The Legislative Response to Sweetheart Management Contracts: Protecting the Condominium Purchaser

Thomas G. Krebs

Follow this and additional works at: https://scholarship.kentlaw.iit.edu/cklawreview

Part of the Law Commons

Recommended Citation
Available at: https://scholarship.kentlaw.iit.edu/cklawreview/vol55/iss2/3
The American consumer has been protected by his government in the purchase of most of the relatively inexpensive items which are offered to the general public. However, until very recently he has received little or no effective protection in the purchase of a condominium. One particular source of problems for the residential condominium purchaser has been management contracts executed by developers prior to the transfer of control of the condominium association to the unit owners. All too frequently these contracts bind the association to a specific managing agent or management firm for a number of years with no express right to renegotiate or cancel. This situation may be further exacerbated if the managing agent is a subsidiary of, or related to, the developer who originally executed the contract. The long-term duration of these so-called “sweetheart” contracts constitutes an infringement upon rights of the association and the unit owners to contract on their own behalf. Moreover, because these contracts may be self-serving for the developer-manager, he may include terms which are commercially unreasonable.

Since most of the original state condominium legislation did not address the management contract problem, condominium associations and individual owners sought redress in the courts. However, this approach did not produce any significant relief from the “sweetheart”
contracts. In response, several state legislatures have enacted "second-generation" condominium acts which are intended to solve this problem. In addition to these state enactments, various municipal governments have passed ordinances aimed at the same problems, Congress has proposed a federal Condominium Act, and the National Conference of Commissioners on Uniform State Laws has proposed a Uniform Condominium Act.

These legislative responses vary greatly in their overall approach to solving the "sweetheart" contract problem. However, each approach is composed of at least one of four precepts. This article will analyze and compare the four principles and will discuss the adequacy of each to deal with the problem of these management contracts, while balancing the interests of the developer and the purchasers. Close scrutiny of these "second-generation" statutes will be helpful in refining the law in this area and will aid those states which still are operating under "first-generation" statutes in amending their laws.

BACKGROUND

Although reported decisions dealing specifically with the problem of management contracts are relatively few in number, a brief survey of the more important decisions in Florida will serve to illustrate the problems purchasers have faced in challenging these contracts. Much of the difficulty encountered by condominium owners and associations in seeking relief from onerous contracts in Florida resulted from the

4. See text accompanying notes 11-25, infra.
8. UNIFORM CONDOMINIUM ACT §§ 1-101 through 5-110 (7 UNIFORM LAWS ANN. 97 (1978)) [hereinafter referred to as the U.C.A.].
9. This discussion will be limited to new residential condominiums. Because conversions, recreational condominiums, cooperative apartments and condominiums sold as investments present special problems which require distinct solutions, they are beyond the scope of this article.
10. The bulk of relevant case law predating the "second-generation" statutes arose in Florida. This preponderance of decisions emanating from Florida courts may be explained by the early popularity of the condominium form of home ownership in that state.
1967 Florida appellate court decision in *Fountainview v. Bell*. In that case a condominium association had brought an action for rescission of a management contract and cancellation of a recreational lease, both of which contained allegedly inflated price terms and were of unreasonably lengthy duration. The association alleged that the agreements in question were executed by the defendants while acting in the capacities of directors and officers of the association prior to the initial sales of units, and that the defendants derived private or secret profits from the agreements. Despite the fact that the association was organized as a not-for-profit corporation, the court held that the case was governed by Florida corporation law as it pertained to corporations organized for profit. The court reasoned, albeit with some reluctance, that since the defendants were the sole members of the association at the time the agreements were formed, the plaintiffs were not entitled to equitable relief.

The *Fountainview* decision has been followed, with continued reluctance, by other Florida courts in upholding similar agreements. In *Wechsler v. Goldman*, for example, a group of condominium owners brought an action for cancellation or termination of a ninety-nine year lease of recreational facilities. This lease had been executed by defendant promoters, as directors of the association, with a corporation also owned or controlled by the defendants. The individual plaintiffs in *Wechsler* were not informed of the lease when they executed preliminary sales contracts, but expressly accepted the lease when they subsequently executed the closing contracts. The court held that their knowledge was sufficient to bind the plaintiffs, but also stated that "[w]hat occurred in this instance and in the *Fountainview* case may indicate a need for legislative action to amend the Condominium Act to prevent unfair dealing by promoters of condominium associations."

