningful change. As stated above, more stringent rules for pre-sale and post-sale condominium transactions would greatly impact the law and the emerging issues faced by buyers and sellers alike.

V. COMMON CAUSES OF ACTION AGAINST DEVELOPERS

When any or all of the precautionary measures mentioned above fail, condo owners may be forced to examine potential common causes of action against developers. Associations and unit-owners (and indeed counsel representing them), when faced with building, unit or common area problems relating to a particular property, must inform themselves about the available causes of action that can be sustained against a recalcitrant developer and his agents. Usually where counsel is retained, an evaluation must be made of whether claims are individual or common, whether the association entity should make claims on behalf of unit owners, and whether contractual provisions prohibit recovery in any areas. Regardless of what claims are ultimately levied, success or failure depends heavily on the on the proofs that can be collected against a developer or his agents, and it is incumbent upon parties and their counsel to be aware of what their local and neighboring jurisdiction may allow. In many instances, unit owners may have claims for breach of contract, warranty or for breach of a fiduciary duty. In still other cases, claims of fraud may be warranted, however all of these depend on the law of the particular jurisdiction and the facts of the case that will or will not, bring a matter within a particular cause of action.

A. Warranty Breaches, Deceptive Trade Practices and Fraud

Many states have what are generally known as consumer protection acts or deceptive trade practices acts.¹²⁷ In general, these

¹²⁶ *Id.* at 945.

¹²⁷ Kennedy & de Haan, *supra* note 29 (citing Richard D. Connor & Cynthia A. Hatfield, *Unfair and Deceptive Trade Practices in Construction Litigation and*

acts broadly provide that unfair business practices in the course and conduct of trade and commerce may give rise to liability.¹²⁸ Under such acts, a corporate officer or agent of a developer may be held personally liable for damages caused by his fraud and deceit.¹²⁹ Also, “[a]n equitable accounting is or may be proper where a fiduciary relationship exists between the parties, where fraud or misrepresentation is alleged, or where accounts are mutual or complicated and plaintiff does not possess an adequate remedy at law.”¹³⁰ It is important that transactions are carefully documented, and that claims involving fraud or misrepresentation are backed by the ability to prove them with clear and convincing evidence.

Sometimes the issue in a fraud case revolves around whether the fraud claim is based upon what the developer said he did, or what he said he would do in the future. Supporting claims against the developer, various courts look to what kind of duties are owed to the purchaser. In Indiana, for example, courts have found as a matter of law that a developer owed a purchaser a duty of fair dealing and honesty and a duty of good faith and fair dealing.¹³¹ In holding that where evidence established fraud and the developer’s failure to meet its contractual duties (even where statements were of a future regard rather than as to present facts that typically support claims of fraud or constructive fraud), because there was a fiduciary relationship between real estate developer and the buyer, a constructive fraud finding was appropriate.¹³² This means that Indiana courts not only hold consumer protection in high regard, but established it as a firm principle that is inherent in the purchase of real estate. Where unqualified statements were made in order to induce buyers to purchase real estate, such inducement and resulting damages can amount to constructive fraud.¹³³ This suggests again that pre-sale disclosures ought to be bolstered with municipal and title company requirements and inspections that give the purchaser every assurance

Arbitration, 49 S.C. L. REV. 977 (1989)).

¹²⁸ *Id.*

¹²⁹ Hyatt & Rhoads, *supra* note 12, at 972 (citing 3A W. FLETCHER, PRIVATE CORPORATIONS § 1143, at 207 (perm. ed. rev. 1975)).

¹³⁰ Greencort Partners Condo. Ass’n v. Greencort Partners, No. 4045, 2005 WL 2562909, at *7 (Pa. Com. Pl. Oct. 4, 2005) (citing *Rock v. Pyle*, 720 A.2d 137, 142 (Pa. Super. 1998)).

¹³¹ *See Yeager v. McManara*, 874 N.E.2d 629, 636 (Ind. Ct. App. 2007) (although the court did not require a fiduciary relationship to exist to base the constructive fraud finding).

¹³² *Id.*

¹³³ *Id.* at 642.

that work is complete and satisfactory, before the transaction funds and closes.

In most courts, fraud claims require very specific allegations, the establishment of facts to meet required factors, and ultimate proofs of intentional conduct. Although it is often hard to prove intentional conduct in relation to business decisions, would-be plaintiffs can outline contractual provisions that cover failure-to-follow municipal rules regarding licensure, permitting and codes in support of fraud and contractual claims. Apart from what is, or may be, embodied in the contract, implied terms and warranties are often applicable to protect purchasers.

