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THE INTERSTATE LAND SALES FULL DISCLOSURE ACT: ITS REQUIREMENTS, CONSEQUENCES, AND IMPLICATIONS FOR PERSONS PARTICIPATING IN REAL ESTATE DEVELOPMENT†

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I. INTRODUCTION

The Interstate Land Sales Full Disclosure Act, (ILSFDA),¹ was passed by Congress as Title XIV of the Housing and Urban Development Act of 1968 and became effective on April 28, 1969.² The ILSFDA contains provisions for the prevention of fraud and misrepresentation in interstate land sales. The Secretary of the Department of Housing and Urban Development ("HUD") has authority and responsibility for administration of the ILSFDA.³ In turn, the Secretary has delegated most of his authority and responsibility to the Interstate Land Sales Administrator, who heads the Office of Interstate Land Sales Registration (OILSR).⁴ OILSR, thus, has primary responsibility for the administration of the ILSFDA and must determine whether it applies to any given "person". For purposes of the statute, "person" includes an individual,

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¹ 15 U.S.C. §§ 1701-20 (1976 & Supp. V 1981).

² Title XIV of the Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (codified as amended at 15 U.S.C. §§ 1701-20 (1976 & Supp. V 1981)).

³ 15 U.S.C. § 1715(a) (1976 & Supp. V 1981); 24 C.F.R. § 1700.5 (1982). (The Secretary of HUD shall hereinafter be referred to as the "Secretary.")

⁴ 24 C.F.R. §§ 1700.10-.20 (1982). (The Interstate Land Sales Administrator is hereinafter referred to as the "Administrator.") The OILSR has been divided into several divisions; *see id.* § 1700.25 (1982). For a description of the authority and function of each division, *see id.* § 1700.80 (1982) (Examination Division); *id.* § 1700.85 (1982) (Land Sales Enforcement Division); *id.* § 1700.90 (1982) (Policy Development and Control Division); *id.* § 1700.91 (1982) (Field Review Division).

an unincorporated organization, a partnership, an association, a corporation, a trust or an estate.⁵ In general, persons affected by the ILSFDA can be classified into three groups: 1) those subject to the ILSFDA; 2) those subject to the ILSFDA but exempt from certain requirements; and 3) those who are not subject to the ILSFDA.

Although the classification of persons may appear to be relatively straightforward, the process, in fact, is often quite unclear. Ambiguity in classification and characterization of persons is of concern to everyone involved in real estate development because of the serious implications of the ILSFDA. It is the goal of this article to clarify these implications by examining the purpose, requirements and consequences of the ILSFDA. In particular, this article will examine the following aspects of the ILSFDA: (1) its purpose and background; (2) the general requirements for compliance; (3) the conditions for asserting violations; (4) its scope of liability; (5) its procedural aspects; and (6) its implications for persons participating in real estate development.

II. PURPOSE AND BACKGROUND OF THE ILSFDA

As originally enacted, the ILSFDA emphasized disclosure and registration of real estate development plans and purchase conditions.⁶ Major amendments enacted in December of 1979 brought a shift in emphasis away from the extensive paperwork of disclosure and registration towards increased anti-fraud protection, consumer rights, and enforcement against serious sales abuses by developers.⁷ The purpose of disclosure under the ILSFDA 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."⁸ As enacted, the ILSFDA was supposed to protect real estate purchasers and lessees by requiring the preparation of both a "Statement of Record" and a "Property Report" in order to disclose important information about the property and proposed improvements.⁹ The Statement of Record and Property Report are filed with HUD through OILSR, but only the Property Report is delivered to prospective purchasers or lessees.¹⁰ Through the registration and disclosure requirements, consumers are allegedly less likely to fall prey to "get rich quick promoters" because of the availability of better information.¹¹

⁵ 15 U.S.C. § 1701 (1976); 24 C.F.R. § 1710.1 (1982).

⁶ See generally DEPT. OF HOUSING AND URBAN DEVELOPMENT, OILSR *Biennial Rep. To Congress*, 3-4 (March 1981).

⁷ *Id.* at 3-4.

⁸ CONF. REP. NO. 1785, 90th Cong., 2d Sess. 161 (1968), reprinted in 1968 U.S. CODE CONG. & AD. NEWS 3053, 3066.

⁹ 15 U.S.C. § 1703(a), (b) (1976 & Supp. V 1982); see also *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778 (1976) (recognizing that the purpose of the ILSFDA is to prevent false and deceptive practices in the sale of land by requiring developers to disclose information needed by potential purchasers).

¹⁰ 15 U.S.C. § 1703(a) (1976 & Supp. V 1981).

¹¹ See *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 250 (6th Cir. 1980).

The ILSFDA's general disclosure and anti-fraud provisions are based on similar provisions of the Securities Act of 1933 and the Security Exchange Act of 1934.¹² In general, the ILSFDA has been given a liberal or expansive interpretation, similar to the approach under the Securities Laws.¹³ Despite its liberal judicial interpretations, the ILSFDA was not effective in its early years. The ILSFDA remained ineffective due to lack of experienced administrative personnel, a reliance on voluntary compliance, uninformed or misinformed members of the legal profession, and unaware consumers who either did not receive or did not read information disclosed in the Property Report.¹⁴ In order to remedy perceived weakness in the original provisions, the 1979 amendments added provisions for increased damages and enforcement.¹⁵ In addition, the 1979 amendments established new contractual rights for private enforcement¹⁶ and lowered the threshold for application of the anti-fraud provisions to subdivisions with 25 or more lots from the previous threshold of 100 or more lots.¹⁷

The 1979 amendments also sought to reduce paper work and compliance costs to developers by providing for state certification procedures that eliminate the need for duplicate registrations with state agencies as well as with OILSR.¹⁸ The ILSFDA permits states requiring substantially similar standards for land sales and development to implement state registration requirements that can serve as the federal registration of the Statement of Record and Property Report.¹⁹ Two states with major land sales and development industries have been certified under the ILSFDA's provisions: California on January 6, 1981 and Florida on January 18, 1982.²⁰ The provisions for state

¹² *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778 (1976). See also *Hester v. Hidden Valley Lakes Inc.*, 495 F. Supp. 48, 53 (N.D. Miss. 1980), *United States v. Del Rio Springs, Inc.*, 392 F. Supp. 226, 227-28 (D. Ariz. 1975) (addressing the similarity of purpose and approach of the ILSFDA and the securities laws).

¹³ See, e.g., *De Luz Ranchos Inv., Ltd. v. Coldwell Bank & Co.*, 608 F.2d 1297, 1302 (9th Cir. 1979); *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1975). See also *Cumberland Capital Corp. v. Harris*, 621 F.2d 246 (6th Cir. 1980).

¹⁴ See *Biennial Rep. To Congress*, *supra* note 6, at 3; see also Walsh, *The Role of the Federal Government In Land Development Sales*, 47 NOTRE DAME LAW. 267, 267 (1971).

¹⁵ 15 U.S.C. §§ 1702, 1709 (Supp. V 1981). See generally *Biennial Rep. To Congress*, *supra* note 6, at 4.

¹⁶ Pub. L. No. 96-153, title IV, §§ 403, 405, 93 Stat. 1127, 1130 (1979) (now codified at 15 U.S.C. §§ 1703(a)(2)(d), (d) (Supp. V 1981)).

¹⁷ Pub. L. No. 96-153, title IV, § 402, 93 Stat. 1123 (1979) (now codified at 15 U.S.C. § 1702(a)(1) (Supp. V 1981). Subdivision 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." 15 U.S.C. § 1701(3) (1976 & Supp. V 1981).

¹⁸ See *Biennial Rep. To Congress*, *supra* note 6, at 25. (In the *Report*, survey evidence indicated that the cost of filing prior to 1979 was between \$7,500 and \$25,000. A later survey suggested a cost reduction of as much as 34% due to simplification under the 1979 amendments to the ILSFDA.)

¹⁹ 15 U.S.C. § 1708 (Supp. V 1981).

²⁰ *Biennial Rep. To Congress*, *supra* note 6, at 21 (Information on California is in the report. For the Florida agreement, see the Agreement Between the State of Florida and the

certification eliminate wasteful duplication by allowing a state required registration to serve as the federal registration rather than requiring two separate registrations. Registration under a certified state plan does not exempt a person from the other provisions of the ILSFDA.²¹

In an effort to keep the ILSFDA responsive to changing real estate development practices, the 1979 amendments included a requirement that the Secretary prepare and submit a report to Congress on March 1, 1981, and biennially thereafter.²² The 1981 report showed only seventeen industry (real estate developer) complaints during 1980 and most of these concerned exemption qualifications rather than any particular actions taken by HUD or OILSR.²³ On the other hand, formal consumer complaints (lot purchasers or lessees) for the period January 1979 to November 1980 numbered 1,802.²⁴

A brief review of the consumer complaints received by OILSR showed that they were based on the following: failure to provide facilities and utilities as promised (33.3%); sales abuses (22.7%); problems with title, deeds, or restrictions (24.4%); failure to deliver a property report, as required (8.7%); use of false or misleading advertising (6.4%); and other matters (4.5%).²⁵ An analysis of the complaints showed that the number of complaints dramatically increased with the size of the subdivision.²⁶ On a state by state basis complaints were evaluated by total number and by the number attributable to in-state purchasers as opposed to out-of-state purchasers.²⁷ Surprisingly the states with the most complaints were from all regions of the country and included; Texas (371), Virginia (87), Illinois (86), New York (84), Florida (83), Indiana (77), Maryland (74) and North Carolina (72) and only North Dakota and Wyoming had no complaints.²⁸

United States Department of Housing and Urban Development (January 18, 1982) (obtainable from the Florida Department of Business Regulation).

²¹ The ILSFDA applies unless there is an exemption from coverage. There is no provision for exemption merely because of compliance with a filing requirement of a certified state. Thus, registration with a certified state does not mean that one is exempt from the other provisions of the ILSFDA.

²² Pub. L. No. 96-153, title IV, § 409, 93 Stat. 1132 (1979) (now codified at 15 U.S.C. § 1719(a)(Supp. V 1981)).

²³ *Biennial Rep. To Congress*, *supra* note 6, at 5.

²⁴ *Id.* at 6.

²⁵ *Id.* at 9 (contract remedies under 15 U.S.C. § 1703(2)(d) are intended to reduce complaints for failure to complete improvements by giving purchasers contractual rights against the seller).

²⁶ *Id.* at 12.

²⁷ *Id.* at 13-14.

²⁸ *Id.* (Alabama (22), Alaska (4), Arizona (32), Arkansas (23), California (43), Colorado (27), Connecticut (15), Delaware (6), District of Columbia (10), Georgia (29), Hawaii (3), Idaho (2), Iowa (7), Kansas (15), Kentucky (19), Louisiana (48), Maine (1), Massachusetts (19), Michigan (29), Minnesota (5), Mississippi (11), Missouri (68), Montana (2), Nebraska (16), Nevada (5), New Hampshire (3), New Jersey (52), New Mexico (36), Ohio (66), Oklahoma (25), Oregon (12), Pennsylvania (60), Rhode Island (8), South Carolina (17), South Dakota (1), Tennessee (45), Utah (10), Vermont (3), Washington (18), West Virginia (10), Wisconsin (17), Foreign (24)).

The Secretary's 1981 report to Congress revealed that OILSR could determine the age of sales contracts in less than half of the consumer complaints and that 70% of the contracts were 3 or more years old with an average age of 5 years old.²⁹ The age of the contract is important because of the 3 year statute of limitation provided in the ILSFDA.³⁰ OILSR believed a major reason for the delay in consumer complaints reaching it was the use of the installment sales contract.³¹ Under the installment sales contract the purchaser is generally not entitled to possession or title to the property until a number of years after he starts making regular payments. With delivery of title and possession delayed, purchasers often remain unaware of problems effecting their property until substantial time has passed.

OILSR tries to resolve as many complaints as possible. The following statistics, which show how 819 complaints were resolved from January of 1978 to November of 1980, indicate OILSR's success: refunds obtained (13.3%); specific performance and other pre-trial settlements (14.4%); no final resolution pending bankruptcy proceedings (14.7%); strong factual dispute with recommendation that the consumer pursue private action (9.9%); unsatisfied, no jurisdiction primarily as result of running of the statute of limitations (19.5%).³²

III. GENERAL REQUIREMENTS OF THE ILSFDA

The general requirements of the ILSFDA involve, (A) application, (B) disclosure requirements and (C) anti-fraud provisions.

A. Application Of The ILSFDA

The ILSFDA prohibits, with certain exceptions, the sale or lease by developers of lots in a subdivision, by use of any means or instruments of transportation or communication in interstate commerce, or of the mails, unless a Statement of Record is in effect.³³ In understanding the application of the prohibition of the ILSFDA, consideration should be made of its component parts and of related enforcement concepts. For example, a showing of minimal use of the mails or telephone has been held sufficient to subject a person to federal jurisdiction under the prohibition "... by use of any means or instruments of transportation or communication in interstate commerce, or of

²⁹ *Id.* at 6-7.

³⁰ See 15 U.S.C. § 1711 (Supp. V 1981).

³¹ *Biennial Rep. To Congress*, *supra* note 6, at 8. Provisions to discourage the use of installment sales contracts by exempting from extended revocation and refund requirements transactions where deeds are delivered within 180 days of signing of a purchase contract are found in 15 U.S.C. § 1703 (Supp. V 1981).

³² *Id.* at 16-19 (28.2% were open or unresolved at the time of the survey).

³³ 15 U.S.C. § 1703(a) (1976 & Supp. V 1981). See also 24 C.F.R. § 1710.3 (1982). Definitions of the terms used in the ILSFDA appear in 24 C.F.R. § 1710.1 (1982).

the mails."³⁴ Other activities which have been deemed sufficient for purposes of federal jurisdiction under the ILSFDA include advertising in newspapers with at least minimal interstate distribution,³⁵ telephone listings in the local directory indicating use of the telephone system in conducting business,³⁶ and sales figures indicating as little as 1.5% of sales to out-of-state purchasers.³⁷

Furthermore, in determining whether the ILSFDA applies, the OILSR will look closely at transactions in which a real estate development is marketed in phases, where phase one is sold intrastate and later phases are sold interstate.³⁸ This marketing strategy can be used in large land developments where the goal is to saturate the local market before using more expensive interstate marketing. Such an approach can be cost effective from a marketing viewpoint and, if it can remove the intrastate phase from the application of the ILSFDA, it can save additional time and money in compliance costs.

On the other hand, a developer seeking to develop a project in phases must be aware of the concept of a "common promotional plan." Under the concept of a common promotional plan OILSR can look at the intent or marketing strategy of a developer to disregard the separate phases of a development even when separate corporate entities are used for construction and sale of the separate phases or when the phases are treated as separate subdivisions.³⁹ If OILSR disregards the separation of the phased development strategy, then it should be able to bring all lots in all phases within the ILSFDA. Such reasoning indicates that a developer, marketing later interstate phases, may find himself liable for violations of the ILSFDA pertaining to lots sold in an earlier intrastate phase. In essence the later interstate sales can "infect" or "taint" earlier intrastate sales requiring the entire development, as part of a common promotional plan, to be brought within the ILSFDA. The same reasoning indicates that a developer with separate land development projects in noncontig-

³⁴ See, e.g., *United States v. Goldberg*, 527 F.2d 165, 171 (2d Cir. 1975), *cert. denied*, 425 U.S. 971 (1976) (referring to use of interstate highways); *Commodore Properties v. Hills*, 417 F. Supp. 1388, 1390 (D. Neb. 1976) (this case gives analogy to securities laws). See also Walsh, *supra* note 14, at 270-71.

³⁵ *Commodore Properties v. Hills*, 417 F. Supp. 1388, 1390 (D. Neb. 1976).

³⁶ *Id.*

³⁷ *Happy Investment Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 181-82 (N.D. Cal. 1975); *Wiggins v. Lynn*, 406 F. Supp. 338, 345 (E.D. Tex. 1975). See also Walsh, *supra* note 14, at 269 (noting that the OILSR takes the position that a ratio of out of state sales in excess of several percent raises a presumption that the development is interstate and subject to the ILSFDA). At the time of his article Mr. Walsh was a realty specialist for OILSR and his comments were made on behalf of the OILSR.

³⁸ See Walsh, *supra* note 14, at 269.

³⁹ *Id.* 15 U.S.C. § 1701(4) (Supp. V 1981) defines "common promotional plan" as "a plan, undertaken by a single developer or group of developers acting in concert, to offer lots for sale or lease; where such land is offered for sale by such a 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, such land shall be presumed, without regard to the number of lots covered by each individual offering, as being offered for sale or lease as part of a common promotional plan." 15 U.S.C. § 1701(4) (Supp. V 1981).

uous geographical locations could have his seemingly separate ventures treated as one, in accordance with the ILSFDA's common promotional plan, if he promoted and sold lots for each through a common service or sales network.

Another requirement for the application of the ILSFDA is that there be a sale or lease of a non-exempt lot in a transaction covered by the ILSFDA.⁴⁰ The meaning of "sale" has been questioned in the context of the running of the statute of limitations. In that context, "sale" has been interpreted to include the event of signing a contract for sale or the delivery of a deed as a separate sale.⁴¹ In the case of an installment sale contract, the courts have reasoned that a "sale" can continue as an "incomplete sale" until the whole purchase price is paid.⁴² Treating delivery of a deed as a separate sale disregards the doctrine of merger.⁴³ This means that acceptance of the deed will not be construed as acceptance by the purchaser, of all the terms and conditions of the sale. The anti-merger position was adopted by OILSR in recognition of the fact that certain of the ILSFDA's consumer protection provisions would be easily avoided if limited to the executory contract period.⁴⁴

The meaning of "Lot" has been raised with respect to the application of the ILSFDA to condominium units. The response has been to treat condominium units as within the meaning of lot as used in the ILSFDA.⁴⁵ By applying the ILSFDA to condominium units, an important potential issue arises for the growing popularity of interval ownership or time sharing units. Though no court has decided the issue, it would seem that time sharing units, like condominiums, should be treated as lots under the ILSFDA. In time sharing developments, apartment units are sold or leased in weekly ownership intervals. If each time share interval is considered a separate lot, a small building can quickly become a significant subdivision. Time share development projects are similar to condominiums in legal documentation, sharing of common elements and general operation and appearance, with the exception that the

⁴⁰ See 15 U.S.C. § 1703(a) (1976 & Supp. V 1981); 24 C.F.R. § 1710.3 (1982). The anti-fraud provisions, 15 U.S.C. § 1703(a)(2) (1976 & Supp. V 1981), also apply to offers to sell or lease.