12. The *Fountainview* court relied on the 1930 Florida Supreme Court decision in *Lake Mabel Development Corp. v. Bird*, 99 Fla. 253, 126 So. 356 (1930). In *Lake Mabel*, a corporation had defended a mortgage foreclosure proceeding by alleging that the underlying transaction was tainted by the self-dealing of the promoters of the corporation in selling land owned by themselves to the corporation at a generous profit. The court held that the answer was insufficient at law, stating that the corporation could not:

> while its promoters own all its outstanding stock, avoid in equity a purchase of property sold to it by its promoters at a large profit, represented by stock of the corporation issued to such promoters, since the corporation thus has full knowledge of the facts and the rights of innocent purchasers of stock have not arisen.

99 Fla. at 257, 126 So. at 358.
13. 203 So. 2d at 659.
14. 214 So. 2d 741, 744 (Fla. App. 1968).
15. *Id.*
16. *Id.* (citations omitted). *See also Commodore Plaza at Century 21 Condominium Assoc., Inc. v. Saul J. Morgan Enterprises, Inc.*, 301 So. 2d 783 (Fla. App. 1974).
The same reasoning was utilized by the Florida Supreme Court in *Point East Management Corp. v. Point East One Condominium Corp.*,\(^{17}\) without reference to either *Fountainview* or *Wechsler*. At issue in *Point East* were a twenty-five year management contract and a ninety-nine year recreational lease which the developer had executed with itself on behalf of the association. Present unit owners and members of the association sought rescission of both the contract and the lease, damages for fraud, damages for breach of a fiduciary duty, and damages for breach of contract.\(^{18}\) The trial court ruled in plaintiff's favor. However, the Florida Supreme Court reversed the lower court\(^ {19}\) and stated:

Admittedly, a prospective purchaser had no option as to the management contract, but he knew or should have known that the contract was part of the purchase price of his condominium unit. Considered in that light, enforcement of the contract cannot be said to work a hardship on the present condominium owners.\(^ {20}\)

In *Avila South Condominium Association v. Kappa Corp.*,\(^ {21}\) the Florida Supreme Court held that an unjust enrichment theory might be successful. However, the court limited recovery under this theory to the situation in which the "interested" developer receives funds without "the consent of a substantial number of the individuals comprising the association."\(^ {22}\) The court did not expand on what would constitute "consent." If it is sufficient for a developer to show that a copy of a management contract was included in the papers tendered at the time of sale and was not rejected by the purchaser, the individuals of the association will have gained little ground, if any. The impact of this decision will not be known until the courts have had the opportunity to define consent.

These types of agreements have been challenged on several other theories, but there has been no clear success. Challenges by residential condominium associations under the Federal Securities Act have failed.\(^ {23}\) However, the management contract has not been at issue in

---

17. 282 So. 2d 628 (Fla. 1973).
18. *Id.* at 629.
19. In reversing the lower court, the *Point East* court applied the reasoning set forth in *Lake Mable*, 99 Fla. 253, 126 So. 356 (1930). See note 12, *supra*.
20. 282 So. 2d at 629.
21. 347 So. 2d 599 (Fla. 1977).
22. *Id.* at 607.
23. The Securities and Exchange Commission [hereinafter referred to as SEC] has issued guidelines, 38 FED. REG. 1735, SEC Release No. 5347, HOUS. & DEV. REP. (BNA) ¶ 25:2501 Jan. 4, 1973, which indicate that a condominium offering will not be considered a securities offering absent some "collateral arrangements" which would qualify as an investment contract under the criteria of SEC v. W.J. Howey Co., 328 U.S. 293 (1946). The "collateral arrangements" would include, but not necessarily be limited to: an offering and sale with "emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter... [in] rental of the units;" an offering of a rental pool; and an offering which requires the purchaser to "hold
any reported decision to date. Although characterization of the forced acceptance of contracts at the time of closing the sale as an illegal tying arrangement has been held to state a cause of action, the proof needed to prevail on this theory has not been established.\(^\text{24}\)

