

5-1-1975

Real Property--Condominiums--Developer Self-Dealing--Point East Management Corp. v. Point East One Condominium Corp.

Follow this and additional works at: <https://digitalcommons.law.byu.edu/lawreview>



Part of the [Property Law and Real Estate Commons](#)

Recommended Citation

Real Property--Condominiums--Developer Self-Dealing--Point East Management Corp. v. Point East One Condominium Corp., 1975 BYU L. Rev. 295 (1975).

Available at: <https://digitalcommons.law.byu.edu/lawreview/vol1975/iss1/19>

This Casenote is brought to you for free and open access by the Brigham Young University Law Review at BYU Law Digital Commons. It has been accepted for inclusion in BYU Law Review by an authorized editor of BYU Law Digital Commons. For more information, please contact hunterlawlibrary@byu.edu.

Real Property — CONDOMINIUMS — DEVELOPER SELF-DEALING — *Point East Management Corp. v. Point East One Condominium Corp.*, 282 So. 2d 628 (Fla. 1973), *rev'g* 258 So. 2d 322 (Fla. 3d Dist. Ct. App. 1972), *cert. denied*, 415 U.S. 921 (1974).

A group of individuals developed a Florida condominium complex composed of four separate condominium clusters, each with its own incorporated¹ owners association. While the developers owned all of the condominium units and controlled the owners associations, they caused the associations to enter into 25-year management contracts with a management corporation also controlled by the developers and a 99-year lease of adjacent land owned by the developers for use as a common recreational facility.² When the purchasers of the individual units later assumed control of the owners associations, they felt that the terms of the management contracts and the lease were onerous and sued for their rescission. The associations alleged that by engaging in self-dealing the developers had breached fiduciary duties owed to unit purchasers, and asked that the management contracts be declared void for containing provisions contrary to the intent of the Florida Condominium Act.³ The trial court agreed that the management contracts were clearly in violation of the intent of the Condominium Act because “[t]his delegation and abdication of responsibility and control exceeds the bounds of statutory authority and defeats the purposes of the Condominium Act.”⁴ The trial court declared the management contracts unlawful and void,⁵ but denied all other relief sought.⁶ The District Court of Appeals affirmed *per curiam*,⁷ but the Florida Supreme Court reversed, holding that the legislature did

¹Incorporation of the owners association is authorized by FLA. STAT. ANN. § 711.12(1) (1969), reproduced here at note 23 *infra*.

²The separate lease of recreational property was authorized by FLA. STAT. ANN. § 711.121 (1969), reproduced here at note 13 *infra*.

³FLA. STAT. ANN. § 711 (1969). The specific language relied upon by the associations in *Point East* appears in section 711.12(1) (“The operation of the condominium shall be by the association, the name of which shall be stated in the declaration.”) and section 711.03(2) (“Association means the entity responsible for the operation of a condominium.”).

⁴258 So. 2d 322, 324 (Fla. 3d Dist. Ct. App. 1972).

⁵*Id.*

⁶The action in the trial court was actually a consolidation of three separate suits:

In one action the associations sued the management corporation seeking cancellation of the management contracts because of alleged breaches of contract; damages for breach of contract; an accounting; and a determination that the management contracts were void because against public policy and for failure to conform to the requirements for such contracts as provided for in the Condominium Act [citation omitted].

In a second action the associations sued the four individual developers seeking damages for alleged fraud and breach of fiduciary duties. The third action was by the associations against the four individual defendants, for cancellation of the . . . lease, of which said defendants were the lessors.

Id. at 323-34.

⁷*Id.* at 324.

not intend to restrict the power of the associations to contract for the management of condominium properties, and adding that management contracts should not be declared invalid solely because the developers had contracted with themselves.⁸

I. BACKGROUND

In recent years, condominiums⁹ have proliferated as an alternative to the single family dwelling.¹⁰ A condominium purchaser buys not only his own unit,¹¹ but also an undivided interest in common elements.¹² The common elements are typically maintained by a unit owners association, and the costs of improving and maintaining them are generally shared by the unit owners through payment of a required monthly assessment.

These common ownership arrangements, foreign to most purchasers of single family homes, have been used to disguise developer compensation not reflected in the purchase price of the unit, but passed to the buyer through monthly assessments. For example, the developer will sometimes sell or lease recreational facilities to the association, rather than making them a part of the common elements included in the pur-

⁸282 So. 2d 628, 630 (Fla. 1973).

⁹Condominiums are generally creatures of statutory law. State enabling acts were passed in response to section 234 of the National Housing Act, which authorized FHA insurance on individual condominium unit mortgages, where recognized by state law. National Housing Act § 234, 12 U.S.C. § 1715y (1962). See also, Legislation Note, *Condominium — A Comparative Analysis of Condominium Statutes*, 13 DE PAUL L. REV. 111 (1963).