⁴¹ See *Gaudet v. Woodlake Development Co.*, 413 F. Supp. 486, 488-89 (E.D. La. 1976).

⁴² See *Husted v. Amrep Corp.*, 429 F. Supp. 298, 307 (S.D.N.Y. 1977). *Contra* *Fogel v. Sellamerica, Ltd.*, 455 F. Supp. 1269, 1275 (S.D.N.Y. 1978). See also 24 C.F.R. § 1715.3 (1982) (Current rules and regulations speak in terms of "the date of signing the contract").

⁴³ See *Gaudet v. Woodlake Development Co.*, 399 F. Supp. 1005, 1007 (E.D. La. 1975); *Bettis v. Lakeland Inc.*, 402 F. Supp. 1300, 1302 (E.D. Tenn. 1975); see also *Walsh, supra* note 14 at 276-77 (noting that OILSR has always rejected the doctrine of merger and taken the position that no purchaser's rights are lost by mere delivery of the deed).

⁴⁴ See *Walsh, supra* note 14, at 276-77. (The doctrine of merger, if recognized, could diminish a purchaser's two year right to revoke under 24 C.F.R. § 1715.3 (1982) if the contract of sale and delivery of the deed occurred within a short period of time.)

⁴⁵ See, e.g., *Narqiz v. Henlopen Developers*, 380 A.2d 1361, 1363-64 (Del. 1977); see also *Walsh, supra* note 14, at 27. The discussion on condominium and time share units relates primarily to sales made prior to completion of all the promised improvements in the development.

units are sold or leased in terms of given time periods rather than as a continuous right to possession and occupation. Consequently, potential purchasers would need the same type of protection in a time share development as they need in a condominium development. In fact, given the high overhead and speculative nature of time share developments, consumers of such developments may need even more protection than condominium buyers. As a result of the multiplication factor in time share developments, developers can quickly exceed minimum lot requirements for certain exemptions under the ILSFDA. For consumers, the multiplication factor is significant because evidence of reported abuses increases dramatically in correlation with the increase in the size of a development.⁴⁶

If an initial review reveals that a person or real estate development may be subject to the ILSFDA it is important to determine if an appropriate exemption exists. The ILSFDA provides for certain exemptions some of which are self-activating and rely on voluntary compliance and others which require action by the Secretary.⁴⁷ Exemptions apply to qualified persons as long as the method of qualification is not adopted for the purpose of evading the requirements of the ILSFDA.⁴⁸ If qualification for an exemption is in doubt, a person may obtain an "advisory opinion" or "no action letter" from the OILSR.⁴⁹ An important consideration for a person who is determining whether he is covered by an exemption is the distinct possibility that a dispute at a later date with an unsatisfied purchaser or lessee may focus on the validity of the claimed exemption. In such a hindsight situation, an unfavorable administrative or judicial determination could result in extensive liability to the developer and parties associated with him.

Distinct threshold requirements are established for exemptions from the application of the ILSFDA corresponding to its distinct, yet complimentary, goals of providing consumer disclosure and preventing fraud.⁵⁰ The disclosure provisions are aimed at larger developers and numerous exemptions are provided in order to reduce paper work where certain criteria are met.⁵¹ On the other hand, the anti-fraud provisions apply to small as well as large developers and exemptions are much more limited.⁵² A policy of narrowly construing the

⁴⁶ See *Biennial Rep. To Congress*, *supra* note 6, at 12.

⁴⁷ 15 U.S.C. § 1702 (1976 & Supp. V 1981); 24 C.F.R. § 1710.4(d) (1982). See also *Wiggins v. Lynn*, 406 F. Supp. 338, 344-45 (E.D. Tex. 1975); *Happy Investment Group v. Lakeworld Property Inc.*, 396 F. Supp. 175, 186-87 (N.D. Cal 1975).

⁴⁸ 15 U.S.C. § 1702 (1976 & Supp. V 1981); 24 C.F.R. § 1710.4(a) (1982).

⁴⁹ 24 C.F.R. § 1710.17 (1982) (advisory opinions); *id.* § 1710.18 (1982) (no action letters). Advisory opinions and no action letters are of questionable value since they seem to be non-binding. (Refer to section V part (B) of this article for further discussion on this point.)

⁵⁰ See 15 U.S.C. § 1702 (1976 & Supp. V 1981).

⁵¹ 24 C.F.R. §§ 1710.4, 1710.5 (1982). (This 25 lot threshold is contrasted with the 100 lot threshold under 24 C.F.R. § 1710.6 (1982).)

⁵² Compare 15 U.S.C. § 1702(a) with § 1702(b) (Supp. V 1981). See also 24 C.F.R. §§ 1710.4(b), 1710.5 (1982).

exemptions has developed as part of a judicially liberal construction that gives the ILSFDA a broad application.⁵³ This policy of liberal interpretation and broad coverage combined with the somewhat complex conditions for exemption has been challenged as making the ILSFDA unconstitutionally vague but at least one court has ruled in favor of its constitutionality.⁵⁴

A matter that is certain is that the ILSFDA should be analyzed carefully before proceeding with any multiple sales or leases of real estate lots. The ILSFDA has broad application to real estate transactions and the basis for federal jurisdiction is liberally construed. Even a careful analysis can become a complicated and risky endeavor when attempts are made to determine if and when an appropriate exemption from the ILSFDA will be available to a person or real estate development.

B. *Disclosure Requirements Of The ILSFDA*

The ILSFDA requires disclosure through the preparation and dissemination of a Statement of Record and Property Report.⁵⁵ Both the Statement of Record and Property Report must be prepared and filed by the developer or seller with the OILSR, but only the Property Report must be delivered to prospective purchasers. The Property Report must be delivered at or before the signing of a contract of sale or lease and the purchaser must be notified of his right to revoke the contract, exercisable until at least midnight of the seventh day following its execution.⁵⁶ It has been held that mere recital in the sales contract that the purchaser has received the Property Report prior to execution is not sufficient evidence of delivery and inquiry may be made into the facts surrounding the transaction.⁵⁷ Late, incomplete, or substituted delivery of the Property Report or the information to be contained in it are also not sufficient for compliance with the ILSFDA.⁵⁸ Furthermore, even if a purchaser is experienced in business and sophisticated in real estate transactions, he must receive a property report at or before execution of the contract.⁵⁹ There can be

⁵³ See, e.g., *De Luz Ranchos Inv., Ltd. v. Coldwell Banker & Co.*, 608 F.2d 1297, 1302 (9th Cir. 1979); see also *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1979). (Although not specifically addressing exemptions, the court in *McCown* did express the need for a liberal interpretation of the ILSFDA.)

⁵⁴ See *United States v. Dacus*, 634 F.2d 441, 444 (9th Cir. 1980).

⁵⁵ 15 U.S.C. § 1703 (1976 & Supp. V 1981). The regulations promulgated under the ILSFDA which prescribe the content of the disclosure documents and the filing procedures are found at 24 C.F.R. §§ 1710.20, 1710.100-219 (1982).

⁵⁶ 15 U.S.C. § 1703(a), (b) (Supp. V 1981); see also 24 C.F.R. § 1715.2 (1982). (If state law provides purchasers with a longer period of time then the longer period of time is made applicable under the federal law.)

⁵⁷ *Salter v. Vanotti*, 42 Colo. App. 448, 599 P.2d 962, 963 (1979).

⁵⁸ See, e.g., *Law v. Royal Palm Beach Colony, Inc.*, 578 F.2d 98, 100 (5th Cir. 1978); *Rockefeller v. High Sky, Inc.*, 394 F. Supp. 303, 305-06 (E.D. Pa. 1975); *Gaudet v. Woodlake Development Co.*, 399 F. Supp. 1005, 1007 (E.D. La. 1975).

⁵⁹ *Rockefeller v. High Sky Inc.*, 394 F. Supp. 303, 305 (E.D. Pa. 1975).

no substitute for the Property Report and the failure to prepare or deliver one, in a nonexempt transaction, is itself a violation of the ILSFDA.⁶⁰

The information that must be disclosed in the Statement of Record and Property Report includes detailed information about the community, environment, development plans, title, roads, financing, climate, and land use restrictions.⁶¹ The environmental disclosures do not embrace all of the data required by an Environmental Impact Statement but they do include information about soil, water, sewage, utility, drainage and zoning which are useful to consumers.⁶²

Although the Secretary may accept a Statement of Record and Property Report, which become effective within thirty days, the fact that they are effective does not mean that the content is approved, accurate, complete or endorsed by HUD.⁶³ Thus, the ILSFDA still leaves consumers with the task of investigating matters on their own prior to investing their money. The Property Report can, however, provide useful information to consumers about their proposed real estate investment and the disclosures contained in the Property Report can form the basis for legal action against the developer if the disclosures are incomplete, inaccurate or deceptive.⁶⁴ Legal action against a person can be brought by the government as well as by the aggrieved consumer.⁶⁵

OILSR encourages consumers to pursue their own remedies in court and recent changes in the ILSFDA promote such actions.⁶⁶ Examples of consumer oriented changes in the 1979 amendments include: (1) provisions for increased damages that make the value of a successful law suit more of an incentive, and (2) creation of a private contract right of action for failure to complete promised improvements to the property.⁶⁷ Furthermore, a contract purchaser or lessee can use the Property Report as the basis of a regular contract action by showing

⁶⁰ See *Cooper v. Mason*, 151 Ga. App. 793, 794-95, 261 S.E.2d 738, 739-40 (1979).

⁶¹ 24 C.F.R. §§ 1710.100-.219 (1982).

⁶² See *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 788-89 (1976) (holding that the National Environmental Policy Act, 42 U.S.C. §§ 4321-70 (1976 & Supp. IV 1981), does not require the preparation of an Environmental Impact Statement before approval of a real estate development, Property Report or Statement of Record under the ILSFDA).

⁶³ 15 U.S.C. § 1716 (1976). See also *Husted v. Amrep Corp.*, 429 F. Supp. 298, 304 (S.D.N.Y. 1977); *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 781-82 (1976). The Property Report and Statement of Record become effective within 30 days unless the Secretary notifies the applicant that the filing is incomplete. 15 U.S.C. § 1706(a), (b); 24 C.F.R. §§ 1710.20-.23 (1982).

⁶⁴ See, 15 U.S.C. § 1703(2) (1976 & Supp. V 1981).

⁶⁵ 15 U.S.C. § 1714 (1981).

⁶⁶ See *Biennial Rep. To Congress*, *supra* note 6, at 18-19.

⁶⁷ 15 U.S.C. §§ 1703, 1709(a), (c) (Supp. V 1981). *Contra Biennial Rep. To Congress*, *supra* note 6, at 26. (A private cause of action is created where the developer represents certain improvements "will be made" and they are not in fact made. One Administrative Law Judge has said that the use of the phrase "may be made" instead of "shall be made" eliminates the cause of action under the ILSFDA. Thus, wording is significant.)

that the Property Report was incorporated into the terms of the contract for sale or lease.⁶⁸

The disclosure requirements of the ILSFDA give potential purchasers or lessees information about the real estate development. The information is supposed to facilitate better informed investment decisions. Disclosure requires the filing of a Property Report and a Statement of Record with HUD and the delivery of an approved Property Report to all prospective purchasers and lessees prior to execution of a contract for sale or lease. An injured purchaser or lessee may sue a seller based on the information contained in the Property Report.

C. Anti-Fraud Provisions Of The ILSFDA

The anti-fraud provisions of the ILSFDA apply to persons subject to the ILSFDA, unless exempted,⁶⁹ and they prohibit: (1) the employing of any device, scheme or artifice to defraud; (2) obtaining money or property by means of any untrue statement or omission of a material fact; (3) engaging in any transaction, practice or course of business that operates as a fraud or deceit upon purchasers; or (4) representing that improvements will be completed by the developer without putting such representations into the terms of the contract of sale or lease.⁷⁰ The anti-fraud provisions are separate and distinct from the provisions for disclosure and Statements of Record and Property Reports.⁷¹ Fraud is complete and actionable upon the execution of a contract for sale or lease and legal action should be brought at that time or as soon thereafter as the purchaser or lessee learns of or should have learned of the fraud.⁷²

⁶⁸ *Correa v. Pecos Valley Development Corp.*, 126 Ariz. 601, 606, 617 P.2d 767, 772 (1980); *Kniffin v. Colorado Western Development Co.*, 622 P.2d 586, 590 (Colo. Ct. App. 1980).

⁶⁹ The anti-fraud exemption is different than the disclosure exemptions. For further discussion, see § III(A), *supra*.

⁷⁰ 15 U.S.C. § 1703(a)(2) (Supp. V 1981); *see also* 24 C.F.R. § 1710.4(b), (c) (1982) (fraud and exemptions); *Biennial Rep. To Congress, supra* note 6, at 3. 15 U.S.C. § 1703(a)(2) provides that it is unlawful:

(A) to employ any device, scheme, or artifice to defraud; (B) to obtain money or property by means of any untrue statement of a material fact, or any omission to state a material fact necessary in order to make the statements made (in light of the circumstances in which they were made and within the context of the overall offer and sale or lease) not misleading, with respect to any information pertinent to the lot or subdivision; (C) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon a purchaser; or (D) to represent that roads, sewer, water, gas, or electric services, or recreational amenities will be provided or completed by the developer without stipulating in the contract of sale or lease that such services or amenities will be provided or completed by the developer without stipulating in the contract of sale or lease that such services or amenities will be provided or completed.

15 U.S.C. § 1703(a)(2) (Supp. V 1981).

⁷¹ Compare 15 U.S.C. § 1703(a)(1) (Supp. V 1981) (registration and disclosure) with 15 U.S.C. § 1703(a)(2) (anti-fraud provisions); *see also* *United States v. Del Rio Springs, Inc.*, 392 F. Supp. 226, 227-28 (D. Ariz. 1975).

⁷² *See* *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1048 (S.D.N.Y. 1975).

Violations typically raised under the anti-fraud provisions of the ILSFDA include: (1) representations that septic tanks and standard sewage facilities will be installed by the developer or can be installed by the purchaser when, in fact, they are not installed by the developer and soil reports indicate that special rather than standard sewage facilities will be required;⁷³ (2) representations that the overall real estate development and appurtenant facilities have been unconditionally approved by appropriate governmental agencies and permitting authorities when, in fact, there has been no such approval or approval has been made conditional;⁷⁴ (3) representations of rapid population growth or increases in property values when, in fact, the population growth projections are based on unrealistic data and represented increases in property values are based on dissimilar properties;⁷⁵ (4) representations that wooded areas, lakes or numerous amenities are part of the real estate development when, in fact, the development is not as depicted and the woods, lakes and amenities, if in existence, are not part of the development being sold;⁷⁶ or (5) representations that services, such as a lot resale program or recreational programs will be provided when, in fact, there are no such services or programs and the developer has made no arrangement for their establishment, operation or completion.⁷⁷

To be actionable, a misrepresentation may be either written or oral and may be part of the "sales pitch" or part of the Property Report.⁷⁸ As to both omissions and misrepresentations, courts have discussed the need for reliance or materiality to the purchaser or lessee. Omissions do not require proof of reliance and are actionable on proof of materiality of the omission.⁷⁹ This is a reasonable position because one could hardly assert reliance on undisclosed information. Misrepresentations, on the other hand, have been held to require proof of reliance by the purchaser or lessee.⁸⁰ In either situation, proving

⁷³ See *Husted v. Amrep Corp.*, 429 F. Supp. 298, 312 (S.D.N.Y. 1977); *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89 (M.D. Pa. 1973).

⁷⁴ See *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1291 & n.6 (3d Cir. 1978).

⁷⁵ See *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 986 (N.D. Cal. 1978); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 303, 310 & n.8 (S.D.N.Y. 1977).

⁷⁶ See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1272 (S.D.N.Y. 1978); *Gilbert v. Woods Marketing, Inc.*, 454 F. Supp. 745, 750 (D. Minn. 1978).

⁷⁷ See *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 51 (N.D. Miss. 1980) (recreational facilities); *Melhorn v. Amrep. Corp.*, 373 F. Supp. 1378, 1379 (N.D. Pa. 1974) (resale program).

⁷⁸ See *Biennial Rep. To Congress*, *supra* note 6, at 8; see also *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 319-20 (S.D.N.Y. 1977) (implying that each of these types of misrepresentation are actionable under the ILSFDA).

⁷⁹ See *Gilbert v. Woods Marketing, Inc.*, 454 F. Supp. 745, 749 (D. Minn. 1978) (comparison to securities law issue of a material omission under Rule 10B(5)); *cf. Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 90 (M.D. Pa. 1973) (comparison to securities law § 12(2) of the Securities Act of 1933 in that an omission or misrepresentation is actionable upon proof of materiality).

⁸⁰ See *Gilbert v. Woods Marketing, Inc.*, 454 F. Supp. 745, 748-49 (D. Minn. 1978).

materiality or reliance will be similar because each is a measure of how important the information was or would have been to the purchaser or lessee.

The test for materiality considers whether a reasonable investor might have considered the omitted fact or misrepresentation to be important in making a decision.⁸¹ The case of *Hester v. Hidden Valley Lakes, Inc.*,⁸² gives examples of what the Federal District Court for the Northern District of Mississippi determined to be "material" and included the following: (1) failure to disclose that a potential bankruptcy of the developer could result in loss to a purchaser; (2) failure to identify arrangements made by the developer to assure the completion of promised amenities such as by bonding or escrows or else the disclosure that no arrangements had been made; (3) failure to fully disclose sewage treatment information, anticipated costs and percolation test results when a purchaser is required to install his own facility; and (4) failure to disclose that none of the property within the real estate development had been approved for FHA or VA financing.⁸³

Fraud, under the ILSFDA, can be a continuing violation for as long as the wrongdoing continues. In an installment sales contract the developer is obtaining money throughout the term of the contract, until the land is fully paid for, and if the contract were signed and monies paid on account of prohibited misrepresentations then the period in which violations occur could extend throughout the term of the contract.⁸⁴ Sending updated promotional newsletters and sales reports to purchasers in order to induce continued payments on their lots can also be continuations of a fraud where they serve to mislead purchasers about the true status of their investment.⁸⁵ On the other hand, mere silence on the part of a developer may not constitute a continuing violation of the anti-fraud provisions where the developer takes no additional fraudulent actions to negotiate or induce further payment from a purchaser.⁸⁶

A developer does not violate the anti-fraud provisions when he or his agent makes future promises or representations, such as promising to construct recreational facilities, if there is a present intent to perform.⁸⁷ A developer who in good faith presently intends to build amenities and makes future promises and representations about them but is subsequently unable to perform, for economic or other reasons not within his control, will not be held to have com-

⁸¹ See *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 54 (N.D. Miss. 1980); *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1109 (5th Cir. 1975).

