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The Interstate Land Sales Full Disclosure Act: Analysis and Evaluation

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THE INTERSTATE LAND SALES FULL DISCLOSURE ACT: ANALYSIS AND EVALUATION

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I. INTRODUCTION

The growth of the subdivided land market during the last two decades has been at a phenomenal rate. A substantial part of this growth has been in the area of interstate land sales. It has been estimated that subdivision promoters, through the use of national publications, mail circulars, and the telephone, have accounted for an annual sales volume in excess of $700 million.[1] Purchasers, buying-by-mail and by telephone, have bought property in swamps, deserts, jungles and on the sides of cliffs.[2] The subdivided land market is characterized by volume sales of raw land purchased in bulk and offered to low and average income individuals.[3]

On April 28, 1969, the federal government entered into this area of consumer protection. On that date Title XIV of the Housing and Urban Development Act, entitled "The Interstate Land Sales Full Disclosure Act", became effective.[4] The

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On January 27, 1972, after this article was submitted for publication, certain new rules and regulations promulgated by the Secretary of HUD became effective. The following article does not describe the few minor changes effected by these regulations. These newly adopted rules and regulations, along with the procedure to be followed in filing under the Act, will be the subject of a subsequent article by the author.

1. *Hearings on Interstate Mail Order Land Sales Before the Subcomm. on Frauds and Misrepresentations Affecting the Elderly of the Special Senate Comm. on Aging,* 88th Cong., 2d Sess., pt. 1, at 3 (1964) [Hereinafter cited as *1964 Hearings*].

2. *Hearings on S. 2672 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency,* 89th Cong., 2d Sess. 2 (1966) [hereinafter cited as *1966 Hearings*].

3. Note, *Regulating the Subdivided Land Market,* 81 HARV. L. REV. 1528 (1968).

4. *Interstate Land Sales Full Disclosure Act,* 15 U.S.C. §§ 1701-20 (1970) [hereinafter cited as ILSFDA].

Act empowers the Secretary of Housing and Urban Development (HUD) to create the Office of Interstate Land Sales Registration (OILSR) and requires disclosure of any and all material facts concerning land that is being offered by means of interstate commerce for sale or lease. The Act was greeted by the subdivided land industry with apprehension and a tone of disapproval.[5] Most writers, however, have generally considered it as a needed step in the area of consumer protection.[6]

This article will enumerate some of the problems created by the sale of land across state boundaries and briefly comment upon and analyze some of the methods previously used to control the industry. Strong emphasis will be placed on the Act's propriety and effectiveness relative to consumer need and protection vis-a-vis the land industry's capability of meeting the Act's requirements.

II. THE NEED FOR COMPREHENSIVE LEGISLATION:

Caveat Emptor

Unless a vendor intentionally and fraudulently gives a false representation of a material fact, the buyer who rightfully relies on the representation and does not receive what he anticipated, has been without remedy.[7] The courts have generally held that the rule of *caveat emptor* applies in the case of a purchaser of land who relies upon an "innocent" misrepresentation made by the vendor when the purchaser by the exercise of ordinary diligence could have ascertained the truth.[8] The old common law doctrine of *caveat emptor* varies in application among jurisdictions. Recently the case law involving the sale of realty has tended to lessen the purchaser's obligation of due diligence required under this rule.[9] The due

5. Sanford, *Thinking of Buying Some Land,* THE NEW REPUBLIC, October 11, 1969, at 18.

6. 113 CONG. REC. 1407, 1408 (daily ed. Feb. 16, 1967) (message sent to Congress by President Johnson regarding consumer protection legislation).

7. *See* Bearman, *Caveat Emptor in Sales of Realty — Recent Assaults Upon the Rule,* 14 VAND. L. REV. 541 (1961).

8. *See* Note, *Misrepresentation, Caveat Emptor and the Right to Rescind,* 3 WILLAMETTE L.J. 183 (1965).