1. Implied Warranties

"In the sale of new homes, the vast majority of states recognize an implied warranty of habitability between the buyer and seller" in real estate transactions.¹³⁴ Multiple types of warranties exist, including the implied warranty of habitability, the implied warranty of fitness for a particular purpose and the implied warranty of good and workmanlike construction.¹³⁵ Some jurisdictions allow an implied warranty that a home will comply with the applicable building code.¹³⁶ In construction contracts, it is usually implied, unless there is an express contract or agreement to the contrary, that a builder will erect the building in a reasonably good and workmanlike manner, and it will be reasonably fit for its intended purpose.¹³⁷

But what if the prospective homeowner does not hire the builder to build the house, but instead buys one from him already built? Given the increasing complexity of construction techniques and limitations on access to the property during various building stages may prevent inspection, courts have recognized that buyers have to rely on the skills of the builder.¹³⁸ The Iowa Supreme Court, relying on the Missouri Supreme Court decision of *Smith v. Old Warson Development Co.* (sitting *en banc*) noted the following:

¹³⁴ Kennedy & de Haan, *supra* note 29, at 4 (quoting Caryn M. Chittenden, *From Caveat Emptor to Consumer Equity - The Implied Warranty of Quality Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 571, 572 (1992); Hyatt & Rhoads, *supra* note 12, at 955-58).

¹³⁵ *Id.* at 4 (citing *Luker v. Arnold*, 843 S.W.2d 108, 115 (Tex. Ct. App. 1992); *Gorsky v. Triou's Custom Homes, Inc.* 755 N.Y.S.2d 197, 201 (N.Y. Sup. Ct. 2002); Chittenden, *supra* note 134, at 572).

¹³⁶ Sandgrund & Smith, *supra* note 33, at 92.

¹³⁷ *Busker v. Sokolowski*, 203 N.W.2d 301, 303 (Iowa 1972).

¹³⁸ *See, e.g., Kirk v. Ridgeway*, 373 N.W.2d 491, 494 (Iowa 1985).

Although considered to be a real estate transaction because the ownership of land is transferred, the purchase of a residence is in most cases, the purchase of a manufactured product: the house. The land involved is seldom the prime element in such a purchase . . . certainly not in urban areas . . . The structural quality of a house, by its very nature, is nearly impossible to determine by inspection after the house is built, since many of the most important elements of its construction are hidden from view. The ordinary "consumer" can determine little about the soundness of the construction, and must rely on the fact that the builder-vendor holds the structure out to the public as fit for use as a residence, and being of reasonable quality. Certainly . . . no determination of the existence of a defect [the settling of the house] could have been made without ripping out the slab that settled, and maybe not even then. The defect was latent and not capable of discovery by even a careful inspection . . . common sense tells us that a purchaser under those circumstances should have at least as much protection as a purchaser of a new car, or a gas stove, or a sump pump or a ladder.¹³⁹

Thus, if meaningful change can be made to our "system" of overseeing real estate transactions, it is imperative that there is imposed the requirement that the developer hire an independent engineer to evaluate the property and for the developer to make known publicly, the findings of said engineer. Only then can it be fairly said that what the true professionals did not find or know about, the developer could not disclose. In that scenario, where the buyer did not go into the wall or under the house, he might be fairly required to take his chances when he buys a home already built, and there also existed the option for him to build one himself. Apart from the cost differences that make the higher priced inspection options less of a choice for most people, the real issue is that for there to be a uniform system involving the developer, so too must there be one relative to the buyer. If we are to think that a home purchase in Wyoming is just as special as in Virginia, then so too must there be uniformity in the approaches to the risks of home purchasing, one that fairly balances the rights of the vendor as against the vendee. Buyers in all states need to inspect, and proceed from start to finish with experienced real estate counsel. Since in many jurisdictions the

¹³⁹ *Id.* (citing *Smith v. Old Warson Dev. Co.*, 479 S.W.2d 795, 799 (Mo. 1972) (en banc)).

use of attorneys to assist with supposedly "simple" real estate transactions is regarded as wasteful or unnecessary, if there were greater recognition and acceptance from the public that navigation assistance through these legal waters was important, there could be meaningful change accomplished.

The Uniform Land Transactions Act ("ULTA") reflects the current trend toward refusing to apply the traditional doctrine of *caveat emptor* where injustice will occur, by providing in part that an implied warranty will cover all purchases from "sellers in the business of selling real estate."¹⁴⁰ The ULTA "applies to all real estate, not just houses, and warrants that the building will be 'suitable for the ordinary uses of real estate of its type' and is (1) free from defective material and (2) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner."¹⁴¹

As an added measure, "an implied warranty also takes into account the equitable consideration that, between two innocent parties, the one in the better position to prevent the harm ought to bear the loss."¹⁴² While a builder-vendor certainly has the opportunity to notice, avoid, or correct latent defects during the construction process, a similar opportunity exists for the developer-vendor. As one court reasoned,

Purchasers from a developer-vendor depend on his ability to hire a contractor capable of building a home of sound structure. Where the buyer has no control over the seller-developer's choice of contractor, the developer-seller stands in the best position to know whether the contractor he has hired can complete the work adequately. By protecting the innocent home purchaser by holding the developer-seller liable the law is coming to recognize that the purchaser of a home does not stand on equal footing with the builder-vendor or developer-vendor.¹⁴³

The essence of the transaction is an implicit promise on the

¹⁴⁰ *Id.* at 495.

¹⁴¹ *Id.* (citing UNIFORM LAND TRANSACTION ACT § 2-309, 13 U.L.A. at 609-10 (1980)).

¹⁴² Davencourt at Pilgrim's Landing Homeowner's Ass'n v. Davencourt at Pilgrim's Landing, LC, 221 P.3d 234, 251 (Utah 2009) (citing Chandler v. Madsen, 642 P.2d 1028 (Mont. 1982)).