¹⁰Figures released by the Department of Housing and Urban Development indicate that during 1973 construction was started on approximately 241,000 condominium units, representing roughly 29 percent of all private starts of housing for sale in the United States. Nearly half of the unit starts reported by HUD were in the South, principally in Florida. *Lines & Numbers*, HUD CHALLENGE, January 1975, at 33. A 1972 HUD study revealed that in that year condominiums constituted 40.3 percent of new housing units completed for sale, and 49 percent of all housing units under construction, in 25 selected metropolitan areas. NAHB JOURNAL-SCOPE, November 5, 1973, at 47. Although much of the early condominium growth was in the vacation or second home market, current inflationary trends are pricing the single family dwelling out of the reach of many would-be home owners. The condominium offers most of the incidents of home ownership, often at a significantly lower cost per square foot. See *Introduction* to I P. ROHAN & M. RESKIN, *CONDOMINIUM LAW AND PRACTICE* at Intro-1 (1974) [hereinafter cited as ROHAN & RESKIN]; Berger, *Condominium: Shelter On A Statutory Foundation*, 63 COLUM. L. REV. 987 (1963); Seeber, *Condominiums in North Carolina: Improving The Statutory Base*, 7 WAKE FOREST L. REV. 355, 356 (1971); Comment, *Condominium: An Introduction To The Horizontal Property System*, 11 DE PAUL L. REV. 319, 321 (1962).

¹¹There is some disagreement as to whether the "unit" owned in fee simple by the purchaser consists of the floor, ceiling, and walls surrounding the unit or only the air space enclosed therein. 1 ROHAN & RESKIN § 1.01 [2].

¹²Essentially, the "common elements" include everything in the condominium complex not owned in fee simple by the unit purchaser; areas for the use of all unit owners ("general common elements") and areas for the use of more than one but less than all unit owners ("limited common elements"). 1 ROHAN & RESKIN § 6.01.

chase price of a unit.¹³ Perhaps the most important opportunity for the developer to increase his undisclosed profits on a condominium project results from the fact that until there are a sufficient number of unit owners to assume control of the owners association and elect their own managing board,¹⁴ the developer controls the association.¹⁵ During this interim period, the developer may engage in self-dealing by executing contracts on behalf of the owners association with developer-owned or affiliated companies on terms far less favorable to the prospective unit owners than would have resulted from arms-length transactions.¹⁶ In this way, the developer can obtain an inflated price for recreational property,¹⁷ or assure himself of continuing profits of as much as 300 percent per year by leasing it at an excessive rental,¹⁸ or he may hire his own

¹³Florida's Condominium Act, for example, specifically provides that the owners association may obtain an interest in recreational property apart from that which is actually submitted to condominium:

In addition to any other provisions of this chapter, an association may acquire and enter into agreements whereby it acquires leaseholds, memberships and other possessory or use interests in lands or facilities including but not limited to country clubs, golf courses, marinas and other recreational facilities, whether or not contiguous to the lands of the condominium, intended to provide for the enjoyment, recreation or other use or benefit of the unit owners.

FLA. STAT. ANN. § 711.121 (1969).

¹⁴The managing board is the governing body for the owners association, and assumes the basic responsibility for management and maintenance of the condominium. Where the condominium project is a large one, the board may delegate the day-to-day duties and decision-making authority to a professional management company. For a discussion in connection with the *Point East* case of the extent of the owners association's power to delegate management duties see Note, *Long Term Management Contracts Between Condominium Associations and Developer-Controlled Management Corporations Held Not Violative of The Florida Condominium Act*, 28 U. MIAMI L. REV. 451, 456 (1974).

¹⁵State condominium acts do not specify when the unit owners are entitled to assume control of the owners association. Rohan and Reskin suggest that the declaration or bylaws of a condominium commonly provide that the initial meeting is to be called by the developer any time after at least 51 percent of the units are occupied, but not later than the final occupancy of all the units. 1 ROHAN & RESKIN § 17.02, at 17-3. Some developers take advantage of the general uncertainty and hang on as long as possible. A Florida commission investigating condominium problems in that state heard several such complaints. Note, *Legal Protection For Florida Condominium and Cooperative Buyers and Owners*, 27 U. MIAMI L. REV. 451, 455 (1973).

¹⁶See, e.g., note 18 *infra* and accompanying text.

¹⁷The developer may reap unconscionable, though undisclosed, profits by conspiring with a third party. For example, he may buy the property at a price far in excess of fair market value, and then sell it to the association at an apparently reasonable profit. He derives an unfair profit by receiving a secret rebate from the third-party seller. For discussion of this sort of "flip sale" in connection with the purchase of condominium or cooperative property see Note, *Cooperative Housing Corporations and The Federal Securities Laws*, 71 COLUM. L. REV. 118, 120 (1971).

¹⁸The Attorney General of Florida has recently stated that developers investing as little as \$2 million in recreational facilities typically reap unconscionable profits of between \$3 million and \$6 million annually, theoretically for as long as 99 years. N.Y. Times, Sept. 6, 1974, at 1, col. 4.

management company to maintain and manage the common areas.¹⁹ To date, Florida cases are the only reported decisions on the issue of whether the unit owners, when they assume control of their owners association, can be bound by such agreements.

