Drafting The Purchase Contract: ILSA Considerations

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Cases over the last 10 years provide a lot of guidance (not all of it consistent) about good and bad provisions in purchase contracts when it comes to complying with the requirements of or for exemptions from the Interstate Land Sales Full Disclosure Act ("ILSA"), 15 U.S.C. §1701 et seq.

LACK OF PERFECT CLARITY (I hesitate to say "ambiguity") may be your friend when drafting contracts for ILSA compliance. This is because ILSA is not a causation statute. If you fail to register a project that turns out not to be exempt from registration, or if you fail to include a mandatory contract provision in the manner required by ILSA, the buyer has an automatic two-year right of rescission, even if the defect has nothing whatever to do with the facts of the situation. Consequently, it may often be the case that the more precise you try to be about what you mean by "completion of construction," "force majeure" or "damages," the more you risk an abstract argument, whereas the ambiguity you tried to avoid might never have become factually relevant. The risk of losing that abstract argument is rescission. In addition, you might consider that if a contract provision fails an ILSA hurdle, then similarly written contracts have the same problem—again, causation is not relevant – whereas the specifics of meaning can more likely be argued case

by case, when that particular issue is relevant, and where the consequence of losing may be less severe than rescission.

Consider the following example. You want to be sure that force majeure includes delays for severe weather. So you write that into your force majeure definition—"events beyond the control of the seller, including but not limited to severe weather":

- Suppose the project never suffers severe weather. In that case a clause that did not address severe weather would not have hurt anything. But a clause that included severe weather as an excuse to timely performance could nonetheless be challenged by a buyer as making the promise to build within two years illusory and therefore makes the ILSA exemption unavailable, even though no severe weather or construction delay actually ensued;
- Suppose instead there was severe weather, but construction is completed within two years anyway. The same analysis applies. A clause that did not address severe weather would not have hurt anything. But a clause that included severe weather could nonetheless be challenged by a buyer as making the promise to build within two years illusory and therefore makes the ILSA exemption unavailable, subsequent beautiful weather notwithstanding;
- Suppose there was severe weather and completion of construction is delayed beyond two years as to some buyers. If the force majeure clause did not expressly address severe weather, the contracts of those buyers not outside the two-year construction window (which is measured from the date of each buyer's signing the contract to purchase) are unaffected. For those who are affected, if one of them sues the seller, you can argue that "events beyond the control of the seller" includes severe weather. If you lose (the court concludes, for example, that severe weather may be foreseeable and therefore not outside the contemplation of the parties (*see, e.g., Disimone v. LDG South II,* LLC, 2009 WL 210711 (M.D. Fla. Jan. 28, 2009)), you have a breach of contract damages claim not a rescission risk (the ILSA exemption is not lost just because construction takes more than two years to complete, *Lopez v. TRG-Brickell Point West, Ltd.*, 2009 WL 1456340 (S.D. Fla. May 22, 2009) and *Pellegrino v. Koeckritz Dev. Of Boca Raton,* 2008 WL 6128748 (S.D. Fla. July 10, 2008)) and only by affected buyers.

NON-EXEMPT PROJECTS • Many projects are not exempt from ILSA, something that will be increasingly true, given the apparent death of a meaningful piggy-back 100-lot exemption because of rulings in *Bodansky v. Fifth on Park Condo, LLC*, 635 F.3d 75, 83 (2d Cir. 2011), *Nickell v. Beau View of Biloxi, L.L.C.*, 636 F.3d 752 (5th Cir. 2011) and *Nahigian v. Juno-Loudoun, LLC*, 677 F.3d 579 (4th Cir. 2012). These cases say that nothing you draft can make a lot or unit exempt that is not already exempt when the purchase contract is signed. In other words, you cannot have a plan to sell other lots or units under an exemption – you must have already sold them under the exemption.