¹⁴³ *Id.* at 251 (citing Tassan v. United Dev. Co., 410 N.E.2d 902, 908 (Ill. App. Ct. 1980)).

part of the seller to transfer a house suitable for habitation.¹⁴⁴ If the purchaser expected anything less, there would be no sale.¹⁴⁵ An express written warranty may not provide sufficient protection concerning latent defects, as suggested above, inasmuch as a buyer who has no knowledge, notice, or warning of defects is in no position to exact specific warranties from a developer, and any written warranty demanded in any case would necessarily be too general to enforce.¹⁴⁶ Only where a buyer knows of all of the problems with a particular parcel of real estate can he protect himself from the developer who promises to fix them. Issues can arise as well, when a developer does not undertake all repairs that are listed in common warranty provisions provided by their counsel, so that the unit owner may invariably feel a false sense of security when in fact, items not improved by the developer form the foundation of warranty claims.

Purchasers and counsel must carefully align inspection lists with implied warranty exclusions, so that defective or unfinished items are included in the developer's obligatory fixes. Where there is a requirement upon the developer to disclose (within an engineer-prepared property report all of the good and the bad), then similarly, where a condominium buyer informs himself about the true condition of the property through a proper inspection, then problems are minimized, thus lessening the negative effects of condominium ownership.

2. Express Warranties

Apart from implied warranties, "in those instances where express warranties have been made, either orally or in writing, they are generally enforceable under basic theories of contract law."¹⁴⁷ Oral warranties, of course, may be rendered unenforceable through the statute of frauds; however, the "part performance" exception may be implicated where work relates to common elements of a condominium project."¹⁴⁸

In examining cases involving fiduciary duties and warranty claims, the Virginia case of *Luria v. Board of Directors of Westbriar Condominium Unit Owners' Ass'n*, was instructive. In that case, there

¹⁴⁴ *Id.* (citing *Yepsen v. Burgess*, 525 P.2d 1019, 1022 (Or. 1974)).

¹⁴⁵ *Id.* (citing *Sloat v. Matheny*, 625 P.2d 1031, 1033 (Colo. 1981)).

¹⁴⁶ *Bethlamy v. Bechtel*, 415 P.2d 698, 707 (Idaho 1966).

¹⁴⁷ *Hyatt & Rhoads*, *supra* note 12, at 955 (citing 3 SAMUEL WILLISTON, CONTRACTS § 526 (3d ed. 1963)).

¹⁴⁸ *Id.* (citing Leo Bearman, *Caveat Emptor in Sales of Realty - Recent Assaults on the Rule*, 14 VAND. L. REV. 541, 548 (1961)).

was no fiduciary duty vis-à-vis the developer (through his entities) and the condominium association because the association was not a “creditor” of the developer.¹⁴⁹ The Virginia Supreme Court, relying on tort law and the law of fraudulent conveyances, determined that a creditor who was duly noticed of a potential warranty claim under the statutory warranty scheme of the Virginia Condominium Act could be held liable for a breach of a fiduciary duty for self-dealing.¹⁵⁰

Although the Virginia court determined that the developer in *Luria* was not put on actual notice of defects that could withstand a claim for statutory warranty relief under the Virginia Condominium Act, the court refused to find that the developer was a creditor who owed the unit owners a fiduciary duty for their self-dealing.¹⁵¹ The opinion does not mention any other possibilities of imposing a fiduciary duty in Virginia against a recalcitrant developer, suggesting that as of 2009, there is no applicable authority on the issue. As such, what is clear at a minimum, is that express warranties must be drafted and also edited in the negotiation phase of the transaction – to reflect actual property conditions and to hold the developer to the standard that the purchaser and indeed, the law, typically expects.

3. Liability Based On Fraud

Regarding expectations, it is fair to say that no one would purchase a condominium if they thought that the developer was engaging in outright fraud. As in other causes of action against a developer, a developer-builder or a developer-seller can also be held liable under a theory of fraudulent misrepresentation if the characteristics or quality of a home or unit are expressly misrepresented.¹⁵² In many instances, a developer’s fraud does not consist of express misrepresentations; rather it is made up of the developer’s silence when the facts demand disclosure of his knowledge to the purchaser.¹⁵³ This can happen (and often does) when the developer or his agents (including the realtor who shows the property to prospective purchasers) have knowledge of important

¹⁴⁹ *Luria v. Bd. of Dirs. of Westbriar Condo. Unit Owners Ass’n*, 672 S.E.2d 837, 841 (Va. 2009).

¹⁵⁰ *Id.* at 840.

¹⁵¹ *Id.*

¹⁵² Kennedy & de Haan, *supra* note 29, at 7 (citing Lynn Y. McKernan, *Strict Liability Against Homebuilders for Material Latent Defects: It's Time Arizona*, 38 ARIZ. L. REV. 373, 378 (1996); Hyatt & Rhoads, *supra* note 12, at 970).