9. *See* Lobdell v. Miller, 114 Cal. App. 2d 328, 250 P.2d 357 (1952); Janinda v. Lanning, 87 Idaho 91, 390 P.2d 826 (1964); Libly Creek Logging, Inc. v. Johnson, 225 Ore. 336, 358 P.2d 491 (1960); Schaler v. Humphrey, 198 Ore. 458, 257 P.2d 865 (1953); Gamble v. Beahm, 198 Ore. 537, 257 P.2d 882 (1953).

diligence requirement has been replaced with a subjective test of reasonableness in light of the purchaser's limited experience, knowledge, and familiarity with the area. The failure, however, of the common law to move more rapidly in the area of consumer protection has left injured purchasers of realty without proper recourse.[10]

The very fact that relief to injured purchasers continues to be denied due to disclaimers of reliance[11] and distinctions between active misrepresentations and passive non-disclosure[12] demonstrates the need for comprehensive regulations. The innocent purchaser seeking remedies at common law was usually faced with the heavy burden of showing fraud or misrepresentation. Likewise, the difficulty in determining whether the purchaser has exercised ordinary diligence or has acted without due regard to the nature of the transaction has caused the courts to rely on irrelevant and often minute distinctions. The necessity in the past of distinguishing between "fact" and "opinion" has presented the courts with equally difficult issues.

The rapid rise in the volume of transactions involving interstate land sales has expanded the problems faced by the courts. Often the purchaser buys land which he has never seen, simply on the representation of the vendor. The unsuspecting buyer usually has little knowledge about the area. Often the nature of the transaction and the distance involved make a trip to the property impractical. Even when the purchaser inspects the property, he is usually unfamiliar with the surrounding facilities, terrain, and topography and thus unable to render a valid appraisal. Similarly, he will normally take the vendor's word regarding the state of the title, the economic stability of the developer, and the proposed improvements to be made on the property.[13] The common law remedies have developed at a slow pace, thereby pointing out the need for more extensive consumer protection.

10. 3 WILLAMETTE L. J., *supra* note 8, at 186.

11. Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 157 N.E.2d 597, 184 N.Y.S.2d 599 (1959).

12. Haye v. Century Builders, Inc., 52 Wash. 2d 830, 329 P.2d 474 (1958). *See also* Note, *S-275 The Interstate Land Sales Full Disclosure Act,* 21 RUTGERS L. REV. 714 (1967).

13. *1964 Hearings,* pt. 2, at 166, 168.

III. FEDERAL REGULATIONS

Congress has authority, through its power to regulate interstate commerce, to assert jurisdiction over the subdivided land market. The power extends to the regulation of the interstate transportation facilities, communications media, and the U.S. Postal Service. In certain situations, the power may extend even to wholly *intra*state activity.[14] Prior to the enactment of the Interstate Land Sales Act, the following unsuccessful attempts were made by the federal government to regulate the subdivision market:

(1) Postal service enforcement of the mail fraud laws;[15]
(2) Federal Trade Commission control of advertising;[16]
(3) Security Exchange Commission control of offers and sales of "investment contracts".[17]

Each of these attempts will be briefly discussed in the following material in an effort to provide the necessary background information for a better understanding of the new Act.

Mail Fraud Statutes

The mail fraud statutes provide for criminal prosecution of any person convicted of "conducting a scheme or device for obtaining money or property through the mail by means of false or fraudulent pretenses, representations, or promises."[18] In order to obtain a conviction, it must be proven that such a scheme exists and that the mails are used.[19] Actual proof of successful fraud is not necessary.[20] The Postmaster General is empowered with authority to have mail involved in a fraudulent scheme marked "fraudulent" and returned to the sender. Before the order can be issued, however, the existence of such a scheme must first be established at an administrative hearing.[21] A preliminary injunction may be sought in a federal court to detain incoming mail until the conclusion of the hearings.

14. Gibbons v. Ogden, 22 U.S. (9 Wheat.) 195 (1824).
15. Postal Reorganization Act, 39. U.S.C. § 3005 (1970).
16. Federal Trade Commission Act, 15 U.S.C. §§ 45, 52, 53 (1970).
17. Securities Act of 1933, 15 U.S.C. §§ 77a-aa (1970).
18. Postal Reorganization Act, 39 U.S.C. § 3005(a) (1970).
19. United States v. Hopkins, 357 F.2d 14 (6th Cir. 1966), *cert. denied,* 385 U.S. 858 (1966).
20. United States v. White, 355 F.2d 909 (7th Cir. 1966).
21. Kirby v. Shaw, 358 F.2d 446 (9th Cir. 1966).

The use of the Post Office Department to regulate fraudulent land sales has several drawbacks. First, the mails must be the source utilized to conduct the scheme. The mail fraud statutes do not reach the developer who advertises through national publications or by word of mouth. Secondly, the mail fraud laws require that a specific intent to defraud be shown in order to obtain a criminal conviction.[22] Likewise, intent must be shown before a preliminary injunction can be issued. Thus, because of the length of time that may be required to prove intent, the developer is able to continue his fraudulent practice for several more weeks or even months.

