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SALE OF CONDOMINIUM UNITS COVERED BY DISCLOSURE REQUIREMENTS OF INTERSTATE LAND SALES FULL DISCLOSURE ACT

In *N & C Properties v. Pritchard*, 525 So. 2d 1346 (Ala. 1988), cert. denied, — U.S. —, 109 S. Ct. 146 (1988), the Supreme Court of Alabama considered whether the sale of condominium units is covered by the Interstate Land Sales Full Disclosure Act, (“ILSFDA” or “the Act”), 15 U.S.C. §§ 1701-1720 (1982 & Supp. IV 1986). The court determined that the Act does apply to condominium unit sales. Furthermore, the court held that the exemptions from the disclosure provisions of the Act claimed by the appellant developers were unavailable.

Background

Charles Pritchard, Alton Foster, and Donald and Kathy Johnson (“buyers”) purchased condominium units in a project called East Pass Towers in Florida. The buyers entered into pre-construction purchase agreements with N & C Properties (“N & C”), and for security, they deposited three letters of credit with N & C, each with a value of approximately \$30,000. Although the buyers later tried to enjoin the funding of the letters of credit, the letters eventually were funded.

The buyers sued N & C, Chancellor Land Company, Inc., and Neda, Inc. (“developers”) in the Circuit Court of Lauderdale County pursuant to the ILSFDA for failing to provide the disclosure documents required under § 1703 of the Act. That section makes it unlawful for a developer to sell or to lease any non-exempt lot without providing the buyer with a printed prospectus or property report. The same provision of the Act requires that the prospectus disclose specific information regarding the developer and the development project, including a description of the land, the names and addresses of all owners and promoters, the range of selling prices, disclosure of any encumbrances or easements, and any other relevant information. Disclosure of this information is mandated to ensure that the buyer is fully informed and to prevent fraud in the sale of subdivided real estate. It was undisputed that no printed prospectus was provided to the buyers.

Both the buyers and the developers moved for summary judgment. The buyers claimed they should have received a prospectus, and the developers contended that sales of condominium

units were not covered by the ILSFDA. The trial court granted the buyers’ motion, and entered a final judgment in their favor. The court rescinded the purchase agreements and awarded the buyers the amount paid as earnest money as well as attorneys’ fees.

On appeal, the developers presented two principal arguments. First, they argued that the ILSFDA does not apply to the sale of condominium units. Second, they argued that even if the Act does apply to those sales, the offering in question was for fewer than 100 units and therefore was exempt under § 1702(b)(1) of the Act. The Supreme Court of Alabama rejected both arguments and affirmed the circuit court’s decision.

The Opinion of the Supreme Court of Alabama

Because the Act requires that a prospectus be provided when any non-exempt lot is sold or leased, the court first had to determine whether in fact a condominium unit is a “lot” under the ILSFDA. In making that determination, the court relied heavily on the decision of the United States Court of Appeals for the Eleventh Circuit in *Winter v. Hollingsworth Properties*, 777 F.2d 1444 (11th Cir. 1985). Similarly presented with the issue of the applicability of the ILSFDA to condominium sales, the court in *Winter* held that condominium units were lots under the ILSFDA.

The *Winter* court recognized that the Act is similar to the Securities Act of 1933 in requiring disclosure as a means of preventing investor or consumer fraud. In *Winter*, the court noted that although “lot” is not defined in the Act, and although the Act may have been geared in large part toward the sale of raw land, Congress did in fact make the Act applicable to all lots, and exempted only certain forms of improved land. The *Winter* court also noted that the Secretary of Housing and Urban Development had stated that application of the ILSFDA to condominium sales was consistent with Congressional intent and the statutory scheme. Moreover, during rule-making, the Secretary had defined “lot” as “any portion, piece, division, unit, or undivided interest in land . . .” 777 F.2d at 1447, quoting 24 C.F.R. § 1710.1 (1985). The *Winter* court thus considered it clear that the term “lot” covers condominium units.

Accepting this reasoning, the Supreme Court of Alabama also held that condominium units are lots under the Act. The court stated that the Act specifically exempts from the disclosure requirement the sale or lease of improved land on which a condominium building exists or on

which one must be built within two years; such a specific exemption would be redundant if the Act did not as a general matter apply to condominium sale or lease.

The court also rejected the developers' second contention, that even if the ILSFDA did apply to the sale of condominium units the offering was exempt under § 1702(b)(1) of the Act. That section exempts from the disclosure provisions any offering of fewer than 100 lots. The East Pass Towers development was to be offered in two phases, I and II. The buyers purchased in Phase I, which contained 55 units. Phase II was to contain 46 units. The developers contended that because Phase II was never formally offered for sale, and because no condominium documents covering Phase II had been drafted, construction of Phase II was optional and unrelated to Phase I. The developers concluded that the offering was for 55 units and therefore exempt.

The buyers argued that the two phases were part of a common promotional plan. If so, the development contained 101 units and was covered by the Act. The court agreed, and concluded that the development of Phase II was presumed to be part of a common plan with Phase I. In reaching its decision, the court relied upon the Act's definitions of "offer," "subdivision," and "common promotional plan" as applied to the facts of the case.

The buyer pointed to sworn testimony that the role of Neda, Inc., was to advertise and sell units in both Phases, and that the project was presented by the developers as a dual phase project consisting of two adjoining towers and containing over 100 units. Furthermore, there was testimony to the effect that the president of Chancellor Land Company, Inc., told the Johnsons that they could trade their Phase I unit for a nicer unit in Phase II when it was completed. Finally, a prospectus prepared by the developers

(but not given to the buyers before sale) gave the general impression that, although the developers had reserved the right to build Phase II at their discretion, the ultimate form of East Pass Towers would be a twin tower development.

The court cited *Grove Towers v. Lopez*, 467 So.2d 358 (Fla. 3d Dist. Ct. App. 1984), cert. denied, 480 So. 2d 1294 (Fla. 1985), for the proposition that an option not to build all of a planned development is an insufficient basis for a claim of an exemption from the Act's disclosure requirements. Next, the court noted that § 1701(11) of the Act defines "offer" as any inducement, solicitation, or attempt to encourage an individual to acquire a lot in a subdivision, and that § 1701(3) defines "subdivision" as land divided into lots for the purpose of sale or lease as part of a common promotional plan. Section 1701(4) defines "common promotional plan" as any plan in which land is known or advertised by a common name, regardless of the number of lots included in any offering.

In light of *Grove Towers*, the statutory definitions, and the developers' representations, the court held that Phases I and II could not be separated. The offering thus was not exempt from coverage under the Act. Accordingly, the developers unlawfully sold the units when they did so without providing a prospectus to each buyer prior to execution of the sales agreements.

Finally, the developers argued that the buyers intended to resell the units, thereby exempting the developers from the Act's disclosure requirements under § 1702(a)(7) of the Act. The court rejected this contention because the developers had produced no evidence of such intent on the buyers' part, and the regulations covering exemptions under the Act require the developer who wishes to claim an exemption to maintain records showing the exemption's prerequisites are satisfied. 24 C.F.R. § 1710.4(d) (1988).

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