¹⁵³ *Id.* at 8.

issues affecting the property and they decide not to disclose them.¹⁵⁴

Some states impose an authoritative rule on would-be developers and take a “no prisoners” attitude toward shoddy construction. For example, California courts have held that fraudulent concealment occurs when a developer conceals from a purchaser a material fact of the subject matter on which the transaction is based, which the developer had a duty to disclose, thus imposing an affirmative duty upon the developer to disclose to buyers information that would affect, or might affect, the value of the homes which they sought to purchase.¹⁵⁵ The courts’ rationale was that a developer’s duty hinged on the disclosure of what was, *what could be*, or *what might be*, in terms of value, safety, structural integrity, and promises made.¹⁵⁶

In Ohio, developers have been held strictly liable for fraudulent failure to make (whether directly or indirectly) statutorily required disclosures of all material circumstances or features affecting the development in a readable and understandable written statement, which may not omit or exclude any material facts or otherwise contain any untrue statements of material fact.¹⁵⁷ Ohio remedies are available to actual and prospective purchasers, and the plaintiff in such actions is not required to show damages caused by any violation of a developer’s disclosure provisions before recovering damages (calculated by a statutory formula).¹⁵⁸ Moreover, the Ohio legislature forbids a developer’s waiver or exculpatory language in a condominium declaration (i.e. “opt out”), even where such a provision is or was adopted and/or ratified by an owner’s association (insofar as such a release of liability is contrary to and in conflict with the statute and thus invalid).¹⁵⁹ This should be more commonplace and, like in California, the concept of holding a developer liable for failing (in essence) to do his “job” is one that is being embraced with more frequency in the judiciary.

B. Negligence

In some jurisdictions, purchasers or associations may have

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* (citing *Barnhouse v. City of Pinole*, 183 Cal. Rptr. 881, 884, 890 (Cal. App. 1st Dist. 1982)).

¹⁵⁶ *Id.*

¹⁵⁷ 16 OHIO JUR. 3d *Condominiums, Etc.* § 16 (2011).

¹⁵⁸ *Id.* § 19.

¹⁵⁹ *Id.*; see also, *Springer v. Koehler Bros.*, 591 N.E.2d 316 (Ohio Ct. App. 1990).

viable actions for negligence against the developer pertaining to the design or construction of real estate or to common areas within association boundaries.¹⁶⁰ To maintain a successful negligence claim in most courts, aggrieved parties have to show that there was an unsafe condition, negligently created by the developer or his agents. This is because someone who is a real estate developer is traditionally expected to exercise a certain degree of skill and expertise that is typically thought of as being common amongst those in the particular locale, who do what he does – develop land for a particular use.¹⁶¹ The fiduciary duty between a developer and an association or its members constitutes a type of special relationship that gives rise to an independent duty in tort.¹⁶² Many courts have recognized that fiduciary relationships, such as attorney-client, doctor-patient, and insurer-insured, automatically trigger independent duties of care.¹⁶³ However, cases of negligence and non-compliance with a building code do not arise from a fiduciary duty and thus, may be precluded by the economic loss rule.¹⁶⁴ This means that counsel evaluating a buyer's remedies against a developer must be aware that tort rules may push any given case in court toward either an avenue of fraud or breach of fiduciary duty on one hand, or to a breach of contract or warranty on the other.

Some states have allowed causes of action sounding in negligence where there was alleged a duty on the part of the developer, who was not the builder, to ensure that work on a condominium was completed in a workmanlike manner (as if he were the builder himself).¹⁶⁵ Courts have held that the developer was under an obligation to oversee the details of the construction and to ensure the condominium complex was built in a non-negligent manner and with quality materials.¹⁶⁶ This gives rise to a duty to supervise work or a cause of action for negligent supervision.

¹⁶⁰ Kennedy & de Haan, *supra* note 25, at 9 (citing Lynn Y. McKernan, *Strict Liability Against Homebuilders for Material Latent Defects: Its Time Arizona*, 38 ARIZ. L. REV. 373, 375, fn. 24 (1996)).

¹⁶¹ *Id.* (citing McKernan, *supra* note 160, at 375, fn. 24); *see also*, Hyatt & Rhoads, *supra* note 12, at 962.

¹⁶² *Davencourt at Pilgrim's Landing Homeowners Ass'n v. Davencourt at Pilgrim's Landing LC*, 221 P.3d 234, 247-48 (Utah 2009) (citing *Grynberg v. Agri Tech, Inc.*, 10 P.3d 1267, 1271 (Colo. 2000)).

¹⁶³ *Id.* at 247.

¹⁶⁴ *Id.*

¹⁶⁵ Kennedy & de Haan, *supra* note 29, at 10; *see also*, *Point E. Condo. Owners Ass'n v. Cedar House Ass'n*, 663 N.E.2d 343, 356-57 (Ohio Ct. App. 1995).

¹⁶⁶ Kennedy & de Haan, *supra* note 29, at 10.