When a project is not exempt from ILSA, section 1703(d) contains provisions that the contract must include. If the contract does not include them, the buyer has an automatic two-year right of rescission (and an equitable right of rescission for up to three years). The required provisions are:

- A description of the lot which makes such lot clearly identifiable and which is in a form acceptable for recording by the appropriate public official responsible for maintaining land records in the jurisdiction in which the lot is located;
- That, in the event of a default or breach of the contract or agreement by the purchaser or lessee, the seller or lessor (or successor thereof) will provide the purchaser or lessee with written notice of such default or breach and of the opportunity, which shall be given such purchaser or

lessee, to remedy such default or breach within twenty days after the date of the receipt of such notice; and

- That, if the purchaser or lessee loses rights and interest in the lot as a result of a default or breach of the contract or agreement which occurs after the purchaser or lessee has paid 15 per centum of the purchase price of the lot, excluding any interest owed under the contract or agreement, the seller or lessor (or successor thereof) shall refund to such purchaser or lessee any amount which remains after subtracting: (i) 15 per centum of the purchase price of the lot, excluding any interest owed under the contract or agreement, or the amount of damages incurred by the seller or lessor (or successor thereof) as a result of such breach, whichever is greater; from (ii) the amount paid by the purchaser or lessee with respect to the purchase price of the lot, excluding any interest paid under the contract or agreement.

The notice and right to cure requirement seems straight-forward enough. Just be sure to tie the twenty days to the "receipt" of the notice, not something else like the "giving" of notice. Must it be actual receipt or can you assume receipt 3 business days after deposit in the US Mail? – There are no cases, so the best practice for now is to provide for some kind of evidenced receipt.

Concerning damages, we have not seen reported cases concerning the meaning of either the "purchase price" or what kind of damages the seller can calculate. With respect to the former, the drafter needs to be careful that the number to which the 15 percent limitation is tied is the entire purchase price, not just some base price. Even if there are custom items which substantially increase the purchase price of the condominium or house over the base price, there is no language in ILSA that excludes the cost of those items from the "purchase price."

There are other issues in this provision. Technically, the language does not limit the seller's damages; rather, it provides for a refund of deposits received in excess of 15 percent of the purchase price. If the seller refunds the excess, can it still sue the buyer for more liquidated damages? In other words, is it a release of a lien (possessory interest in the deposit) or a waiver of liquidated damages over 15 percent? There is no case on this question. Literally, ILSA addresses a deposit refund, not a claims limitation, but judging from how cases have gone in the past 10 years the safe route is to conclude a court would view this provision as a limitation on the amount of damages.

Also, the provision applies only "if the purchaser or lessee loses rights and interest in the lot." Does that mean that the seller can provide for a remedy of specific performance against the buyer, possibly allowing the seller to hold onto the excess deposit while it does so (a prospect certainly more terrifying than the loss of 15 percent of the purchase price)? There is no case on this question. While the most conservative approach is to forget specific performance against the buyer, it might be that the client is willing to take this risk because the refund language of the statute is expressly predicated on the buyer's losing its interest in the lot, not being required to accept it.

If Buyer defaults in its obligations under this Contract and fails to sure such default within twenty (20) days after receiving written notice from Seller specifying the default, Seller shall have the right, as its sole and exclusive remedies and in its sole election, to either (i) terminate this Contract and refund to Buyer the Deposit and any other amounts paid by Buyer with respect to the purchase price of the Lot to the extent it exceeds the greater of liquidated damages in the amount of fifteen percent (15%) of the purchase price of the Lot or the amount of damages incurred by Seller as a result of Buyer's default, or (ii) continue this Contract and enforce a right of specific performance against Buyer.

Be sure to check the law of your jurisdiction to see if you need to elect in the contract between liquidated and actual damages. If a substantial amount of the purchase price is payment for custom product, you may want to choose the damages test rather than liquidated damages.

