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Applying ILSA to Sales of Condominium Units


Todd E. Soloway and Luisa K. Hagemeier

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As if the past three years weren't hard enough for New York real estate developers, adding insult to injury, courts in the Southern and Eastern districts of New York have held that pre-construction sales of condominium units fall within the ambit of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. 1701 et seq. (ILSA), a statute that was intended to apply only to sales of unimproved land. As a result, under certain circumstances, buyers were given an automatic right to rescind their purchase agreements within two years of signing if a developer had not complied with ILSA's disclosure requirements. Although ILSA has both disclosure requirements and anti-fraud provisions, it is the strict-liability disclosure scheme that has been exploited by condominium purchasers in New York, none of whom has even alleged fraud or injury of any kind.

Prior to the most recent real estate crash, ILSA, which was enacted in 1968, had never been used to this effect in New York.[1] However, after the bottom fell out of the New York real estate market and the ILSA-condominium connection hit the radar screen, purchasers who had contracted to pay pre-crash prices for units that no longer seemed to be worth as much lined up in droves to rescind. One commentator tallied over 40 reported state and federal cases of buyers seeking to rescind under ILSA in the first six months of 2009 alone,[2] and a quick survey suggests that about a quarter of these were in the Southern and Eastern districts of New York.[3]

Based on a convergence of factors—the last of the boom-time pre-construction contracts by the end of 2008; ILSA's two-year statute of limitations for giving notice of rescission; and developers' compliance in the wake of their rude awakening to ILSA—we have probably seen most, if not all, of the "buyer's remorse" ILSA-condominium rescission cases in New York. Nevertheless, the affected community—condominium developers and attorneys who represent them—should not necessarily accede to what the authors believe to be the mistaken overextension of this federal regulatory scheme to the already highly-regulated field of condominium development.

Policy and Intended Scope

ILSA's express purpose is to protect purchasers from false and deceptive practices by unscrupulous sellers of out-of-state parcels of subdivided land marketed for development, often as an investment or as the site of a

future retirement home, that actually turns out to be under water or suitable only for grazing.[4] Such buyers would close on the deal and either receive a deed or enter into an installment contract for the deed, only to later inspect the land, find it uninhabitable or unsuitable for development, but be time-barred from seeking a remedy.[5]

Modeled on the Securities Act of 1933, ILSA requires developers who employ interstate commerce or the mails to sell or lease "lots" in "subdivisions" to register the property with HUD, the agency (with the Office of Interstate Land Sales Registration (OILSR)) administering ILSA, and to disclose specified information deemed necessary for potential buyers.[6]

ILSA's principal disclosure devices are the "statement of record" to be filed with HUD and the printed "property report" to be provided to the buyer or lessee in advance of signing the purchase agreement or lease. Unless the seller has done both, a purchaser of a non-exempt "lot" may be entitled to rescind the purchase agreement within two years of signing.[7]

By its terms, ILSA applies to "lots" (other than those that are exempt pursuant to §1702) in "subdivisions" offered for sale or lease by a developer or agent, making use of interstate commerce or the mails, pursuant to a "common promotional plan." Although the term "lot" is not expressly defined—which has proven to be the root of the problem for condominium units—the clear intent and predominant language of the statute relate only to unimproved land, and nowhere contemplate or signal application of the statute to anything else. However, the absence from ILSA of a specific definition of the term "lot" was taken by courts as an invitation for interpretation that has, apparently, gone awry.

A "Lot" Is Only Raw Land

ILSA's language, requirements and legislative histories should have led to the conclusion that a "lot" is only raw land. Indeed, HUD's own website instructs that "[t]he Interstate Land Sales program protects consumers from fraud and abuse in the sale of *land*."[8]