⁸² 495 F. Supp. 48 (N.D. Miss. 1980).

⁸³ *Id.* at 51-52.

⁸⁴ See *Husted v. Amrep Corp.*, 429 F. Supp. 298, 308 (S.D.N.Y. 1977).

⁸⁵ See *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 987 (N.D. Cal. 1978).

⁸⁶ See *Hall v. Bryce's Mountain Resort, Inc.*, 379 F. Supp. 165, 170 (W.D. Va. 1974). (Although the case presents a direct challenge to the failure to deliver the appropriate disclosure documents, the Property Report, footnote 2 at 167 reveals that the omission of material information that should have been revealed in a Property Report is what gave rise to the initial conflict between the parties.)

⁸⁷ See *Solomon v. Pendaries Properties, Inc.*, 623 F.2d 602, 604 (10th Cir. 1980).

mitted fraud under the ILSFDA.⁸⁸ An aggrieved purchaser can challenge this position by submitting any proof, properly connected to the developer, which establishes the developer's intent and the manner in which the alleged fraudulent scheme was carried out.⁸⁹ Proof may include: promotional literature and correspondence; evidence of the "sales pitch" and method; copies of the contracts of sale or lease; evidence of the manner and degree to which the developer failed to perform; and a record of purchaser complaints and corresponding responses of the developer.⁹⁰ In this manner, evidence of a developer's overall conduct can reveal his intent and proof of even a reckless indifference for the truth and accuracy of his representations may be viewed as fraudulent.⁹¹

The anti-fraud provisions of the ILSFDA seek to prevent omissions or misrepresentations of material facts necessary for a purchaser or lessee to make an informed investment decision. In essence, the anti-fraud provisions try to prevent fraud, deceit and misrepresentation while giving meaning to the disclosure requirements by providing a basis for legal action when sellers or their agents use improper means to sell or lease real estate lots.

IV. ASSERTING VIOLATIONS OF THE ILSFDA

The primary focus of this section of the article is to examine how to pursue a legal action under the ILSFDA. In this respect, asserting violations of the ILSFDA involves an examination of: (A) jurisdiction — getting into the proper forum; (B) standing — being an appropriate party to assert the cause of action; and (C) maintaining class actions — using the legal process to settle numerous claims in one proceeding.

A. *Jurisdiction For Asserting Violations Of The ILSFDA*

The general principles of administrative law apply to administrative actions under the ILSFDA; therefore, prior to judicial review of an administrative action, a person must pursue his administrative remedies. Only after "final agency action" under the ILSFDA can the aggrieved person seek judicial review.⁹² If OILSR or HUD action is not final, a claim may not be

⁸⁸ *Id.* In *Solomon*, the developer made promises as to future improvements but economic recession and a depressed real estate market prevented completion. *Id.* This was not fraud or misrepresentation and evidence of the developer's actions and attempts to complete improvements were relevant as to his intent at the time the promises were made. *Id.*

⁸⁹ See *United States v. Amrep Corp.*, 560 F.2d 539, 545-46 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978); *United States v. Amrep Corp.*, 545 F.2d 797, 800 (2d Cir. 1976).

⁹⁰ See *United States v. Amrep Corp.*, 560 F.2d 539, 545-46 (2d Cir. 1977). The court also noted that a declaration as to future events which the declarant does not in fact believe may be found by a jury as fraudulent and that declarations made with a reckless indifference for the truth may be viewed as fraudulent. *Id.* at 543-44. See also *United States v. Amrep Corp.*, 545 F.2d 797, 800 (2d Cir. 1976).

⁹¹ See *Hester v. Hidden Lakes, Inc.*, 495 F. Supp. 48 (N.D. Miss. 1980).

⁹² See *Cumberland Capital Corp. v. Harris*, 490 F. Supp. 551, 555-56 *rev'd on other grounds*, 621 F.2d 246 (6th Cir. 1980).

reviewed in the courts.⁹³ There is a presumption that the ruling of the Secretary is final unless otherwise indicated on its face or an agency rule identifies such a ruling or decision as tentative and subject to further consideration.⁹⁴

The ILSFDA gives the Secretary authority to propose rulemaking, conduct formal investigations, issue subpoenas and make recommendations to the Attorney General for commencing appropriate criminal proceedings.⁹⁵ In carrying out his subpoena power, the Secretary may invoke the aid of any court of the United States within the jurisdiction of the location of an investigation or proceeding, or where the person issued the subpoena resides or carries on business.⁹⁶ By subpoena, the Secretary can require the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records and documents.⁹⁷ Failure to obey an order of a court aiding the Secretary may subject a person to punishment for contempt of court.⁹⁸

An administrative subpoena issued under the ILSFDA need not meet a standard of probable cause to investigate, but such a subpoena may, however, be challenged on the following grounds: (1) that the investigation is not being conducted for a legitimate purpose; (2) that the inquiry is not relevant even if the purpose is legitimate; (3) that the information sought is already in the possession of the agency; and (4) that the administrative steps required by Congressional guidelines have not been followed.⁹⁹

Beyond administrative proceedings and after final agency action all suits in equity and actions at law to enforce any liability or duty created by the ILSFDA can be brought in the District Courts of the United States.¹⁰⁰ Suit or action for enforcement is in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated.¹⁰¹

⁹³ *Cumberland Capital Corp. v. Harris*, 490 F. Supp. at 555-56 (citing 5 U.S.C. § 704 (1976)).

⁹⁴ See 5 U.S.C. § 704 (1976).

⁹⁵ 15 U.S.C. §§ 1714(a)-(d), 1718 (1976); 24 C.F.R. §§ 1720.15, 1720.20, 1720.45-.95, 1720.105-.635 (1982); see also *Wiggins v. Lynn*, 406 F. Supp. 338, 343 (E.D. Tex. 1975).

⁹⁶ 15 U.S.C. § 1714(d) (1976).

⁹⁷ *Id.*; see also 24 C.F.R. § 1720.70 (1982) (purposes for which subpoenas may be issued in connection with investigation of alleged violation of the ILSFDA).

⁹⁸ 15 U.S.C. § 1714(d) (1976).

⁹⁹ See *Lynn v. Biderman*, 536 F.2d 820, 824 (9th Cir. 1976), *cert. denied*, 429 U.S. 920 (1976) (citing *United States v. Powell*, 379 U.S. 48 (1964), where the Supreme Court established the standard for obtaining judicial enforcement of an administrative subpoena). The *Lynn* court noted that an administrative summons cannot be used for purposes of conducting a criminal investigation, but when no criminal case is pending an administrative summons issued for a civil purpose can uncover evidence of a crime. *Lynn*, 536 F.2d at 824 & n.3.

¹⁰⁰ 15 U.S.C. § 1719 (1976).

¹⁰¹ *Id.*

Any person seeking review of an order or determination of the Secretary may obtain review in the Court of Appeals of the United States.¹⁰² Review in the Court of Appeals is to any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia.¹⁰³ Diversity of citizenship and amount in controversy are not prerequisites to Federal Court jurisdiction.¹⁰⁴

State courts have concurrent jurisdiction with the United States District Court.¹⁰⁵ Within the state court system venue is generally in the court located in the county or district where the property is situated but, depending on state law, actions at law for damages for alleged misrepresentation in the sale of land may be considered transitory, allowing them to be brought in state courts located outside the county or district of the property.¹⁰⁶

B. *Standing To Assert Violations Of The ILSFDA*

OILSR is active in investigating alleged violations of the ILSFDA.¹⁰⁷ Investigations allow OILSR to collect valuable information, to negotiate settlements of consumer disputes, and to make recommendations of action to the Department of Justice.¹⁰⁸ OILSR uses its investigative power to obtain names of lot purchasers or lessees so that they can be notified of potential violations of the ILSFDA and informed of their possible right to rescind contracts and collect damages.¹⁰⁹ The notification process extends to third parties such as banks or individuals involved in the financing of a purchase or holding a purchase money mortgage because OILSR includes these third parties within the class of persons to be protected by the ILSFDA.¹¹⁰ The investigation and notification process can be a strong weapon in enforcing the ILSFDA because parties are

¹⁰² *Id.* § 1710(a).

¹⁰³ *Id.*

¹⁰⁴ *Campbell v. Glacier Park Co.*, 381 F. Supp. 1243, 1248 (D. Idaho 1974). (This case relies, by analogy, on *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 289-90 (1940), where the U.S. Supreme Court interpreted the securities law to confer federal jurisdiction without regard to the amount in controversy or diversity of citizenship.) *Contra White v. Deltona Corp.*, 66 F.R.D. 560, 563 (S.D. Fla. 1975). (This case involved a class action and the court spoke in terms of each individual needing to meet the \$10,000 jurisdictional amount.)

¹⁰⁵ 15 U.S.C. § 1719 (1976); *see also Nargiz v. Henlopen Developers*, 380 A.2d 1361, 1363 (Del. 1977) (state court exercising concurrent jurisdiction).

¹⁰⁶ *See Oestreich v. Ocean Shores Estates, Inc.*, 83 Wash. 2d 143, 144-45, 516 P.2d 507, 508.

¹⁰⁷ *See Biennial Rep. To Congress*, *supra* note 6, at 16-19.

¹⁰⁸ *Id.* (Page 10 has a reference to 34 referrals in an 18 month period and the Dept. of Justice filed formal complaints in 21 of these instances. Pages 16-19 contain information on OILSR settlements of disputes.)

¹⁰⁹ *See Lynn v. Biderman*, 536 F.2d 820, 826 (9th Cir. 1976) (upholding subpoenas requiring developer to produce customer list but prohibiting issuance of letters to customers thereby identified to inform them they had a right to void their contracts and to have monies paid refunded); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 70 (W.D. Va. 1975), *aff'd*, 538 F.2d 594 (4th Cir. 1975); *Walsh*, *supra* note 14, at 274-75.

¹¹⁰ *See Walsh*, *supra* note 14, at 275.

notified without regard to possible individual defenses, and the result can be severe legal and financial problems for an alleged violator.

In addition to pursuing investigations, the OILSR encourages private action to assist in enforcement of the ILSFDA.¹¹¹ Private action can be effective but before a person can bring a lawsuit he must have standing. The language of the ILSFDA provides that civil actions can be brought by "purchaser[s] or lessee[s]. . . at law or in equity against a developer or agent if the sale or lease was made in violation of [the ILSFDA]."¹¹²

Thus, a person who is a purchaser or lessee has standing to bring a lawsuit under the ILSFDA.¹¹³ Standing also extends to an administrator and substitute trustees for the estate of a person who was a purchaser or lessee.¹¹⁴ Subsequent purchasers, lessees, or assignees of an original purchaser or lessee may not have standing under the ILSFDA, however, because they may be considered outside the scope of persons meant to be protected.¹¹⁵ One state court held that where purchasers assigned their contract to immediate family members, the assignees were unable to exercise the right of rescission provided in the ILSFDA.¹¹⁶ A decision of this sort mechanically eliminates rights upon the event of assignment when in most instances, absent a contract provision to the contrary, a developer should not be surprised to learn of an assignment. Inasmuch as the assignee can read the Property Report and sales information at the time of assignment, there would seem to be no reason for denying protection to him and no reason for allowing a developer to escape the consequences of violating the ILSFDA. The real concern of a developer should be the extent to which his original purchaser or lessee makes additional representations or omissions in structuring the assignment to subsequent parties. A developer should not be responsible for the representations or omissions of an unrelated party but to the extent that a developer's original purchaser or lessee structures an assignment where the assignee relies upon the information prepared by the developer, the developer should remain accountable. In *Adolphus v. Zebelman*,¹¹⁷ the Eighth Circuit Court of Appeals held that to establish standing the plaintiff, a minority stockholder in a corporation potentially liable under the ILSFDA,

¹¹¹ See *Biennial Rep. To Congress*, *supra* note 6, at 4.

¹¹² 15 U.S.C. § 1709(a), (b) (Supp. V 1981).

¹¹³ *Id.*; see, e.g., *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1290 (3d Cir. 1978); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 301-02 (S.D.N.Y. 1977). *But see* *White v. Deltona Corp.*, 66 F.R.D. 560, 562 (S.D. Fla. 1975) (no standing when alleged violation occurred prior to effective date of the ILSFDA).

¹¹⁴ See *Wiggins v. Lynn*, 406 F. Supp. 338, 338 (E.D. Tex. 1975) (suit by plaintiff, individually, and as administratrix and substitute trustee of her husband's estate).

¹¹⁵ *Konopisos v. Phillips*, 30 N.C. App. 209, 226 S.E.2d 522, 524 (1976); see also *WALSH*, *supra* note 12 at 275 (noting that the right of revocation provided to a purchaser by the ILSFDA has been interpreted as personal and thus not transferable to an assignee or purchaser from the original purchaser).

¹¹⁶ *Konopisos v. Phillips*, 30 N.C. App. 209, 226 S.E.2d 522, 523-24 (1976).

¹¹⁷ *Adolphus v. Zebelman*, 486 F.2d 1323 (8th Cir. 1973).

needed to allege that (1) the challenged action had caused him injury in fact, economic or otherwise, and (2) the interest sought to be protected was arguably within the zone of interests protected or regulated by the ILSFDA.¹¹⁸ In *Adolphus*, the court decided that a minority stockholder satisfied the standing requirements by alleging that continued corporate wrongdoing, in violation of the ILSFDA, would create irreparable financial harm to the corporation and depress or destroy the value of his stock.¹¹⁹

Another case, *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*,¹²⁰ considered the standing issue in light of a challenge to the effective date of a Statement of Record and Property Report and the lack of an Environmental Impact Statement for the proposed real estate development. The plaintiff in *Flint Ridge*, a preservationist group, sought to require HUD to prepare an Environmental Impact Statement, in accordance with the National Environmental Policy Act (NEPA), before the developer's Statement of Record and Property Report could become effective.¹²¹ The United States Supreme Court held that NEPA was inapplicable to the ILSFDA, but recognized that the plaintiff had standing as a nonprofit corporation organized for the purpose of protecting the river area.¹²² Some of plaintiff's members used the river for recreation and the plaintiff, therefore, contended that the river would be adversely affected by a 2,200 acre real estate development to be constructed along it.¹²³

The *Adolphus* and *Flint Ridge* decisions allow standing under the ILSFDA for persons other than direct purchasers or lessees and, thus, they provide a basis for further extension of standing. As suggested by these decisions, subsequent purchasers, lessees, or assignees should be granted standing provided they have an interest in real estate that is subject to the ILSFDA. Once a person has acquired a protected interest within the scope of the ILSFDA and a loss has occurred, then that person should have standing to allege violations as long as there is, arguably, a causal connection between the protected interest and the resulting loss.¹²⁴

¹¹⁸ *Id.* at 1325.

¹¹⁹ *Id.* at 1326. The Stockholder in *Adolphus* held 15% of the stock. *Id.* See also *Heit v. Amrep Corp.*, 82 F.R.D. 130, 131-32 (S.D.N.Y. 1979) (discussion of settlement of stockholder suit under the securities laws based on failure to disclose that corporate profits were based on sales practices unlawful under the ILSFDA).

¹²⁰ *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 782 (1976) (although the opinion of the court does not directly address the standing issue the court does recognize the position of Scenic Rivers Ass'n of Oklahoma and therefore implies standing for similar groups).

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.*

¹²⁴ See *United States v. Students Challenging Regulatory Agency Procedures*, 412 U.S. 669, 684-89 (1973) (giving a liberal interpretation to standing). *But cf.* *Johnson v. Stephen Development Corp.*, 538 F.2d 664, 665 (5th Cir. 1976). (The plaintiff reached a settlement with

C. Class Actions In Asserting Violations Of The ILSFDA

Class action suits can be an effective way of enforcing the ILSFDA because they create incentive for private action. Incentive comes from the potential aggregate damages available in class actions — making the payment of legal fees and expenses of major litigation considerably more feasible than numerous individual lawsuits, each for nominal damages. In a class action, a representative plaintiff seeks certification of a class action pursuant to the Federal Rules of Civil Procedure.¹²⁵ The general guidelines for class actions under the ILSFDA follow Federal Rule 23 and require that: (1) the class be so numerous that joinder of all members is impracticable, (2) there be questions of law or fact common to the class, (3) the claims or defenses of the representative plaintiff be typical of the claims or defenses of the class, and (4) the representative plaintiff will be able to fairly and adequately protect the interests of the class.¹²⁶

In determining the viability of class actions under the ILSFDA, two approaches have been used — the condition precedent approach and the condition subsequent approach.¹²⁷ The condition precedent approach involves a judicial determination of the viability of a class action at an early stage based on the complaint and preliminary information.¹²⁸ The condition subsequent approach involves a “wait and see” attitude that encourages class actions by favoring continued discovery and prosecution of the case until it becomes evident that a class action is, or is not appropriate.¹²⁹ Reasons for favoring the condition subsequent approach include a feeling that, (1) it is easier to reduce the class size than to increase it later, (2) most individual claims are small so that the continued threat of a class action is an incentive to proceed with litigation or settlement, and (3) more information can come to light in the early stages of a dispute by allowing continuation of the class action.¹³⁰ Regardless of the approach taken, the court must ultimately determine whether or not the action should be certified as a class action for its final disposition.

Under either the condition precedent or the condition subsequent approach, an initial inquiry should be made into the composition of the class. Each person in the class should be within the jurisdiction of the selected court

the developer but the plaintiff's attorney sought to continue the action. The attorney alleged that his contingency fee agreement amounted to an assignment of an interest in the plaintiff's real estate. The court, while not ruling that an assignee of a purchaser is unable to assert a violation of the ILSFDA, held that the contingency fee agreement did not give the attorney an interest in plaintiff's real estate nor in the cause of action.)