Federal Trade Commission Control

The Federal Trade Commission (FTC) is empowered, upon complaint and administrative hearing, to issue cease and desist orders to any advertiser who is misrepresenting his product.[23] However, like the mail fraud statutes, the FTC is handicapped by the complaint-hearing-appeal procedure set out in the Commission's regulations. During this procedure the FTC is unable to offer preventive relief to the public against the developer. The FTC is further hindered with problems of limited funds, time, and manpower.[24]

Security Exchange Commission Control

Land sales which are of a *speculative* nature may be controlled under the Securities Act of 1933. The SEC became involved in the control of land sales in 1943 with the case of *SEC v. C.M. Joiner Leasing Corp.*[25] which concerned the promotion of leasehold interests in a tract of land based on nearby oil well drilling. The extent to which the SEC had penetrated the field was not clearly defined, however, until *SEC v. W.J. Howey Co.* where the court defined "investment contracts" to include "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or a third party. . . ."[26]

The problem inherent in this means of controlling inter-

22. Neilly v. Pincuss, 338 U.S. 269 (1949).

23. Federal Trade Commission Act, 15 U.S.C. § 45 (1970).

24. 21 RUTGERS L. REV, *supra* note 12, at 723.

25. 320 U.S. 344 (1943). The idea of including speculative land sales in securities definition, however, was first advanced in the 1920's.

26. 328 U.S. 293 ,298, 299 (1946).

state land sales is that all promotional schemes may not be considered "speculative" in nature. At the same time it can readily be seen that certain advantages would be gained by including the subdivided land market under the 1933 Act. Such inclusion would assure full disclosure of the transactions and provide an administrative agency, experienced in requiring full disclosure, with some authority. It was no doubt these advantages that prompted Senator Harrison Williams of New Jersey to propose S-275, the Interstate Land Sales Full Disclosure Act and the forerunner of the present legislation.[27] Proposed S-275, by including land transactions in the existing definitional framework of the Securities Act, seemed a likely alternative to the dilemma presented.

Proposed S-275 was closely patterned after the Securities Act of 1933. It required a "registration statement" and "prospectus",[28] however, there were serious objections made to the form of the proposed Act. The witnesses appearing before the Senate subcommittee argued that land was not like securities and representatives from the land industry projected substantial increases in the cost of lots as a result of the prospectus requirement.[29] Nevertheless, in 1968, the Interstate Land Sales Full Disclosure Act[30] was passed, retaining a remarkable similarity to the Securities Act, but with obvious differences from that originally proposed as S-275.[31] The Department of Housing and Urban Development (HUD) was placed in charge of the Act and the Secretary empowered to established the Office of Interstate Land Sales Registration (OILSR).

IV. The Interstate Land Sales Full Disclosure Act

State and federal control over the subdivided land industry has largely been ineffective. The time involved in ob-

27. *Hearings on S. 275 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. 4-36 (1967) [hereinafter cited as *1967 Hearings*].

28. *1966 Hearings, supra* note 2, at 91-100, 247.

29. *Id.* at 300.

30. *ILSFDA, supra* note 4.

31. It is not for the purpose of this article to discuss in great detail various aspects of S. 275 and the various proposals under consideration. For an excellent commentary on the legislative history of S. 275 see Coffey and Welch, *Federal Regulation of Land Sales: Full Disclosure Comes Down to Earth,* 21 Case W. Res. L. Rev. 5 (1969).

taining convictions, the heavy burden of showing fraud or misrepresentation, the total absence of private civil remedies, and the general lack of injunctive relief all worked an undue hardship on the unfortunate buyer. With the foregoing discussion as a basis for understanding the problem presented by the interstate sale of unimproved subdivided land and the inability of our past legal structure to grasp that problem and offer adequate protection, it is now appropriate to look at the new Act. The Act's propriety and effectiveness must be judged on the basis of: (1) whether it meets the problems with which the subdivided land industry and the public are faced; (2) whether it offers sufficient protection to the public without imposing unnecessary burdens on the industry; and (3) whether it overcomes the infirmities of common law remedies.

General Provisions

The Act requires that any developer or agent selling or leasing fifty or more lots of "unimproved land"[32] as part of a "common promotional plan" in interstate commerce, must first file with the Secretary of HUD a "Statement of Record" disclosing certain information about the land. The developer must further furnish each purchaser with a printed property report in advance of the signing by the purchaser of any contract for sale or lease.[33]

The requirements of the Act are fully satisfied when disclosure is accomplished by filing a Statement of Record with the Secretary of HUD and providing the purchaser with a property report. Until a statement concerning the subdivision has been filed and has become effective, the sale or lease of land (unless exempt) in such subdivision is illegal.[34] The effective date of a statement or amendment is the thirtieth day after filing unless shortened by the Secretary.

