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# **Interstate Land Sales Full Disclosure Act: Emerging Legal Threat**

## **Avoiding Contract Rescission, Fines and Penalties Under ILSA**

**A Live 90-Minute Teleconference/Webinar with Interactive Q&A**

**Today's panel features:**

Adam K. Feldman, Of Counsel, **Brownstein Hyatt Farber Schreck**, Denver  
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**Thursday, February 4, 2010**

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**1 pm Eastern**

**12 pm Central**

**11 am Mountain**

**10 am Pacific**

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Concerned about schemes to sell undevelopable swampland, desert scrub, and property lacking roads, utilities, and other basic infrastructure to unsuspecting consumers, Congress in 1968 passed the Interstate Land Sales Full Disclosure Act (ILSA), 15 U.S.C. §§ 1701 et seq., "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." H.R. Rep. No. 1785 (Conf. Rep.), as reprinted in 1968 U.S.C.C.A.N. vol. 2, at 3066. ILSA was written with a fairly broad brush, however, and in the ensuing 40 years it has been used in an ever-widening context, including by buyers seeking to avoid purchase contracts for condominium units in high-rise buildings that have been completed with full utilities, roads, and amenities.

Every real estate downturn brings a

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resurgence of litigation under ILSA. In the first six months of 2009 alone, buyers sought a right of rescission under ILSA in more than 40 reported state and federal cases. The law has become a battleground for alleged violations in cases brought by speculators who do not claim to have been defrauded or misled. Under applicable circumstances the right of rescission is automatic, even if the developer's violation bears no relation to the reason the buyer invokes it and the severity of the remedy is out of all proportion to the harm (if any) done by the violation. So long as the remedy for a developer's guessing wrong about the availability of an exemption or the acceptability of certain contract provisions is rescission, plaintiffs' lawyers will test the boundaries of ILSA's protective umbrella.

The technicalities of ILSA have become so complex that after four decades the courts are in conflict about its requirements and developers are uncertain about how to avoid its pitfalls. Most cases are private suits rather than

actions by the U.S. Department of Housing and Urban Development (HUD), the enforcement agency for ILSA. The litigation under ILSA generally focuses on one or more of four basic issues: whether ILSA applies to the transaction, whether the transaction is exempt from ILSA, whether a partial exemption excuses the developer from registering a statement of record with HUD and providing a property report to the buyer, and whether a limitations period bars the suit. This article takes a look at these issues.

### The Structure of ILSA

ILSA, which is patterned after the Securities Law of 1933, does three basic things with respect to sales and leases of property in interstate commerce. First, it generally prohibits fraud and misrepresentation. 15 U.S.C. § 1703(a)(2). Second, it requires certain consumer-favored provisions in purchase and lease agreements. Id. § 1703(d). Third, it requires the developer to register non-exempt property with HUD and to give a

Max Licht



## A BRIEF SURVEY OF CONTINUING ISSUES WITH THE INTERSTATE LAND SALES FULL DISCLOSURE ACT

# WILL THE FAT LADY NEVER SING?

By Richard C. Linqunti

detailed property report to a buyer before a contract is signed. Id. § 1703(a)(1).

ILSA provides a number of potent legal remedies, both civil and criminal. HUD can obtain injunctions against wrongful behavior and shut down sales, id. § 1714, and can impose civil penalties of up to \$1,000 per violation. Id. § 1717a. Criminal sanctions include a fine of up to \$10,000 and a prison term of up to five years. Id. § 1717. More importantly for consumers, ILSA allows a buyer or lessee to rescind a contract within two years from the date of execution, id. § 1703(c), and bring a private cause of action within three years. Id. §§ 1709(b), 1711. Compliance with ILSA cannot be waived by contract, id. § 1712, and the buyer's rights do not merge into the delivery of the deed. Id. § 1711(b). Thus, if a buyer can establish that ILSA applies and that there is no exemption applicable to the transaction, the buyer can use ILSA as a powerful weapon to avoid contractual liability. Moreover, ILSA is not preemptive of other statutes and remedies; thus, consumers may combine ILSA with other state or federal remedies. Id. § 1713.

Enacted by Congress in 1968 and substantially rewritten in 1979, ILSA applies if any means of interstate commerce are used to solicit offers to buy or lease or to make offers to sell or lease real property lots. To use ILSA to avoid a purchase contract, the buyer must first establish that the law applies to the transaction. ILSA generally applies to commercial as well as residential property, to leases longer than five years, to sales of property to be improved, and to vacant land not planned for improvement by the developer. The definitions in ILSA, however, exclude some persons, projects, or practices from coverage, as discussed in more detail below. Id. § 1701; 24 C.F.R. § 1710.1.