Express language in the statute makes this clear. A "subdivision," for instance, is defined as "any *land* which is located in any State or in a foreign country and is divided or is proposed to be divided into lots, whether contiguous or not, for the purpose of sale or lease as part of a common promotional plan to offer lots for sale."[9] A "common promotional plan" is "a plan, undertaken by a single developer or a group of developers acting in concert, to offer *lots* for sale or lease; where *such land* is offered for sale by such developer or group of developers acting in concert, and such land is contiguous or is known, designated, or advertised as a common unit or by a common name."[10] Among "lots" that may qualify for exemption from ILSA are "improved land"; "cemetery lots"; "lots in a subdivision in which each of the lots is at least twenty acres"; lots "situated on a paved street or highway" to which at the time of closing "potable water, sanitary sewage disposal, and electricity have been extended"; and lots on which "a mobile home is to be erected or placed…as a residence."[11] In each case, it would be impossible to interpret the word "lot" as anything other than "land," and the exemption regarding mobile homes is especially instructive in this regard, defining "lot" as a "home site" distinguishable from the "home" that will be built or placed upon it.[12]

Furthermore, the kinds of information required to be disclosed in the "statement of record" to be filed with HUD reinforce the conclusion that a "lot" is land and not, for instance, a condominium unit which is necessarily a structure. Among other things, the statement of record must contain a legal description of the lots covered (including a statement of topography), of their relation to existing streets and roads, of the present condition of access to the subdivision, of the availability of sewage disposal facilities and other public utilities, and of the proximity of the subdivision in miles to the nearest municipalities.[13]

If a developer intends to sell or lease additional lots with lots already registered, it must file a consolidated statement of record unless the additional lots are "simply the result of a replatting of lots previously registered

and enumerated in the Property Report and do not include any additional *land*."[14] Certainly, if "lots" was meant to encompass more than land, the word "lots" would have been used here, since there is no conceivable reason why a consolidated statement of record should be required if a developer adds land, but not additional condominium units (e.g., by adding floors to a building).

Similarly, the majority of information required to be disclosed in the property report to be provided to potential purchasers could not relate to anything but land. In addition to the information from the statement of record, the property report must disclose, among other things: (i) "Risks of Buying *Land*" (including that changes in plant and animal life may affect purchasers' use and enjoyment of and ability to sell the lots);[15] (ii) "Title to the Property and *Land* Use" (including disclosures regarding *oil, gas and mineral rights* and easements (such as drainage easements) that will encroach upon *building area of the lot*);[16] (iii) "Roads" (including disclosures regarding private or public road access to the subdivision, *whether "legal and physical access by conventional automobile [have] been or will…be, provided to the lots*, and "how many lanes do the *interior roads* have?");[17] and "Subdivision Characteristics and Climate" (including disclosures regarding *topography, water coverage of any lots, drainage and fill, flooding and erosion* and climate)."[18]

If ILSA's language does not make the point plainly enough—which we believe it does—its legislative history should dispel any doubt. The House Report accompanying the original enactment states that the statute's purpose is "to deter or prohibit the sale of land by use of the mails or other channels of interstate commerce through misrepresentation of material facts relating to the property."[19] In connection with amendments to ILSA in 1979, the House Report noted that:

Purchasers living in the same state where the *land* was located or living out of state were persuaded to buy *land* that they had never seen by sophisticated sales forces promising that the *land* (which might be under water or suitable only for grazing purposes) was a good investment, *suitable for homesites* and easily resellable.[20]

Forcefully making the point that ILSA was not intended to apply to condominium units, at the same time as Congress was considering amendments to ILSA in 1979, it considered a bill for the Condominium Act of 1979, which was unsuccessful, and on which the same House Report relating to the ILSA amendments states that:

The Committee (Banking, Finance and Urban Affairs) conducted hearings on H.R. 2792, the Condominium Act of 1979 in response to the request of many members of Congress and reports of a significant number of consumer problems and developer abuses with respect to condominium development and conversions…. The Committee believes that states and local governments now perceive the need to enact appropriate safeguards and are taking steps to solve these problems. Accordingly, it does not, at this time, see an overwhelming need for establishing national minimum standards of disclosure and protection.[21]

If Congress intended and believed that ILSA applied to sales of condominium units, the House Report would have said something like, "ILSA already addresses these concerns." Instead, well aware that problems of the type addressed by ILSA in the context of land might also exist with respect to condominiums, Congress demonstrated its belief and intent that ILSA relates only to land sales by (i) rejecting the bill to federalize condominium development and (ii) failing to reference condominiums in the 1979 amendments to ILSA.