General contractors have also been held to a duty to ensure that the sprinkler sub-contractor had constructed the sprinkler system in a good and workmanlike manner with quality materials, and the fact that a subcontract existed between the general contractor and the subcontractor was irrelevant to the court.¹⁶⁷ This creates the potential for a complication in the generally accepted definition of “independent contractor” vis-à-vis “employee,” whereby traditional notions of independent work can come into conflict with generally accepted legal principles relating to worker’s compensation, mechanic’s lien issues, and contractual liability. Specifically, if a particular subcontractor is regarded as an employee of the general contractor, then there is a line drawn in terms of whether or not that subcontractor could be held liable for bad work, and vice versa. As such, while not only should the developer and purchaser carefully draft their agreements with these issues in mind, so too should subcontractors and general contractors document their arrangements and scope of work and supervision, so as to avoid these complications.

In some instances, the developer does not act as the actual builder, and he instead acts as owner who contracts with a general contractor or construction manager.¹⁶⁸ This does not mean that the unit owners or association would have no recourse against the developer in this scenario. Rather, courts have increasingly recognized that the developer merely impliedly warrants that it will develop in a good and workmanlike manner, and such warranties are actionable (regardless of whether he is the one to hire the subcontractors doing the work or not).¹⁶⁹ Where a developer claims that liability for faulty work or building issues should not attach because he was not the builder, courts have found that the developer’s implied warranties require development and construction in a good and workmanlike manner with quality materials.¹⁷⁰

A Texas Court in the case of *Luker v. Arnold* aptly explained that:

[T]he developer is in a better position to prevent loss . . . Further, most purchasers do not have responsibility or experience to determine lot size . . . or deed restrictions . . . They must rely on the developer’s expertise in this area.

¹⁶⁷ *Point E. Condo*, 663 N.E.2d at 353.

¹⁶⁸ *Kennedy & de Haan*, *supra* note 29, at 10.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 11 (citing *Luker v. Arnold*, 843 S.W.2d 108, 109 (Tex. Ct. App. 1992)).

Finally the developer is more able to absorb the cost of damages associated with inferior development than the individual consumer.¹⁷¹

This acknowledgement of the relative ease within which the developer should shoulder such burdens and the difficulty for the buyer to do so, is exactly why warranties should be closely examined. If a warranty exculpates a developer from having to abide by these general responsibilities and shifts the burden unfairly, then it is indeed necessary that such language be modified.

Indeed, where the developer has obtained substantial loan or sales proceeds, he should be deemed to be in the better position to avoid property and building related issues vis-à-vis the buyers. Further, where municipal or statutory provisions do not afford consumer protections, it is incumbent upon the purchaser to fully inspect and fully document the transaction to cover all bases, including paying full attention to the warranty provisions and exclusions vis-à-vis the known property condition and inspection reports.

C. Lender Liability

Apart from a focus on the developer, what about the entity that funds his work? What happens in situations when the developer is potentially liable to a homeowners' association or to an individual unit owner, but the developer is insolvent?¹⁷² If the developer is insolvent, potential plaintiffs should be able to sue the developer's lender because lenders in many instances have the right to oversee and fund the work being done before sales take place, thus placing themselves square in the cross-hairs when work is done poorly (since often it is the case that a payout is not approved absent inspection and architect approval). Where the plaintiff can establish that the lender participated in the construction, or possessed certain specific rights of control over the project, courts have found that the lender could be liable for the plaintiff's damages.

A distant California decision, *Connor v. Great Western Savings & Loan Ass'n* illustrates that a lender may be subject to liability if it actively participates in the development of real estate.¹⁷³ Where the lender has the right to control disbursement of funds and

¹⁷¹ *Id.* (citing *Luker*, 843 S.W.2d at 117).

¹⁷² *Id.* at 32.

¹⁷³ *Id.* at 33 (citing *Connor v. Great W. Savings & Loan Ass'n*, 447 P.2d 609 (Cal. 1968)).

the right of refusal when work is non-conforming to codes or plans and specifications, then it may be found that the lender has gone far beyond its traditional role as mere financier, and instead could be found to be a joint venturer or partner with regard to the development.¹⁷⁴ The *Connor* Court was unique in its approach to the lender, and that viewpoint is one that should be expanded nationally and could easily be expanded, because nearly all mortgage and security instruments and promissory notes provide lenders with rights of control, supervision and access to the property to protect their collateral. In theory, lenders undertake a significant amount of due diligence when evaluating a loan for real estate, and where a project is funded and a developer is given large amounts of money but fails to complete the project or to use the money wisely, if the financial institution had the right and ability to oversee it, that lender should potentially be liable to the unsuspecting consumers who purchase that real estate for the simple reason that the lender is in an excellent position to impose rules that require the developer to follow both the law, and commercially reasonable construction standards that the lender can not only double-check, but can refuse to fund if inappropriate.

Similarly, when a lender forecloses on real estate that is incomplete and comes in to replace the developer and finishes a project or a unit, the lender may be held responsible under the developer or builder's standards and duties. Where a lender becomes involved in a project other than as a mere lender, the lender becomes liable for its own acts, omissions under the *Connor* standard, and any obvious and discoverable construction defects caused by the original developer or builder.¹⁷⁵ In *Chotka v. Fidelco Growth*, a lender foreclosed on property that had been substantially completed by the developer, excepting recreational areas and lobbies.¹⁷⁶ In *Chotka*, the lender also undertook to complete some individual units, and later certain unit owners sued for acts and omissions related to the construction.¹⁷⁷ The lender denied knowledge of the defects at the time of foreclosure and denied that it was liable as a developer of the project.¹⁷⁸ Looking beyond the characterization of the lender as a mere financier, the court reasoned that the defendant became more than a lender when it took title to the project by virtue of the

¹⁷⁴ *Id.* at 33-34; *Connor*, 447 P.2d at 616.