The next drafting question is whether or not to define "damages." Those who believe in drafting for certainty may be tempted to use an inclusive definition, such as "including, but not limited to, lost profits and incidental and consequential damages." The problem with this drafting approach in ILSA situations is discussed above. Is it worth including the possibility that you might remotely need the claim against the increased certainty that it will be challenged as not satisfying the mandatory contract limitations of §1703(d)(3), considering that if you lose the argument you are subject to rescission for all similarly written contracts in the project?

Finally, we get to the description of the lot or unit "in a form acceptable for recording." The point of that requirement is not self-evident for a couple of reasons. First, ILSA does not give a consumer the right to record a contract. Second, this is in addition to the requirement in section 1703(d)(1) that the contract contain a description "which makes such lot clearly identifiable" so there must be something more required than adequate identification. The District Court in *Bacolitsas v. 86th & 3rd Owner, LLC*, 2010 WL 3734088 (S.D.N.Y. Sept. 21, 2010) concluded that a legal description, standing alone, could not be recorded; it had to be attached to something. And since ILSA concerned itself with purchase contracts, ILSA must mean the purchase contract has to be in a form acceptable for recording and therefore must be recordable. The District Court was reversed on appeal, 702 F.3d 673 (2d Cir. 2012), concluding that the description of the lot, not the contract, must be in a proper form. To the relief of advocates of clear title everywhere, the Second Circuit concluded that if Congress had intended to mandate the recordability of purchase contracts, there was a more direct way to do so than by the language of §1703(d)(3).

Just as importantly, the Court held that the form could be satisfied by something less than the finality of description that would be required in a deed of that lot or unit. Exactly what that information needs to be is not clear, although what was acceptable in this case was where:

- A draft declaration was provided;
- The draft declaration contained all of the information necessary to establish a condominium under New York law;
- And the contract identified the apartment by a unique unit number, provided a building plan locating the unit and the direction it faced, and provided a floor plan with dimensions and locations of rooms and windows.

The Second Circuit's decision puts it in agreement with *Taplett v. TRG Oasis (Tower Two), Ltd.*, 755 F. Supp.2d 1197 (M.D. Fla. 2009), which held that there was sufficient unit identifying information of the unit in the declaration that the contract required to be recorded before closing and ruled against rescission. The usual practice is for the statute or draft declaration to state the generic form of legal description for units in that condominium, for the draft declaration to attach a plan that locates the units and provides each of them with a unique identifying number, and for the purchase contract to reference that number.

If you are not in the Second Circuit or Florida, you might worry about *Berkovich v. Vue-North Carolina, LLC*, 2011 WL 5037124 (W.D.N.C. Oct. 24, 2011). In that case, the court found that the form of description needed to be one that was immediately recordable (not going so far as the District Court in *Bacolitsas* as to require the document to be recordable), meaning if the condominium did not legally exist when the purchase contract is signed, the contract is revocable. In response to the developer's pointing out that under North Carolina law the

declaration could not be recorded until construction was completed, the court said that the developer needed to live with those consequences—the privilege of signing up purchasers before construction was completed was at the cost of giving the purchasers a right of rescission.

One can only hope this is a case idiosyncratic to this one jurisdiction. This is a situation, by definition, where there is a filing and hence there is a great amount of disclosure to the consumer given before he or she makes the decision to purchase. By definition of the other half of section 1703(d)(1), the unit is already adequately described as a practical matter. And although the court expressed the view that the developer is not being punished, an ILSA right of rescission is not merged into the deed; one may exercise the right after closing has occurred (15 U.S.C. §1711(b)). It certainly feels like a punishment!