¹²⁵ See *Lukenas v. Bruce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71 (W.D. Va. 1975), *aff'd*, 538 F.2d 594 (4th Cir. 1975).

¹²⁶ *Id.*

¹²⁷ See *Bryan v. Amrep. Corp.*, 429 F. Supp. 313, 320 (S.D.N.Y. 1977).

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ See generally *id.*

even though at the outset the actual size of the class may be indeterminable.¹³¹ Persons who allege violations based on activities prior to the effective date of the ILSFDA cannot join a class of protected persons because there is no provision for retroactive application.¹³² Issues common to the class should predominate over issues affecting individual class members so that the class action can be superior to other available methods for the fair and efficient adjudication of the dispute.¹³³

The fact that damages will need to be determined on an individual basis is not by itself a reason for denying a class action under the ILSFDA.¹³⁴ Issues and facts that can act independently or collectively to prevent a class action under the ILSFDA include: (1) in the case of misrepresentation, whether or not all persons received the same Property Report so that the same material misrepresentation effects all members of the class;¹³⁵ (2) whether or not a case is one of material omission or material misrepresentation for proof of material misrepresentation, unlike material omission, requires proof of reliance upon the misrepresentation on a case by case basis;¹³⁶ (3) whether the "sales pitch" varied over the time period covered by the action such that issues of knowledge, reliance, or misrepresentation would be individual in nature;¹³⁷ (4) whether the time period represented by individual transactions raises individual problems with the running of the statute of limitations;¹³⁸ and (5) whether the defendant has affirmative defenses that are affected by the facts of transactions that are specific to individual purchasers or lessees.¹³⁹

¹³¹ 15 U.S.C. § 1710 (1982); see also *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89 (M.D. Pa. 1973) (saying that it is unnecessary to know the actual class size at the outset in a class action suit, for this can be determined later in discovery).

¹³² See *White v. Deltona Corp.*, 66 F.R.D. 560, 562 (S.D. Fla. 1975).

¹³³ See *id.* at 561; *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 96 (M.D. Pa. 1973).

¹³⁴ See *Gilbert v. Woods Marketing, Inc.*, 454 F. Supp. 745, 750 (D. Minn. 1978); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 316 (S.D.N.Y. 1977); *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89-90 (M.D. Pa. 1973).

¹³⁵ See *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 317 (S.D.N.Y. 1977) (involving different Property Reports); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 73 (W.D. Va. 1975) (involving six Property Reports); *Hoffman v. Charnita*, 58 F.R.D. 86, 90-91 (M.D. Pa. 1973) (involving same Property Report).

¹³⁶ See *Gilbert v. Woods Marketing Inc.*, 454 F. Supp. 745, 749-50 (D. Minn. 1978) (characterization as omission was important here though distinction seemed of little difference); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 320 (S.D.N.Y. 1977) (no need to show reliance for either omission or misrepresentation); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 73 (W.D. Va. 1975) (proof of reliance is important); *Hoffman v. Charnita*, 58 F.R.D. 86, 90-91 (M.D. Pa. 1973).

¹³⁷ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 133-35 (S.D.N.Y. 1979) (It seems that the longer a marketing effort, which can be years for large developments, the more likely there will be problems with an effective class action); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 317 (S.D.N.Y. 1977).

¹³⁸ See *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71-73 (W.D. Va. 1975) (statute of limitations is an affirmative defense but once raised a plaintiff can overcome the defense upon a showing of appropriate facts).

¹³⁹ See *White v. Deltona Corp.*, 66 F.R.D. 560, 564 (S.D. Fla. 1975).

In some cases, despite these problems, courts will proceed with class actions if manageable subclasses can be identified and the representative plaintiff will not have an adverse interest or conflict with the other subclasses or members of the class.¹⁴⁰ In addition to subclasses which are formed because members were subject to different circumstances, there may be a subclass of persons who "opt out" of the class action and thereby leave their claims open to independent resolution.¹⁴¹ If a representative plaintiff has a claim adverse to the interest of a subclass of members he cannot qualify for class certification by seeking to have adverse members "opt out."¹⁴²

In actions concerning the ILSFDA, the most common conflict between class members relates to the remedy being sought. The courts have found a conflict when some members of the class seek rescission of their contracts while others want to retain their property interest even though they are seeking damages.¹⁴³ The primary element of the conflict between these class members is their respective interests in the continued financial viability of the developer (defendant).¹⁴⁴ Those members who want to retain their interests in the property have an interest in the continued financial viability of the developer in order to ensure the successful completion of improvements or sales in the development.¹⁴⁵ On the other hand, members seeking to rescind their contracts and give up their interests in the property might seek extensive damages that could destroy the financial viability of the developer and severely reduce property values in the development.¹⁴⁶

The settlement of a class action must account for all of the above considerations because approval of a settlement by the representative plaintiff will bind all the members of the class who have not "opted out."¹⁴⁷ The court must determine whether the settlement is fair and adequate in light of all the cir-

¹⁴⁰ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 132 (S.D.N.Y. 1979) (subclasses based on who viewed the property within six months of contracting); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 317 (S.D.N.Y. 1977) (subclasses based on who viewed the property and who did not); *Lukenas v. Bryce's Mountain Resort Inc.*, 66 F.R.D. 69, 71-72 (W.D. Va. 1975) (subclasses based on date of transaction and those seeking rescission instead of damages).

¹⁴¹ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 133 (S.D.N.Y. 1979); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 72 (W.D. Va. 1975) (an "opt out" alternative does not bring an otherwise nonrepresentative plaintiff within the Federal Rules).

¹⁴² *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 72 (W.D. Va. 1975).

¹⁴³ See *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 318 (S.D.N.Y. 1977); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71-72 (W.D. Va. 1975); *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89-90 (M.D. Pa. 1973).

¹⁴⁴ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 135-137 (S.D.N.Y. 1979); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 318 (S.D.N.Y. 1977); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71-72 (W.D. Va. 1975); *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89-90 (M.D. Pa. 1973).

¹⁴⁵ See cases cited *supra* note 134.

¹⁴⁶ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 135-137 (S.D.N.Y. 1979); *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 318 (S.D.N.Y. 1977); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71-72 (W.D. Va. 1975).

¹⁴⁷ See *Heit v. Amrep Corp.*, 82 F.R.D. 130, 137 (S.D.N.Y. 1979).

cumstances including the representative plaintiff's potential for winning on the merits.¹⁴⁸ In making such a determination, the court must balance the developer's ability to pay damages against the severity of the plaintiff's injury. Damages should not result in the financial collapse of a real estate project that would lead to a further loss in plaintiff's property values. On the other hand, an undercapitalized developer should not be allowed to escape effective enforcement of the ILSFDA by merely claiming financial difficulties. Such circumstances require judicial appraisal of the assets of the developer and its investors and related entities. The court must ensure that settlements are substantial enough to encourage compliance with the ILSFDA while avoiding financially disruptive damages that would create a disincentive for actions by plaintiffs seeking to retain their ownership interests.

V. SCOPE OF LIABILITY UNDER THE ILSFDA

The scope of potential liability is best understood by analyzing the ILSFDA in relation to its impact on the following groups: (A) developers and agents other than lenders; (B) lenders and noteholders; and (C) entities and individuals with corporate relationships.

A. The Liability of a Developer and Agent, Other Than Lender, Under the ILSFDA

The ILSFDA defines a "Developer" as any person who, directly or indirectly, sells or leases, or offers to sell or lease, or advertises for sale or lease any lots in a subdivision.¹⁴⁹ The ILSFDA defines an "Agent" as any person who represents, or acts for or on behalf of, a developer in selling or leasing, or offering to sell or lease, any lot or lots in a subdivision, but shall not include an attorney at law whose representation of another person consists solely of rendering legal services.¹⁵⁰ The ILSFDA addresses the activities of developers and agents by making it unlawful for any developer or agent, directly or indirectly, "to make use of any means or instruments of transportation or communication in interstate commerce, or of the mails . . ." for certain prohibited purposes such as to sell or lease lots without complying with the disclosure and anti-fraud provisions.¹⁵¹ Similarly, a purchaser or lessee may bring an action at law or in equity against a developer or agent if the sale or lease was made in violation of the ILSFDA.¹⁵² An attorney should be careful to avoid participation in a client's real estate development project in order to prevent being

¹⁴⁸ *Id.* at 133.

¹⁴⁹ 15 U.S.C. § 1701(5) (1982).

¹⁵⁰ *Id.* § 1701(6).

¹⁵¹ *Id.* § 1703(a).

¹⁵² *Id.* § 1709.

classified as an agent for having exceeded the somewhat vague standard of representing another person "solely" by rendering legal services.¹⁵³

Liability of a developer or agent results from failure to comply with either the disclosure or anti-fraud provisions of the ILSFDA.¹⁵⁴ A court has defined the grounds for developer and agent liability liberally by giving the ILSFDA a broad application.¹⁵⁵ A policy of liberal interpretation of the ILSFDA has caused many people in the real estate development business to be uncertain as to the appropriate outer limit of the scope of liability. Judicial efforts have been made to limit the scope of agent liability on the grounds that while Congress intended the developer to be liable for its own acts and those of its agents it did not mean to include every guide or salesman unless they too had authority to sell or did in fact sell on their own account.¹⁵⁶ Even exemptions from the registration requirement of the ILSFDA do not entirely remove the possibility of liability because all real estate projects with twenty-five or more lots in a common promotional plan involving the use of interstate commerce or the mails are subject to the anti-fraud requirements of the ILSFDA.¹⁵⁷ Furthermore, an exemption will not eliminate developer or agent liability when a person with standing demonstrates that the exemption was used to avoid the disclosure or anti-fraud provisions of the ILSFDA.¹⁵⁸ Upon such a showing, OILSR can declare a self-activating exemption invalid and proceed to hold the violator liable under the ILSFDA.¹⁵⁹

In the usual case, a developer may suspect he is subject to the ILSFDA and, therefore, seek avoidance of its requirements through a self-activating exemption. Typically, the developer is advised by his attorney to seek the easiest ILSFDA exemption — promising in the contract of sale or lease to complete improvements on the property within two years.¹⁶⁰ The same contracts, however, typically contain standard provisions requiring the purchaser to waive all rights to damages and specific performance in the event of the developer's default or nonperformance.¹⁶¹ In almost all instances, the only motivation for this procedure is to qualify for an exemption and thereby avoid

¹⁵³ *Id.* § 1701(b).

¹⁵⁴ See *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1292-93 (3d Cir. 1978); *Johnson v. Stephens Development Corp.*, 538 F.2d 664, 665 (5th Cir. 1976) (liability discussed for not filing Statement of Record or Property Report with HUD). See generally *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53-4 (N.D. Miss. 1980).

¹⁵⁵ See *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1975) (the ILSFDA is to be interpreted liberally to effectuate its remedial purpose).

¹⁵⁶ See *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1293 (3d Cir. 1978) (referring to *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105 (5th Cir. 1975)).

¹⁵⁷ 15 U.S.C. § 1702(a) (1982).

¹⁵⁸ 24 C.F.R. §§ 1710.4, 1710.5 (1982).

¹⁵⁹ 15 U.S.C. § 1702(a) (1982).

¹⁶⁰ This is common practice in South Florida where extensive real estate development is under way.

¹⁶¹ This is a typical practice in the South Florida real estate market.

the costly disclosure requirements of the ILSFDA.¹⁶² Granting exemptions in such situations, however, seems to circumvent the underlying purpose of the ILSFDA.

The two year contract exemption, for instance, is included in the ILSFDA because it purportedly provides consumers with adequate protection in that they can sue on their contract if the developer fails to perform as promised.¹⁶³ Failure to complete the development, including improvements, within the two year period would, under the justification for the exemption, allow a purchaser to rescind the contract, seek damages, or demand specific performance. The threat of damages or specific performance was intended to be a strong weapon against a developer. The effect of this threat is severely diluted, however, by inclusion in the developer's standard contract of provisions which require purchasers to waive the remedies of damages and specific performance. Such a waiver leaves the purchaser with only one option — to rescind the contract. The possibility that a purchaser may rescind a contract within two years, however, is of little consequence to a developer. Should the real estate market change or should the developer have better financial opportunities, there is little incentive for the developer to continue with a project, particularly when the only consequence for not completing the project is that purchasers may rescind their obligation to pay the balance of the contract price. Where the sale or lease contract contains extensive waiver provisions the developer risks very little in the event of his nonperformance. From the standpoint of the purchaser or lessee, the combination of the contractual promise to perform within two years and the waiver creates a worse situation than where there is no promise to complete improvements within two years because the promise itself can create a false or misleading impression. Persons unfamiliar with standard boiler plate language may not realize the consequences of waiving their right to damages and specific performance.

In order to carry out the purpose of the ILSFDA, self-activating exemptions, such as the two year contract rule, should be ineffective when a developer uses other means to dilute or eliminate the substance behind the justification for the exemption. Furthermore, evidence of diluted exemptions should be persuasive in judicial interpretation of whether a developer selected a particular exemption for the impermissible purpose of evading the requirements of the ILSFDA.

By using contract provisions such as waiver developers have been able, in the past, to avoid liability under the ILSFDA. The justification behind such avoidance of liability is now in doubt and developers should be concerned with

¹⁶² 24 C.F.R. § 1710.5(b) (1982).

¹⁶³ *Id.* The two year contract exemption requires completion of an entire project including all common elements and recreational facilities within two years of the date of the first contract for sale or lease of any lot within a project. Walsh, *supra* note 124, at 271. Lot includes a condominium unit. *Id.*

the future consequences. Developers, however, are not the only people that need to be concerned about liability for the selling or leasing of lots subject to the ILSFDA. Agents of the developer or seller must also be concerned. Engaging, directly or indirectly, in the sale or lease of lots can give rise to both developer and agent liability under the ILSFDA.¹⁶⁴ To the extent that indirect selling or leasing is involved, the courts have limited agent liability by defining "indirect" selling or leasing to mean the way in which the selling or leasing is done, such as by telephone or pamphlets.¹⁶⁵

The Fifth Circuit Court of Appeals addressed issues of agent liability in *Paquin v. Four Seasons of Tennessee, Inc.*¹⁶⁶ In *Paquin*, the plaintiffs read promotional material in a newspaper containing inducements to visit a development, that was then under construction.¹⁶⁷ When the plaintiffs arrived at the development, they observed great activity in both sales and construction operations.¹⁶⁸ A salesman explained the overall development plans including proposed recreational facilities.¹⁶⁹ The plaintiffs obtained and read a Property Report and then signed a purchase contract.¹⁷⁰ The Property Report stated that completion of the development depended upon satisfactory sales levels and the developer's ability to secure adequate financing.¹⁷¹ Ultimately, the project was not completed because adequate financing was not secured.¹⁷² The plaintiffs alleged that the failure to secure adequate financing was due to the bankruptcy of the "grandparent" company (the parent company of the parent company) of the developer.¹⁷³ The plaintiffs brought an action against both the developer and the salesman for failure to disclose the financial status of the related grandparent company.¹⁷⁴ The court held that the financial status of the grandparent company was not material information and that the salesman, though the developer's agent for property sales, was not an "agent" within the scope of the ILSFDA.¹⁷⁵ The court considered the following factors to be relevant in determining that the salesman in this case should not be held liable: (1) the salesman's only interest in the development was his sales commission; (2) the sales contract named the developer as seller; (3) the sales contract was prepared by the developer's secretary; (4) the salesman in the presence of plaintiffs had

¹⁶⁴ See *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53-4 (N.D. Miss. 1980); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1275-6 (S.D.N.Y. 1978).

¹⁶⁵ See *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1293 (3d Cir. 1978).

¹⁶⁶ See *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1110 (5th Cir. 1975), cert. denied, 425 U.S. 972 (1976).

¹⁶⁷ *Id.* at 1107.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 1108.

¹⁷¹ *Id.*

¹⁷² *Id.* at 1107-08.

¹⁷³ *Id.* at 1110-111.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at 1111.

to request the developer's approval of the sales price; and (5) the salesman neither sold nor had authority to sell the property on his own account.¹⁷⁶ Thus, in the *Paquin* case the court focused not merely on the traditional concept of agency relationships but also evaluated each particular relationship on the basis of the agent's authority to sell or lease on his own account.¹⁷⁷ *Paquin* should, therefore, be understood to mean that when the developer and not the salesman has the actual authority to sell then the salesman should not be liable as an agent under the ILSFDA.

With the exception of determining the effectiveness of a self-activating exemption, a developer's liability is usually easier to determine than that of an agent. Developers are generally identified as the title holder, contract seller, and grantor of the property. The courts have held that liability as a developer can extend, however, to any person who has a pecuniary and management interest in property and who actively participates in the management of the project.¹⁷⁸

Despite its apparent simplicity, the concepts of developer and agent liability have raised questions about the extent to which lenders, investors, or corporate officers or directors could be subject to liability under the ILSFDA.¹⁷⁹ In each instance, liability as a developer or agent under the ILSFDA has been determined on the basis of whether or not there was a pecuniary and managerial interest in the development. A developer or agent's liability under the ILSFDA can also be based on the breach of covenants in a contract of sale or lease which incorporates the Property Report.¹⁸⁰

¹⁷⁶ *Id.*

¹⁷⁷ See *United States v. Dacus*, 634 F.2d 441, 443 (9th Cir. 1980); *United States v. Amrep Corp.*, 560 F.2d 539, 544-45 (2d Cir. 1977), *cert. denied*, 434 U.S. 1015 (1978); *United States v. Amrep Corp.*, 545 F.2d 797, 799-80 (2d Cir. 1976); *United States v. Goldberg*, 527 F.2d 165, 167, 168-69 (2d Cir. 1975), *cert. denied*, 425 U.S. 971 (1976); *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1111-112 (5th Cir. 1975).

¹⁷⁸ See cases cited *supra* note 156.