¹⁷⁵ Kennedy & de Haan, *supra* note 29, at 35; *see also*, *Chotka v. Fidelco Growth*, 383 So. 2d 1169 (Fla. Dist. Ct. App. 1980).

¹⁷⁶ Kennedy & de Haan, *supra* note 29, at 35.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

foreclosure and finished the outstanding work left to be done by the original developer.¹⁷⁹

As in *Chotka*, where a lender takes title to a project, completes construction, holds itself out as developer and owner, and markets and sells units, it steps into the shoes of the developer and is liable in the same manner as the original developer.¹⁸⁰ Therefore, buyers must be wary of projects with lender involvement. Due diligence, including public record and title searches that include collateral assignments and documents evidencing a lender's ownership and/or right to manage the property can often times signal that the developer had problems, which may not be too far from the surface. Where a developer could not adequately fund construction to completion such that a lender was forced to take over, one should be extra weary of the state of the union in real time, and not just on paper.

VI. VACANT REAL ESTATE

Sometimes the issue in a real estate dispute is one over the purchase and/or development of vacant land, which is very common in condominium purchases and sales. The Interstate Land Sales Full Disclosure Act applies to property for sale or lease, including condominium properties, conveyed through interstate commerce that is divided and/or is proposed to be divided for the purpose of sale or lease as part of a common promotional plan.¹⁸¹ Omitting many variables that are required in traditional causes of action, a claim under this act does not require a wronged plaintiff to prove reliance, or the defendant's fraudulent intent. Instead, the claimant must establish material omission or misrepresentation (even innocent or unintentional) by the developer. This statute, however, applies only to unimproved lots, and it is not intended to apply to a parcel of land that is already developed or improved.¹⁸² The statute usually applies to claims made by purchasers claiming they were induced to buy land as a result of false promises and misrepresentations.¹⁸³ Since this

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at 36; *see also*, *McKnight v. Bd. of Dirs.*, 512 N.E.2d 316, 319 (Ohio 1987).

¹⁸¹ Interstate Land Sales Full Disclosure Act, 15 U.S.C. 1701 (1968).

¹⁸² *Id.* §1403(a)(2).

¹⁸³ *Kennedy & de Haan*, *supra* note 29, at 21-22. (citing *Beauford v. Helmsley*, 740 F. Supp. 201, 209 (S.D.N.Y. 1990); *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53 (S.D.N.Y. 1977); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 320 (S.D.N.Y. 1977).

scenario is often experienced by out of state claimants and those who invest a substantial sum in furtherance of lofty property goals, utilization of the Act is a definite go-to tool in any legal arsenal, when eyeing possible causes of action against developer wrongdoing.

VII. AFFIRMATIVE DEFENSES COMMONLY ASSERTED BY DEVELOPERS

No trip into the land of developer lawsuits would be complete without at least a cursory mention of the defenses that could be asserted by a developer. It is important to note that although it may be obvious, even where a developer has breached his duty to a purchaser, where an appropriate and applicable defense is asserted, the developer may escape full liability to a plaintiff-purchaser. Surprisingly, some courts often allow affirmative defenses held by the developer when posed with questions about developer liability for acts and omissions during their control over real estate. In *Raintree Homeowners' Ass'n. v. The Dreyfus Interstate Development Corp.*, the Minnesota appellate court granted summary judgment in favor of the developer, relying on three affirmative defenses: lack of notice, statute of limitations and laches.¹⁸⁴

In that case, the developer Dreyfus undertook to build 336 condominiums.¹⁸⁵ The declarations provided that the developer would remit payment to the association for all undeveloped units.¹⁸⁶ The association was responsible to annually calculate each owner's assessment and send written notice of the amount due.¹⁸⁷ In addition, unpaid assessments were to be automatically treated as liens upon the property.¹⁸⁸ After building only 172 units, the developer sent notice to the association.¹⁸⁹ Nineteen years later, after the lapse of all notices regarding the assessments for subsequent years, the association brought suit against the developer for the unpaid yearly assessments, alleging breach of contract and breach of fiduciary duty, and seeking declaratory relief and damages for the unpaid assessments, interest and legal fees.¹⁹⁰

¹⁸⁴ *Raintree Homeowners' Ass'n v. Dreyfus Interstate Dev. Corp.*, No. C3-00-2202, 2001 WL 712019 (Minn. Ct. App. June 26, 2001).