Moreover, it is clear that absent remedial legislation, condominium purchasers would be continually victimized by onerous long term contractual agreements to which they were not parties and for which they have no effective remedy. This concern is reflected in the legislative purpose enunciated in the proposed Condominium Act of 1978:

> It is therefore the purpose of the Act to establish national standards for consumer protection and disclosure together with appropriate enforcement procedures, to encourage States to adopt statutes which will provide substantially equivalent or greater consumer protection, and to correct and prevent continuing abuses including abusive use of long-term leasing of recreation and other condominium related facilities.\(^\text{25}\)

**LEGISLATIVE REMEDIES: FOUR PRECEPTS**

The apparent need for protection for condominium purchasers has led to legislation in fourteen states.\(^\text{26}\) This legislation is aimed at limit-

his unit available for rental for any part of the year, [or to] use an exclusive rental agent,” or which materially restricts the purchaser’s “occupancy” or rental of his unit.”

Since the above types of agreements are not normally associated with the strictly residential development to which this article is addressed, it is not likely that a purchase agreement with a management contract appended would bring these developments within the purview of the SEC. **See also, Fed. Sec. L. Rep. (CCH) \$ 78,447-78,449 (1972); Note, Securities Regulation of Condominium Offerings, 51 Chi.-Kent L. Rev. 148 (1974).**

24. Miller v. Granados, 529 F.2d 393 (5th Cir. 1976). The defendants in *Miller* were the manager and developer of the condominium and served as controlling officers and directors of the owners association for six years. The contract provided for their fees to increase in relation to the cost of living index. *Id.* at 394-95. The court held that the complaint established a prima facie showing of a tying arrangement actionable under section 1 of the Sherman Anti-Trust Act, 15 U.S.C. § 1 (1976). *Id.* at 397. **See also Imperial Point Colonnades Condominium, Inc. v. Mangurian, 549 F.2d 1029 (5th Cir.), cert. denied, 434 U.S. 859 (1977); Jones v. 247 East Chestnut Properties, 1975-2 Trade Cases (CCH) \$ 60,491 (N.D. Ill. 1974).** The court in *Jones* held that condominium and management services were “generally different products” and that a claim under section 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1-2 (1976), was clearly stated by the complaint. However, the court refused to grant defendants’ motion for summary judgment, citing the need for more evidence regarding the economic impact of the tying arrangement on the relevant market and the effect of the arrangement on interstate commerce. 1975-2 Trade Cases \$ 60,491 at 67,162-67,163.


ing the potential for abuse, without unduly burdening the developer. These statutes utilize a combination of four basic precepts. Simply stated, they are: automatic termination of the management contract; compulsory transfer of control over the association; mandatory disclosure of the existence and/or terms of such contracts; and governmental supervision of condominium offerings.

Thirteen states have chosen to limit the term which a management contract may run either by providing for cancellation, without cause, by the association or by setting a specific time limit.27 Both the U.C.A.28 and the proposed Condominium Act of 1978 have similar provisions.29 Specific provisions for the transfer of control of the association from the declarant to the unit owners have been enacted in six states30 and proposed in the U.C.A.31 and the proposed Condominium Act of 1978.32 Twelve states,33 the U.C.A.,34 the proposed Condominium Act of 197835 and the Chicago city ordinance,36 have opted for some form of mandatory disclosure. Finally, statutes in five states provide for supervision of the offering and selling process by some governmental agency.37 The proposed Condominium Act of 1978 also


28. U.C.A., supra note 8, at § 3-105.

29. The proposed Condominium Act of 1978, supra note 7, at §§ 205(a)(11), 209(a)-209(e).


31. U.C.A., supra note 8, at §§ 3-103(c) through 3-103(d).


34. U.C.A., supra note 8, at §§ 4-102, 4-106.

35. The proposed Condominium Act of 1978, supra note 7, at §§ 203(a), 206(a)(6)(iii)-206(a)(6)(iv), 208(a)-208(d), 211(c)-211(d), 212, 215, 219, 220(a)-220(c).