¹⁷⁹ See *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 247-49 (6th Cir. 1980) (lender as alleged developer); *Bartholomew v. Northampton Nat'l Bank of Easton*, 584 F.2d 1288, 1290-94 (3d Cir. 1978) (lender as alleged developer and developer liability alleged for various corporate relationships); *United States v. Amrep Corp.*, 560 F.2d 539, 544-45 (2d Cir. 1977) (corporate relationships); *United States v. Amrep Corp.*, 545 F.2d 797, 799-800 (2d Cir. 1976) (corporate relationships); *Johnson v. Stephens Development Corp.*, 538 F.2d 664, 665 (5th Cir. 1976) (developer liability alleged against individual); *United States v. Goldberg*, 527 F.2d 165, 167-69 (2d Cir. 1975) (developer liability alleged against individual); *McCown v. Heidler*, 527 F.2d 204, 206 (10th Cir. 1975) (alleged developer liability of individuals); *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 986 (N.D. Cal. 1978) (lender as alleged developer and developer liability alleged for various corporate relationships); *Timmreck v. Munn*, 433 F. Supp. 396, 399 (N.D. Ill. 1977) (lender as alleged developer); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 302-04 (S.D.N.Y. 1977) (alleged developer liability of individuals); *Davis v. Rio Rancho Estate, Inc.*, 401 F. Supp. 1045, 1047 (S.D.N.Y. 1975) (corporate relationships); *Zachery v. Treasure Lake of Georgia, Inc.*, 374 F. Supp. 251, 252-55 (N.D. Ga. 1974) (lender as alleged developer); *Adema v. Great Northern Development Co.*, 374 F. Supp. 318, 318-19 (N.D. Ga. 1973) (lender as alleged developer); *Wachovia Bank & Trust Co., N.A. v. Glass*, 575 S.W.2d 950, 952-53 (Tenn. Ct. App. 1978) (lender as alleged developer or agent).

¹⁸⁰ See *Kniffin v. Colorado Western Development Co.*, 622 P.2d 586, 590 (Colo. App. 1980).

B. *Lender and Noteholder Liability Under the ILSFDA*

The ILSFDA provides an express exemption for "the sale of evidences of indebtedness secured by a mortgage or deed of trust on real estate."¹⁸¹ Nonetheless, violations of the ILSFDA have been alleged against lending institutions and persons holding promissory notes. In general, it would seem that the motivations for such allegations are: (1) to avoid further payment on outstanding loans; (2) to seek a "deep pocket" for damages; (3) to obtain performance from a solvent person when the developer and its agents have gone bankrupt or otherwise become unable to perform; and (4) to vindicate a good faith belief that there is wrongdoing involved.

In *Wachovia Bank & Trust Company, N.A. v. Glass*,¹⁸² the lending institution was alleged to be an agent of a developer under the ILSFDA. Wachovia brought the action to collect on a defaulted promissory note and the defendant filed a cross complaint alleging violations of the ILSFDA by Wachovia as the agent of the developer.¹⁸³ By asserting agent liability against Wachovia, the defendant hoped to rescind the promissory note, receive a refund of all payments made to date and obtain reimbursement for expenses.¹⁸⁴ Wachovia admitted taking an assignment of the defendant's promissory note, that had been made payable to the developer, but asserted that: first, there were no agreements between Wachovia and the developer; second, Wachovia never offered to sell or lease any property in the development; and third, no employees or agents of Wachovia were involved with the management or marketing of the developer's project.¹⁸⁵ Based on these facts and on the defendant's failure to submit evidence supporting his allegations, the Tennessee Appellate Court held in favor of Wachovia.¹⁸⁶

In holding for Wachovia, the court determined that the mere sending of two letters in an effort to collect on the promissory note did not make Wachovia an agent of the developer under the ILSFDA.¹⁸⁷ According to the court, the letters in question did not indicate that Wachovia engaged in any direct or indirect selling or leasing.¹⁸⁸ Instead, the court found that the letters were standard inducements for payment of a debt owing to Wachovia by virtue of being the assignee of defendant's promissory note.¹⁸⁹ Wachovia obtained the promissory note as an assignee of an assignee of the original holder.¹⁹⁰ The original holder was the developer of the real estate project but the first assignee and

¹⁸¹ 15 U.S.C. § 1702(a)(3) (1982); 24 C.F.R. § 1710.5(c) (1982).

¹⁸² *Wachovia Bank & Trust Co., N.A. v. Glass*, 575 S.W.2d 950, 952 (Tenn. Ct. App. 1978).

¹⁸³ *Id.* at 952, 954.

¹⁸⁴ *Id.* at 952, 954, 957.

¹⁸⁵ *Id.* at 952-54.

¹⁸⁶ *Id.* at 955-57.

¹⁸⁷ *Id.* at 955.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.* at 952-53.

Wachovia were entities totally unrelated — either to each other or to the developer.¹⁹¹ Wachovia had neither outstanding loan agreements nor any history of involvement with this developer or his project.¹⁹² The court found that Wachovia was a holder in due course because there was no evidence of any defenses to the promissory note prior to the assignment to Wachovia.¹⁹³ Significant to the court's analysis of the case was the lack of involvement on the part of Wachovia in the developer's real estate project.¹⁹⁴ Unlike a situation involving a construction loan or a commitment to make end loan financing available to lot purchasers, this case involved no working relationship between Wachovia and the developer.¹⁹⁵ Without a working relationship between Wachovia and the developer, and in the absence of other significant facts, the court refused to imply agent liability under the ILSFDA.¹⁹⁶

In addition to potential agent liability, lenders may be liable as developers under the ILSFDA. When developer status is alleged against a lender, the courts will make a determination on a case by case basis, focusing on the activities of the lender.¹⁹⁷ Conduct going beyond the normal course of a lender's business may be sufficient to establish liability under the ILSFDA.¹⁹⁸

In *Cumberland Capital Corporation v. Harris*,¹⁹⁹ the lender, Cumberland, sought declaratory relief from a determination by OILSR that it was a developer. OILSR had identified Cumberland as a developer and then sent it a "no action letter."²⁰⁰ Cumberland brought this suit because a "no action letter" does not prohibit action by purchasers nor prohibit future action by HUD.²⁰¹ OILSR classified Cumberland as a developer because of real estate activities connected with its portfolio of loans secured by mortgages or deeds of

¹⁹¹ *Id.*

¹⁹² *Id.* at 953.

¹⁹³ *Id.* at 955, 957.

¹⁹⁴ *Id.* at 953.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.* at 953, 955-57.

¹⁹⁷ See *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 251 (6th Cir. 1980); *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1294 (3d Cir. 1978); *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 989 (N.D. Cal. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 405-07 (N.D. Ill. 1977).

¹⁹⁸ See cases cited *supra* note 164.

¹⁹⁹ *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 247-48 (6th Cir. 1980).

²⁰⁰ *Id.* at 248-49.

²⁰¹ See 24 C.F.R. § 1710.18(c) (1982) ("No Action Letters"). Because the implications of the ILSFDA create substantial risk for persons participating in real estate development, HUD should adopt a policy of issuing binding advance private letter rulings similar to those used by the Internal Revenue Service. The HUD rulings should be qualified in scope but not revoked or modified retroactively if there has been full and accurate disclosure, no change in the applicable law, and the ruling was relied on in good faith. HUD letter rulings could address issues of jurisdiction or exemption qualification and status as a developer or agent.

Review of development plans should be sufficient for determining jurisdiction and exemption qualification, and review of the loan documents of a lender or syndication offer and entity structure of an investment vehicle should provide the basis for a binding determination of developer or agent status. HUD letter rulings could reduce uncertainty and business risk while

trust on real estate.²⁰² OILSR found that in a twenty month period, between August 1970 and September 1973, 12% of Cumberland's total transactions were secured in whole or in part by real estate and that these transactions represented 52% of its dollar amount of volume.²⁰³ Additionally, the OILSR found that when a loan went into default, Cumberland would foreclose and proceed to sell the property.²⁰⁴ The selling activity of Cumberland was sufficient, according to the OILSR, to merit classifying Cumberland as a developer.²⁰⁵ The Sixth Circuit Court of Appeals, however, rejected the OILSR's conclusion, holding that the selling activity was insufficient, under these circumstances, for OILSR to continue to classify Cumberland as a developer under the ILSFDA.²⁰⁶ In analyzing this particular dispute, the court felt it was significant that Cumberland never altered, improved, replatted, or subdivided the property during the period of its ownership.²⁰⁷ In essence, the court determined that Cumberland did not engage in the normal activities of a developer nor did it participate in a working relationship with a developer by selling the property.²⁰⁸ The activity of Cumberland was within the normal course of the lending business in that it was necessitated by defaulting borrowers.²⁰⁹ The court concluded that exemption from the ILSFDA for the sale of evidences of indebtedness secured by a mortgage or deed of trust on real estate included the right to enforce those instruments.²¹⁰ At the same time, the court acknowledged that the decision in this case did not mean that a lender could never be properly classified as a developer under the ILSFDA.²¹¹

In resolving issues of lender liability, as in other situations where liability as an agent or developer is at issue, courts should analyze the working relationship between the lender and developer, looking for indicia of the lender's pecuniary and management interest in the developer's project.²¹² When the lender's pecuniary and management interest in the developer's project go beyond the ordinary course of a lender's business then classification as an agent or developer under the ILSFDA is more likely.

creating incentive for persons to abide by conservative interpretations of the ILSFDA in order to avoid the risks of their own nonbinding interpretation of its requirements.

²⁰² *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 249 (6th Cir. 1980).

²⁰³ *Id.* at 249.

²⁰⁴ *Id.*

²⁰⁵ *Id.* at 248-49.

²⁰⁶ *Id.* at 251.

²⁰⁷ *Id.* at 249.

²⁰⁸ *Id.* at 249-51.

²⁰⁹ *Id.* at 249.

²¹⁰ *Id.* at 249, 251.

²¹¹ *Id.* at 251.

²¹² See generally *Adema v. Great Northern Development Co.*, 374 F. Supp. 318, 319 (N.D. Ga. 1973) (Absent evidence of control or ownership, an agreement for end loan financing was not sufficient to establish a lender's liability as a developer under the ILSFDA.). See also *Zachery v. Treasure Lake of Georgia, Inc.*, 374 F. Supp. 251, 253-54 (N.D. Ga. 1974).

For instance in *Timmreck v. Mann*,²¹³ the lender, Continental Illinois National Bank, was joined as a co-defendant in a suit alleging violations of the ILSFDA. The plaintiffs alleged that Continental, in financing the development, allowed itself to be held out to the general public as the financial backer of the project while aiding and abetting the developer in the preparation and filing of the Statement of Record and the sale of lots.²¹⁴ The allegation emphasized that Continental went beyond mere financing of the project and actively aided and abetted the developers.²¹⁵ At the center of controversy was Continental's agreement to purchase the secured notes of lot purchasers.²¹⁶ The agreement included a provision that Continental would not purchase the notes unless work on all improvements was continuing on schedule and sufficient funds were available to complete the improvements.²¹⁷ The plaintiffs argued that a lot purchaser or lessee could have been persuaded that Continental's continued purchase of notes implied that the project was properly financed and progressing to completion.²¹⁸ The Federal District Court for the Northern District of Illinois concluded that if the plaintiffs could prove that they relied on Continental's continued purchase of notes, then Continental could be held liable as an aider and abettor of the developer in violating the ILSFDA, despite the statutory exemption for lenders acting within the normal course of their business.²¹⁹ Thus, this case recognized that a lender may be liable as either a developer or an aider and abettor when a working relationship between the lender and developer implies a cooperative effort in the success of a real estate project. Notably, the agreement and provision relied upon as the basis of Continental's potential liability under the ILSFDA was considerably less specific or intrusive than many provisions of a typical construction loan agreement.²²⁰ Thus, a construction loan may present a clearer situation of when a working relationship can lead to lender liability under the ILSFDA.

The issue of lender liability under the ILSFDA was also addressed in *Fuls v. Shastina Properties, Inc.*²²¹ In this case, a lender, Diversified Mortgage In-

²¹³ *Timmreck v. Munn*, 433 F. Supp. 396, 399 (N.D. Ill. 1977).

²¹⁴ *Id.* at 405.

²¹⁵ *Id.*

²¹⁶ *Id.* at 405-06.

²¹⁷ *Id.* at 406 (The agreement provided that Continental would not purchase notes unless the developer "has continued and is continuing to complete all improvements of the Candlewick Lake Subdivision, including (without limitations) the dam, lake, association, club and utilities, within the periods set forth in Exhibit 3 hereto, and it appears that there are sufficient funds available to complete the improvements.").

²¹⁸ *Id.* at 405-07.

²¹⁹ *Id.* at 405-06 (reference is made to *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975), in extending potential liability to aiders and abettors).

²²⁰ Compare *Timmreck v. Munn*, 433 F. Supp. 396, 405-07 (N.D. Ill. 1977) (non-construction loan) with *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 989-90 (N.D. Cal. 1978) (construction loan involved). See generally MADISON AND DWYER, *THE LAW OF REAL ESTATE FINANCING*, Fm. 4.1 (1982) (sample building loan agreement).

²²¹ *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 985-86, 989-90 (N.D. Cal. 1978)

vestors, (DMI), required its construction loan documents to contain standard provisions for receipt of the developer's annual reports, financial statements and sales records; requiring periodic on site inspections of the construction work; and establishing a specific mortgage release price and schedule for each lot in the development.²²² DMI allegedly violated the ILSFDA by aiding and abetting the developer in certain misrepresentations about the investment value of the lots being sold.²²³ The Federal District Court for the Northern District of California ruled that liability as an aider and abettor under the ILSFDA required proof of DMI's knowing assistance or participation in the alleged misrepresentations.²²⁴ The court found that the provisions of the loan documents were insufficient, in the absence of other evidence, to prove DMI's knowing assistance or participation in the misrepresentations and held, therefore, that DMI could not be held liable as an aider and abettor under the ILSFDA.²²⁵ The court emphasized that the plaintiff's evidence failed to establish a sufficient entanglement of the working relationship between DMI and the developer such that DMI acquired a managerial and proprietary interest in the development.²²⁶ The lack of evidence on this point was costly to the plaintiff, who was then unable to prevail on an aider and abettor theory because there was no proof of DMI's knowingly making or facilitating misrepresentations about the investment opportunities of the development.²²⁷

The plaintiff, in *Fuls*, tried to compensate for his inability to establish the necessary basis for entanglement or aider and abettor liability by alleging, under a separate state law count, that DMI had become liable as a joint venturer with the developer.²²⁸ In considering this theory, the court determined that the mortgage release payments were merely a schedule for repayment of the loan plus interest and did not amount to the requisite profit sharing necessary to establish a joint venture under California law.²²⁹ Failure of the joint venture argument under state law would not seem to preclude a plaintiff from successfully using a similar argument to allege DMI's liability as a developer or agent under the ILSFDA. The ILSFDA is given a liberal interpretation to effectuate its remedial purpose and therefore, like the federal securities laws, should be given an expansive application that extends beyond the confines of more limited state laws. It is, therefore, possible that certain loan requirements, even if falling short of a joint venture, could arguably establish sufficient managerial and proprietary interest in a lender for a court to find liability under the ILSFDA.

(reference is made to the broad coverage of the ILSFDA applied in *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975)).

²²² *Id.* at 989-90.

²²³ *Id.*

²²⁴ *Id.* at 990.

²²⁵ *Id.*

²²⁶ *Id.* at 989-90.

²²⁷ *Id.* at 990.

²²⁸ *Id.* at 990-91.

²²⁹ *Id.*

As a result of the developing case law in the area of lender liability, there has been increasing tension between a lender's potential liability under the ILSFDA and its legitimate business interest in protecting its security when financing real estate development. The more precautions a lender takes to protect its security, the more its loan requirements seem to indicate that the lender is linked with project management and participation. Loan requirements for construction site supervision, architectural plan approvals, component material selection, manpower and cost planning, financial statement and sales income monitoring, or the tying of draw down payments to a condition that the project be on a timely completion schedule with sufficient assets can all begin to look like an entanglement of participation between the lender and the developer and lead to potential liability under the ILSFDA.

From the developing case law, a thin line emerges to distinguish a lender protecting its security interest within the ordinary course of its business from a lender participating in a project for purposes of the ILSFDA. Apparently, the distinction must consider the extent to which the lender views loan requirements as passive requirements enforceable for violations after the fact, as opposed to affirmative provisions allowing lender input into the actual progress of the project. To the extent that the lender takes a passive position, the chances are reduced that there will be liability under the ILSFDA. At the same time, the more passive the lender, the more control in the developer and the riskier the security for the loan. This distinction and resulting tension has become even more problematic in the real estate market of the 1980's where concerns about interest rates and mortgage markets have caused some lenders to engage in "creative" loan activities. Lenders increase their potential for liability under the ILSFDA when they "creatively" engage in: (1) placing some of their own officers or employees as corporate officers or directors of a developer corporation, (2) reducing construction loan interest rates in exchange for a percent of project profits, or (3) retaining an equity interest in a project as a condition to more favorable loan terms.²³⁰ All of these activities make the lender feel more secure about the loan or the money to be made from the loan but they also illustrate an affirmative interest or participation in the managerial or proprietary operations of the real estate project.

Noteholders or persons who purchase promissory notes as investments may also have difficulty under the ILSFDA. Complications under the ILSFDA can arise for the noteholder when he seeks judicial aid to compel payment on the promissory note. The typical defense to an enforcement action is for the defendant to attempt rescission of the promissory note within the two year period provided in the ILSFDA for violations of the disclosure requirements.²³¹ In an instance where disclosure violations occurred, a court has held that the

²³⁰ This is a generally accepted practice by some major lenders, including Canadian lending institutions, for real estate development in Florida.

²³¹ 24 C.F.R. §§ 1715.3-.5 (1982).

borrower's defense is effective against both the original lender and subsequent holders of the promissory note where the subsequent holder takes the assignment: (1) as part of a scheme to cut short the borrower's rescission time for violations of the ILSFDA; or (2) when the assignee does not take the assignment as a holder in due course.²³²

To be a holder in due course one must take for value, in good faith, and without notice of the promissory note being overdue, dishonored or subject to any defense or claims by any person.²³³ There is no affirmative duty under the ILSFDA to investigate compliance with its requirements unless good faith, in light of the facts, gives notice of irregularities.²³⁴ This standard should not protect a person who has any suspicion or doubt about compliance with the ILSFDA based on his knowledge of the people, property, or documents involved in the transaction. Irregularities which one court found to raise doubt about compliance with the ILSFDA were: a noteholder buying a note at a substantial discount — 30% to 40% discount — and when the note, mortgage or other documents do not indicate proper delivery and receipt of the Property Report prior to the sale.²³⁵

Potential lender and noteholder liability raises serious problems for real estate transactions subject to the ILSFDA. Lenders and purchasers of outstanding promissory notes play an important role in funding real estate development. The potential for liability, however, should cause concern for the manner in which both lenders and noteholders participate in a transaction. A lender should restrict its involvement with a developer or project to that of a lender making a loan in the ordinary course of its business. The lender should refrain from direct control or entanglement in the management or profit of the real estate development. A noteholder should likewise avoid involvement with a developer or project and should take reasonable precautions to assure itself that there is no reason to doubt the developer's compliance with the ILSFDA.