Even if a transaction is within the basic scope of ILSA, section 1702 provides exemptions from it—subsection (a) for full exemptions and subsection (b) for partial exemptions. 15 U.S.C. § 1702; 24 C.F.R. §§ 1710.4–1710.13; *Guidelines for Exemptions Available Under the Interstate Land Sales Full Disclosure Act (Guidelines)*, 61 Fed. Reg. 13,596 et seq. (Mar. 27, 1996). Section 1702(c) authorizes HUD to adopt regulatory exemptions, which are contained in 24 C.F.R. § 1710.14.

## Does ILSA Apply?

Section 1703 makes it unlawful for any developer or agent, directly or indirectly, to use interstate commerce or the mails to sell or lease any lot not exempt under section 1702 without filing a statement of record with HUD and delivering a property report to the buyer or lessee, or to commit fraud or be misleading in making the sale or lease. If the activity does not involve a “developer or agent” in the “sale or lease” of a “lot” in a “subdivision,” it is excluded from coverage by ILSA by definition.

### Developer/Agent

A “developer” is “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.” 15 U.S.C. § 1701(5). In *Santidrian v. Landmark Custom Ranches, Inc.*, No. 08-60791-CIV, 2009 WL 210668 (S.D. Fla. Jan. 28, 2009), the court held that the president of the defendant company was a “developer” because he participated extensively in the negotiations and final signing of the contract with the buyer. Thus, active participants in an ILSA violation can be held individually liable and are not shielded by the corporate structure of the seller.

An “agent” is “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.” 15 U.S.C. § 1701(6). A “person” is “an individual, or an unincorporated organization, partnership, association, corporation, trust, or estate.” Id. § 1701(2). An “indirect sale” occurs when the seller conducts selling efforts through means other than direct, face-to-face contact with the buyer. *Bartholomew v. Northampton Nat'l Bank*, 584 F.2d 1288, 1293 (3d Cir. 1978).

Interpreting the requirement that the seller be a “developer or agent,” cases hold that ILSA did not apply to:

- a transaction in which the buyer was the assignee of the original buyer with whom the developer entered into the contract (*Gibbes v.*

*Rose Hill Plantation Dev. Co.*, 794 F. Supp. 1327, 1333–34 (D.S.C. 1992));

- a defendant that was not the actual seller involved in the sale of the property or its agent when there was no corporate affiliation and no continuity of interests or control (*Paniaguas v. Aldon Cos., Inc.*, No. 2:04-CV-468-PRC, 2005 WL 1983859 (N.D. Ind. Aug. 17, 2005)); or
- a defendant that was the developer of the lots but did not sell the lot to the buyer and did not act as the agent of the seller in the sale (*Tomlinson v. Village Oaks Dev. Co., LLC*, No. IP-02-0599-C-M/S, 2003 WL 21180644 (S.D. Ind. Apr. 17, 2003)).

### Sale/Lease

The regulations define a sale as “any obligation or arrangement for consideration to purchase or lease.” 24 C.F.R. § 1710.1(b). The *Guidelines* state that a nonbinding reservation is not a sale when the reservation deposit is only a modest amount and is fully refundable at the election of the buyer and when the buyer must take some affirmative step to move from reservation to contract. 61 Fed. Reg. at 13,602–13,603.

A “sale” under ILSA is the point in the marketing process at which the buyer makes the purchase decision. This is generally when the buyer signs a contract to purchase. HUD's *Guidelines*, however, make it clear that there may be other indications that the developer has induced the buyer to make a purchase decision, such as when the buyer places a substantial reservation deposit or when the reservation ripens into a contract by default.

Because, under ILSA, the “sale” occurs at contract and not at closing, one determines the existence of an exemption at the time of contract. A failed exemption cannot be cured by subsequent facts, even if the closing has not yet occurred. See, e.g., *Law v. Royal Palm Beach Colony, Inc.*, 578 F.2d 98 (5th Cir. 1978). But it cuts both ways. A buyer may run through the two-year right of rescission even before the closing occurs.

### Lot in a Subdivision

HUD defines a “lot” as “any portion, piece, division, unit, or undivided

interest in land located in any State or foreign country, if the interest includes the right to the exclusive use of a specific portion of the land.” 24 C.F.R. § 1710.1(b). The *Guidelines* exclude from ILSA coverage a sale of undivided interests that does not provide the exclusive right to use the lot, such as a camping subdivision tenant-in-common arrangement in which the campsites are available on a first-come, first-served basis. 61 Fed. Reg. at 13,603; cf. *Becherer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 127 F.3d 478 (6th Cir. 1997) (holding that interests in condominium hotel units were not “lots” within the meaning of ILSA when the

**ILSA DOES NOT USE THE TERM “SUBDIVISION” IN THE SENSE THAT THE REAL ESTATE INDUSTRY DOES, NAMELY A PLATTED CONTIGUOUS PROPERTY.**

owners had occupancy rights only 14 days per year).