Courts Go the Other Way

It momentarily looked as though courts would interpret the statute accordingly. In 1984, in one of the first federal court decisions on the issue, the District Court for the Southern District of Florida in *Winter v. Hollingsworth* held that condominium units were not "lots" subject to ILSA.[22] In support of that holding, the court cited the reasons discussed above, and also the addition of the word "condominium" to ILSA in 1978 only to exempt already improved land from the statute's scope, and not elsewhere.[23] The court furthermore refused to defer to or credit a 1972 Advisory Opinion by the OISLR disagreeing that "the concepts and characteristics of a lot and a condominium unit are [not] mutually exclusive and that, therefore, a 'unit' in a condominium cannot be

considered a 'lot.'"[24] The court found that interpretation "absurd" and "inconsistent" with the statute's language and purpose, reasoning that:

[i]t is impossible to think of a [twenty] acre condominium, or of the exemption of a condominium unit if a mobile home will be placed thereon. Under OILSR's interpretation, a seller would have to answer questions regarding zoning or surveying a condominium unit. To define the term "lot" as including a "condominium unit" would be clearly inconsistent with the language and purpose of the Act.[25]

However, the U.S. Court of Appeals for the Eleventh Circuit reversed.[26] Differing 180 degrees from the District Court, the Court of Appeals found that ILSA's use of the term "lots" instead of just "land" and the legislative history's employment of the words "land" and "real estate" interchangeably, signified that Congress meant ILSA to cover more than just land.[27] According "great deference" to agency interpretations of the statute, it found that the definition of "lot" in the implementing regulations also supported reaching beyond land.[28] Furthermore, contrary to the District Court, the Court of Appeals found OISLR's Advisory Opinion persuasive and consistent with the statute, as it also did agency commentary regarding the inclusion of condominium units in the definition of "lots" that:

[t]he application of the Act to condominiums has been consistent OILSR [Office of Interstate Land Sales Registration] policy since the issue was first raised in 1969. The bases for this position are that condominiums carry the indicia of and in fact are real estate, whether or not the units therein have been constructed. A condominium is accordingly viewed by OILSR as equivalent to a subdivision, each unit being a lot…the right to condominium space is a form of ownership, not a structural description [and thus a condominium is not the equivalent of a house, to which ILSA is not applicable].[29]

Courts in the Southern and Eastern districts of New York have adopted *Winter* wholesale,[30] and one of the most recent decisions, *Indomenico v. 123 Washington*, warrants particular discussion.[31]

The defendant argued that ILSA was clear on its face, using the word "land" in the definition of "subdivision," which necessitated the reading of the word "lot" and "land" interchangeably as a physical area on the earth's surface, not covered by water. On a policy level, the defendant contended that applying ILSA to condominiums would overlap and potentially conflict with the requirements of applicable New York law.

After expressly acknowledging that ILSA was "originally concerned with the development of raw undeveloped land," the court rejected the defendant's arguments, embarking on an extensive discourse on various dictionary meanings of the word "land," and rejecting the notion that congressional intent could not be inferred based on conflicts with state law, which was trumped by federal law, in any event, under the Supremacy Clause.[32]

Then, the court concluded that condominium units are "lots" subject to ILSA, basing its decision almost entirely on the "determinations" of HUD and the OILSR: HUD's definition of "lot" in the implementing regulations, and the court's finding that "[a] condominium purchase agreement does give the owner exclusive use of a specific portion of the unit"; OILSR's 1972 Advisory Opinion disagreeing with the notion that a "unit" cannot be considered a "lot"; and HUD's "interpretive guidelines" providing that a "lot" means "any portion, piece, division, unit or undivided interest in land if such interest includes the right to the exclusive use of a specific potion of the land or unit.

This applies to the sale of a condominium or cooperative unit or a campsite as well as a traditional lot."[33] The court conceded that these "determinations" were not entitled to "*Chevron* deference" requiring the court's acceptance so long as reasonable, but nevertheless found them worthy of "*Skidmore/Christensen* deference" entitling them to "respect" to the extent they have the "power to persuade."[34]

How or why the agency interpretations are persuasive, however, neither the *Indomenico* court, nor any other,

has ever really said.