contains such a provision and the U.C.A. has an optional provision of a similar nature.\(^{39}\)

Despite apparent consensus for the need for this legislation among the states addressing the issue, there are significant differences in the provisions which have been adopted. These differences reflect significant differences in public policy and may affect the relative efficacy of the statutes in protecting the condominium purchaser. A careful analysis of the statutes will illustrate these differences and will provide an insight into the degree of consideration given the various interests and the potential effectiveness and workability of the statutes.

**Limitations on the Contract Duration**

The most drastic remedy for long-term management contracts would be to make them voidable by the association at any time after control is transferred from the developer. The Florida Condominium Act comes the closest to this extreme. It allows any management contract to be terminated upon affirmative vote of seventy-five percent of the unit owners other than the developer. Next is the U.C.A. which provides that any management contract which was unconscionable at the time of formation may be terminated by a board elected by the unit owners after ninety days notice.\(^{41}\) The proposed Condominium Act of 1978 requires that management contracts be voidable after the developer’s control has ended and upon ninety days notice.\(^{42}\) It further provides that any contract between the unit owner and the developer, or affiliate, which has a term of two years or more is terminable upon a vote of the unit owners.\(^{43}\)

A more restrictive provision has been employed in four states.\(^{44}\) In Illinois, for example, any management contract which extends beyond two years may be cancelled by a majority vote of the unit owners during the ninety day period following the expiration of the two years. Maryland and Louisiana have very similar provisions, differing only in


38. The proposed Condominium Act of 1978, supra note 7, at §§ 201(22), 202(b), 270(b), 208, 215-218.


41. U.C.A., supra note 8, at § 3-105.

42. The proposed Condominium Act of 1978, supra note 7, at § 205(a)(11).

43. Id. at § 209.


the time period allowed. Michigan varies the pattern somewhat by permitting cancellation during the first ninety days following termination of the developer's control, for any reason. Thereafter the association is permitted to cancel only for cause and after giving the developer thirty days notice.

The chief advantage of the more restrictive variations of this precept is that they encourage owners' associations to scrutinize the contracts which they inherit from the developer-controlled association. In addition, they encourage the developer to execute commercially reasonable contracts which will survive scrutiny. The developer is not forestalled from contracting with himself or an affiliate, but is encouraged to exercise restraint in the terms of the contract. On the other hand, the developer is vulnerable to the vagaries of the association, which may cancel the contract without any justifiable reason. If this occurs, the developer loses some of his ability to protect his investment in any unsold units. However, he is provided some measure of protection by those statutes which allow cancellation only by a vote of more than a majority of the unit owners. Furthermore, by explicitly stating the period in which cancellation is permitted, four states have forced the associations to act promptly so as not to lose the privilege.

A variation which affords the developer a greater measure of protection has been adopted in six other states. Under this method, management contracts are limited to a specific term of years, ranging from one year in Hawaii to seven years for a "staged" condominium in Oregon. These statutes give the developer the security of knowing that he will have a major influence on the management of the condominium during the period of heaviest sales activity. This is the period during which he is seeking to recover his investment and realize a reasonable profit. Unfortunately, the association remains at the mercy of the developer during this period. During the term of the contract, the association would have no remedy if the developer chose to realize

51. OR. REV. STAT. § 91.557 (1977). A "staged" condominium is a condominium which is intended to be developed over a period of years with individual segments completed at different times.
some quick profits. Utah, however, has gone to the other extreme. It provides that management contracts must be specifically ratified or renewed by a majority of the unit owners. Here the developer is afforded virtually no protection after control has been transferred.

These differing approaches illustrate the conflicting interests which must be considered. A developer who contracts for management services with his own, or a related firm, should not be assumed to be primarily interested in realizing excessive profits. The developer has a significant financial interest in the project until all of the units have been sold. Poor management could easily reduce the desirability of the condominium, thereby making it more difficult to sell the units. Many developers legitimately seek to control the management of the condominium for that very reason.