The first condominium developer self-dealing case in Florida was *Fountainview Association, Inc., No. 4 v. Bell*.²⁰ In that case, the developers, while serving as the sole officers of the owners association,²¹ individually conveyed or leased land to the associations on allegedly inflated terms and entered into third-party management contracts at allegedly exorbitant fees.²² When the unit purchasers later assumed control of the associations, organized by the developers as nonprofit corporations,²³ they caused the associations to bring a suit to recover the excessive profits and fees. The court interpreted the Florida Condominium Act²⁴ to mean that such associations are to be governed by the law applicable to private corporations for profit and ruled against the associations, holding that a 1930 Florida case, *Lake Mabel Development Corp. v. Bird*,²⁵ was dispositive.²⁶ According to the *Fountainview* majority, *Lake Mabel* held that a sale of property to a corporation by its promoters, while they still held all of its outstanding stock, could not later be avoided by the corporation, because the corporation had full knowledge of the facts at the time of the sale and the rights of prospective purchasers had not yet arisen. The Florida Supreme Court affirmed the *Fountainview* decision per curiam.²⁷

Since *Fountainview*, the Florida courts have consistently refused to invalidate the actions of self-dealing developers. In *Wechsler v. Gold-*

¹⁹The developer may hire a subsidiary to manage the condominium, or an affiliated management company, or he may receive a kickback for awarding the management contract to a third-party management company. Note, *Florida Condominiums—Developer Abuses and Securities Law Implications Create a Need for a State Regulatory Agency*, 25 U. FLA. L. REV. 350, 353 (1973).

²⁰203 So. 2d 657 (Fla. 3d Dist. Ct. App. 1967), *aff'd per curiam*, 214 So. 2d 609 (Fla. 1968).

²¹As in the *Point East* case, the project was organized as several separate condominiums, each with its own association. In *Fountainview*, only associations No. 4 and No. 5 were joined as plaintiffs. *Id.*

²²*Id.* at 658.

²³The Florida Condominium Act provides that:

The declaration may require the association to be organized as a particular entity, *such as but not limited to* a corporation for profit or corporation not for profit, in which the owners of units shall be stockholders or members.

FLA. STAT. ANN. § 711.12(1) (1969) (emphasis added).

²⁴*Id.*; 203 So. 2d at 659.

²⁵99 Fla. 253, 126 So. 356 (1930).

²⁶203 So. 2d at 659.

²⁷*Fountainview Association, Inc., No. 4 v. Bell*, 214 So. 2d 609 (Fla. 1968). Before *Fountainview*, authorities had suggested that the choice of a corporate form of owners association would have no legal consequences. H. Kane & W. Helms, *The Illinois Condominium Property Act*, 2 U. ILL. L.F. 157, 175 (1970).

man,²⁸ the developers were the sole directors of a corporation which leased communal recreational facilities to an owners association which they also controlled. Although the annual rental was greater than the assessed value of the property, the court upheld the validity of the lease, citing *Fountainview* and adding that there had been adequate disclosure to the purchasers at closing,²⁹ notwithstanding the fact that they had not been advised of the lease when they were initially solicited or at the time they signed preliminary contracts. The court acknowledged its reluctance to deny relief from the lease, and suggested that the facts in *Wechsler* and *Fountainview* indicated a need for legislative amendment of the Condominium Act to prevent future developer abuses.³⁰ Similarly, in *Riviera Condominium Apartments, Inc., v. Weinberger*,³¹ the court denied relief to the plaintiff owners association, but reiterated the call for legislative reform.

II. INSTANT CASE

The district court³² decision in *Point East* appeared to be a reversal of the previous Florida pattern of refusal to invalidate condominium developer self-dealing. The court declared invalid contracts

made or caused to be made by the original owners or developers of a condominium between the condominium association and a manager or management corporation, which [operate] to divest from the association in a material or substantial degree the power and privilege granted it by the statute to operate the condominium.³³

The court emphasized that the *Fountainview* and *Riviera* cases were distinguishable from the *Point East* decision in that they turned on the validity of developer self-dealing *per se*, while *Point East* did not. Instead, the *Point East* trial court examined the express language of the Condominium Act and concluded that an owners association, regardless of who controlled it, could legally enter into a management contract, but only to the extent that it was not thereby substantially or materially divested of control over the management of the condominium. The

²⁸214 So. 2d 741 (Fla. 3d Dist. Ct. App. 1968).

²⁹At closing, all but one of the purchasers individually agreed in their closing contracts to be guarantors of the lease. *Id.* at 742.

³⁰*Id.* at 744.

³¹231 So. 2d 850 (Fla. 3d Dist. Ct. App. 1970). In *Riviera*, the developers, while acting as directors of the incorporated owners association as well as directors of the corporation providing management and maintenance services, made an allegedly excessive payment of \$7500 for management services from the association to the management company only two weeks before turning over control to the unit owners. Noting that services had been rendered and that purchasers knew of the payment before they bought, the court upheld the payment citing *Wechsler* and *Fountainview*.

³²This was the same District Court of Appeals that had denied relief to the plaintiff associations in *Fountainview*, *Wechsler*, and *Riviera*.

³³258 So. 2d at 325.

specific evil which the trial court seized upon in *Point East* was *excessive delegation* of the authority to manage, not self-dealing on the part of the developers.³⁴ This interpretation of statutory language was limited to the management contract, however. The district court admitted that the lease contained provisions which might motivate a court of equity to grant relief, but citing *Wechsler*, found it valid.³⁵

The Florida Supreme Court reexamined the language of the Condominium Act relied upon by the district court and concluded that the legislature, recognizing the magnitude of the maintenance and management tasks in a large condominium complex, had not intended to restrict the ability of condominium owners associations to contract for management services.³⁶ Neither the degree of delegation nor the long duration of the *Point East* management contracts were found to make them objectionable. Further, the court concluded that the fact that the contract was entered into by the developers, dealing with themselves, rather than by associations controlled by the unit owners, did not invalidate it, citing *Lake Mabel*.³⁷ In a vigorous dissent, Justice Ervin argued that the *Lake Mabel* decision was irrelevant because the district court decision in *Point East* rested almost exclusively on the court's interpretation of the Condominium Act.³⁸