C. Entities and Individuals with Corporate Relationships and Liability Under the ILSFDA

There are no special liability provisions in the ILSFDA for corporate relationships but liability has been extended to them by judicial interpretation.²³⁶ The most important case in this area is *McCown v. Heidler*.²³⁷ In *McCown*, the plaintiffs, alleging fraud, deceit and material omissions and misrepresenta-

²³² See *Bettis v. Lakeland, Inc.*, 402 F. Supp. 1300, 1301-02 (E.D. Tenn. 1975).

²³³ See *Stewart v. Thornton*, 116 Ariz. 107, 108, 568 P.2d 414, 415 (1977) (A general reference would be to U.C.C. § 3 (1978)).

²³⁴ *Id.* at 109-10, 568 P.2d at 416-17.

²³⁵ See *Stewart v. Thornton*, 116 Ariz. 107, 109-10, 568 P.2d 414, 416-17 (1977); *Salter v. Vanotti*, 42 Colo. App. 448, 599 P.2d 962, 964-65 (1979) (standard contract provision reciting receipt of Property Report is not conclusive as to receipt).

²³⁶ See *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1975).

²³⁷ *Id.* at 206.

tions, sued the developer, Timberlake, Inc., its parent company, Heidler Corporation, and various individuals who were officers and directors of both Timberlake and Heidler.²³⁸ The trial court decided that the individuals, as corporate officers and directors, were neither developers or agents nor within the narrow "target of suit" covered by the ILSFDA.²³⁹ On appeal, the Tenth Circuit Court of Appeal disagreed, noting that the ILSFDA "should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes."²⁴⁰ The court further observed that for the ILSFDA to be meaningful, liability must extend to all fraudulent planners and profit makers.²⁴¹ The court found that this category of persons includes corporate officers and directors who participate in fraud and who, if not primarily liable as developers or agents, could be liable for aiding and abetting.²⁴² Thus, the *McCown* case greatly extended liability beyond mere developers and agents to include planners, profit makers and aiders and abettors.

In *McCown*, the court found support for its extension of liability under a theory of aider and abettor in the case law which has developed relative to aider and abettor liability under § 10b and Rule 10B(5) of The Securities and Exchange Act of 1934.²⁴³ It should be noted, however, that other courts have rejected the analogy to the securities laws as a basis for aider and abettor liability under the ILSFDA.²⁴⁴ One court found a significant distinction between the two areas of law in that the general anti-fraud provisions of the securities laws apply to "any person" whereas the corresponding provisions of the ILSFDA apply to "developers and their agents."²⁴⁵ In light of the above distinction, one could hold that a corporate stockholder, who allowed his name and position to be used in promotional materials, was not liable as an aider and abettor under the ILSFDA because there was no evidence that he was a developer or agent nor that he participated or planned any corporate activities in violation of the ILSFDA.²⁴⁶ On the other hand, corporate officers, directors, stockholders, planners, or aiders and abettors have been held liable where they: (1) have a significant relationship to the corporation and its management activities; (2) have signed or distributed a Property Report as a corporate officer; (3) have had sufficient control over employees to be able to give instructions for

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ *Id.* at 207, quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

²⁴¹ *Id.*

²⁴² *Id.* (supporting its decision on aiding and abetting by reference to prior decisions involving liability under Rule 10B(5) of securities laws).

²⁴³ *Id.*

²⁴⁴ See *Bartholomew v. Northampton Nat'l Bank of Easton*, 584 F.2d 1288, 1292-94 (3d Cir. 1978).

²⁴⁵ *Id.* at 1294.

²⁴⁶ *Id.* at 1291-94 (A U.S. Senator, William Brock, was involved as a limited partner of a company that was a part owner and promoter of a real estate development.).

distribution of Property Reports; and (4) have maintained an office near the real estate development from which salesmen have operated.²⁴⁷ Thus, a relationship to the corporation as an officer, director, or stockholder coupled with participation in managerial decision-making may establish a relationship between a person and a corporation sufficient for holding them liable for violations of the ILSFDA. Furthermore, it appears there may need to be less evidence of managerial participation where there is evidence of knowledge or actual involvement in wrongful corporate activities.

Liability under the ILSFDA is not limited to civil penalties and a number of investors, corporate officers or directors, or persons with otherwise significant relationships to the wrongdoing have been subject to criminal prosecution.²⁴⁸ Of course, participation by one person or group of persons in violating the ILSFDA does not *ipso facto* make participants or their associates, officers, directors or stockholders.²⁴⁹ The prerequisite to liability is an administrative or judicial determination that the person is a developer or agent under the ILSFDA or that they actively and knowingly participated with the principal wrongdoer.²⁵⁰

When corporate relationships are involved, the courts seem to favor allowing law suits that include as defendants: (1) parent and subsidiary corporations; (2) separate corporate divisions; and (3) component partnership and limited partnership entities.²⁵¹ Exceptions to this practice have involved cases where the plaintiffs admitted that a particular entity was not involved in the alleged wrongdoing and those where the entity being sued is a successor in ownership to an earlier entity which was not in existence at the time of the alleged wrongdoing.²⁵² In these instances other defendants were always

²⁴⁷ See *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 54 (N.D. Miss. 1980).

²⁴⁸ See *United States v. Dacus*, 634 F.2d 441, 442-43, 446 (9th Cir. 1980); *Schenker v. United States*, 529 F.2d 96, 97-98 (9th Cir. 1976), *cert. denied*, 429 U.S. 818 (1976); *United States v. Goldberg*, 527 F.2d 165, 167, 173 (2d Cir. 1975); *United States v. Pocono Int'l Corp.*, 378 F. Supp. 1265, 1265-66 (S.D.N.Y. 1974).

²⁴⁹ See *United States v. Amrep Corp.*, 560 F.2d 539, 545 (2d Cir. 1977).

²⁵⁰ *Id.* at 544-45.

²⁵¹ See *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1290-91 (3d Cir. 1978) (corporations, limited and general partnerships); *United States v. Amrep Corp.*, 560 F.2d 539, 544-45 (2d Cir. 1977) (parent and subsidiary corporations); *McCown v. Heidler*, 527 F.2d 204, 206 (10th Cir. 1975) (parent and subsidiary corporations); *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1107 (5th Cir. 1975) (parent and subsidiary corporations); *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 985-86 (N.D. Cal. 1978) (corporate alter ego under California law); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 301-02 (S.D.N.Y. 1977) (parent and subsidiary corporations); *Davis v. Rio Rancho Estates, Inc.*, 401 F. Supp. 1045, 1046 (S.D.N.Y. 1975) (corporate divisions); *Zachery v. Treasure Lake of Georgia, Inc.*, 374 F. Supp. 251, 251-52 (N.D. Ga. 1974) (parent and subsidiary corporations); *Melhorn v. Amrep Corp.*, 373 F. Supp. 1378, 1379 (N.D. Pa. 1974) (subsidiary corporations).

²⁵² See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1279 (S.D.N.Y. 1978) (plaintiff admits that a particular corporation was not involved in the wrongdoing); *Bettis v. Lakeland, Inc.*, 402 F. Supp. 1300, 1302 (E.D. Tenn. 1975) (corporation not in existence at time of alleged wrongdoing); *Zachery v. Treasure Lake of Georgia, Inc.*, 374 F. Supp. 251, 255 (N.D. Ga. 1974) (corporation not in existence at time of alleged wrongdoing).

available to continue the law suit so that by dismissing certain defendants the courts did not eliminate a plaintiff's ability to pursue a remedy.²⁵³

At least one court has limited liability in the context of corporate relationships by restricting the scope of disclosure required in a Property Report with regard to the financial affairs of the grandparent company (the parent corporation of the parent corporation) of the developer corporation.²⁵⁴ In that instance, the plaintiffs alleged that such financial information was material within the meaning of the ILSFDA but the court ruled that it was not material in as much as the developer corporation was a separate entity with its own substantial assets and was pursuing the real estate project in question without the participation or supervision of its parent companies.²⁵⁵

It appears from the developing case law that persons involved in corporate relationships such as in the structuring, operating or equity funding of various entities risk potential liability under the ILSFDA. Persons in such situations should, therefore, be careful to avoid activities that might give an appearance of participation or assistance to the entity violating the requirements of the ILSFDA.²⁵⁶

VI. PROCEDURAL ASPECTS OF THE ILSFDA

The procedural aspects of the ILSFDA involve: (a) consequences for violation, and (b) statutory limitations on actions.

A. *Consequences of Violating the ILSFDA*

The ILSFDA provides for both civil and criminal penalties.²⁵⁷ Rights and remedies provided by the ILSFDA are in addition to any and all other rights and remedies that may exist at law or in equity.²⁵⁸

²⁵³ See cases cited *supra* note 197.

²⁵⁴ See *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1111 (5th Cir. 1975).

²⁵⁵ *Id.* at 1110-111.

²⁵⁶ For further discussion about the implications for these relationships, see *supra* § VII(c).

²⁵⁷ 15 U.S.C. § 1709 (1982) (civil liabilities); *id.* § 1717 (1982) (criminal penalties). See also *United States v. Dacus*, 634 F.2d 441, 442-43 (9th Cir. 1980) (criminal proceeding); *United States v. Amrep Corp.*, 560 F.2d 539, 542 (2d Cir. 1977) (criminal proceeding); *United States v. Amrep Corp.*, 545 F.2d 797, 799 (2d Cir. 1976) (criminal proceeding); *Schenker v. United States*, 529 F.2d 96, 97 (9th Cir. 1976) (criminal proceeding); *United States v. Goldberg*, 527 F.2d 165, 167-68 (2d Cir. 1975) (criminal proceeding); *United States v. Steinhilber*, 484 F.2d 386, 387 (8th Cir. 1973) (criminal action ending in reversal of trial court conviction); *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, 53-54 (N.D. Miss. 1980) (misrepresentation and fraud—civil action); *Heit v. Amrep Corp.*, 82 F.R.D. 130, 131-32 (S.D.N.Y. 1979) (class action civil suit); *United States v. Del Rio Springs, Inc.*, 392 F. Supp. 226, 227-28 (D. Ariz. 1975) (criminal proceeding); *United States v. Pocono Int'l Corp.*, 378 F. Supp. 1265, 1267-68 (S.D.N.Y. 1974) (criminal proceeding); *Hoffman v. Charnita*, 58 F.R.D. 86, 88-89 (M.D. Pa. 1973) (class action civil suit); *Kniffin v. Colorado Western Development Co.*, 622 P.2d 586, 587-88 (Colo. Ct. App. 1980) (breach of contract action).

²⁵⁸ 15 U.S.C. § 1713 (1982).

In civil actions, the court may order damages, specific performance or other fair, just and equitable relief.²⁵⁹ In granting relief, the court may consider: the contract price; the amount actually paid; the cost of improvements; and the fair market value at the time of purchase.²⁶⁰ A purchaser can bring an action to enforce the rights provided under the disclosure and anti-fraud provisions of § 1703 of the ILSFDA.²⁶¹ In addition to other amounts recoverable by a purchaser, the court may award interest, court costs, reasonable attorneys' fees, independent appraisers' fees, and costs of travel to and from the lot.²⁶² Every person held civilly liable under the ILSFDA may seek contribution from any person who, if sued separately, would have been liable to make the same payment.²⁶³

In civil actions the plaintiff cannot have his lawsuit dismissed for failing to properly calculate damages because the court can determine damages on its own.²⁶⁴ The 1979 amendments to the ILSFDA gave courts greater discretion in determining damages.²⁶⁵ The original provisions on damages generally allowed recovery only of the plaintiff's out of pocket costs — the cost of the lot plus improvements.²⁶⁶ Now, purchasers may recover costs plus interest, attorney fees and other expenses.²⁶⁷ Even with the possibility of substantial damages it is still possible to have only nominal damages if a defendant's wrongful act has not left plaintiff in a worse position or diminished the value of his investment.²⁶⁸ Of course, nominal damages would have been more likely under the old provisions when out of pocket costs were generally the only consideration.

The OILSR hopes that more remedies for purchasers will increase incentives for private actions to enforce the ILSFDA.²⁶⁹ It should be noted, however, that the 1979 amendments to the damages and remedies provisions have been interpreted to have no retroactive application.²⁷⁰ This means that the additional remedies and incentives provided by the 1979 amendments are not available to persons alleging damage based on actions prior to the amendments.

²⁵⁹ *Id.* § 1709(a).

²⁶⁰ *Id.*

²⁶¹ *Id.* § 1709(b). In other words, a purchaser can bring an action to enforce the disclosure and anti-fraud provisions of the ILSFDA and can revoke contracts for improper transactions under 15 U.S.C. § 1703 (1982).

²⁶² *Id.* § 1709(c).

²⁶³ *Id.* § 1709(d).

²⁶⁴ See *Bongratz v. W.L. Belvidere, Inc.*, 416 F. Supp. 27, 30 (N.D. Ill. 1976) (defendant tried to defeat plaintiff's cause of action alleging improper claim for damages).

²⁶⁵ See 15 U.S.C. § 1709 (1982). See also *Biennial Rep. To Congress*, *supra* note 6, at 18-19.

²⁶⁶ See *Fitzgerald v. Century Park, Inc.*, 642 F.2d 356, 358-59 (9th Cir. 1981).

²⁶⁷ See 15 U.S.C. § 1709 (1982). See also *Biennial Rep. To Congress*, *supra* note 6, at 18-19.

²⁶⁸ *Fitzgerald v. Century Park, Inc.*, 642 F.2d 356, 359 (9th Cir. 1981); *Johnson v. Stephens Development Corp.*, 538 F.2d 664, 666 (5th Cir. 1976).

²⁶⁹ See *Biennial Rep. To Congress*, *supra* note 6, at 18-19.

²⁷⁰ See *Fitzgerald v. Century Park, Inc.*, 642 F.2d 356, 359 (9th Cir. 1981); *Hester v. Hidden Valley Lakes, Inc.*, 495 F. Supp. 48, n.2 at 55 (N.D. Miss. 1980).

One court has held, as to available remedies under the original provisions of the ILSFDA, that a purchaser's option to rescind a purchase contract and to have his payments returned is a remedy that can be elected but is not cumulative with the right to seek damages.²⁷¹ Several class action suits have also considered the separate remedies of rescission and damages with the conclusion being that they are antagonistic remedies which can not be jointly prosecuted by the same representative of the class.²⁷² To the extent that the remedies may be mutually exclusive a defendant should use trial strategy favoring the least expensive remedy should he lose on the merits.

One of HUD's most effective tools for wide scale enforcement of the ILSFDA is to obtain names of purchasers from developers and send them notice of possible violations and remedies.²⁷³ In order to obtain the names of purchasers and other information, HUD has the power to obtain subpoenas and to investigate alleged violations.²⁷⁴ The Secretary may also seek injunctions to prevent acts or practices that constitute or will constitute a violation of the ILSFDA and the Secretary may recommend to the Attorney General that appropriate criminal proceedings be instituted.²⁷⁵ In conjunction with these powers, the Secretary can suspend the effectiveness of a Statement of Record and Property Report, thereby prohibiting future sales in a nonexempt development.²⁷⁶

On the other hand, declaratory and injunctive relief are available to protect developers from HUD actions. In one instance, a bank sought and obtained declaratory relief from an OILSR classification of the bank as a developer subject to the ILSFDA.²⁷⁷ In another situation, a developer obtained injunctive relief which prevented the Secretary from notifying purchasers of possible violations and rights of rescission or damages.²⁷⁸ The injunction against the Secretary was granted because the statute of limitations had run against all purchasers so that no legitimate purpose would be served by notification.²⁷⁹ In the same case, however, the court also granted the Secretary an injunction against the developer's sales activities and upheld a subpoena of corporate information including the names of all purchasers.²⁸⁰ Even though

²⁷¹ See *Gaudet v. Woodlake Development Co.*, 413 F. Supp. 486, 490 (E.D. La. 1976).

²⁷² See *Bryan v. Amrep Corp.*, 429 F. Supp. 313, 317-18 (S.D.N.Y. 1977); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71-72 (W.D. Va. 1975); *Hoffman v. Charnita, Inc.*, 58 F.R.D. 86, 89-90 (M.D. Pa. 1973).

²⁷³ See *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 70 (letters were sent to purchasers); *Walsh*, *supra* note 14, at 274-75.

²⁷⁴ 15 U.S.C. §§ 1714(b), (c), (d) (1982). See also *Lynn v. Biderman*, 536 F.2d 820, 823, 825 (9th Cir. 1976); *Cumberland Capital Corp. v. Harris*, 490 F. Supp. 551, 559-60 (M.D. Tenn. 1977), *rev'd on other grounds*, 621 F.2d 246 (6th Cir. 1980).

²⁷⁵ 15 U.S.C. § 1714 (1982).

²⁷⁶ See 24 C.F.R. § 1710.45 (1982). See also *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1291 (3d Cir. 1978) (situation where a suspension was issued).

²⁷⁷ See *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 248 (6th Cir. 1980).

²⁷⁸ See *Lynn v. Biderman*, 536 F.2d 820, 826-27 (9th Cir. 1976).

²⁷⁹ *Id.* at 824, 826-27.

²⁸⁰ *Id.* at 825-27.

purchasers were not to be notified, the court stated that the names were necessary to assist the Secretary in compiling information to support the injunction against further sales and to provide information for formulating new legislative recommendations for improving the ILSFDA.²⁸¹

The government may institute a criminal action against any person who willfully violates any provisions of the ILSFDA or any of its rules and regulations and against any person who, in a Statement of Record or Property Report, willfully makes any untrue statement of a material fact or omits to state any material fact required to be stated.²⁸² Upon conviction, the person is subject to a fine of not more than \$10,000 or imprisonment for not more than five years, or both.²⁸³ In a criminal case evidence on appeal will be viewed in a light most favorable to the government.²⁸⁴

The consequences of violating the ILSFDA can be serious. Civil damages can result in financial loss to a developer and administrative proceedings can severely hinder sales efforts. In addition to civil or administrative proceedings the willful violator of the ILSFDA may have a criminal action instituted against him by the government.