However, it is also clear that the interest of the developer in protecting his investment is not of indefinite duration. There is a point at which the unit owners’ interest in controlling their own affairs outweighs the developer’s interest. For this reason those statutes which permit binding management contracts for a specified period of time seem to represent the best balancing of interests.

Transfer of Control

The ability of the developer to bind the association to a management contract is also diminished by provisions which require control of the association to be transferred to the unit owners within a certain time. Six states have statutes which require transition to be complete within three to seven years from the initial sale to a party other than the developer. The length of time allowed depends upon whether the condominium is a single development or an expandable development—one which is developed in stages. This approach has also been adopted by the U.C.A. and the proposed Condominium Act of 1978. In addition, Florida and Connecticut provide for a phase-in of unit owner control as greater percentages of units are sold.

Statutes which limit the duration of contracts and those which pro-
vide for the transfer of control of the condominium association have as a common element the placement of an absolute limitation upon the time during which the developer will have control over the management of the development. However, there is also a distinct difference between these two approaches. Limiting the duration of contracts forces the association to reconsider its management needs at a specific point in time. The association is thereby forced to contract on its own behalf, to strike its own bargain, and, obviously, to make its own mistakes. This method also automatically terminates favorable contracts, and could conceivably result in the loss of an advantageous contract, due to changed market conditions. Although empirical data is unavailable, it is possible also that this approach is open to opportunistic exploitation. There is nothing to prevent formation of a short-term contract with highly inflated rates, which would continue the former abuses on a smaller scale.

On the other hand, transfer of control permits the association to consider the contracts on their merits and does not force undesirable termination. These types of provisions could encourage developers to form commercially reasonable contracts at the outset and to perform management functions efficiently in the hope of a continued relationship. Such a relationship would result in steady, even though less spectacular, profits for a longer period after the development of the project is completed. Of course, an indolent association might fail to extricate itself; but at least the terms of the contract would not be forced upon the association by the developer. Perhaps the best way to blend these two types of provisions is to provide for mandatory transfer of control and to grant the owner-controlled board the option to terminate without cause at a specified time in the future.\textsuperscript{59} While the board might treat a developer unfairly by cancelling on a whim, the board would be guaranteed the right to contract on its own behalf. In addition, the developer's interests are protected during the period in which the initial

\textsuperscript{59}. \textit{See, e.g.}, the following excerpt from the Illinois statute:

\begin{quote}
Until election of the initial board of managers, the same rights, \ldots vested in, \ldots the board of managers by this Act and in the declaration and by-laws shall be held and performed by the developer. The election of the initial board of managers shall be held not later than 60 days after the conveyance by the developer of 75\% of the units or 3 years after the recording of the declaration, whichever is earlier. If the initial board of managers is not elected by the unit owners at the time so established, the developer shall continue in office for a period of 30 days whereupon written notice of his resignation shall be sent to all of the unit owners entitled to vote at such election. \ldots Any contract, lease, or other agreement made prior to the election of a majority of the board of managers other than the developer by or on behalf of unit owners \ldots which extends for a period of more than 2 years from the recording of the declaration, shall be subject to cancellation \ldots .\end{quote}

\textsuperscript{\textit{ILL. REV. STAT.} ch. 30, § 318.2 (Supp. 1978). \textit{See also} \textit{VA. CODE} § 55-79.74(b)(1) (Supp. 1976).}
investment is recovered, and are protected to a lesser extent as the community's interest in self-determination begins to outweigh the developer's interests.

**Disclosure**

By limiting the contract term or giving the association some cancellation rights, the legislatures have placed the primary burden upon the developer to execute fair contracts and to protect his interests in some other way. In addition, by requiring the developer to transfer control after a specified period, the legislatures have taken the burden off both the developer and the purchasers. In contrast, mandatory disclosure of a "sweetheart" contract and/or its terms to potential purchasers may shift the burden to the purchaser. Barring fraud or misleading statements, the purchaser who has been informed and thereafter signs a purchase agreement is presumed to have determined that the contract is commercially fair and reasonable. He probably will not be able to challenge the contract at a later date. Therefore the effectiveness of disclosure statutes is largely dependent upon the amount and type of information disclosed, the availability of comparative data, the relative expertise of the purchaser and/or his counsel, and the enforcement procedures available.