III. ANALYSIS

A. Judicial Relief from Condominium Developer Self-dealing

Although a few commentators have suggested that the Florida cases upholding condominium developer self-dealing are contrary to the trend

³⁴The court was probably attempting to reach the equities involved by using a theory more consistent with the rationale of the prior self-dealing cases, rather than directly overruling them. One commentator has recently suggested that the trial court result in *Point East* could be reached by applying corporate doctrines limiting the power of a corporation's board of directors to delegate their duty to manage the corporation. Note, *Long Term Management Contracts Between Condominium Associations and Developer-Controlled Management Corporations Held Not Violative of the Florida Condominium Act*, 28 U. MIAMI L. REV. 451, 456 (1974). Of course, this theory and the statutory interpretation approach used by the *Point East* trial court are both of limited value to owners associations in that they are only applicable to management contracts, leaving onerous leases and other self-dealing contracts untouched.

³⁵258 So. 2d at 326.

³⁶*Point East Management Corp. v. Point East One Condominium Corp.*, 282 So. 2d 628 (Fla. 1973).

³⁷*Id.* at 630.

³⁸*Id.* (dissenting opinion). The *Point East* plaintiff associations subsequently brought suit in Federal Court based upon an antitrust tie-in theory.

The defendants, on the eve of a jury trial in which they were facing treble damages as to fees received under the Management Agreements terminated the Agreements in full settlement of all claims and thereby released the four Plaintiff Associations from any liability under the remaining 17 years of the Agreements.

in the majority of jurisdictions,³⁹ there have been no condominium developer self-dealing cases reported outside Florida. This lack of case law is partly due to the fact that other states are only now beginning to experience the rapid growth in condominium development which has characterized the Miami area for a number of years. Many other states, however, permit incorporation of the owners association, either expressly in the condominium act or impliedly by making no reference to the form of organization to be used. There is some danger that those states will choose to follow the Florida cases or may be influenced to reach the same result by applying their own comparable principles of corporation law.

Although there are no cases outside Florida on the problem of condominium developer self-dealing, there were several New York cases in the 1950s involving self-dealing on the part of sponsors of cooperative housing projects.⁴⁰ The New York courts held that sponsors owed a measure of fiduciary duty to purchasers, and the original *Fountainview* plaintiffs sought to draw support from those decisions.⁴¹ The *Fountainview* court ignored the New York cases, however, reasoning that *Fountainview* was not a case of first impression in Florida and relying instead on *Lake Mabel*.⁴² The New York courts had concluded that a self-dealing cooperative sponsor could be held to strict fiduciary standards only for self-dealing transactions which occurred *after* sales to the public had begun.⁴³ As to self-dealing occurring prior to any such sales, the sponsor was held only to a duty to disclose the resulting contracts to the unit buyers.⁴⁴

Letter from Gerald F. Richman, counsel for plaintiff associations, to James E. Gleason, Jr., October 23, 1974, on file in the Brigham Young University Law Review.

³⁹Note, *Florida Condominiums — Developer Abuses and Securities Law Implications Create a Need For a State Regulatory Agency*, 25 U. FLA. L. REV. 350, 355 (1973); Note, *Real Property — Georgia's Apartment Ownership Act — Its Scope Analyzed in View of Emerging Litigation in Other Jurisdictions*, 23 MERCER L. REV. 405, 411 (1972); COOPERATIVES AND CONDOMINIUMS 17 (J. McCord ed. 1968); see also Justice Ervin's dissent from the Florida Supreme Court's opinion in *Point East*, 282 So. 2d at 634.

⁴⁰The leading case was *Northridge Co-op. Section No. 1, Inc. v. 32nd Ave. Constr. Corp.*, 207 Misc. 164, 136 N.Y.S.2d 737 (Sup. Ct. 1955), *modified*, 286 App. Div. 422, 142 N.Y.S.2d 534 (1955), *aff'd*, 2 N.Y.2d 514, 161 N.Y.S.2d 404, 141 N.E.2d 802 (1957). For other cases and discussion see Note, *Federal Assistance In Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 586 & n.281 (1959). For discussion comparing condominiums to cooperative apartments see 1 ROHAN AND RESKIN § 1.01 [2]; 1 A. FERRER AND K. STECHER, LAW OF CONDOMINIUM § 10 (1967); Comment, *Practical Guide to Condominium Law in Connecticut*, 4 CONN. L. REV. 669, 673-76 (1972); Comment, *FHA Condominium: A Basic Comparison With the FHA Cooperative*, 31 GEO. WASH. L. REV. 1014 (1963).

⁴¹*Fountainview Ass'n, Inc., No. 4 v. Bell*, 203 So. 2d 657, 658 (Fla. 3d Dist. Ct. App. 1967), *aff'd per curiam*, 214 So. 2d 609 (Fla. 1968).

⁴²*Id.*; see note 25 *supra* and accompanying text.

⁴³See note 40 *supra* and accompanying text.