The case law that a condominium unit is a “lot” is now well established. *Winter v. Hollingsworth Props., Inc.*, 777 F.2d 1444 (11th Cir.1985). A Colorado court has held that “parking units” are lots under ILSA. *Giralt v. Vail Village Inn Assocs.*, 759 P.2d 801 (Colo. Ct. App. 1988). Yet, a Florida court has held that transferable limited common elements are not “lots” for ILSA purposes. *Trotta v. Lighthouse Point Land Co., LLC*, 551 F. Supp. 2d 1359 (S.D. Fla. 2008). *Trotta* based this conclusion on the intent of the legislation, saying, “a development does not become meaningfully larger, in the sense that consumers are more likely to need regulatory protection from sophisticated sellers, merely because interests in storage spaces (or parking spaces) are sold along with residential units.” *Id.* at 1363. That rationale may underestimate developers’ creativity, but there are at least two other possible reasons to reach

this conclusion, because the limited common elements are not stand-alone interests but rather are appurtenances to other interests that are “lots,” or because a limited common element is only a right to use, that is, a license, which is not an interest in real property.

Notwithstanding ILSA’s broad interpretation of a “lot,” ILSA will apply only if the lot is in a “subdivision.” The concept of subdivision is important not only for general ILSA coverage; it also forms the basis of several full and partial exemptions, such as the full exemption for the sale of fewer than 25 lots, 15 U.S.C. § 1702(a)(1), and the partial exemption for the sale of fewer than 100 lots in a subdivision. *Id.* § 1702(b)(1).

ILSA does not use the term “subdivision” in the sense that the real estate industry does, namely a platted contiguous property. Section 1701(3) defines “subdivision” to mean land that 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.” There is no implied geographic radius; “[p]hysical distances, common streets and utilities, and historical unity” are factors to be considered. *State v. Heck*, 817 P.2d 247, 250 (N.M. Ct. App. 1991).

“Common promotional plan” is defined in section 1701(4) to mean any plan undertaken by a single person or group of persons acting in concert to offer lots for sale or lease. The definition includes a rebuttable presumption that a common promotional plan exists if the land offered by a developer or a group of developers acting in concert is contiguous or is known, designated, or advertised as a common development or by a common name. 15 U.S.C. § 1701(4). The *Guidelines* list several characteristics to evaluate whether a common promotional plan exists including, but not limited to, the following: “10% or greater common ownership, same or similar name or identity, common sales agents, common sales facilities, common advertising, and common inventory.” 61 Fed. Reg. at 13,602. These characteristics are not conclusive;

rather, they are indications of the presence of a common promotional plan.

Common ownership is easily determined in most cases. Common agency is a bit trickier. The presence of independent brokers selling lots for different individuals, with the broker merely receiving the usual real estate commission for such sales, is not sufficient by itself. *Id.* Some coordinated effort seems to be required. Several cases have been brought against regional or national homebuilders to try to combine their disparate projects because they are advertised under a common brand or are advertised on a common web site. In the *Trotta* case, which was brought against national homebuilder Toll Brothers, the court concluded that there was not a common promotional plan when the projects were on separate sites, maintained separate sales offices, conducted separate advertising campaigns, and filed separate registrations with the state regulatory authorities. *Trotta*, 551 F. Supp. 2d at 1363–64.

The subdivision by a developer and subsequent sale of some of the lots in bulk to a homebuilder raise questions about whether the lots in the subdivision are all of the lots created by the master developer or are only the lots sold by the homebuilder. In *Tomlinson*, *supra*, plaintiffs brought suit against the subdivision developer although they bought their lots from a homebuilder to which the subdivision developer had sold several lots for resale. The court concluded that the subdivision developer did not act as the agent of the homebuilder, although both the subdivision developer and the homebuilder were identified in the same marketing brochure. Their separate roles in the development were clearly identified. The court concluded that they were not acting “in concert.” The court reached a similar conclusion in *Orsi v. Kirkwood*, 999 F.2d 86 (4th Cir. 1993). In that case, the court concluded that the subdivision developer and the builder did not act in concert, that the lot sales from the subdivision developer to the homebuilder were at arm’s-length, that neither party had a financial interest in the other, that there were no common officers or directors, and that the sales brochure that listed the lots of both the subdivision developer and the homebuilder was prepared by the broker at its own expense and without approval by the subdivision developer or the homebuilder.