Perhaps the most crucial consideration is: what must be disclosed? In seven states, the purchaser must be provided with a copy of the contract itself. While this approach is probably the most informative, it is not without some drawbacks. The contract on its face may not reveal the interest of the developer in the management company, nor would the technical language of the contract necessarily be comprehensible to the average purchaser. Since most condominium purchasers should be represented by competent counsel, this point is more in the nature of a warning than a serious obstacle. However, it would be necessary under this type of legislation for a buyer's attorney to intelligently examine the contract to determine its effect upon his client in the future and to consider whether the terms therein are commercially reasonable.

A less informative approach has been adopted by Oregon, Louisiana, and the city of Chicago and has been proposed in the

60. See text accompanying notes 11-20, supra.
U.C.A.\textsuperscript{65} and the proposed Condominium Act of 1978.\textsuperscript{66} These statutes require only that the developer make available a description of the contract rather than the document itself.\textsuperscript{67} The effectiveness of these statutes in protecting purchasers depends primarily upon the completeness of the disclosure. Certainly it is likely that the average purchaser will be more able to comprehend clearly drafted descriptive statements than technical contractual language. However, there is also more possibility for omissions, misleading statements, or intentionally vague wording unless there are sufficient enforcement provisions to discourage obfuscation and encourage candor and clarity.

In Hawaii,\textsuperscript{68} Illinois\textsuperscript{69} and Michigan\textsuperscript{70} the developer is only required to disclose the costs and expenses of management. While this information may be useful in determining the actual cost of the purchase, it does little to help the purchaser identify the developer's interest or to make the purchaser aware of renewal clauses or escalation clauses. Connecticut,\textsuperscript{71} Louisiana\textsuperscript{72} and Virginia\textsuperscript{73} have attempted to bolster this requirement by mandating that any interest the developer has in the management firm be disclosed as well. This particular requirement, which is also in the proposed Condominium Act of 1978,\textsuperscript{74} is extremely important for the purchaser to determine the fairness of a particular contract.

The effectiveness of a disclosure statute depends largely upon the availability of private remedies and/or public enforcement. In this regard there are two basic questions: what happens if no disclosure is made, and what happens if the disclosure is fraudulent or misleading?

\textsuperscript{64} CHICAGO, ILL. MUN. CODE ch. 100.2, §§ 1-2(M)(2), 2(N)(2) (1977).
\textsuperscript{65} U.C.A., supra note 8, at § 4-102.
\textsuperscript{66} The proposed Condominium Act of 1978, supra note 7, at § 206(a)(6)(iii).
\textsuperscript{67} The following is illustrative of this type of provision:
A. Prior to each sale or execution of a contract to sell a condominium unit, the seller must make full disclosure of, and provide to the other party to the agreement the following information:
\begin{itemize}
\item[(5)] A written statement indicating whether the developer has entered into or intends to enter into a contract for the management of the condominium property. With respect to any such contract, this statement shall specify in detail, the services to be rendered, the amount or estimate of the costs to be incurred thereunder and the duration thereof, including any renewal provisions, and any relationship, whether direct or indirect, between the seller and the person to perform such management services;
\end{itemize}
\textsuperscript{68} HAW. REV. STAT. § 514A-61(a) (Supp. 1977).
\textsuperscript{69} ILL. REV. STAT. ch. 30, § 322(c) (1977).
\textsuperscript{70} MICH. COMP. LAWS ANN. § 559.24 (West Supp. 1978).
\textsuperscript{71} CONN. GEN. STAT. § 47-71b (1977).
\textsuperscript{72} LA. REV. STAT. ANN. § 9-1140A(5) (West Supp. 1978).
\textsuperscript{73} VA. CODE § 55-79.90(4) (Supp. 1976).
\textsuperscript{74} The proposed Condominium Act of 1978, supra note 7, at § 206(a)(6)(iv).
The most frequent response to the former question is that sales contracts are unenforceable unless full disclosure has been made.\(^7\) A variation on this theme is to hold the sales contract voidable by the purchaser until full disclosure has been made.\(^6\) In both cases, the purchaser is frequently given a maximum period of time, usually fifteen days, in which to peruse the disclosed information before the sales contract becomes enforceable and binding.\(^7\) In Virginia, a disclosure statement must be prepared in accordance with the statute before a permit to sell is issued by the Virginia Real Estate Commission.\(^8\) While any of these provisions is likely to be effective in forcing compliance, the primary benefit of the Virginia statute would seem to be that disclosure would be guaranteed at the outset. Under the more popular approach of granting an express right of rescission there is also a greater possibility of confusion. "Full disclosure" of all relevant information is a subjective phrase. The developer may feel that he has fully disclosed the relevant terms, only to find the purchaser disagreeing.