⁴⁴At least one cooperative case interpreted the sponsor's duty of disclosure to extend not only to the terms of contracts entered into, but specifically to the dual position occupied by the sponsor-director. *Clearview Gardens First, Fourth, Fifth and Sixth Corp. v. Weisman*, N.Y.L.J., Aug. 26, 1957, p. 11, col. 7 (N.Y. Sup. Ct. 1957).

Accordingly, a New York sponsor could easily enter into binding contracts with himself, covering sales or leases of land, maintenance, management, or even construction,⁴⁵ prior to making the first sale. Thus, the cooperative sponsor's duty was not actually fiduciary in nature but was effectively limited to disclosure in a manner somewhat analogous to the application of corporation law principles relied on by the Florida courts in the condominium cases. The fact that the New York courts, when confronted with equities similar to those involved in the Florida condominium cases, also denied relief to purchasers underscores the possibility that courts in other jurisdictions will determine that relief from condominium developer self-dealing is unavailable under existing corporate and condominium law.

The Florida cases, and the New York decisions before them, rest in part on the finding in each instance that the allegedly onerous contracts had been "disclosed" to the prospective purchasers prior to sale, implying that those who bought knew what they were getting into and should not later be heard to complain. However, the adequacy of the disclosure commonly provided in the homebuilding industry is open to question.⁴⁶ The "notice" received by the average purchaser from the voluminous and highly technical contracts of sale⁴⁷ and supporting documentation is often only a legal fiction. Even if the prospective purchaser reads the documentation, he frequently lacks the expertise necessary to assess the reasonableness of the reported costs and estimates of future costs,⁴⁸ and is often unwilling to pay for expert advice. Further, a tight housing market may pressure him into overlooking unfavorable terms that he might otherwise question.⁴⁹ Finally, the selection of a personal residence is not purely an objective investment decision, but involves elements of emotion, personal taste, etc.

The above factors call into question the application of older corporation law cases, such as *Lake Mabel*, in the context of condominium de-

⁴⁵One reason the doctrine established by the New York courts was thought viable was that under FHA rules, the actual construction of a cooperative could not begin until its stock was 90 percent subscribed. Unfortunately, that rule did not preclude entering into binding construction contracts in advance. Note, *Federal Assistance in Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 586-87 (1959).

⁴⁶*Id.* at 587; Wash. Post, July 6, 1974, at D1, col. 1.

⁴⁷The sales contract itself may run more than 100 pages. Wash. Post, July 6, 1974, at D1, col. 1.

⁴⁸Note, *Federal Assistance in Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 587 and n.290 (1959); Comment, *Condominiums in Virginia — The Condominium Act of 1974*, 9 U. RICHMOND L. REV. 135, at 146 & n.107 (1974).

⁴⁹The New York courts have refused to be influenced by the problems associated with a tight housing market. In some of the cooperative cases, the courts recognized the existence of a housing shortage, but refused to give it special weight in assessing the developer's fiduciary duty. *Nostrand Gardens, Inc. v. Roche*, N.Y.L.J., June 20, 1958, p. 9 (N.Y. Sup. Ct. 1957); *Northridge Co-op. Section No. 1, Inc. v. 32nd Ave. Constr. Corp.*, 286 App. Div. 422, 434, 142 N.Y.S.2d 534, 546 (1955) (dissenting opinion).

veloper self-dealing.⁵⁰ Since 1930, when *Lake Mabel* was decided, both the federal government and the states have recognized a need to impose more stringent disclosure standards on corporate promoters, and have enacted federal securities acts and state "blue sky" laws. The Florida courts, by reaching back to *Lake Mabel* for corporation law precedent,⁵¹ have seized upon a disclosure standard which has long since been recognized as inadequate in the corporation law context and is even less appropriate in the condominium field. Until stringent statutory disclosure standards are imposed in the condominium field, the courts should avoid Florida's inappropriate application of out-dated corporation law and exercise their equity powers to grant relief where disclosure has actually been inadequate.

B. Legislative Action To Curb Developer Self-Dealing

If the Florida and New York cases are any indication of the approach that courts in other jurisdictions are likely to take in future self-dealing cases, the responsibility for providing adequate protection for condominium buyers will ultimately fall on the legislatures. The threshold policy issue is the extent to which condominium purchasers should be protected, not only from self-dealing developers, but from themselves. The available policy alternatives range from *parens patriae* to *caveat emptor*.

1. *Supervision by a state administrative agency.* Just as many "blue sky" laws regulating the offering and sale of securities provide that an offering must pass a state "merit" review, a state legislature could empower an administrative agency to police condominium offerings. Such an approach has a predecessor in FHA regulation of cooperative housing projects in the 1950s.⁵²

Because most of the postwar cooperatives were FHA insured,⁵³ the FHA used its approval power over applications for mortgage insurance to implement rules designed to curb developers' self-dealing abuses.⁵⁴ For example, whenever an "identity of interest" existed between the cooperative corporation and the general contractor, a cost-plus-fixed-fee construction contract was required.⁵⁵ Additionally, any such builder-

⁵⁰See, e.g., *Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U.S. 206 (1908); *Lake Mabel Dev. Corp. v. Bird*, 99 Fla. 253, 126 So. 2d 356 (1930).

⁵¹See text accompanying note 25 *supra*.

⁵²Note, *Federal Assistance in Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 588-92 (1959).

⁵³National Housing Act § 213, 12 U.S.C. § 1715y (1962).

⁵⁴Note, *Federal Assistance in Financing Middle-Income Cooperative Apartments*, 68 YALE L.J. 542, 588-89 (1959).