But a court accepted a more expansive view of “subdivision” in *Paniaguas v. Aldon Cos., Inc.*, No. 2:04-CV-468-PRC, 2006 WL 2568210 (N.D. Ind. Sept. 5, 2006), *reconsideration denied*, 2007 WL 2228597 (N.D. Ind. July 31, 2007). Plaintiffs argued that the number of units in two “subdivisions” under common ownership and with the common name of “Fieldstone” should be aggregated as a single “subdivision” for ILSA purposes. Plaintiffs alleged that the lots in the Fieldstone subdivision should be combined with others under the common name of Northwoods because the same model home was used to promote both sets of subdivisions. A copy of the Northwoods covenants was supplied as an example of what the Fieldstone covenants would look like. The court concluded there was a genuine issue of material fact as to whether the projects were part of a common promotional plan.

### Exemptions

Section 1702 provides for full exemption from ILSA, partial statutory exemption, and partial regulatory exemption. As discussed below, even if the developer can establish the existence of a partial statutory or regulatory exemption, the question remains if there is a residual obligation for the purchase contract to contain certain provisions that a developer would not normally include.

Before examining the technical requirements and scope of the exemptions, a buyer may try to avoid the issue of exemptions altogether because they are not available if “the method of disposition is adopted for the purpose of evasion of this title.” The non-evasion requirement qualifies all of the full and partial exemptions, but it is not clear how much of a limitation this provision places on a developer’s ability to plan to avoid coverage by ILSA. Developers regularly try to use savings and severability clauses specifically to be sure their contracts comply with one or another ILSA exemption, but they have been met with mixed success.

*Gentry v. Harborage Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239 (S.D. Fla. 2009), denied an exemption when the seller did not have an independent “legitimate business purpose” for structuring a transaction as it did. It is hard to see, however, how there can be a “legitimate business

purpose” other than taking advantage of the exemption when one looks at some of them, such as section 1702(a)(2), in which the developer promises to construct the improvements within two years from the date of contract. The Eighth Circuit suggested a better approach to the anti-evasion analysis, namely whether or not there is an element of fraud or bad faith. *Atteberry v. Maumelle Co.*, 60 F.3d 415 (8th Cir. 1995). The court required that the plaintiffs prove fraudulent intent such as a lack



of intent by the developer to fulfill its contractual obligations, saying: “Even a good-faith use of the enumerated exceptions arguably could be viewed as an evasion of the Act, but we think the phrase ‘adopted for the purpose of evasion of this chapter’ must be read more narrowly and confined to use of the enumerated exceptions with fraudulent intent.” *Id.* at 421.

### Full Statutory Exemptions

Section 1702(a) enumerates the full statutory exemptions from ILSA. The full exemptions are for (1) twenty-five lots, (2) improved lots, (3) evidences of indebtedness, (4) securities, (5) government sales, (6) cemetery lots, (7) sales to builders, and (8) industrial or commercial developments. There are no regulations for these provisions, but the *Guidelines* provide a useful and detailed discussion of each exemption. 61 Fed. Reg. at 13,596. If a property satisfies the requirements for a full exemption, ILSA will not apply in any respect. If the property does not satisfy an exemption, but the developer mistakenly believes it does and does not extend a seven-day right of rescission (15 U.S.C. § 1703(b)) or

deliver a property report (*id.* § 1703(c)), the buyer has a right of rescission for at least two years after contract. *Id.*

The most popular and most frequently litigated exemption is the so-called improved lot exemption. This provision exempts lots on which there is a completed building or where the developer is obligated to construct a completed building within two years from the date of the contract. *Id.* § 1702(a)(2). There has been a great deal of litigation about the second alternative.

### The Two-Year Period

The two-year obligation to construct is measured from the date that the consumer enters into a binding obligation to purchase. *Aldrich v. McCulloch Props., Inc.*, 627 F.2d 1036, 1044 (10th Cir. 1980). The obligation period ends when the improvements are issued a certificate of occupancy. *Harvey v. Lake Buena Vista Resort, LLC*, 568 F. Supp. 2d 1354 (M.D. Fla. 2008); *Guidelines*, 61 Fed. Reg. at 13,603.

The statute ties the exemption to the developer’s contractual commitment on the date the contract is executed, not to the actual completion of construction within two years from the date of contract. “There is no indication in the statute that the seller’s failure to fulfill its obligation eliminates the exemption.” *Pellegrino v. Koeckritz Dev.*, No. 08-80164-CIV, 2008 WL 6128748, at \*4 n.3 (S.D. Fla. July 10, 2008). In the author’s experience, however, HUD enforcement officials appear to be reluctant to concede that the developer retains the exemption if the improvements are not constructed within two years.