Compliance with the mechanics of disclosure may be insufficient to adequately protect the rights of the purchaser. Additional protection is needed in the case of fraudulent or misleading disclosure. The private remedy most frequently provided is rescission of the sales contract. The language usually employed is very similar to that found in the Hawaii statute:

```
No officer, agent, or employee of any company, . . . may knowingly authorize, direct, or aid in the publication, . . . of any false statement or representation . . . and no person may issue, circulate, publish, or distribute any advertisement, pamphlet, prospectus, or letter . . . which contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements therein made in the light of the circumstances under which they are made not misleading.

Every sale made in violation of [the foregoing section] is voidable at the election of the purchaser. . . .\(^7\)
```

In the case of management contracts, information which might fall within the purview of this statute would include statements relating to costs of management, the share of the costs apportioned to the specific unit being purchased, the relationship, if any, between the developer


and the managing agent, and clauses relating to renewal of the contract, penalties for nonperformance or accelerated cancellation, and possibly those which are exculpatory. Seven other states have some provision for rescission of the sales contract if the statutory anti-fraud provisions are violated. Florida and Michigan permit a purchaser to seek damages if the disclosure is fraudulent or misleading. This type of provision seems to be an extremely important method for encouraging good faith disclosure. Permitting the purchaser to take direct action for the redress of wrongful disclosure, provides him the opportunity to recoup his losses in addition to extricating himself. These provisions do not seem to be overly burdensome for the developer who engages in good faith sales practices. He would be less likely to be sued and would be likely to successfully defend, albeit at some cost.

In addition to the foregoing private remedies, several enactments afford some form of public enforcement. Penalties in the form of fines or even imprisonment are provided for in Virginia, Oregon, Georgia, Chicago, and in the Condominium Act of 1978. In addition, Oregon has empowered the real estate commission to adopt rules and regulations and issue cease and desist orders. Michigan has similarly empowered the department of commerce to regulate the form of disclosure and to refuse to issue a permit to sell. The Division of Florida Land Sales and Condominiums also has been given rule-making power and the authority to seek cease and desist orders. The optional enforcement agency proposed in the U.C.A. has similar powers.

Administrative and Supervisory Agencies

Some mention should also be made of the role of administrative and supervisory agencies in protecting purchasers. A comprehensive discussion of the different types of agencies, their powers, duties, and their effectiveness, is beyond the scope of this article.

87. The proposed Condominium Act of 1978, supra note 7, at § 212.
91. U.C.A., supra note 8, at §§ 5-101 through 5-110.
92. A comprehensive discussion of the different types of agencies, their powers, duties, and their effectiveness, is beyond the scope of this article.
CONDOMINIUM PURCHASER PROTECTION

will be helpful in understanding the protection available under the more recent statutes. Several of the states seem to pattern their agency after the SEC. For example, some form of registration is required of the developer by Florida, 93 Michigan, 94 Oregon, 95 Virginia, 96 and the U.C.A. 97 In connection with the registration process the developer is also required to prepare some form of public offering statement, 98 similar to an SEC approved prospectus. 99 Such a statement is also required by Hawaii 100 and in the proposed Condominium Act of 1978. 101 It is in the public offering statement that management contracts must be disclosed. 102