⁵⁵*Id.* at 588 & n.296. Of course, the restraining power of the regulation was dependent upon how broadly "identity of interest" was construed.

sponsor was required to employ an independent attorney who represented the future purchasers during contract negotiations and to appoint an independent board of directors to serve until the purchasers could elect their own.⁵⁶

The FHA has similar power to regulate condominium developers under the section 234 condominium mortgage insurance program.⁵⁷ However, because relatively few condominium developers currently seek FHA approval,⁵⁸ FHA regulation is largely ineffective.

A similar administrative approach could be adapted for use at the state level, however, and one writer has suggested legislative creation of a state condominium agency as a solution to Florida's condominium problems.⁵⁹ Several states already require condominium developers to submit their declarations and other documentation to an existing state commission to assure that they meet the requirements of the state's condominium act prior to any public offering.⁶⁰ The commissions are frequently empowered to inspect projects prior to approval.⁶¹ Once the developer has secured approval, no changes may be made in the approved documents without the consent of the state commission. The authority of such commissions could be expanded beyond assuring accurate disclosure to policing the reasonableness of the offering. Where volume demanded it, the function could be shifted to a separate condominium agency. Such an administrative approach at the state level would afford wide-ranging protection to condominium purchasers without requiring them to seek redress in the courts.

2. *Total revision of the state condominium statute.* Active policing of condominium offerings by a state agency naturally requires considerable continuing state involvement. In states where condominium abuses

⁵⁶The "independence" of any developer-appointed attorney seems highly questionable. *Id.* at 588.

⁵⁷National Housing Act § 234, 12 U.S.C. § 1715y (1962). The FHA has developed model condominium organizational documents which it requires developers to follow "with only such changes as may be required to conform to the facts pertaining to the individual project or to requirements of local law" (FEDERAL HOUSING ADMINISTRATION, CONDOMINIUM HOUSING INSURANCE AND SERVICING HANDBOOK, FHA MANUAL, Vol. VI, Book 2, Part B, Appendix V-4 § 4.2). See, e.g., 1 ROHAN & RESKIN § 9.04 [7] for an explanation of FHA Form No. 3281, the model management agreement.

⁵⁸HUD figures indicate that in 1973, of 241,000 condominium units started, only 9,785 units were HUD/FHA insured. *Lines & Numbers*, HUD CHALLENGE, January 1975, at 33. See also Vishney, *Financing the Condominium*, 1970 U. ILL. L.F. 181, 182-83 (1970). Ironically, the availability of FHA insurance on individual condominium units precipitated the enactment of the state condominium acts. Note 9 *supra*.

⁵⁹Note, *Florida Condominiums — Developer Abuses and Securities Law Implications Create a Need For a State Regulatory Agency*, 25 U. FLA. L. REV. 350, 365 (1973).

⁶⁰See, e.g., HAWAII REV. LAWS § 514-15 (1968); MICH. COMP. LAWS ANN. §§ 559.23-27 (1967); VA. CODE ANN. §§ 55-79.16 to -79.21 (1974); WASH. REV. CODE ANN. § 64.32.100 (1965) (in Washington, the documents are submitted to the county auditor).

⁶¹See, e.g., HAWAII REV. LAWS § 514-31 (1968).

are not extensive, a less expensive alternative would be a thorough review and overhaul, if necessary, of the state's condominium act. When FHA mortgage insurance was authorized for individual loans on condominium units in 1962, the states scrambled to respond with condominium enabling legislation.⁶² Typically, these early condominium statutes were poorly drafted and are inadequate to cope with developer abuses, including self-dealing, which were not foreseen when the statutes were enacted. While Virginia and Florida have created special commissions to thoroughly examine their condominium acts, most states have not adequately updated their statutes.⁶³ As the inadequacies of these acts become increasingly apparent, states should modify their statutes accordingly.

3. *Statutory imposition of developer fiduciary duties.* Although the Florida courts refused to recognize the plaintiff associations' claim that the developers owed a fiduciary duty to purchasers, one specific remedy for developer self-dealing would be to identify those duties in the condominium act itself. So far, such provisions in the condominium acts have been limited to prohibiting misrepresentation in promotional materials or official documentation.⁶⁴ Given the inadequate disclosure standards in the condominium field, unscrupulous promoters need not resort to outright misrepresentation to reap exorbitant profits from self-dealing. Statutorily imposed fiduciary standards should be broader and directed at self-dealing transactions occurring *at any time* during the development of a condominium project.

After identifying the developer's fiduciary obligations, the statute should broaden remedies available to aggrieved purchasers and associations for violation of those duties. Presently, the only remedy available under the misrepresentation statutes is rescission of the contract of sale.⁶⁵ Yet in most instances, the condominium buyer has purchased his unit because he wants to live in it. Especially where he has moved his family and possessions in, his interest may not be best served by rescission. A more appropriate remedy might be invalidation of onerous management contracts, leases, and other agreements arising out of developer self-dealing, and an accounting for and recovery of excessive amounts already paid by purchasers.

4. *Statutory restrictions on management contracts.* Another approach to upgrading condominium statutes would be to place statutory restrictions on management contracts. For example, in 1973, the Vir-

⁶²National Housing Act § 234, 12 U.S.C. § 1715y (1962).