The Jurisdictional Means

The heart of the entire Act is subsection 1703 (a) which provides the jurisdictional base on which the Act is established.

32. "Unimproved Land" is defined in the Regulations as "lots . . . upon which there are no residential, commercial or industrial buildings." 24 C.F.R. §§ 1710.1 (1) (1971).

33. *ILSFDA* § 1703.

34. *Id.*

> Sec. 1703 (a) It shall be unlawful for any developer or agent, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce, or of the mails—
>
> (1) to sell or lease any lot in any subdivision unless a statement of record with respect to such lot is in effect in accordance with section 1706 and a printed property report, meeting the requirements of section 1707 of this title, is furnished to the purchaser in advance of the signing of any contract or agreement for sale or lease by the purchaser; and
>
> (2) in selling or leasing, or offering to sell or lease, any lot in a subdivision—
>
> (A) to employ any device, scheme, or artifice to defraud, or
>
> (B) to obtain money or property by means of a material misrepresentation with respect to any information included in the statement of record or the property report or with respect to any other information pertinent to the lot or the subdivision and upon which the purchaser relies, or
>
> (C) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon a purchaser. . . .

The question immediately arises, to what extent may the force and effect of the Act be circumvented by avoiding the use of the jurisdictional means? Because of its recent enactment there is no case law directly in point. Similar language in the Securities Act has been interpreted to include the mails, telephone, railroad and airplane, and even the automobile.[35] Various writers have predicted that the scope of the jurisdictional means in the Interstate Land Act may be even broader.[36] This suggestion is apparently made without cognizance of the Senate report (then S. 3497) or regulations issued pursuant to the Act. Regulation 1710.10(*l*) issued by the Secretary provides that "the sale or lease of lots where the offering is entirely or *almost entirely* intrastate"[37] shall be exempt from the Act. This exemption would seem to clearly exempt *intrastate* transactions even though *interstate* facilities are used in extending the offer. This regulation is an illustration of very poor draftsmanship on the part of the Secretary and will no doubt be a future source of concern to OILSR and many developers. Other

35. *See* Securities Act of 1933, 15 U.S.C. § 77e (1970). *See generally* Moses v. Michael, 292 F.2d 614 (5th Cir. 1961); Burno v. United States, 286 F.2d 152 (10th Cir. 1961); Matheson v. Armbrust, 284 F.2d 670 (9th Cir 1960), *cert. denied*, 365 U.S. 870 (1961); Nicewarner v. Bleavins, 244 F. Supp. 261 (D. Colo. 1965); Moore v. German, 75 F. Supp. 453 (S.D.N.Y. 1948).

36. 21 CASE W. RES. L. REV., *supra*, note 31, at 22-25.

37. 24 C.F.R. §§ 1710.10(1) (1971) (emphasis added).

regulations have provided no further explanation of the meaning of this phrase. It does appear from the Senate report, however, that Congress recognized the almost impossible situation of avoiding the use of interstate facilities and desired to exempt those cases where interstate sales were very unlikely.[38] The Senate report gives some indication as to the intent of the legislators:

> . . . furthermore, the Committee expects the Secretary to utilize the discretion given him to exempt sales of lots in subdivisions which would technically be covered, but which are *intra*state or almost entirely intrastate in nature—such cases as where interstate sales are very few in number and mainly coincidental. Such a situation could arise, for example, where a few out-of-state purchasers buy lots in a subdivision which is only being offered for sale within the state of the land's location or in nearby communities.[39]

Obviously, it is going to be necessary for the OILSR to establish practical guidelines which will offer an objective standard for determining what is "almost entirely intrastate". In the meantime, a developer must either assume the risk of noncompliance, register under the Act, or ask the Secretary for an advisory opinion on the matter. In view of the Senate report and Regulation 1710.10(*l*) the contention that the jurisdictional means is to have as broad an interpretation as the Securities Act is clearly erroneous. It now remains for the Secretary to clarify this question.

Definitional Scope of the Act

The scope of the Act extends to "subdivisions" which are defined to be "any land which is divided or proposed to be divided into fifty or more lots, whether contiguous or not, for the purpose of sale or lease as part of a common promotional plan. . . ."[40] Earlier versions of the Act set the lot minimums at five and twenty-five.[41] It appears that the drafters labored under the very questionable assumption that only tracts containing more than fifty lots have enough troublesome characteristics to create a need for buyer protection.