The foregoing requirements are aimed primarily at gathering information and making it available to the ultimate purchaser and the administrative agency. The paramount feature of the statutes empowering these agencies is the establishment of enforcement procedures. Four of the five states which have authorized this agency, specifically grant it the power to investigate and supervise condominium sales. 103 Thus, an agency would be capable of inquiring into any ambiguities or potentially false or misleading representations concerning management contracts. Assuming that the agency is properly funded and aggressive, this power will be of particular importance in determining whether there is any relationship between the developer and agent which would be detrimental to an association or individual unit owner.

Florida, 104 Michigan, 105 Oregon 106 and Virginia 107 go even further

97. U.C.A. supra note 8, at §§ 5-102 through 5-106.
98. The Virginia statute, for example, specifically states that public offering statements for offers of units currently registered with the Securities Division of the State Corporation Commission or the Securities and Exchange Commission are presumed to be in compliance with the statutory requirements. VA. CODE § 55-79.90(d) (Supp. 1976).
101. The proposed Condominium Act of 1978, supra note 7, at § 206 (no registration requirement).
102. See, e.g., FLA. STAT. ANN. § 718.503(2)(e) (West Supp. 1978). See also text accompanying notes 60-82, supra.
by granting power to impose sanctions such as cease and desist orders, to institute judicial proceedings, and to compel testimony. The proposed Condominium Act of 1978 has similar provisions.\textsuperscript{108} While the U.C.A. grants power to issue cease and desist orders, it does not grant the power to seek judicial enforcement of its orders.\textsuperscript{109} These powers are important tools which can provide significant protection for purchasers if they are vigorously utilized. However, lax enforcement could result in additional damage to purchasers. The existence of these agencies could tend to lull a potential purchaser into a false sense of security, thereby causing a decrease in diligence on his part. Under the reasoning in \textit{Fountainview},\textsuperscript{110} a purchaser operating under such a delusion who discovers his error after signing the closing agreement would have difficulty in obtaining redress, unless intentional fraud could be shown. On the other hand, overly enthusiastic enforcement could result in harassment of developers and would have a stifling effect upon the condominium market. The amount of documentation already required under the disclosure statutes is overwhelming. Governmental regulation at any level is likely to increase the bureaucratic burden on the erstwhile developer.

\textbf{Conclusion}

The foregoing discussion demonstrates that developers are gradually being limited in their ability to bind associations to management contracts which are not in the association’s best interests. The thrust of the current legislation seems to be to limit the term for which a contract may be binding while permitting the developer at least a modicum of protection against poor management decisions. In addition, there is a general trend toward forced disclosure of material information, which includes some disclosure of information regarding management contracts. These disclosure requirements are generally bolstered by public and private enforcement procedures, including direct governmental regulation.

The result of this approach is to emphasize informed consent on the part of the purchaser. There is no limitation on the content of the contract, nor is a contract which involves the developer on both sides summarily prohibited. Thus, the duty to examine the contract falls

\begin{itemize}
\item \textsuperscript{107} \textsc{Va. Code} §§ 55-79.98 through 55-79.101, 55-79.103 (Supp. 1976).
\item \textsuperscript{108} The proposed Condominium Act of 1978, \textit{supra} note 7, at § 208.
\item \textsuperscript{109} \textsc{U.C.A.}, \textit{supra} note 8, at § 5-105.
\item \textsuperscript{110} 203 So. 2d 657 (Fla. App. 1967), \textit{cert. discharged}, 214 So. 2d 609 (Fla. 1968). \textit{See} text accompanying notes 11-13 \textit{supra}.
\end{itemize}
upon the purchaser, whose primary recourse is to decline to purchase, buttressed by the possibility of rescission of the sales contract under certain circumstances. While there is certainly incentive for a developer to deal fairly in contracting for management services, it is still possible for an unwary buyer to find himself paying unnecessarily high fees for a number of years as a result of his carelessness.