⁶³See, e.g., notes 64, 66, 67 & 69 *infra* and accompanying text.

⁶⁴See, e.g., HAWAII REV. LAWS § 514-45 (1968); MICH. COMP. LAWS ANN. § 559.28 (1967); VA. CODE ANN. § 55-79.28 (1974).

⁶⁵See, e.g., HAWAII REV. LAWS § 514-47 (1972). Developers found guilty of misrepresentation are also subject to criminal penalties: HAWAII REV. LAWS § 514-46 (1968); MICH. COMP. LAWS ANN. § 559.28 (1967); VA. CODE ANN. § 55-79.28 (1962).

ginia legislature amended the state's condominium act to limit developer-created management contracts to five years.⁶⁶ Such a provision does nothing, however, to limit onerous covenants in the contracts, such as authority to make major expenditures for repairs from association funds without association approval. Florida has provided a broader remedy by making any original management or maintenance contract subject to cancellation upon a 75 percent vote of the association members⁶⁷ any time after the unit owners assume control of the association.⁶⁸ In California, where condominiums are regulated for some purposes by the Real Estate Commission, a 51 percent vote of the unit owners will suffice.⁶⁹ Even these remedies, however, reach only management contracts. Similar remedies should be extended to leases or sales of recreational facilities, and other contractual arrangements arising out of developer self-dealing.

5. *Imposition of more stringent disclosure standards.* Finally, those legislatures that prefer to stay closer to the *caveat emptor* philosophy should at least develop or strengthen disclosure standards in the condominium field. Disclosure should be simple and brief enough that the average purchaser, without benefit of counsel, will not be discouraged from reading it, yet clear and complete enough that he will be warned of potential pitfalls. For example, adequate disclosure is increasingly being compelled by statutes and administrative decisions which treat condominium offerings involving rental pool arrangements or other profit incentives as investment contracts or securities, and require registration and disclosure under the securities laws.⁷⁰ Another example is the state requirement of a separate short-form statement, containing prescribed

⁶⁶V.A. CODE ANN. § 55-79.21:2 (1974).

⁶⁷FLA. STAT. ANN. § 711.13(4) (Cum. Supp. 1974-75), *repealed*, Ch. 74-104, § 8 [1974] 1 Laws of Fla. 2d Reg. Sess. 163, 172, *reenacted in substance as* 711.66(5), Ch. 74-104, § 16 [1974] 1 Laws of Fla. 2d Reg. Sess. 163, 190. Justice Ervin, in his dissent in the *Point East* case, points out that the existence of this 75 percent rule at the time the *Point East* case arose did not render the plaintiff associations remediless in that litigation because the management contracts involved there were entered into prior to the effective date of that legislation (282 So. 2d 628, at 633).

⁶⁸There is some dispute over when the unit purchasers are entitled to take over. If as Rohan and Reskin suggest, 1 ROHAN & RESKIN § 17.02, at 17-3, it is any time after 51 percent of the units are owner occupied, the Florida 75 percent rule (note 67 *supra*) could be invoked by as little as 39 percent of the eventual total membership of the association.

⁶⁹California's 51 percent rule is an administrative regulation promulgated by the Real Estate Commissioner. 10 CALIF. ADMIN. CODE § 2792.8(18)(a) at 4023 (1971).

⁷⁰For fuller discussion of the characteristics that have caused some condominium offerings to be construed as securities see 1A ROHAN AND RESKIN § 18; Clurman, *Condominiums As Securities: A Current Look*, 19 N.Y.L.F. 457 (1974); R. Dickey & B. Thorpe, *Federal Securities Regulation of Condominiums: A Purchaser's Perspective*, 62 GEO. L.J. 1403 (1974); Ellsworth, *Condominiums Are Securities?*, 2 REAL ESTATE L.J. 694 (1974); Comment, *Securities: Another Way to Regulate the Resort Development Boom*, 27 OKLA. L. REV. 104 (1974); Comment, *Securities Regulation of Condominium Offerings*, 51 CHI-KENT L. REV. 148 (1974).

information and warnings.⁷¹ If the burden is to be left on the buyer to protect himself against developer fraud, more stringent disclosure standards can at least provide him with more accurate and complete information on which to base his judgment.

IV. CONCLUSION

That self-dealing abuse by condominium developers has become a serious problem is evidenced by recent action at both the state and federal levels.⁷² In the absence of federal regulatory action, the burden remains on the states to protect the unsuspecting condominium buyer, not only from misrepresentation, but from readily disguised self-dealing abuses as well. The *Point East* and other Florida cases, and the New York cooperative decisions before them, suggest that the courts may fail to provide such protection. The state legislatures should therefore determine

⁷¹Florida's newly revamped Condominium Act, in addition to setting forth in considerable detail the items of information which must be included in the developer's prospectus or offering circular, requires that the purchaser be provided a statement entitled "Important Matters To Be Considered In Acquiring A Condominium Unit," containing prescribed bold-faced warnings about recreational leases, management contracts, and several other potential hazards, where applicable to the particular offering. The new Florida act also requires that any contract for the sale or lease of a condominium unit by a developer must contain a caveat in bold-faced type to the effect that oral representations by the developer cannot be relied upon and that the buyer should refer to the contract and required documents. Ch. 74-104, [1974] 1 Laws of Fla. 2d Reg. Sess. 163, 193. The changes suggested by the Florida condominium commission are discussed in Comment, *Legal Protection For Florida Condominium and Cooperative Buyers and Owners*, 27 U. MIAMI L. REV. 451 (1973).