In any case, When drafting a purchase agreement for a registered project, remember to disclose the right of rescission to the purchaser—for seven days (or more if required by state law) under 15 USC §1703(b). This raises the question, if you believe the project is exempt from registration, should you hedge your bets by disclosing that there is a two-year right of rescission under 15 USC §1703(c) if the project is not found to be exempt and a property report was not given to the purchaser? The reason for considering this step is the language "and such contract or agreement shall clearly provide this right." Cases exist where the argument is made that a failure to disclose the right means the two-year rescission period did not start to run, and the consumer's rescission right ran until the three-year statute of repose under 15 USC §1711(b) (see, e.g., *Nu-Chan, LLC v. 20 Pine St. LLC,* 2010 WL 3825734 (S.D.N.Y. Sept. 30, 2010)). My personal view is not to volunteer the disclosure because it asks for trouble, and because the prevailing view seems to be that the consumer would need to prove entitlement to equitable relief to claim a right of rescission for that third year (*see, e.g., Taylor v. Holiday Isle*, 561 F. Supp. 2d 1269 (S.D. Ala. 2008) and *Venezia v. 12th & Division Properties, LLC*, 679 F. Supp. 2d 842 (M.D. Tenn. 2009).

EXEMPT PROJECTS • Exempt projects include the following:

1. Two-Year Obligation to Complete Construction (15 USC §1702(a)(2))

The first thing to note is that the obligation runs two years from the date that the purchaser signs the contract. *Long v. Merrifield Town Center LP,* 611 F.3d 240 (4th Cir. 2010). So do not draft that it is two years "from the effective date" or "from the seller's acceptance of this contract."

Seller agrees to substantially complete construction of the Unit, in the manner specified in this Agreement by a date no later than two (2) years from the date Buyer signs this Agreement.

Quoted in *Stefan v. Singer Island Condominiums Ltd.*, 2009 WL 426291 (S.D. Fla. Feb. 20, 2009). See similar language in *In re Mona Lisa at Celebration, LLC*, 472 B.R. 582 (Bankr. M.D. Fla. 2012), aff'd, 495 B.R. 535 (M.D. Fla. 2013) and *Jankus v. The Edge Investors, L.P.,* 619 F. Supp.2d 1328, S.D. Fla. 2009), *aff'd,* 306 Fed. Appx. 471 (11th Cir. 2009) *withdrawn and superseded on reconsideration by* 650 F. Supp. 2d 1248 (S.D. Fla. 2009).

Also, note that the developer must make a contractual "promise." It is not sufficient to estimate or anticipate a construction completion date, or merely make the buyer's obligations contingent on a two-year completion date being met. *Cruz v. Leviev Fulton Club, LLC,*_711 F. Supp.2d 329 (S.D.N.Y. 2010).

2. Force Majeure

For the reasons given at the beginning of this paper, less is more. A good provision is:

subject, however, only to delays caused by matters which are legally recognized as defenses to contract actions in the jurisdiction where the Building is being erected.

Quoted in *Stefan v. Singer Island Condominiums Ltd.*, 2009 WL 426291 (S.D. Fla. Feb. 20, 2009). See similar language in *Jankus v. The Edge Investors, L.P.*, 619 F. Supp.2d 1328, S.D. Fla. 2009).

Another provision, slightly more restrictive, but including the approved element of "beyond Seller's control" is:

The date for completion of such construction may not be extended by the Seller for any reason other than delays caused by circumstances beyond Seller's control, such as acts of God, or other grounds cognizable in Florida contract law as impossibility or frustration of performance.

Quoted in *In re Mona Lisa at Celebration, LLC*, 472 B.R. 582 (Bankr. M.D. Fla. 2012).

I do not recommend listing weather events, work stoppages and other events that might be debatable excuses, although there are some individual cases approving those things. There are also a number of cases that are concerned about language that has too broad a reach – for example:

The date for completion may be extended by reason of delays incurred by circumstances beyond Seller's control, such as acts of God, war, civil unrest, imposition by a governmental authority of a moratorium upon construction of the Unit or providing of utilities or services which are essential to such construction, casualty losses or material shortages or any other grounds cognizable in Florida contract law as impossibility or frustration of performance, including, without limitation, delays occasioned by wind, rain, lightning and storms.