Current State of the Law

The jurisprudence has developed in the wrong direction as a matter of both statutory construction and policy. Of course it is true that the meaning of the term "lot" would have been clearer if Congress had defined it specifically, but the language of ILSA is nonetheless facially plain enough to obviate the need for interpretation, either by agencies or the courts. The statute employs the word "land" and concepts that could relate only to land, and which would be extremely difficult, bordering on impossible (as the *Winter* District Court observed, in much harsher terms) if applied to structures or mere "interests" in real estate. At the same time, there is no textual basis in ILSA supporting the conclusion that a condominium unit falls within the meaning of "lot."

Looking outside the statute at all was thus an unnecessary reach, and then, when courts did so, it seems as if the most important factor was overlooked: Congress' expressed intentions in the legislative history.[35] It certainly seems incongruous for the *Indomenico* court to recognize that ILSA was "originally concerned with the development of raw undeveloped land," only to hold that it also applies to condominium units despite the absence of any basis for concluding that Congress' "original concern" has changed.

The House Reports accompanying ILSA's original enactment and 1979 amendments leave no room for doubt that the statute was intended to apply only to sales of raw land, marketed as suitable for "homesites," a term actually used synonymously with land in the statute's exemption for lots on which mobile homes are to be placed.[36] Furthermore, Congress' explicit rejection in 1979 of a federal statute regulating the sales of condominiums, together with its failure at that time to state that ILSA already covered that territory or to include specific references to condominium units in its amendments to ILSA that year, seems rather decisive proof of its understanding of and intent for ILSA's scope. The conclusion that a "lot" includes a condominium unit cannot be reconciled with Congress' intent.

Conclusion

The misinterpretation of the term "lot" in ILSA that has proliferated in this era of hyper-federalized regulation does not appear to withstand scrutiny, and the courts and Congress would do well to right the course. Otherwise, condominium developers should prepare to add ILSA compliance permanently to their already heavy burdens in the highly-regulated condominium market.

Todd E. Soloway *is a partner and* **Luisa K. Hagemeier** *is of counsel at Pryor Cashman.*

Endnotes:

1. A single decision in 1990, *Beauford v. Helmsley*, 740 F. Supp. 201, 209-10 (S.D.N.Y. 1990), cited the view of HUD, two district courts and one state court outside of New York that condominium units were encompassed in the term "lot," but that question was ultimately moot, as the court held that the units were exempt from ILSA anyway.

2. See R.C. Linquanti, "A Brief Survey of Continuing Issues With the Interstate Land Sales Full Disclosure Act: Will the Fat Lady Never Sing?" 23 Probate & Property 46 (ABA November/December 2009).

3. See, e.g., *Pasquino v. Lev Parkview Developers, LLC*, 09 Civ. 4255 (S.D.N.Y); *Sanz v. Myrtle Owner, LLC*, 09 Civ. 3809 (E.D.N.Y.); *Griffith v. Steiner Williamsburg, LLC* (S.D.N.Y.); *Nu-Chan, LLC v. 20 Pine St. LLC*, 09 Civ. 00477 (S.D.N.Y.); *Bacolitsas v. 86 & 3rd Owner, LLC*, 09 Civ. 7158 (S.D.N.Y); *An v. Leviev Fulton Club, LLC*, 09 Civ. 1937 (S.D.N.Y.); *Gregori v. 90 William St. Dev. Group LLC*, 09 Civ. 4753 (S.D.N.Y.); *Smith v. Myrtle Owner, LLC*, 09 Civ. 1655 (E.D.N.Y.); *Cruz v. Leviev Fulton Club, LLC*, 09 Civ. 6982 (S.D.N.Y.); *Romero v. Borden E. River Realty LLC*, 09 Civ. 665 (E.D.N.Y.); *Bodansky v. Fifth on the Park*

Condo, LLC, 09 Civ. 4651 (S.D.N.Y.).

4. See H.R. Rep. No. 1785 (Conf. Rep.), 90th Cong., 2d Sess., reprinted in 1968 U.S. Cong. Code & Admin. News, vol. 2, at 3066 (statute's purpose is "to deter or prohibit the sale of land by use of the mails or other channels of interstate commerce through misrepresentation of material facts relating to the property"), cited in *Bodansky v. Fifth on the Park Condo, LLC*, 635 F.3d 75, 80 (2d Cir. 2011).