Virginia has also revised its condominium act in an effort to afford the purchaser a full and fair disclosure comparable to that required under the federal securities regulation acts. VA. CODE ANN. §§ 55-79.39 to -79.103 (Cum. Supp. 1974). The Virginia act requires an elaborate public offering statement, to be delivered to the purchaser either 10 days before the signing of the contract, or on the contract date provided the purchaser is given 10 days in which to cancel. The Virginia Real Estate Commission is given broad powers of enforcement under the Act's disclosure requirements, including imposition of criminal penalties of up to 6 months imprisonment and/or \$50,000 in fines for each offense. The amended Virginia Condominium Act is discussed in Comment, *Condominiums in Virginia — The Condominium Act of 1974*, 9 U. RICHMOND L. REV. 135 (1974).

In Hawaii, the Real Estate Commission not only inspects the brochures, declarations, by-laws, and other documents associated with each condominium offering, but prepares its own report to be distributed to each potential purchaser, containing clear warnings about any self-dealing transactions the developer has entered into as well as comparisons of the project's costs and cost estimates with averages for comparable projects. The developer may not enter into a binding sales contract until the prospective purchaser has read and executed a receipt for the real estate commissioner's final public report. HAWAII REV. LAWS § 514-41 (1968). If subsequent circumstances occur which would render the final public report misleading to purchasers, the developer must stop all sales until a supplementary public report describing all changes has been issued. HAWAII REV. LAWS § 514-42 (1968).

⁷²The state of Florida has filed a test case against one of its biggest condominium developers, charging that an onerous recreational facilities lease amounts to an illegal restraint on trade in violation of a Florida statute patterned after the Federal Trade Commission Act. N.Y. Times, Sept. 6, 1974, at 1, col. 4. The FTC has itself undertaken a wide-ranging investigation of the condominium industry, stemming from a preliminary investigation of Florida abuses. Wash. Post, July 6, 1974, at D1, col. 1.

as a matter of policy the extent to which they will protect condominium purchasers and then implement that policy through revisions of their condominium acts.

Trademarks—SECTION 44(d) OF THE LANHAM ACT—USE IN COMMERCE BY THE FOREIGN APPLICANT AS A PREREQUISITE TO SECURING A UNITED STATES TRADEMARK REGISTRATION—*John Lecroy & Son, Inc. v. Langis Foods Ltd.*, 376 F. Supp. 962, 182 U.S.P.Q. 132 (D.D.C. 1974).

During the past 25 years, patent tribunals have alternated between two conflicting positions as to the requirements for foreign applicants seeking United States trademark registrations. *John Lecroy & Son, Inc. v. Langis Foods Ltd.*¹ was hailed as an opportunity for a judicial tribunal to confront this administrative confusion squarely and settle the matter. Instead, the court chose to cast aside the alternatives offered by previous administrative decisions and to forge a third position. Thus, the conclusion of the court, rather than dousing the fires of confusion, has only served to fuel them.

Langis Foods Limited (Langis), a Canadian corporation, filed application in Canada on March 28, 1969, to register the trademark "Lemon Tree."² At this time Langis had not used this mark in either Canada or the United States.³ By September 19, 1969, the date it filed application for registration of Lemon Tree in the United States, Langis had begun using the mark in Canada. As Langis had still not used the mark in the United States, it stated a claim of priority under section 44(d) of the Trademark Act of 1946 (Lanham Act)⁴ which would have given Langis an effective application date of March 28, 1969, the filing date of its Canadian application.

During the interval between Langis' Canadian and United States filing dates, John Lecroy & Son, Inc. (Lecroy), a United States corporation, commenced using the trademark Lemon Tree in the United States,

¹*John Lecroy & Son, Inc. v. Langis Foods Ltd.*, 376 F. Supp. 962, 182 U.S.P.Q. 132, 64 TRADE-MARK REP. 301 (D.D.C. 1974), *appeal docketed sub nom. SCM Corp. v. Langis Foods Ltd.*, No. 74-1841, D. C. Cir., August 26, 1974.

²The trademark "Lemon Tree" is for use in conjunction with dry crystals which when mixed with water create lemonade. *Id.* at 964, 182 U.S.P.Q. at 133, 64 TRADE-MARK REP. at 302.

³Unlike the law in the United States, Canadian law permits an applicant to file for registration of a "proposed" trademark before the mark has actually been used. However, registration is granted only if use of the trademark is commenced within 6 months of the date of the initial filing. In fact, of the more than 70 nations subscribing to the International Convention for the Protection of Industrial Property, [1962] 1 U.S.T. 1, T.I.A.S. No. 4931, no more than three require use prior to the filing of an application. *John Lecroy & Son, Inc. v. Langis Foods Ltd.*, 177 U.S.P.Q. 717, 64 TRADE-MARK REP. 308 (T.T.A.B. 1973), *vacated*, 376 F. Supp. 962, 182 U.S.P.Q. 132, 64 TRADE-MARK REP. 301 (D.D.C. 1974), *appeal docketed sub nom. SCM Corp. v. Langis Foods Ltd.*, No. 74-1841, D.C. Cir., August 26, 1974.

⁴Lanham Act § 44(d), 15 U.S.C. § 1126(d) (1970).