B. Statutory Limitations on Actions Under the ILSFDA

The ILSFDA provides that civil actions must be brought: (1) for violations of disclosure provisions, within three years of signing a contract for sale or lease; and (2) for violations of the anti-fraud provisions, within three years of discovery of the violation or within three years of the date discovery should have been made by the exercise of reasonable diligence.²⁸⁵ These provisions, which were part of the 1979 amendments, are significantly different from the original provision which required that: (1) actions for violations of the disclosure provisions were to be brought within two years of the violation; (2) actions for violations of the anti-fraud provisions were to be brought within one year of discovery or within one year from when it should have been discovered by the exercise of reasonable diligence; and (3) in no event was any action to be brought by a purchaser more than three years after the sale or lease.²⁸⁶ The change in the statute of limitations has benefited consumers who previously were often frustrated by the short time period.²⁸⁷

The most frustrating aspect for consumers was the third part of the original provisions which provided that in no event was any action to be brought more than three years after the sale or lease. The "in no event"

²⁸¹ *Id.* at 824-25.

²⁸² See 15 U.S.C. § 1717 (1982).

²⁸³ *Id.*

²⁸⁴ *United States v. Dacus*, 634 F.2d 441, 444 (9th Cir. 1980); *United States v. Goldberg*, 527 F.2d 165, 168 (2d Cir. 1975); *United States v. Steinhilber*, 484 F.2d 386, 389 (8th Cir. 1973).

²⁸⁵ 15 U.S.C. § 1711 (1982).

²⁸⁶ See *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977).

²⁸⁷ See *Biennial Rep. To Congress*, *supra* note 6, at 8, 18.

language was interpreted as an absolute bar to all actions not brought within three years of the sale or lease.²⁸⁸ The absolute bar was applied regardless of the reason for delay.²⁸⁹ Accordingly, courts did not apply the doctrine of "equitable estoppel" to extend the running of the statute beyond the three year absolute bar.²⁹⁰

Under the original provisions, courts did accept the doctrine of equitable estoppel as to the one and two year periods, allowing them to be tolled, in proper situations, up to the three year absolute bar.²⁹¹ Tolling was allowed when continued misrepresentations were made by a developer or his agents to a purchaser including false statements that lot values were increasing, that construction work was proceeding on schedule, and that there was no need for a personal inspection of the property.²⁹² Mere discussion or negotiation of a settlement, however, is not enough under the ILSFDA to constitute a wrongful act by a defendant for purposes of applying the doctrine of equitable estoppel to the ILSFDA.²⁹³ To hold otherwise would have created a disincentive for legitimate attempts to settle disputes out of court prior to the running of the statute of limitations.

The new limitation period in the ILSFDA provides for a three year time period for both the disclosure and anti-fraud provisions while eliminating the controversial "in no event" language. Based on the new language, the courts should extend the general rule that federal statutes are to have read into them the doctrine of equitable estoppel to the ILSFDA's three year statute of limitations.²⁹⁴

²⁸⁸ See *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1042-43 (10th Cir. 1980); *Newell v. High Vistas, Inc.*, 479 F. Supp. 97, 100-01 (M.D. Pa. 1979); *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977); *Lukenas v. Bryce's Mountain Resort, Inc.*, 66 F.R.D. 69, 71, 73 (W.D. Va. 1975). *Contra Bomba v. W.L. Belvidere, Inc.*, 579 F.2d 1067, 1070-71 (7th Cir. 1978).

²⁸⁹ See *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1042 (10th Cir. 1980); *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977) (The general rule is that federal statutes have the doctrine of equitable estoppel read into them unless congressional intent is clearly otherwise. The language of the original ILSFDA limitation presented a problem because of the three year absolute bar language.).

²⁹⁰ See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977). See also *Melhorn v. Amrep Corp.*, 373 F. Supp. 1378, 1380-81 (N.D. Pa. 1974). *Contra Bomba v. W.L. Belvidere, Inc.*, 579 F.2d 1067, 1070-71 (7th Cir. 1978).

²⁹¹ See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274 (S.D.N.Y. 1978); *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 987-88 (N.D. Cal. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 306-08 (S.D.N.Y. 1977); *Happy Investment Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 188-89 (N.D. Cal. 1975).

²⁹² See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977); *Happy Investment Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 188-89 (N.D. Cal. 1975).

²⁹³ See *Melhorn v. Amrep Corp.*, 373 F. Supp. 1378, 1380-82 (N.D. Pa. 1974); *Hall v. Bryce's Mountain Resort, Inc.*, 379 F. Supp. 165, 169-70 (W.D. Va. 1974).

²⁹⁴ See *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1042-43 (10th Cir. 1980).

In addition to extending the application of equitable estoppel under the ILSFDA, the new provisions also clarify when the statute begins to run.²⁹⁵ The earlier version of the statute provided that the statute began to run as of the date of sale or lease but now the provisions refer to the date of signing of the contract of sale or lease as the critical date for all actions except those asserting violations of the anti-fraud provisions.²⁹⁶ In actions under the anti-fraud provisions, the statute runs from the date of discovery of the wrong or the date discovery should have been made in the exercise of reasonable diligence.²⁹⁷ Under the original provisions, in order to get around the three year absolute bar without relying on the doctrine of equitable estoppel, a number of courts developed a flexible definition of sale, including later delivery of a deed as a separate sale and the last payment on an installment sales contract as the sale.²⁹⁸

It should be noted that the new provisions still leave room for manipulating the running of the limitation period. For instance, a change or amendment to a contract or lease could be considered a novation and if wrongdoing continued or occurred at the time of signing the novation documents, the limitation period could be considered to begin anew.²⁹⁹ Obtaining money or property by material misrepresentation or omission is itself a violation of the ILSFDA, therefore each payment made pursuant to a subject transaction could be an event from which the limitation period begins to run if the wrongdoing is continuing at the time of payment.³⁰⁰ Continuing wrongdoing under the ILSFDA can thus create either a new violation or an extension of a previous violation such that the dates for running of the limitations period may be manipulated or the doctrine of equitable estoppel applied.³⁰¹ Either method of

²⁹⁵ See generally *Bongratz v. W.L. Belvidere, Inc.*, 416 F. Supp. 27, 29 (N.D. Ill. 1976) (pleading running of the statute of limitations is an affirmative defense so that defendant must plead facts showing plaintiff's action is in fact barred); *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580, 581-82 (N.D. Miss. 1975) (the limitations period is tolled from the date of filing a complaint and not the date of service of process).

²⁹⁶ See 15 U.S.C. § 1711 (1982). See also *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977).

²⁹⁷ See 15 U.S.C. § 1711 (1982). See also *Timmreck v. Munn*, 433 F. Supp. 396, 407-09 (N.D. Ill. 1977).

²⁹⁸ See *Newell v. High Vista, Inc.*, 479 F. Supp. 97, 99-100 (M.D. Pa. 1979) (sale is at both time of contract and delivery of deed); *Husted v. Amrep Corp.*, 429 F. Supp. 298, 307 (S.D.N.Y. 1977) (sale is at time of last payment); *Gaudet v. Woodlake Development Co.*, 413 F. Supp. 486, 488-89 (E.D. La. 1976) (sale is at both time of contract and delivery of deed). See generally *McCaffrey v. Diversified Land Co., Inc.*, 564 F.2d 1241, 1242-44 (9th Cir. 1977). *Contra* *Aldrich v. McCulloch Properties, Inc.*, 627 F.2d 1036, 1043-44 (10th Cir. 1980) (sale refers to the time of contract); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274 (S.D.N.Y. 1978) (sale is at time of last payment); *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580, 584 (N.D. Miss. 1975) (sale refers to the time of contract).

²⁹⁹ See generally *Hester v. Hidden Valley Lakes, Inc.*, 404 F. Supp. 580, 582 (N.D. Miss. 1975).

³⁰⁰ See *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274-75 (S.D.N.Y. 1978).

³⁰¹ See *Bomba v. W.L. Belvidere, Inc.*, 579 F.2d 1067, 1070-71 (7th Cir. 1978); *Fogel v. Sellamerica, Ltd.*, 445 F. Supp. 1269, 1274-75 (S.D.N.Y. 1978); *Timmreck v. Munn*, 433 F.

expanding the time period increases the opportunity to correct violations of the ILSFDA thereby creating additional incentives for developers to comply with its provisions in the first instance.

VII. IMPLICATIONS FOR PERSONS PARTICIPATING IN REAL ESTATE DEVELOPMENT

As a result of its two-fold purpose of disclosure and anti-fraud protection, the implications of the ILSFDA can be far-reaching.³⁰² Most people, to date, have failed to appreciate the extent of the potential impact the ILSFDA can have on structuring real estate development projects. Failing to properly structure a project, in light of the purpose, requirements, and consequences of the ILSFDA, may lead to unsuspected legal and financial difficulties. In bringing together the implications suggested by this article, an examination will be made of the potential impact on: (A) developers, (B) lenders, (C) investors and corporate officers or directors, and (D) other participants in real estate development.

A. *Implications for Developers Under the ILSFDA*

Developers are likely to be persons operating under the assumption that they could be subject to the ILSFDA. Twenty-five lots within a common promotional plan is not a large development project by today's standards and the "use of interstate commerce" test for application of the ILSFDA requires only a de minimus showing of interstate sales, advertising, loan financing, or document processing.³⁰³ A developer's primary concern, therefore, is with avoidance of the requirements of the ILSFDA. Avoidance techniques may involve either a plan designed to circumvent jurisdictional criteria, or the election of a specific exemption under the ILSFDA.

In attempting to circumvent the jurisdictional requirements of the ILSFDA, a developer may either manipulate the number of lots within the development or structure separable parcels of the development into purely intrastate marketing efforts. Both of these tactics are highly questionable in terms of effective avoidance of the jurisdictional criteria of the ILSFDA.

Under the concept of "common promotional plan," a developer may find that several individual projects are treated as one by OILSR even though each project is operated as a separate subdivision by distinct corporate or partnership entities.³⁰⁴ Common investors, financiers, parent companies, or sales pro-

Supp. 396, 409 (N.D. Ill. 1977); *Happy Investment Group v. Lakeworld Properties, Inc.*, 396 F. Supp. 175, 188-89 (N.D. Cal. 1975). These cases stand for the proposition that the doctrine of equitable estoppel is separate and apart from the actual language of the statute.

³⁰² One way to reduce the uncertainty of the ILSFDA's implications would be to adopt a policy of issuing advance private letter rulings. See *supra* note 201.

³⁰³ See 24 C.F.R. § 1710.3 (1982); *id.* § 1710.1 (1982) (definitions). See also Walsh, *supra* note 14, at 270-71; 15 U.S.C. § 1701(4) (1982).

³⁰⁴ For further discussion, see *supra* § III(A).

motions may lead the OILSR to treat seemingly separate projects as part of a common offering with the result that the number of lots within the "common development" are aggregated, thereby qualifying the development as one meeting the threshold requirements for application of the ILSFDA.³⁰⁵

Similarly, OILSR may "pierce the veil" of a phased marketing effort where phase one is sold intrastate in an attempt to avoid requirements of the ILSFDA while later phases are sold interstate after the local market is saturated.³⁰⁶ In assessing the total sales effort, OILSR can decide that the entire project rather than just a given phase was required to comply with the ILSFDA.³⁰⁷ Under each tactic, seemingly separate activities could be subject to communal treatment by OILSR, resulting in a developer's violation of the ILSFDA for failure to comply with its requirements from the commencement date of the "common development."

Asserting an exemption is another method of avoiding the costly requirements of the ILSFDA. Most exemptions are self-activating while others may require approval of the Secretary.³⁰⁸ Exemptions may be based on a number of factors including: the degree to which improvements are completed before selling or leasing begin in the development; the type of promises made by the developer in the contract of sale or lease; and the number of lots in the development.³⁰⁹ Although the exemptions are numerous, especially as to disclosure requirements, none of them are effective if elected for the purpose of otherwise avoiding the requirements of the ILSFDA.³¹⁰ In other words, valid exemptions may be limited to legitimate business purposes existing independently of a need or desire to avoid the inconvenience or cost of complying with the ILSFDA.

Because the exemptions are primarily self-activating, their effectiveness can never be assured. In an after-the-fact review of an exemption, OILSR and the courts are free to make their own determination of effectiveness based on an evaluation of all surrounding facts.³¹¹ This after-the-fact review can be risky to a developer in light of the fact that the process would likely be triggered after OILSR receives a consumer complaint. In the reviewing process, factors that can support a determination that an exemption is ineffective because elected for the purpose of improper avoidance of the ILSFDA include: (1) evidence of a high pressure sale or lease campaign; (2) questionable representations as to future improvements or as to present soil or project conditions; (3) less than candid disclosures of financial or contingency completion information; (4)

³⁰⁵ 15 U.S.C. § 1702 (1982).

³⁰⁶ See Walsh, *supra* note 14, at 269-70.

³⁰⁷ For further discussion, see *supra* § III(A).

³⁰⁸ 24 C.F.R. § 1710.4(d) (1982). See Happy Investment Group v. Lakeworld Properties, Inc., 396 F. Supp. 175, 181-82 (N.D. Cal. 1975).

³⁰⁹ 15 U.S.C. § 1702 (1982).

³¹⁰ *Id.* See 24 C.F.R. § 1710.4 (1982).

³¹¹ For further discussion, see *supra* § III(A).

biased, one-sided contract provisions that eliminate or dilute consumer contract remedies; and (5) a history of failing to adequately respond to consumer complaints.³¹² As a result of this review process, a developer who believes he is exempt from the ILSFDA, may find himself liable for violations after his alleged exemption is disallowed.

Developers concerned with avoiding the ILSFDA must be careful. On the surface, avoidance, especially by exemptions, seems relatively easy to accomplish but there exists, nonetheless, a significant risk that jurisdiction may be found and exemptions declared inapplicable. Developers must properly structure their real estate projects by conservatively evaluating the application of the ILSFDA and by accounting for the risk that OILSR or the courts may set aside self-serving interpretations of its requirements.

B. *Implications for Lenders Under the ILSFDA*

Unlike developers, lenders are unlikely to suspect that they may be subject to the ILSFDA because the ILSFDA is primarily focused on the acts of selling and leasing rather than lending. Therefore, the lender's primary concern is not with avoidance techniques but with understanding the initial application of the ILSFDA. A lender may be subject to potential liability under the ILSFDA if the lender can be characterized as a developer,³¹³ agent,³¹⁴ or aider and abettor.³¹⁵ This potential for liability is particularly troublesome in today's real estate markets where sudden changes in economic conditions can have significant effects on a lender's security. Efforts to reduce these effects have led to increased tension between the lender's potential liability under the ILSFDA and its legitimate business interest in protecting its loan security.³¹⁶

Liability as a developer would involve a finding that the lender directly or indirectly engaged in the selling or leasing of lots or that it held a managerial and proprietary interest in the real estate project.³¹⁷ Such a finding is most likely when the lender gets involved in "creative financing" or situations of loan default.³¹⁸

In creative financing, the lender may retain a fee interest in the property as in a sale-lease back agreement,³¹⁹ share in the profits of the development in

³¹² See *id.*

³¹³ See generally *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 251 (6th Cir. 1980).

³¹⁴ See generally *Wachovia Bank & Trust Co. v. Glass*, 575 S.W.2d 950, 955 (Tenn. Ct. App. 1978).

³¹⁵ See generally *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 990 (N.D. Cal. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 406-07 (N.D. Ill. 1977).

³¹⁶ For further discussion, see *supra* § V(B).

³¹⁷ See generally *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 249-51 (6th Cir. 1980).

³¹⁸ For further discussion, see *supra* § V(B).

³¹⁹ A sale-lease back agreement involves a method of financing in which the "borrower" transfers the fee title of his property to the "lender" while retaining a long term leasehold interest for which periodic rental payments are made back to the "lender."

exchange for lower construction loan interest rates,³²⁰ or benefit from equity participation as in a shared appreciation mortgage.³²¹ Through the use of creative financing, the lender seeks to improve the security for its loan and the return on its investment. At the same time, however, the lender establishes an interest in the project beyond the traditional interest of making a return on its loan. This interest may be characterized as the managerial and proprietary interest of a developer and subject the lender to the requirements of the ILSFDA.³²²

Likewise, events subsequent to a default can place lenders in a position which may lead to characterization as a developer. Selling or leasing lots from its own account after foreclosure may be held to be incidental to the exercise of the right to enforce a mortgage or deed of trust on real estate or it may be found to constitute an activity within the scope of the ILSFDA.³²³ In such situations, the courts will pay close attention to the lender's process for selling or leasing and the extent to which improvements may be made to the property while under the lender's ownership.³²⁴ The less that is done to improve the property or to engage in the continuation of a project the less likely it is that a court would construe the lender's activities as being within the ILSFDA.³²⁵

After foreclosure, a lender may also be subject to liability upon "taking over" a project as a mortgagee in possession. In taking possession of a project, the lender carries on the business in order to protect its security and can generally be regarded as managing or operating the project for its own benefit as well as for the benefit of co-mortgagees, if any, and the mortgagor.³²⁶ In such a role, the lender becomes an open target for developer characterization by disgruntled purchasers or investors seeking to recover for alleged violations of the ILSFDA.

To incur agent liability, the lender would have to be entangled in a working relationship with a developer to the extent of appearing to assist in the selling or leasing of lots subject to the ILSFDA.³²⁷ Lender liability as a developer's agent focuses on entanglement so that there should be no need for a finding of a retained managerial or proprietary interest in the development.³²⁸ Moreover, although loan processing or requests for payment may not be sufficient to

³²⁰ The practice in South Florida real estate development can involve a 25% to 30% share in profits for the lender.

³²¹ A shared appreciation mortgage is one where the lender, in addition to receiving regular payments of principal and interest, obtains a right to a prearranged percentage of the equity appreciation of property payable at the time of its later disposition.

³²² For further discussion, see *supra* § V(B).

