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Conditional provisions of real estate contract are exempt from the Interstate Land Sales Full Disclosure Act

by Thomas Holt

In *Atteberry v. Maumelle Co.*, 60 F.3d 415 (8th Cir. 1995), the Eighth Circuit held that a sales contract which provided that the seller would construct a home on the buyer's lot upon the approval of architectural plans in addition to providing evidence of construction financing was exempt from the Interstate Land Sales Full Disclosure Act ("ILSFDA"). The court further held that the conditions of the sales contract were not created with fraudulent intent as required for the application of the ILSFDA.

Contracts contingent upon approval of plans

Maumelle Co. ("Maumelle") was involved in a real estate development plan in which it sold lots in Maumelle, Ark. with the intention of constructing homes on the land. Upon purchasing the land, numerous individuals signed contracts which stated that within 180 days of the purchase, the purchaser agreed to provide the seller with detailed plans of a home which satisfied the architectural requirements of the subdivision. The purchaser was to also provide evidence of adequate construction financing. Financing consisted of the cost of the lot and home construction plus a 10 percent surcharge. Subsequent to the purchaser

providing satisfactory plans and financing, the seller agreed to construct the home within two years from the date of the contract.

The purchasers, a class of approximately 2,000 property owners, claimed that Maumelle sold the real estate pursuant to a promotional plan which involved fraudulent misrepresentations. The class of purchasers filed a complaint in the United States District Court for the Eastern District of Arkansas alleging that each was induced into purchasing the property based on false promises and that Maumelle also failed to provide a property report at the time the contract was signed, both in violation of the ILSFDA. The class also claimed to have suffered intentional infliction of emotional distress. Furthermore, the purchasers alleged that Maumelle was liable for breach of contract because it failed to complete the promised improvements.

Maumelle moved for summary judgment arguing that the ILSFDA was precluded from application in this situation based on section 1702(a)(2). This exemption states that the ILSFDA is inapplicable to the sale of land under a contract obligating the seller to construct a building within two years. Under each contract in question, Maumelle was conditionally obligated to build homes within two years of the contract formation.

Granting Maumelle summary judgment, the district court held that the conditions in the building provision were reasonable steps in the construction process. Furthermore, the provisions were sufficient to satisfy the exemption of section 1702(a)(2).

The purchasers appealed, contending that the building provisions in the contract were insufficient for purposes of section 1702(a)(2) for two reasons: 1) Maumelle included the provision in the contract for the purpose of avoiding the ILSFDA; and 2) the provision failed to unconditionally obligate Maumelle to construct the homes within the two year period as required in the statutory exemption.

Contractual obligations need not be unconditional to fall within statutory exemption

The purchasers argued on appeal that the building provision in the sales contract created conditional obligations that eliminated the applicability of the section 1702(a)(2) exemption. The Department of Justice, as amicus curiae, supported the purchasers' position, relying extensively on guidelines issued by the Department of Housing and Urban Development in 1979. The guidelines provided that the contract must specifically

obligate the seller to complete construction of the building within a two-year period. In determining if the seller has a contractual obligation, the guidelines follow general principles of contract law. These principles state that performance cannot be based entirely on the seller's discretion, because contracts of this nature fail to create a true obligation on behalf of the seller. If the obligation is not fulfilled, nonperformance must be based on circumstances beyond the reasonable control of the seller.

The Eighth Circuit concluded that although the guidelines state the seller's obligation to construct must be specific, an unconditional element was not mentioned. Therefore, the provision for proof of purchaser financing was determined by the contracting parties and the statutory exemption was not defeated.

Court applies objective standard of evaluation with regard to statutory exemption

The purchasers argued that the approval of the architectural plans was at the discretion of the seller and failed to create a specific obligation. The building provision stated that the buyer must submit architectural plans which conform to the requirements of the subdivision.

Although the seller had the authority to make this determination, the contract created an objective standard of evaluation.

The issue before the court was whether nonperformance of the seller was at the full discretion of the seller. Based on Arkansas law, parties have a duty to make a reasonable effort to perform and accept reasonable terms to satisfy the conditions of a contract. The court held that the building provision could not be regarded as an opportunity for Maumelle to evade its contractual obligation. Because Maumelle's performance was contingent upon the specific performance of the purchaser, a binding obligation was created. Therefore, the conditions of the contract were reasonable steps in the construction process and did not infringe upon the rights of the purchaser. The court concluded that the contract satisfied the section 1702(a)(2) exemption.

Court finds no evidence of fraudulent intent

The purchasers also argued that even if the building provision did satisfy the section 1702(a)(2) exemption, the court erred by failing to conclude that Maumelle created the provision for the purpose of eluding the ILSFDA. Section 1702(a)(2) states, in part, that the

exception should apply, "unless the method of disposition is adopted for the purpose of evasion of this chapter." The court narrowly construed the statutory language and confined its use to exceptions created with fraudulent intent. Therefore, the purchasers had to establish that at the time the contract was created, Maumelle had no intention of fulfilling its obligation to construct the homes.

One Maumelle salesman testified that he was able to obtain a better value for the property by selling it under an exception to the ILSFDA, but this testimony failed to establish Maumelle fraudulently evaded the ILSFDA. The testimony of Maumelle's employees and real estate purchasers indicated that Maumelle failed to build any houses but was willing to work closely with property owners in planning houses and obtaining bids for their construction. The testimony also failed to demonstrate fraudulent intent. The evidence offered by witnesses failed to prove that Maumelle refused or discouraged the construction of homes on the lots. Therefore, the purchasers failed to establish that there was a genuine issue of fraudulent intent.

In conclusion, the Eighth Circuit held that the real estate contracts were exempt from the ILSFDA, thus affirming the judgment of the district court in favor of Maumelle.