5. See R. Coffey & J. Welch, Federal Regulation of Land Sales: Full Disclosure Comes Down to Earth, 21 Case W. Res. L. Rev. 5, 6 (1969-70) ("The testimony laid bare an industry, ambitious and adolescent, actively engaged in marketing raw and semideveloped land to the 'sunset set'. …Untold thousands were being flimflammed into purchasing parcels which could not be inhabited without serious threat of death from either thirst or drowning"), cited in Bodansky, 635 F.3d at 79.

6. 15 U.S.C. §1701 et seq. Id. §1703(c); see also 24 C.F.R. §1710.3, id. §§1710.100 et seq.

7. Id. §1703(c); see also 24 C.F.R. §1710.3, id. §§1710.100 et seq.

8. See www.hud.gov/sec10.cfm (emphasis added).

9. 15 U.S.C. §1701(3) (emphasis added).

10. Id. §1701(4) (emphasis added).

11. Id. §§1702(a)(2) and (a)(6), 1702(b)(3), (b)(5)(B)(i) and (C), and (b)(6).

12. Id. §1702(b)(6).

13. Id.§1705

14. See 24 C.F.R. §1710.22(b)(1)-(2) (emphasis added).

15. Id. §1710.107 (emphasis added).

16. Id. §1710.109 (emphasis added).

17. Id. §1710.110 (emphasis added).

18. Id. §1710.115 (emphasis added).

19. H.R. Rep. No. 1785 (Conf. Rep.), reprinted in 1968 U.S. Cong. Code & Admin. News, vol. 2, at 3066.

20. H.R. Rep. No. 96-154, at 30-31, U.S. Code Cong. & Admin. News 1979, at 2317, 2346 (emphasis added), quoted in (among others) *Winter v. Hollingsworth*, 587 F. Supp. 1289, 1291-92 (S.D. Fla. 1984), rev'd, 777 F.2d 1444 (11th Cir. 1985).

21. H.R. Rep. No. 96-154 (to accompany 3875), at 28-20, U.S. Code Cong. & Admin. News 1979, at 2344-45, quoted in *Winter*, 587 F. Supp. at 1292-93.

22. See *Winter*, 587 F. Supp. at 1291.

23. See id. at 1292.

24. See id. at 1291, 1294-95.

25. Id. at 1295, citing 24 C.F.R. §1710(b) and OILSR Exemption Advisory Opinion No. 1710.1(k), at 5 (Aug. 20, 1972).

26. 777 F.2d 1444 (11th Cir. 1985). Less than a handful of cases appear to have confronted the issue prior to *Winter*. See *Schatz v. Jockey Club Phase III Ltd.*, 604 F. Supp. 537 (S.D. Fla. 1985) and *Nargiz v. Henlopen Devs.*, 380 A.2d 1361 (Del. 1977).

27. See id. at 1447

28. See id. at 1448.

29. Id., quoting 38 Fed. Reg. 23,866 (1973).

30. See, e.g., *Pasquino v. Lev Parkview Developers, LLC*, No. 09 Civ. 4255, 2011 U.S. Dist. LEXIS 112460 (S.D.N.Y. Sept. 29, 2011); *An v. Leviev Fulton Club, LLC*, No. 09 CV 1937, 2010 U.S. Dist. LEXIS 83795, at *3 (S.D.N.Y. Aug. 10, 2010); *Nu-Chan LLC v. 20 Pine*, No. 09 Civ. 00477, 2010 U.S. Dist. LEXIS 103541 (S.D.N.Y. Sept. 30, 2010) (seeing no need to engage in analysis and "disturb trend" finding "lot" to encompass condominium unit).

31. No. 10 Civ. 7886, 2011 U.S. Dist. LEXIS 94820 (S.D.N.Y. Aug. 24, 2011).

32. See id. at **18-21.

33. See id. at **13-14, citing and quoting 24 C.F.R. §1710.1(b); OISLR Exemption Advisory Opinion No. 1710.1(k), at 5 (Aug. 20, 1972); 61 Fed Reg. 13602.

34. See id. at *16.

35. The Eleventh Circuit in *Winter* acknowledged, but then dismissed the relevance of, Congress' 1979 rejection of the need for a federal statute regulating condominium sales. See *Winter*, 777 F.2d at 1449 n.13.

36. H.R. Rep. 96-154, at 30-31; 15 U.S.C. §1702(b)(6).