³²³ See *Cumberland Capital Corp. v. Harris*, 621 F.2d 246, 249-51 (6th Cir. 1980).

³²⁴ *Id.*

³²⁵ For further discussion, see *supra* § V(B).

³²⁶ See *MADISON AND DWYER, THE LAW OF REAL ESTATE FINANCING*, § 4.04(8) (1982); *BOYER, FLA. REAL ESTATE TRANS.*, § 32.01(A) (1982).

³²⁷ See generally *Wachovia Bank & Trust Co., N.A. v. Glass*, 575 S.W.2d 950, 953-55 (Tenn. Ct. App. 1978).

³²⁸ For further discussion, see *supra* § V(B).

characterize the lender as a developer under the ILSFDA, activities related to creative financing or being a mortgagee in possession may establish sufficient entanglement with a developer for a finding of agent liability even if insufficient for developer liability.

Even when the lender avoids characterization as a developer or agent, it risks potential liability under the ILSFDA as an aider and abettor.³²⁹ Aiding and abetting is the broadest approach to lender liability under the ILSFDA and is most likely to result from construction loan practices or from financing arrangements involving substantial written agreements and preconditions to funding.³³⁰ All that is required for liability as an aider and abettor is a showing that the lender, expressly or impliedly, led consumers to believe misrepresentations about a project, or that the lender became entangled in the operation and success of a project through its working relationship with the developer.³³¹ Complex financing agreements and construction loans involve numerous instances of lender supervision and funding upon requirements for satisfaction of preconditions which, when funding continues, can imply to consumers that those preconditions have in fact been satisfied. In either instance, potential liability as an aider and abettor under the ILSFDA can apply to activities arguably thought by lenders to be within the normal course of their business.

The potential for lender liability as a developer, agent, or aider and abettor is therefore significant and could be increased by implying a duty to exercise reasonable care to prevent serious violations of the ILSFDA.³³² Serious violations of the ILSFDA usually result in a poorly constructed or incomplete project, or in a completed project substantially different from the one purchasers and investors were led to expect. These results are the foreseeable consequences of serious violations of the ILSFDA and to the extent that the lender's financing makes a project possible, the lender should be under a duty of reasonable care to all potential purchasers or lessees to investigate and ensure the soundness of a proposed development.³³³

The typical lender, unlike the purchaser or lessee of a lot, possesses expertise in evaluating overall project proposals in light of the chances for their successful completion. Furthermore, the lender has access to a developer's financial and project records as well as control over loan disbursements. This information and control give the lender leverage over the developer and the project. In such a situation, the lender should not be surprised to learn that others have

³²⁹ See *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 990 (N.D. Cal. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 406-07 (N.D. Ill. 1977).

³³⁰ For further discussion, see *supra* § V(B).

³³¹ See *Fuls v. Shastina Properties, Inc.*, 448 F. Supp. 983, 990 (N.D. Cal. 1978); *Timmreck v. Munn*, 433 F. Supp. 396, 406-07 (N.D. Ill. 1977).

³³² See *Connor v. Great Western Savings and Loan Ass'n.*, 69 Cal.2d 850, 864, 870, 447 P.2d 609, 616, 620, 73 Cal. Rptr. 369, 376, 380 (1968) (involving extension of liability to a lender for the construction defects of a developer).

³³³ *Id.* at 864-72, 447 P.2d at 616-21, 73 Cal. Rptr. at 376-81 (The lender had a duty of care to protect its own stockholders as well as other foreseeable plaintiffs.).

reasonably relied upon its judgment and commitment for financing nor should it be surprised to be held liable for failing to use reasonable care in reaching its decision to provide financing to a project or a developer. Similar reasoning has been used successfully to imply lender liability for a developer's construction defects and to extend the implied warranty of habitability to subsequent purchasers of a "new" home.³³⁴ There is no reason for lenders to escape the same type of potential liability when similar public policy reasons dictate a similar result under the ILSFDA.

*C. Implications for Investors and Corporate Officers
or Directors Under the ILSFDA*

Investors, including stockholders and limited partners, and corporate officers or directors are like lenders in that they are probably unaware of their potential liability under the ILSFDA. For the most part investors and corporate officers or directors have a sense of limited liability or a feeling that any wrongdoing will be attributed to a specific entity rather than to them personally. In many cases this belief may be a reasonable assumption, but, under the ILSFDA, investors and corporate officers or directors are subject to potential liability as developers, agents, or aiders and abettors.

In order to be held liable as a developer, an investor, or corporate officer or director must have a managerial and proprietary interest in the development and must actively participate in the management of the project.³³⁵ By definition, an investor has a proprietary interest and a corporate officer or director has a managerial interest in a given project. Thus, it is the commingling of these interests, in the presence of active participation, that leads to potential liability as a developer under the ILSFDA.³³⁶ In order to reduce the risk of potential developer liability, an investor should avoid the appearance of authority, both in writing and in practice, in the management of the venture and corporate officers or directors should avoid any direct proprietary interest in the profits or distributions of the venture.

An investor or corporate officer or director is more likely to be held liable as an agent than as a developer under the ILSFDA. Agent liability does not require a showing of active participation in the planning or management of the development.³³⁷ All that is required for agent liability under the ILSFDA is a

³³⁴ *Id.* at 864-72, 447 P.2d at 616-21, 73 Cal. Rptr. at 376-81 (as to lender liability for a developer's construction defects). See also *Redarowicz v. Ohlendorf*, 92 Ill.2d 171, 183-86, 441 N.E.2d 324, 330-31 (1982) (extending implied warranty of habitability); *Moxley v. Laramie Builders, Inc.*, 600 P.2d 733, 735-36 (Wyo. 1979) (extending implied warranty of habitability). See generally *Shedd, The Implied Warranty of Habitability: New Implications, New Applications*, 8 REAL ESTATE L.J. 291, 303-06 (1980) (Within the last 25 years over 35 states have afforded some measure of protection for purchasers of new homes by implying some form of a warranty of habitability.).

³³⁵ See generally *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1110-111 (5th Cir. 1975).

³³⁶ For further discussion, see *supra* § V(A), (C).

³³⁷ For further discussion, see *supra* § V.

managerial or proprietary interest evidenced by selling or leasing or authority to sell or lease lots in the development.³³⁸ Thus, participation short of what is required for characterization as a developer may be sufficient for characterization and liability as an agent.

Liability as an aider and abettor is the broadest grounds for liability under the ILSFDA.³³⁹ Under this judicial extension of the ILSFDA's coverage, all planners and profit makers can be liable for violations.³⁴⁰ Such an application of the ILSFDA affects investors and corporate officers and directors who directly or indirectly participate in a scheme to defraud and who may not be primarily liable as developers or agents.³⁴¹ Under a theory of aider and abettor liability, there is no need for evidence of a managerial or proprietary interest although evidence of such an interest would increase the potential for liability.³⁴² In lieu of a showing of a managerial and proprietary interest the courts have settled on a finding of a significant relationship to the developer and its management activities.³⁴³ Such a significant relationship may exist when a person has authority to supervise, or in fact supervises, activities of the project which amount to violations of the ILSFDA.³⁴⁴ Examples of supervisory activities would include the signing or distribution of a Property Report on behalf of the developer, or the maintenance of an office near the real estate development from which salesmen operated.³⁴⁵ When the underlying activity results in a violation of the ILSFDA, such as through a Property Report or material misrepresentation by salesmen, then the person with supervisory authority can be subject to potential liability as an aider and abettor.³⁴⁶

D. *Implications for Other Participants in Real Estate Development*

Other persons potentially liable under the ILSFDA include noteholders, real estate brokers, attorneys, and title insurance companies. Though each may be liable under different circumstances, they all share the risk of potential liability for activities they generally believe to be in the ordinary course of their business and not subject to the ILSFDA.

Noteholders are persons, other than lenders, who purchase promissory notes as investments. They can be liable under the ILSFDA as aiders and abettors if it is determined that their purchase or assignment of the promissory note

³³⁸ See generally *Paquin v. Four Seasons of Tennessee, Inc.*, 519 F.2d 1105, 1110-111 (5th Cir. 1975).

³³⁹ See *McCown v. Heidler*, 527 F.2d 204, 207 (10th Cir. 1975).

³⁴⁰ For further discussion, see *supra* § V(C).

³⁴¹ For further discussion, see *supra* § V(A), (C).

³⁴² For further discussion, see *supra* § V.

³⁴³ *Id.*

³⁴⁴ *Id.*

³⁴⁵ For further discussion, see *supra* § V(C).

³⁴⁶ *Id.*

was taken as part of a scheme to cut short a borrower's rescission time.³⁴⁷ In such an instance noteholders become one of the fraudulent planners or participants within the scope of the ILSFDA.³⁴⁸ In addition to potential liability as aiders and abettors, noteholders may find they are unable to enforce a promissory note if they take the note under circumstances indicating possible non-compliance with the ILSFDA.³⁴⁹

A real estate broker, including a salesman, who is not otherwise an investor in a project, may still be liable under the ILSFDA as an agent or as an aider and abettor.³⁵⁰ A typical real estate broker has close contact with the consuming public and is a primary source for the dissemination of information about a development. Such visible contact makes the real estate broker a clear target for suits alleging fraud, or material misrepresentation or omission of relevant facts. In a large tract development or condominium project the broker may share office space in a building with the developer making their business operations difficult to distinguish. Despite this apparent entanglement, the ILSFDA does not attribute agency liability to a real estate broker unless it can be shown that he went beyond his role as a mere guide or salesman and actually sold or leased or had authority to sell or lease lots on his own account.³⁵¹ Nonetheless, the apparent entanglement of broker and developer activities can be construed as aiding and abetting in an alleged wrongdoing even if actual agency can not be demonstrated under the ILSFDA.

An attorney representing a person participating in real estate development must limit that representation solely to rendering legal services in order to avoid liability under the ILSFDA.³⁵² Consequently, an attorney should avoid common client overtures to take a "piece of the action" in lieu of certain fees for services rendered. To take an interest in the property itself could make the attorney an investor in the project and subject him to liability on all the same grounds as other investors.³⁵³ Furthermore, an attorney, as an officer of the court, has a special status in our society and may find that his actions or words directly or indirectly persuade consumers of the soundness and legality of a project. Because of this ability to unduly persuade the general public, the attorney must be careful to avoid even the appearance of entanglement with a

³⁴⁷ For further discussion, *see supra* § V(B), (C).

³⁴⁸ For further discussion, *see supra* § V(C).

³⁴⁹ For further discussion, *see supra* § V(B).

³⁵⁰ Real estate brokers and salesmen who have an interest in the actual development have a higher potential for liability under the ILSFDA because they have an investor problem as well as a broker problem.

³⁵¹ *See* *Bartholomew v. Northhampton Nat'l Bank of Easton*, 584 F.2d 1288, 1292-94 (3d Cir. 1978).

³⁵² 15 U.S.C. § 1701(6) (1982).

³⁵³ *See generally* *Goodman v. United States*, 390 F.2d 915, 917-18 (Ct. Cl. 1968), *cert. denied*, 393 U.S. 824 (1968) (A similar problem arose in this case when two attorneys with substantial real estate practices were determined to be "dealers" under the federal tax laws because of their buying and selling activities and their shared interests in client real estate projects.).

developer's project and should refrain from making any representations or suggestions to potential purchasers or lessees who may inquire about his client's development.

A title insurance company also plays an important role in real estate development. Potential liability for the title insurer can arise in two ways under the ILSFDA. In the first instance, the title insurer may suffer economic loss by unwittingly insuring compliance with the ILSFDA by failing to provide an adequate exception from the title insurance coverage. The ILSFDA provides for a period of up to two years for the revocation of agreements, presumably including agreements for deed, and promissory notes.³⁵⁴ This right of revocation, if exercised, can adversely affect the status of a given parcel of real estate causing losses under both owners and mortgagee title insurance policies. In order to minimize such losses, the title insurer must properly satisfy himself that the requirements of the ILSFDA have been complied with and that the revocation provisions do not apply or he must expressly exclude from coverage the possible consequences of these provisions of the ILSFDA.

The second basis for potential liability to the title insurer involves the method in which premiums are paid. In a tract subdivision or condominium project, separate title insurance policies will be issued for each lot as it is sold or leased. Each title insurance policy is issued for a separate premium based on the face amount of coverage and the premium includes a considerable profit margin for the title insurer. Given the direct relationship between the issuing of title insurance for profit and the developer's disposition of lots for profit it is possible to allege their joint venture or shared proprietary interest in the project. Such an arrangement, if coupled with a close or a long-standing working relationship, could be sufficient to subject title insurers to many of the same risks of liability as exist for lenders or investors.

CONCLUSION

Since its passage as part of Title XIV of the Housing and Urban Development Act of 1968, the ILSFDA has imposed a federal regulatory framework on the real estate development industry.³⁵⁵ Most people have failed to appreciate the significant impact the ILSFDA can have on structuring real estate development projects. Those who fail to properly structure their projects, in light of the purpose, requirements, consequences, and implications of the ILSFDA, may face unsuspected legal and financial difficulties.

The ILSFDA can have various implications for different persons depending on their classification as: (1) subject to the ILSFDA; (2) subject to the ILSFDA but exempt from certain requirements; or (3) not subject to the ILSFDA. Any person who uses the mails or other channels of interstate commerce in the sale or lease of lots in a real estate development containing twenty-

³⁵⁴ See 24 C.F.R. §§ 1715.3-.4 (1982).

³⁵⁵ For further discussion, see *supra* § III.

five or more lots as part of a common promotional plan is subject to the jurisdictional requirements of the ILSFDA.³⁵⁶

The "use of interstate commerce" test for application of the ILSFDA requires only a de minimus showing of interstate sales, advertising, loan financing, or document processing, and the concept of a "common promotional plan" allows several allegedly separate projects to be treated as one by OILSR even though each project may be operated through a separate corporate entity.³⁵⁷ Similarly, separate phases of a development may be treated as one if marketing strategies indicate that phase one is sold intrastate to avoid requirements of the ILSFDA while later phases are sold interstate after the local market is saturated.

Many exemptions are provided from certain requirements of the ILSFDA.³⁵⁸ Some exemptions are self-activating while others require approval of the Secretary. An exemption will not be effective if elected for the purposes of otherwise avoiding the requirements of the ILSFDA. In determining if an exemption was elected in order to avoid requirements of the ILSFDA, OILSR can evaluate the totality of surrounding facts and if it is determined that the exemption was used to avoid the requirements of the ILSFDA the exemption can be declared ineffective and the developer held liable for any violations.

Persons subject to the requirements of the ILSFDA need to be aware of who may bring an action against them for violations.³⁵⁹ Whenever a complicated transaction is proposed, it should be structured with potential litigants in mind. In this respect, purchasers, lessees, stockholders, and community groups with an interest in the lands to be effected by a development, have all been granted standing and in light of the generally liberal standing requirements of the Federal Courts, a person would be ill advised to ignore an expansive granting of standing under the ILSFDA.

In addition to more relaxed standing requirements, the 1979 amendments to the ILSFDA increased the amount and type of damages recoverable by aggrieved persons, thereby significantly increasing incentive for class action suits.³⁶⁰ The class action suit is especially hazardous to a developer because of the potential for bankruptcy in an industry that is generally dominated by under-capitalized "shoe string" operations. Even without a fear of bankruptcy, class actions subject developers to extensive discovery requirements, legal expenses, and negative publicity which can significantly hinder future sales within a project.

When the ILSFDA is violated there is a broad scope of potential liability extending beyond mere developers and agents.³⁶¹ In addition to the potential

³⁵⁶ For further discussion, *see supra* § III(A).

³⁵⁷ *Id.*

³⁵⁸ *Id.*

³⁵⁹ For further discussion, *see supra* § IV(B).

³⁶⁰ For further discussion, *see supra* § IV(C).

³⁶¹ For further discussion, *see supra* § V.

liability arising from the complex nature of characterizing persons as developers or agents, liability can inure to any person found to be an aider and abettor in a plan of wrongdoing under the ILSFDA.³⁶² Such a process for affixing liability for violations of the ILSFDA inevitably leads to an increased risk of doing business as a lender, investor, corporate officer or director, real estate broker, attorney, or title insurance company.

In assessing the risks of potential liability under the ILSFDA, a person must consider the severe penalties provided for violations.³⁶³ There are provisions for extensive civil damages, the right to specific performance, and criminal penalties of up to five years in prison and a \$10,000 fine. Short of these measures, administrative actions can be taken that burden a development project and restrict the developer's ability to complete sales and financing. The most dramatic example of administrative action is the power of OILSR to conduct investigations and to obtain the names of all contract purchasers or lessees. OILSR can then notify all of the contract purchasers or lessees of suspected wrongdoing without regard to personal defenses or actual judicial proof of violations of the ILSFDA.

The difficulty of structuring a project to limit potential liability and the consequences of the ILSFDA are compounded by uncertainties with regard to the statute of limitations in such actions.³⁶⁴ The 1979 amendments to the ILSFDA changed the limitations period so that violations of both disclosure and anti-fraud provisions are actionable for three years without any absolute bars. This change allows equitable estoppel to be applied to the ILSFDA. Equitable estoppel can extend the limitations period in an undeterminable fashion. Furthermore, courts can allow extension of the limitations period when a sale or lease involves continued wrongdoing, installment payments, or contractual novations. Uncertainty of the limitations period increases the risk factor in calculations of the impact of potential liability and makes proper legal and financial planning more difficult.

Overall, the ILSFDA has significant implications for modern real estate development.³⁶⁵ Most importantly, uncertainties with respect to potential liability have increased the risk of participating in real estate development and complicated the planning process. Therefore, participants in real estate development should pay close attention to the requirements, consequences and implications of the ILSFDA in structuring their transactions. At the same time, OILSR should pursue more aggressively all persons subject to potential liability in order to more effectively enforce compliance with the ILSFDA. In many instances it is precisely the lenders, investors, corporate officers or directors, noteholders, attorneys, real estate brokers or title insurers that are in the best

³⁶² *Id.*

³⁶³ For further discussion, see *supra* § VI(A).

³⁶⁴ For further discussion, see *supra* § VI(B).

³⁶⁵ For further discussion, see *supra* § VII.

position to assert leverage or control over a development and who should not escape liability merely because there may be uncertainty in characterizing them as developers, agents or aiders and abettors.

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