New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM

An ALM Publication
VOLUME 243—NO. 100
WEDNESDAY, MAY 26, 2010

Outside Counsel

Expert Analysis

Courts Reject Purchasers' Claim For Rescission Under 1968 Law

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Earlier this year, we authored an article discussing the recent trend of purchasers alleging violations of the registration and disclosure requirements of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. §1701, et seq. (2009) (ILSA) by developers in an attempt to have their purchase agreements of preconstruction condominium units rescinded and their earnest money deposits returned. At the time the article was submitted for publication, no New York federal cases had been decided. However, recently two decisions have come out of both the Southern and Eastern District Courts of New York and both courts held that, under the particular facts of each case, certain exemptions in the act relieved the developers from such reporting and disclosure mandates, thereby preserving the efficacy of such purchase agreements.

As a recap, the act requires that the developer of a subdivision consisting of 100 or more lots (which includes condominium units) register with the U.S. Department of Housing Urban Development (HUD), and provide potential purchasers with a printed property report setting forth extensive information concerning matters affecting the real estate. Unless an exemption applies, the failure of the developer to comply with reporting and disclosure requirements entitles the purchaser to revoke the purchase contract within two years from the date of signing.

There are several exemptions to the ILSA reporting and disclosure requirements, which if applicable, would relieve the developers from compliance with such mandates. Two exemptions in particular were examined by the Southern and Eastern District Courts of New York.[1] The first exemption reviewed was the "Hundred Lot Exemption," which provides that the registration and disclosure requirements do not apply to "the sale or lease of lots in a subdivision containing fewer than one hundred lots which are not exempt under [§1702(a)(2)]" [§1702(b)(1)]. The other exemption examined was the "Improved Lot Exemption," which exempts the sale or lease of any improved land on which there is a residential, commercial, condominium, or industrial building, or the sale or lease of land under a contract obligating the seller or lessor to erect such a building thereon within a period of two years [§1702(a)(2)].

> A prudent developer should maintain meticulous records regarding the number of units in the subdivision.

Facts and Arguments

The facts of *Bodansky v. Fifth on the Park Condo, LLC* (*Bodansky*) and *Romero v. Borden East River Realty LLC* (*Borden East*)[2] are substantially similar. Under each case, (i) the developer filed offering plans with the New York State Attorney General's Office for more than 100 condominium units,[3] (ii) none of the purchasers had received a written property report from the sponsor at that time the purchase agreements were executed and the developers admitted that such a report was never prepared or delivered to the purchasers, (iii) the purchasers notified the developer of its claims for rescission within the two-year time period required under the act, and (iv) each developer acknowledged that it had never even heard of the act until the purchasers demanded rescission of their contracts based on violations of the act.

Each party's arguments in the two cases were also essentially similar. The defendants (developers) claimed that they were exempt from the registration and reporting requirements under the act by combining the

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Hundred Lot Exemption and the Improved Lot Exemption. In particular, the Hundred Lot Exemption applied because fewer than 100 uncompleted units were sold at the time a temporary certificate of occupancy (TCO) was issued for the building, and the Improved Lot Exemption applied because the remaining units in the subdivision were sold as completed units after the TCO were issued.

The plaintiffs (purchasers) argued that the exemptions were not applicable because at the time they signed their purchase agreements, more than 100 units in the subdivision were being offered for sale. Thus, the question before the court was during which time period could the exemptions be exercised—i.e., at the time of contract signing or upon the issuance of a TCO.

Court Analysis

The analysis of each case began with a discussion about the long-standing principle regarding statutory interpretation, which "always begins with the plain language of the statute." Both judges found the text of the exemptions unambiguous, and focused on the applicability of the Hundred Lot Exemption, which was the exemption in dispute. Each court held that the "plain meaning" of the Hundred Lot Exemption was clear—that the registration and disclosure statements do not apply if the subdivision contains less than 100 lots which are not exempt under the Improved Lot Exemption.

In other words, the Hundred Lot Exemption can apply to a subdivision project that contains 100 or more units so long as the number of unimproved units sold is 99 or less and the remaining units fall under the Improved Lot Exemption.

The court continued to apply the "plain meaning" rationale to rebuff the plaintiffs' claim that the applicability of the Hundred Lot Exemption should be determined at the time a purchase agreement is executed by the parties. The courts found no evidence in the text of the Hundred Lot Exemption, nor in any other part of the act, which limited the applicability of the exemption to a particular time period. It was also noted that there were timing requirements in other parts of the act, unrelated to the Hundred Lot Exemption, which indicated Congress' intent not to limit the applicability of such exemption to the date when a purchase agreement was signed.

Additional support for the courts' findings was based on a review of regulations and guidelines issued by HUD pertaining to ILSA and the relevant exemptions. In particular, the regulation specifically addressing the applicability of the Hundred Lot Exemption [see 24 C.F.R. §1710.6] did not impose any time limitations on its applicability. The regulations also provide that a developer's eligibility for an exemption under the act is "self-determining" [see 24 C.F.R. §1710.4(d)].

This means that a developer is not required to file any sort of notice to, or obtain the prior approval of, HUD in order to take advantage of an exemption. Therefore, a developer is not required to have a disclosed plan regarding any exemptions that it may be entitled to employ and may decide which exemptions are applicable at any point in time during construction. In essence, so long as a developer does not contract for more than 99 incomplete units, it will be exempt from the reporting and disclosure requirements of the act.

Relief for Developers

These rulings should give developers some relief that their failure to register with HUD and/or to provide purchasers with disclosure statements will not necessarily jeopardize the existence of otherwise valid purchase agreements. So long as a developer can demonstrate that it entered into fewer than 100 contracts for unimproved units prior to the issuance of a temporary certificate of occupancy, and that the remainder of the units were either "improved" or were under contracts obligating the seller to complete the unit within two years, they will be exempt from the registration and reporting requirements under ILSA.

A prudent developer should maintain meticulous records regarding the number of units in the subdivision, the number of contracts entered into, the date and terms of each, and the timing of when each unit is complete in order to demonstrate that the requirements of an exemption have been met. Although each case will be fact-specific, developers in similar situations should take notice of these rulings to determine which exemptions, if any, may apply to their subdivisions.

1. The Eastern District Court also briefly discussed the exemption set forth in §1702(a)(7), which exempts the sale of any unit for the purpose of resale or lease of such lots to persons engaged in such business.

2. The plaintiffs in *Bodansky* consisted of two different plaintiffs, and the plaintiffs in *Borden East* consisted of eight different cases, which were reassigned as related cases.

3. Under the facts of *Bodansky*, the offering plan indicated that the condominium would consist of 160 residential units. Under the facts of *Borden East*, the offering plan specified that the condominium would consist of 132 residential units.