Under the Act the sale of a lot in a subdivision *proposed* for a fifty-lot development would be within the scope of the

38. S. REP No. 1123, 90th Cong., 2d Sess. 111 (1968).

39. *Id.*

40. *ILSFDA* §§ 1701(3).

41. 111 CONG. REC. 27,312 (1965) (five); *1967 Hearings* 5 (twenty-five); *1966 Hearings* 244 (twenty-five).

Act, even though the actual ground work *or* recordation of all fifty lots had not been completed. Likewise, two tracts of twenty-five lots each also come within the purview of the Act if they are offered as part of a "common promotional plan". There also exists a presumption that "non-contiguous" lots are part of such a plan if they are offered by a "single developer, or group of developers acting in concert and are known, designated, or advertised as a common unit by a common name".[42] It is not clear from the hearings or the regulations whether this presumption is rebuttable.

Several problems are presented by the definitions of "subdivision" as used in subsection 1701(3). The phrases "common promotional plan" and "developers acting in concert" are not illustrated or otherwise defined in the Act. Furthermore, the regulations offer no clue as to how they will be interpreted by the OILSR. For illustrative purposes, imagine a small development which is contiguous to a larger one owned by another developer who must register under the Act. Would the small developer be acting pursuant to a "common promotional plan" if he tailored the architectural design and use of his property after that of the larger developer? What if he used the same or a similar name as the larger developer? What if the smaller developer associated the name of the larger development into his general advertising scheme, even though the two had different names? Without further clarification from the OILSR the developer must request an advisory opinion from the Secretary in order to have these questions answered.

A similar problem arises where there exist non-contiguous tracts of twenty-five lots each, both under the same name and owned by the same developer, but on different sides of town. As mentioned above it is presumed that the tracts are part of the same plan. To what extent is the presumption rebuttable? If the developer offers evidence to overcome the presumption that the common name gives, what type of evidence would be forceful? More importantly, why should the size of the development tract be important, *if* jurisdictional means are utilized in marketing the development? This requirement provides the unscrupulous promoter with a means to circumvent the Act.

42. *ILSFDA* §§ 1701(3); *1967 Hearings* 5; *1966 Hearings* 244.

Specific Exemptions

The Act exempts certain lots, offerings, and transactions. Included in these are the sale or lease of land pursuant to a court order, transfers or mortgages, the sale of securities issued by a real estate investment trust, dispositions of land by the government and the sale of cemetery lots.[43] It is apparent that the legislative logic behind the enactment of these exemptions is the protection afforded by other laws or the unlikely application to the general lot purchaser. Subsection 1702(a) attempts to defeat any possibility that an unscrupulous developer would adopt one of the exemptions in an effort to circumvent the Act.

> Sec. 1702(a) Unless the method of disposition is adopted for the purpose of evasion of this chapter, the provisions of this chapter shall not apply to—
>
> (1) the sale or lease of real estate not pursuant to a common promotional plan to offer or sell fifty or more lots in a subdivision;
>
> (2) the sale or lease of lots in a subdivision, all of which are five acres or more in size;
>
> (3) the sale or lease of any improved land on which there is a residential, commercial, or industrial building, or to the sale or lease of land under a contract obligating the seller to erect such a building thereon within a period of two years;
>
> (4) the sale or lease of real estate under or pursuant to court order;
>
> (5) the sale of evidences of indebtedness secured by a mortgage or deed of trust on real estate;
>
> (6) the sale of securities issued by a real estate investment trust;
>
> (7) the sale or lease of real estate by any government or government agency;
>
> (8) the sale or lease of cemetery lots;
>
> (9) the sale or lease of lots to any person who acquires such lots for the purpose of engaging in the business of constructing residential, commercial, or industrial buildings or for the purpose of resale or lease of such lots to persons engaged in such business; or
>
> (10) the sale or lease of real estate which if free and clear of all liens, encumbrances, and adverse claims, if each and every purchaser or his or her spouse has made a personal on-the-lot inspection of the real estate which he purchased and if the developer executes a written affirmation to that effect to be made a matter of record in accordance with rules and regulations of the Secretary. As used in this subparagraph, the terms "liens", "encumbrances", and "adverse claims" do not refer to property reservations which land developers commonly convey or dedicate to local bodies or public utilities for the purpose of bring-