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 1.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

The Court concluded that the developer's failure to be notified for nineteen years after the initial notice was an acceptable affirmative defense.¹⁹¹ As its foundation for denying relief in the years where no notice was mailed, the Court cited to the declaration that required annual notice of all assessments.¹⁹² Finding that the developer was essentially denied due process and an opportunity to be heard, notice was deemed to be a prerequisite to an assessment where provisions in the declaration required it.¹⁹³ Additionally, the Minnesota court relied upon the state's condominium act, which provided a three-year period in which to collect assessments.¹⁹⁴ The court further relied on laches for the proposition that an unreasonable delay and prejudice would befall the developer, because the association could have reasonably prevented the accumulation of damages.¹⁹⁵ Concluding that those three defenses were sufficient to bar all claims, the court declined to further analyze additional defenses, and it upheld the trial court's grant of summary judgment.¹⁹⁶

The availability of these defenses provides an association an impetus to (1) communicate clearly on the issue of outstanding fees, assessments, and financial matters, (2) conduct an annual accounting of condominium fiscal operations, and (3) timely collect whatever sums might be deemed unpaid by the board of managers. Additionally, where it can be established that the association or an individual purchaser had a concurrent obligation to avoid the harm or was in a position to do so, the developer's liability may be abrogated. Any time a claim is thought viable as against a developer or perceived "responsible party," these and other potential defenses should be evaluated.

VIII. RESTATEMENT VIEW

As compared to many jurisdictions and mentioned *supra*, the Restatement view on the topic of developers and fiduciary duties is more restrictive. "Specifically, under the Restatement (Third) of Property, the developer should not be held to the higher standard of a trustee, but rather should be viewed more as a corporate promoter."¹⁹⁷

¹⁹¹ *Id.* at 1-2.

¹⁹² *Id.*

¹⁹³ *Id.* at 2.

¹⁹⁴ *Id.* (citing MINN. STAT. § 515A.3-115(d)(2000)).

¹⁹⁵ *Id.* at 2.

¹⁹⁶ *Id.*

¹⁹⁷ See generally, McConnell, *supra* note 92, at 418.

Under this view, treating the developer and its appointee to the board as trustees overstates the fiduciary component of the relationship.¹⁹⁸ The developer cannot be expected to act solely in the interests of the association and the homeowners.¹⁹⁹ Conflicts of interest are inherent in the developer's role while it retains control over the association.²⁰⁰ The Restatement goes into a lengthy listing of the duties that exist, a number of which are specifically related to maintaining common area property.²⁰¹

What may be questionable about the Restatement view, is that it accepts the conflict of interest, yet makes no mention of any disclosure requirements that developer should be required to make regarding the conflict. For example, obligations to tend to common areas may conflict with the developer's own bottom line. It is not clear in many developer-condo cases where the line is or should be drawn when it comes to this type of typical conflict. The Restatement offers little in the way of bridging this gap.

The Restatement also provides that one of the developer's duties is to enforce the condominium governing documents (i.e. the declaration and by-laws, if adopted), including design controls.²⁰² While the duty only appears to extend until turnover to the owners' association, different opinions exist as to what extent the developer's participation in the management of the association (or lack thereof), can be cured post-turnover.²⁰³

Fiduciary duties, such as above, should have application or extension past the turnover mark. One option is to outline the developer's duty contractually, by inserting language in the contract or addenda outlining repair, maintenance or financial obligations. However, because this can be less uniformly applied if left to the purchaser's counsel, state condominium or community association laws should outline timelines and obligations for developers. These obligations could include: minimum disclosure requirements; completion of necessary capital improvements before conveyance; the creation and enforcement of permitting and inspection guidelines; and the requirement of financial participation in the association by the developer both during and after turnover, especially where

¹⁹⁸ McConnell, *supra* note 92, at 419.

¹⁹⁹ *Id.* (citing RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.20 cmt. a (Tentative Draft No. 7, 1988)).

²⁰⁰ *Id.* at 419.

²⁰¹ *Id.* at 420.

²⁰² *Id.* at 418 (citing RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.20 cmt. a (Tentative Draft No. 7, 1998)).

²⁰³ *Id.*

developer-owned units are still unsold.

The Restatement does accept at least a limited fiduciary duty – whereby because of the developer’s control of an association, he should be bound to exercise and provide limited protection of the association and its members.²⁰⁴ This is certainly an area where the Restatement could use expansion and clarification in light of dangerously common trends. If a developer is not required to manage and have oversight of interests not his own, then likely is the scenario that mismanagement becomes the rule, rather than the exception. Only where there is a requirement of such oversight and management is the developer more likely to participate, engage and honor his obligations to finish what was started by his own “declaration.”

Despite this gap in the law, the developers are not solely to blame. Municipal authorities, nationwide, have failed to recognize that purchasers are not in any position to navigate municipal and legal waters when it comes to purchasing real estate, especially condominiums. The state of the law of condominiums and developer obligations is ripe for change.

IX. THE UNIFORM COMMON INTEREST COMMUNITY ACT

“Originally enacted in 1982, the Uniform Law Commission (“ULC”) initially promulgated the original version of the Uniform Common Interest Ownership Act (the “UCIOA”), which was created as a uniform system encompassing several older ULC acts, including the Uniform Condominium Act, the Uniform Planned Community Act and the Model Real Estate Cooperative Act.”²⁰⁵ “The UCIOA is a comprehensive act that governs the formation, management and termination of common interest communities, whether or not the community is a condominium, planned community or real estate cooperative.”²⁰⁶ The ULC promulgated various amendments in both 2004 and in 2008, addressing various issues. Those changes included: declarant responsibility for large and non-residential projects, easing the process for “opting in” to the act, issues surrounding association empowerment to deal with rented units, clarifying standards of care applicable to association directors, as well as rules to deal with association enforcement of building and aesthetic standards, the

²⁰⁴ Davencourt at Pilgrim’s Landing Homeowners Ass’n v. Davencourt at Pilgrim’s Landing, LC, 221 P.2d 234, 246 (Utah 2009).