### Nature of the Obligation

The obligation to complete construction within two years must be an absolute obligation of the developer, not the buyer, under state contract law principles. The Eighth Circuit allowed the developer to shift the responsibility for completing construction to the buyer by contract. *Atteberry*, *supra*. Subsequently, HUD revised the *Guidelines* and said it would not follow the *Atteberry* decision in this regard. 61 Fed. Reg. at 13,603 (stating that “the contract must obligate the seller to complete the building within two years”) (emphasis added).

The Florida Supreme Court has said that “the obligation to complete construction within two years must not be illusory” and that “in order for the developer to be ‘obligated’ to complete the building within two years, the obligation must be unrestricted and the contract must not limit the purchaser’s right to seek specific performance or damages.” *Samara Dev. Corp. v. Marlow*, 556 So. 2d 1097, 1099, 1100 (Fla. 1990). Of course, the promise must be made in good faith and not just as an evasion. Thus, a court declined to dismiss a complaint in which the plaintiff alleged that the seller stated that the unit would be completed in two years although seller knew at the time of signing that it would not be completed within that time frame. *Sea Shelter IV, LLC v. TRG Sunny Isles V. Ltd.*, No. 08-21767-CIV, 2009 WL 692469 (S.D. Fla. Mar. 17, 2009).

### Pre-Sales Contingency

The regulations allow a limited pre-sales condition that permits the developer to terminate all contracts within 180 days if a pre-sales number is not met, so long as the contingency period does not extend the two-year completion period. 24 C.F.R. § 1710.5. In *Pilato v. Edge Investors, L.P.*, 609 F. Supp. 2d 1301 (S.D. Fla. 2009), the court held that a seller’s two-year completion obligation was not illusory when the contract allowed the seller to unilaterally cancel the contract and refund the buyer’s deposits in the event that the seller did not enter into binding contracts to sell at least 80% of the units in the condominium.

### Remedies

The question of the buyer’s remedies if the developer does not construct within two years entails a determination of whether the developer has really “obligated” itself. State, rather than federal, law governs this determination, so different standards may apply from jurisdiction to jurisdiction, but the *Guidelines* state that “contracts that directly or indirectly waive the buyer’s right to specific performance are treated as lacking a realistic obligation to construct.” 61 Fed. Reg. at 13,603.

The Florida Supreme Court stated

that that the contract “must not limit the purchaser’s right to seek specific performance or damages,” implying that a buyer must have all of the remedies available at law or in equity. *Samara*, 556 So. 2d at 1100. The courts have not applied that standard literally, however. *Hardwick Props. Inc. v. Newbern*, 711 So. 2d 35 (Fla. Dist. Ct. App. 1998), held that a contract that granted to the buyer the right to the remedies available at law or in equity, but specifically not to consequential or special damages, satisfied ILSA’s exemption because, if actual damages were substantial, the promise to complete construction would not be illusory. In *Rosenstein v. Edge Investors, L.P.*, No. 07-80903CIV-MIDDLEBR, 2009 WL 903806 (S.D. Fla. Mar. 30, 2009), a federal court held that a seller’s promise to complete construction within two years was not illusory even though the contract excluded the buyer’s option to obtain a *lis pendens*. In a generous interpretation in another case, the court held that a provision giving the buyer a right to seek specific performance “or if specific performance is not available, the right to seek actual damages” was enough of an obligation to satisfy the exemption. *Rondini v. Evernia Properties, LLLP*, No. 07-81077-CIV, 2008 WL 793512 (S.D. Fla. Feb. 13, 2008).

HUD has been clear that the contract does not need to provide remedies so much as it cannot include a waiver of the right to specific performance. 61 Fed. Reg. at 13,603. There seems to be no problem with the contract providing that in the event of default by the seller, the buyer shall have the right to a refund of the deposit, so long as that is not stated to be the exclusive remedy. HUD’s position found support in *Ndeh v. Midtown Alexandria, L.L.C.*, 300 Fed. Appx. 203 (4th Cir. 2008), the court holding that remedies provided to the buyer are exclusive of other remedies allowed by law only when the language of the contract clearly indicates an intent that the express remedies are exclusive.

### Extending the Two-Year Obligation

Courts continue to wrestle with the issue of what defenses for nonperformance are available to the developer besides the buyer’s own breach of contract. HUD’s position is fairly clear:

Contract provisions which allow for non-performance or for delays of construction completion beyond the two-year period are acceptable if such provisions are legally recognized as defenses to contract actions in the jurisdiction where the building is being erected. . . . [A]s a general rule delay or nonperformance must be based on grounds cognizable in contract law such as impossibility or frustration and on events which are beyond the seller’s reasonable control.