Harvey v. Lake Buena Vista Resort, LLC, 568 F. Supp.2d 1354 (M.D. Fla. 2008), where the Court concluded that "A developer cannot have it both ways. Either it must list the small number of acceptable defenses to timely completion that are narrowly-tailored contract defenses recognized by Florida law and that fit within the exemption, or if it enumerates a broad, all-encompassing list of defenses it is not entitled to the exemption." (In this case, the developer benefitted from a savings clause.)

However, the Eleventh Circuit has perhaps set a new standard of tolerance that diminishes the adverse effect of many of the previous cases largely from the district courts in the Eleventh Circuit, approving:

Seller shall not be responsible for any delay caused by acts of God, weather conditions, restrictions imposed by any governmental agency, labor strikes, material shortages or other delays beyond the control of the Seller and the completion and occupancy date shall be extended accordingly.

Quoted in *Stein v. Paradigm Mirasol, LLC,* 586 F.3d 849 (11th Cir. 2009), *cert. denied,* 559 U.S. 1007 (2010).

3. Remedies

In order for the obligation to construct to be meaningful, there must be adequate remedies to enforce the promise. It has been the position of the federal regulators, CFPB and HUD before it, that specific performance must be an available remedy. Therefore, the first drafting rule is not to negate the buyer's right to specific performance. A risky formulation, therefore, is to draft something that appears to give the consumer a limited remedy while not actually doing so:

If settlement shall not have occurred within the [24-month] period allowed in Section 8 due to reasons within [Midtown's] control, [Ndeh] shall have the option of either: (i) terminating this [contract] by written notice to [Midtown]

..., in which event [Midtown] shall ... cause the [$50,000 deposit] ... to be returned to [Ndeh], and neither party shall have any further liability or obligation hereunder; or (ii) electing to proceed with the purchase of the Condominium Unit when the same is available.

Quoted in *Ndeh v. Midtown Alexandria, LLC,* 300 Fed. Appx. 203 (4th Cir. 2008). The court held that the above were not stated to be the exclusive remedies, and therefore specific performance was available and the contract was exempt under ILSA. It is a gamble. A more conservative position is to expressly acknowledge the right:

[If] Seller fails to perform this Agreement and Buyer is not in default of this Agreement, Buyer may seek specific performance.

Quoted in *Stein v. Paradigm Mirasol, LLC,* 586 F.3d 849 (11th Cir. 2009).

It is unclear to me why the regulatory authorities think that specific performance is such an effective remedy. Do you want a reluctant builder to construct your home? In any event, cases dealing with damages remedies are all over the place. We know from the cases that getting back the deposit alone is not an adequate remedy, and it is fairly clear that a claim for damages does not need to include the full panoply of speculative damages. The 11th Circuit found the following language adequate to comply with ILSA:

Buyer may commence an action to recover only actual and direct damages (out-of-pocket amounts actually paid by Buyer to third parties). Under no circumstances may Buyer seek or be entitled to recover any special, consequential, punitive, speculative or indirect damages, all of which Buyer specifically waives, from Seller for any breach by Seller of its obligation under this Agreement or any representation, warranty or covenant of Seller hereunder.

Quoted in *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849 (11th Cir. 2009), and coupled with the above-quoted provision for specific performance. *See also Hardwick Properties, Inc. v. Newbern*, 711 So.2d 35 (Fla. Dist. Ct. App. 1998).

4. Evasion

The cases thus far allow a developer to provide a business purpose at trial. It may be helpful to have the buyer acknowledge a business purpose to an ILSA exemption in the contract, and it is hard to see how it hurts if the purpose is real.

This contract is exempt from [the statutory registration and disclosure requirements of] the Interstate Land Sales Full Disclosure Act, 15 USC §1701 et seq., which Buyer acknowledges and agrees allows Seller to save time and money by, among other things, allowing greater flexibility in when to market and construct units [lots], when and how to finance the project, and when to contract for labor and materials than if it was required to comply with a regulatory application and review process.

There are many other possible statements that could serve as a "business purpose." For example, promising to complete construction within a certain period of time may facilitate sales since the construction schedule is something that buyers typically want to know. Or perhaps the project contains 99 units because that is the allowable density. It might suffice that a lender requires the developer to comply with an ILSA exemption in order to satisfy a condition to financing.