²⁰⁵ Uniform Law Commission, *Common Interest Ownership Act Summary*, NCCUSL.ORG, <http://uniformlaws.org/ActSummary.aspx?title=Common%20Interest%20Ownership%20Act> (last visited Nov. 19, 2011).

²⁰⁶ *Id.*

treatment of association by-laws, rulemaking, operation and governance, increased flexibility in amending association instruments, and flexibility in enforcement of unit-owner obligations. Amendments also covered an association's record keeping requirements, and expanded liability for a declarant's false statements within public offering statements or financial disclosures, among other things.²⁰⁷

"Along with the 2008 amendments, a new "bill of rights" was drafted that draws together a number of provisions to provide significant rights to unit owners that could be enacted in conjunction with the main Act or as a stand-alone law."²⁰⁸ Surprisingly, although an excellent "discussion," the UCIOA appears to be adopted in a mere three states: Vermont, Connecticut and Delaware, with recent introduction in Mississippi as of 2011.²⁰⁹ As such, additional research is needed to see if there are gaps in the UCIOA covered by other acts, or the Restatement, or if the UCIOA can be viewed as a truly uniform system that should be more closely examined by a larger portion of the country. Nevertheless, the UCIOA's drafters were diligent in fashioning a widely applicable standard for condominium creation and governance, and in so doing, were possibly successful in crafting some solutions to these issues.

X. CONCLUSION

Over the last decade, state legislatures and jurists are identifying and recognizing fiduciary duty issues vis-à-vis real estate developers, which is a significant improvement over prior decades. However, there is much more work needed to obtain a "uniform" system or approach to these issues. In light of the Restatement and other competing judicial viewpoints, it should be incumbent upon the bench and the bar to create authority that would help shape the law in this area.

In jurisdictions that do recognize a fiduciary duty, which is an independent duty of care, courts should also recognize that any tort claims brought under the duty fall outside the scope of the economic loss rule.²¹⁰ This would create a good separation in the courts between cases that can be brought along a straight-line fiduciary duty

²⁰⁷ *Id.*

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ Davencourt at Pilgrim's Landing Homeowners Ass'n v. Davencourt at Pilgrim's Landing, LC, 221 P.2d 234, 247 (Utah 2009) (citing Hermansen v. Tasulis, 48 P.3d 235 (Utah 2002)).

claim and those that must stay within traditional contract principles. Without bright-line rules or tests in fiduciary duty claims, parties and courts alike will be required as before, to meander their way through the court system trying to outline and narrow issues, in hopes that the law will refine itself over time.

Because the Restatement viewpoint is outdated and antagonistic to actual factual scenarios that are landing in court, the old methods of solving condominium-developer-purchaser disputes should not fall to the "usual" risk-shifting analysis that ultimately requires that buyers shoulder more, and the developer less. Instead, the parties in control of the funds, permits, and municipal checklists should be forced to disclose problems, repair defects, sell condominium developments that are financially viable, and to follow the rules. Anything less is a recipe for disaster.

Finally, stricter disclosure and recordation requirements put in place before a condominium declaration is drafted, such as California's mandate for developer-vendors to publish and draft documents that are government cross-checked and offered as "pre-sale" memoranda would go a long way toward avoidance of building condition and failure-to-disclose issues. If the powers that be were to couple these changes with a stricter requirement of oversight by title companies that close these transactions, then there would be no doubt that purchasers, lenders, developers and all of those engaged in some aspect of real estate work, would all be held to an attainable higher standard.

Where savvy buyers and those less inclined to perform adequate due diligence are given access to information that the developer is required to deliver, then both sides can be held to their losses in the event a project does not go as planned. Conversely, where municipalities do not require inspections or where they fail to take action in the pre-closing phase in order to ensure inspections and building conditions are on par, then the buyer should not be forced to shoulder the financial burdens of repair and maintenance. More certainty in the state or municipal requirements of condominium developers as to timelines, financial contributions, permits, inspections and deliverables to purchasers would result in a more informed public, better-qualified participants in the real estate developer game, and less traffic in the courthouses nationwide.

Although there is certainly more ground to cover in the area of condominium law, states and local municipal authorities can do more. There are many states that do not typically use legal counsel in real estate transactions, and it is accepted that parties need to be more sophisticated and advised.

Although reference points such as the Restatement and the UCIOA are available for road mapping various issues, absent more states enacting uniform rules for the creation and administration of condominium property, the law may remain unbalanced on a nationwide scale. Ultimately, however, where consumers are informed and advised, and condominium developers are monitored and forced to put their toes and dollars closer to the line than before, nearly all parties in the condominium purchase process will be flying on a higher plane. In the current economy, this transparency could be nothing but a positive step in the right direction.