*Guidelines*, 61 Fed. Reg. at 13,603. Developers have tried in their contracts to define what those legally recognized defenses might be.

Florida has wrestled with this problem in the context of language in *Samara*, supra, that the obligation must not be “illusory.” In the *Rondini* case, the court approved fairly broad language (“subject to extensions for ‘delays caused by Acts of God, the unavailability of materials, strikes, other labor problems, governmental orders or other events which would support a defense based upon impossibility of performance for reasons beyond [seller’s] control’”). 2008 WL 793512, at \*2. In *Tedder v. Harbour Phase I Owners, LLC*, No. 8:08-cv-1674-T-30TGW, 2009 WL 1043911 (M.D. Fla. Apr. 17, 2009), the court held that a provision that obligated the seller to complete the construction within two years, subject to delays caused by “acts of God or other events that would be a legal defense to Seller’s obligation to perform under Florida law,” was sufficiently narrow so as not to render the promise to build within two years illusory. See also *Stefan v. Singer Island Condominiums Ltd.*, No. 08-80039-CIV, 2009 WL 426291 (S.D. Fla. Feb. 20, 2009) (upholding another force majeure clause).

But, in *Fortunato v. Windjammer Homebuilders, Inc.*, No. 8:04-CV-165-T-26MSS, 2006 WL 208777 (M.D. Fla. Jan. 25, 2006), the court held a provision that the developer would complete construction “as soon as practicable, subject to the availability of labor and supplies,” did not satisfy the obligation. In *Stein v. Paradigm Mirsol, LLC*, 551 F. Supp. 2d 1323, 1330 (M.D. Fla. 2008), the court held a *Rondini*-type clause (“for any delay caused by acts of God, weather conditions, restrictions imposed by any governmental agency, labor strikes, material shortages or other delays beyond the control of Seller”) contained exclusions “broad enough to seriously undermine the

obligation to complete the condominium within two years." This decision was reversed by the Eleventh Circuit as this article was going to press. *Stein v. Paradigm Mirsol, LLC*, No. 08-10983 (11th Cir. Sept. 30, 2009). Accord *Disimone v. LDG South II, LLC*, No. 2:08-cv-544-FtM-29SPC, 2009 WL 210711 (M.D. Fla. Jan. 28, 2009). In *Plaza Court, L.P. v. Baker-Chaput*, Nos. 5D08-899 & 5D08-1188, 2009 WL 1809921 (Fla. Dist. Ct. App. June 26, 2009), the court required that the contract defense language satisfy the "impossibility" standard. When the contract invoked the impossibility standard but used examples the court thought went too far, the developer lost. In *Jankus v. Edge Investors, L.P.*, No. 08-80200-CIV, 2009 WL 2849064, at \*5 (S.D. Fla. Aug. 31, 2009), however, the court found that impossibility was only one example of a defense to performance and allowed the exemption when the contract excused "matters legally recognized as defenses to contract actions in the jurisdiction" generally.

Impossibility or impracticability is not an easy legal concept. It is covered by Restatement (Second) of Contracts §§ 261 et seq. In *Bloom v. Home Devco/Tivoli Isles, LLC*, No. 07-80616-CIV, 2009 WL 36594 (S.D. Fla. Jan. 6, 2009), a federal court held that the failure to include the word "impossible" in a "force majeure" clause did not render the promise illusory because the conditions described in the clause supported an impossibility defense. The balancing of the sometimes conflicting interests of certainty and fairness is well articulated in *Cook v. Deltona Corp.*, 753 F.2d 1552 (11th Cir. 1985), which suggested that the ultimate test for "impossibility" is whether the supervening event was foreseeable. Thus, the foreseeability of the difficulty of obtaining insurance in Florida made the defense of frustration of purpose unavailable. *Home Design Center JV v. County Appliances of Naples, Inc.*, 563 So. 2d 767 (Fla. Dist. Ct. App. 1990). Whether a dispute arising was foreseeable is a triable question of fact. *Walter T. Emrby, Inc. v. LaSalle Nat'l Bank*, 792 So. 2d 567 (Fla. Dist. Ct. App. 2001).

### Partial Statutory Exemptions

Section 1702(b) lists the statutory partial exemptions. The partial exemptions are (1) 100-lot exemption, (2) 12-lot exemption, (3) scattered site exemption, (4) 20-acre lots

exemption, (5) single-family residence exemption, (6) mobile home exemption, (7) intrastate exemption, and (8) Metropolitan Statistical Area (MSA) exemption. The *Guidelines* provide an extended discussion of each partial exemption. 61 Fed. Reg. at 13,604–13,608. Some are also covered by the regulations. 24 C.F.R. §§ 1710.6–1710.13.