5. Savings Clause

Some courts do not trust savings clauses, feeling they are designed to allow the developer to stretch the limits of what is legal and avoid the consequences of stepping over the line. For example, the district court in *Harvey v. Lake Buena Vista*, 568 F. Supp. 2d 1354 (M.D. Fla. 2008), *aff'd* 306 Fed. Appx. 471 (11th Cir. 2009) found the following lan-

guage did not help because excessive rights buffered by a savings clause "would undermine public policy and defeat Congress's purpose in creating this consumer-protection legislation and requirement that the exemptions be read narrowly":

It is the intention of the parties that this sale and purchase shall qualify for the exceptions provided by 15 U.S.C. Section 1702(a)(2), and nothing contained in this Agreement shall be construed or operate, as to any obligations of Seller or Buyer, in a manner which would render the exemption inapplicable.

Other courts more generously considered the savings clause or a severability clause to be a legitimate attempt to avoid an inadvertent overstepping on what is permissible. *See, e.g., Pilato v. The Edge Investors, LP*, 2009 WL 927762 (S.D. Fla. 2009) and *Stefan v. Singer Isl. Condominiums Ltd*., 2009 WL 426291 (S.D. Fla. 2009).

A slightly different approach is to avoid the controversy of a "savings" clause, asking a court to rewrite a provision of a contract, or a "severability" clause, striking the offending language, and instead use a construction or interpretation clause (or so it was characterized by the court), such as the one approved in *Ryan v. WCI Communities, Inc,* 2008 WL 2557541 (N.D. Fla. June 23, 2008), *order vacated by* 2008 WL 2699401 (N.D. Fla. July 1, 2008):

It is the intention of the parties that this sale qualify for the exemption provided by 15 U.S.C. Section 1702(a)(2), and nothing contained in this Residence Purchase Contract shall be construed or operate so as to any obligations of Seller or rights of Purchaser in a manner which would render said exemption inapplicable.

6. Miscellaneous

There are many provisions in a contract that potentially could impact on the obligation to complete construction, which is a good reason to use a savings or interpretation clause. But the primary drafting advice here is to review the contract carefully to delete such clauses, or at least not make them a seller's excuse not to complete construction. Here are examples of clauses that either do not work or that you must think carefully about:

- Definitions of completion of construction that involve anything other than substantial completion of improvements, installation of all utilities, habitability and issuance of a non-contingent certificate of occupancy;
- "Anticipating" or "estimating," and not expressly promising, a two-year construction completion date (*Cruz v. Leviev Fulton Club, LLC,* 711 F. Supp.2d 329 (S.D.N.Y. 2010); *Giralt v. Vail Village Inn Assoc.*, 759 P.2d 801 (Colo. Ct. App. 1988), *cert. denied,* 488 U.S. 1042 (1989));
- A seller's right to terminate the contract unilaterally or for any reason other than the buyer's default;
- A seller's financing contingency;
- A seller's title contingency (*Giralt v. Vail Village Inn Assoc.,* 759 P.2d 801 (Colo. Ct. App. 1988));
- A contingency if seller's design will not fit on the selected lot;
- Seller's right to terminate the contract if there is a casualty event before the closing;
- Seller's right to notice of default and time to cure;
- Seller's contingency on receiving a building permit (*Princeton Homes, Inc. v. Virone,* 612 F.3d 1324 (11th Cir. 2010); *but see Harvey v. Lake Buena Vista Resort, LLC,* 568 F. Supp.2d 1354 (M.D. Fla 2008) and *Cook v. Deltona Corp.,* 753 F.2d 1552 (11th Cir. 1985));
- Conditioning the remedy of specific performance on some other act, such as posting money in escrow (*Kolter Signature Homes, Inc. v. Shenton,* 46 So.3d 1211 (Fla. Dist. Ct. App. 2010)).