There is some debate about the scope of this partial exemption. As previously mentioned, section 1703 has three main provisions: it prohibits fraud and misrepresentation, it requires registration and formal disclosure, and it requires purchase contracts to contain certain provisions that limit a developer's rights in the event of a buyer default. It is clear that a partial exemption does not exempt the developer from the anti-fraud rules, but it does apply to the registration and disclosure requirements. What became suddenly unclear in 2008 was whether the exemption extended to section 1703(d), which requires a contract to provide a legal description appropriate for recording, a 20-day period of notice and right of the buyer to cure a default, and a limitation of damages for the developer to the greater of 15% of the purchase price or actual damages. If the exemption did not extend to the contract requirements, then most contracts written under a partial exemption would nonetheless be subject to a rescission claim unless the buyer's right was time barred.

Much of this past year was spent by ILSA specialists analyzing and critiquing a trilogy of federal cases from the Southern District of Florida that addressed this issue of the scope of the partial exemption. See *Pugliese v. Pukka Dev., Inc.*, 524 F. Supp. 2d 1370 (S.D. Fla. 2007); *Meridian Ventures, LLC v. One North Ocean, LLC*, 538 F. Supp. 2d 1359 (S.D. Fla. 2007); and *Trotta*, 551 F. Supp. 2d 1364. Before these cases, HUD had said, and developers believed, that if their projects were partially exempt from ILSA, their contracts did not need to comply with section 1703(d). See *Pugliese*, 524 F. Supp. 2d at 1373 (citing opinion letter of HUD official); *Trotta*, 551 F. Supp. 2d 1364 (citing affidavit of HUD official). If a contract fails to contain these provisions, the buyer has the right to fully rescind the contract

whether or not that failure is ultimately relevant to the buyer's complaint. Therefore, what was at stake in these cases was the ability to void virtually every contract written by a developer whose property was exempt under section 1702(b), including contracts exempted under the common 100-lot exemption. In *Atteberry*, for example, 178 listed plaintiffs sought to represent a class of 2,000 buyers in one subdivision.

The *Pugliese* cases concluded, contrary to the result reached in the earlier Florida state court case of *Mayersdorf v. Paramount Boynton, LLC*, 910 So. 2d 887 (Fla. Dist. Ct. App. 2005), that the exemption is only from registration and that all other provisions of ILSA, in particular the contract requirements, continue to apply. These cases were decided just as Florida's real estate wheels were falling off (that is probably why the cases were brought in the first place), and the prospect of wholesale contract rescissions drove developers and their lenders to distraction.

It is not difficult to understand how the courts reached their conclusions. They applied the language that is in the exemption provision itself. Section 1702(b) says "the provisions requiring registration and disclosure (as specified in section 1703(a)(1) and sections 1704 through 1707 of this title) shall not apply." There is broader exemption language, however, in the substantive provisions of section 1703(d), which applies to "[a]ny contract or agreement which is for the sale or lease of a lot not exempt under section 1702" without distinguishing between full exemptions in section 1702(a) and partial exemptions in section 1702(b). The problem with the *Pugliese* line of cases was that developers (and their lawyers) had relied on HUD's pronouncements. No one in the nearly 30 years preceding the *Pugliese* trilogy had applied the substantive provisions of section 1703 to the properties exempt under section 1702(b). Now the developers were told that they could not rely on HUD's position, their contracts were unenforceable as a consequence, the buyer had an absolute right to rescission in a declining market, and there was nothing that the developers could do to fix the problem in existing contracts.

The Eleventh Circuit resolved the issue by reversing the district court in *Pugliese v. Pukka Dev., Inc.*, 550 F.3d 1299 (11th Cir. 2008). The fact that the Eleventh Circuit's decision rests at least in part on the deference due to HUD in interpreting ILSA, rather than on the debatable assertion that the language in sections 1702 and 1703 is clearly harmonious, would seem to increase the chances that other federal district and circuit courts will follow the Eleventh Circuit's result. Transactional lawyers outside the Eleventh Circuit, however, cannot dismiss the possibility that the *Pugliese* issue about the scope of the section 1702(b) exemption may be raised in their jurisdictions. Compare *Stockton v. Mustique, LLC*, No. 07-0310-WS-B, 2007 WL 2480244 (S.D. Ala. Aug. 28, 2007) (reaching the same conclusion as *Pugliese* that projects exempt under section 1702(b) must comply with all of section 1703 with the exception of registration under section 1703(a)(1)), with *Bartley v. Merrifield Town Ctr. LP*, 580 F. Supp. 2d 495 (E.D. Va. 2008) (rejecting the *Pugliese* trilogy).

### Limitations Period

The last line of cases this article examines concerns the limitations periods for bringing an action to rescind a contract or transaction under ILSA. The subsections of section 1703 state the limitations periods during which the consumer must assert rescission rights—seven days in the case of section 1703(b) and two years from contract in the case of sections 1703(c) and (d). Sections 1703(b) and (c) require the purchase contract to state the buyer's revocation right. Section 1703(d) requires other specified contract provisions, but does not contain this requirement.

The seven-day and two-year limitations periods have been referred to loosely as a "statute of limitations." See, e.g., *Orsi*, 999 F.2d at 89. Technically, however, they are not because they do not prescribe the date by which suit must be filed. ILSA's actual statute of limitations is set forth in section 1711, and for most purposes it is three years from the date of contract. Because the statute of limitations period is longer than the section 1703 rescission periods, cases continue to address these

questions: how do the section 1703 periods relate to the status of limitations in section 1711, how stringent are these time periods, and when does the limitations period run if the developer failed to recite the revocation right in the contract as required by sections 1703(b) and (c)?

Generally, section 1703 states periods during which the buyer must assert his revocation right in some effective form of notice to the seller, whereas section 1711 states the time by which the buyer must file an action to enforce those rights. *Taylor v. Holiday Isle, LLC*, 561 F. Supp. 2d 1269 (S.D. Ala. 2008). Courts generally have been strict about applying the limitations periods, not allowing "equitable tolling" or making available the revocation remedy to one who brings an action after the section 1703 period has expired but before the section 1711 statute of limitations period has run. *Werdmuller Von Elgg v. Carlisle Developers, Inc.*, No. 6:09-cv-132-Orl-31KRS, 2009 WL 961144 (M.D. Fla. Apr. 7, 2009).

The application of the two-year limitations period has proven more problematic if the court focuses on the developer's failure to provide the disclosure about the limitations period required by sections 1703(b) and (c). The court in *Taylor* concluded that the failure to disclose does not extend the section 1703 limitations period because "[n]othing in the statute says that the two-year period prescribed by § 1703(c) runs from the date that purchasers discovered or should have discovered they had a right to rescind." 561 F. Supp. 2d at 1274-75. The court in *Plaza Court* reached the opposite conclusion, stating that the *Taylor* approach "effectively holds the developer harmless for the failure to give the required notice." 2009 WL 1809921 at \*8.

Technically, the court in *Plaza Court* adopted an analysis that equated the developer's failure to make the disclosure to a waiver of the condition precedent to revocation that the buyer act within two years from the date of contract. But why would a developer who believes that it is exempt from ILSA's disclosure requirements make an unqualified disclosure that the buyer has a right to rescind? That defeats the

whole purpose of the exemption. *Plaza Court* would limit the two-year limitations period to those situations in which the developer discloses that he is intentionally violating ILSA by not providing a property report and that the consumer has a rescission right.

*Taylor* may seem to have the better statutory construction argument because ILSA easily could have said that the two-year limitations period runs from the time of disclosure rather than from the time of contract. The statute of limitations provisions of section 1711 already draw this distinction in the case of fraud claims. Section 1703 does not require any showing by plaintiff that the developer's failure to make a disclosure or include a contract provision actually adversely affected the buyer. As the court observed in *Pigott v. Sanibel Dev., LLC*, 576 F. Supp. 2d 1258, 1264 n.15 (S.D. Ala. 2008): "Under the plain terms of the ILSFDA, if the Project is not exempt, then [developer's] failure to furnish a property report conferred upon plaintiffs an absolute right to back out of the transactions (for good reasons, bad reasons or no reasons) at any time within a two-year period." In cases in which the developer's failure to disclose the rescission right was relevant to the plaintiff's situation, the court could use equity under a section 1709 action brought within the section 1711 statute of limitations period to extend the revocation right. This would soften the hard line taken in the *Werdmuller Von Elgg* case, which seems to preclude any equitable grant of rescission outside of section 1703.

### Conclusion

Buyers will always bring ILSA claims during a real estate market downturn because the rescission remedy is a perfect cure for a bad business decision. Although the original reason for ILSA's existence may have been to protect buyers against land fraud, very few ILSA cases involve fraud. Most ILSA cases concern claims of rescission, not damages or other equitable relief. These facts, and the continuing lack of clarity of the statute, may indicate that it is time to take a fresh look at ILSA and the public policies that support it. ■