43. *ILSFDA* §§ 1702 (a)(4), (5), (6), (7), (8), respectively.

ing public services to the land being developed, nor to taxes and assessments imposed by a State, by any other public body having authority to assess and tax property, or by a property owners' association, which, under applicable State or local law, constitute liens on the property before they are due and payable, nor to beneficial property restrictions which would be enforceable by other lot owners, or lessees in the subdivision, if (A) the developer, prior to the time the contract or sale or lease is entered into, has furnished each purchaser or lessee with a statement, the form and content of which has been approved by the Secretary, setting forth in descriptive and concise terms all such reservations, taxes, assessments, and restrictions which are applicable to the lot to be purchased or leased, and (B) receipt of such statement has been acknowledged in writing by the purchaser or lessee, and a copy of the acknowledged statement is filed with the Secretary in accordance with such rules and regulations as he may require.

The developer has the burden of proving that the exemption is applicable to the lots or offering.[44] It was not the intent of Congress to impose a heavy or difficult burden of proof upon the legitimate, honest and well meaning developer. Thus, the burden would seem to be met by a showing that the form or nature of the transaction was consistent with normal business practices or a custom of the trade.[45]

The Act specifically limits the definition of subdivision and in so doing creates the possibility that in certain situations the purpose and intent of the Act may be escaped. Subsection 1702(a)(1) specifically exempts "the sale or lease of real estate not pursuant to a common promotional plan to offer or sell fifty or more lots in a subdivision", unless the method of disposition is adopted for the purpose of evading the Act.

This part of the Act presents a potentially difficult situation to the developer attempting to comply with its provisions. For example, suppose a developer has 45 lots which are large enough to subdivide several times and make into 90 or 135 smaller lots. The developer, should he choose not to divide the lots, has the burden of proving that his decision was not based on an intent to evade the Act. Clearly, by having only 45 lots the developer would be outside the definition of "subdivision". However, unless he can show that he did not have an evasive purpose, he would not be entitled to the exemption.

44. If the analogy to the Securities Act is followed, the burden of proof would be upon the party seeking the exemption. 1 L. Loss, SECURITIES REGULATION 712-13 (2d ed. 1961).

45. 21 CASE W. RES. L. REV., *supra* note 31, at 36-37.

Another exemption applies to a subdivision where each lot is five acres or larger in size.[46] The incorporation of this exemption into the final version of the Act is without apparent explanation. The exemption did not appear in the earlier drafts of the Act and is a definite deviation from the Act's reported policy.[47] Much of the evidence during the hearings indicated that some of the most overt frauds involved the sale of "investment acreage". Normally, subdivisions are developed on a large tract basis and may encompass several square miles. If a developer has large amounts of raw land available, it is quite possible to divide each lot into 5 or more acres. In fact, the California Real Estate Commissioner, during the hearing meeting, told of one condemned development which was marketed exclusively in five and ten acre lots.[48] This works both a hardship on the honest developer and an added burden on OILSR.

It is possible, and in many parts of the country quite probable, that a developer may have the flexibility, because of the nature of the land, to make the lots five or more acres in size. Subsection 1702(a) places the burden of passing the evasive purpose test directly on the developer, thus penalizing the honest developer. At the same time this exemption, as does the "fifty or more lots" exemption, forces the Secretary to give the "evasive purpose" test substantial weight, possibly more weight than is healthy for the continued stability and progress of the legitimate land market.

The homebuilding industry is primarily responsible for two exemptions in the Act. Subsections 1702(a)(3) and (a)(9) are results of pressure applied by the home building industry to exempt sales where a person is buying a home or where the final result would be the sale of a home. There is a fundamental difference in these two subsections. With respect to subsection 1702(a)(3) the exemption is only applicable where there is a contract obligating the *seller* to construct a home on the lot within two years.[49] The 1702(a)(9) exemption anticipates that a sale is being made to a person who is in the business of constructing or causing the construction of

46. *ILSFDA* §§ 1702(a)(2).

47. *1967 Hearings* 4-36; *1966 Hearings* 243-75.

48. *Id.* A subdivision composed of 50 five-acre lots would merely encompass three-eights of a square mile.

49. *ILSFDA* §§ 1702(a)(3).

buildings. In the latter situation the burden is on the developer (seller) to be satisfied that when such a sale is made it is not made to a buyer who will resell immediately before a building is constructed on the lot.

The exemption provided for a sale under subsection 1702(a)(9), like the sale of securities by a "controlled" person under the 1933 Securities Act,[50] is incrusted with practical problems of application. For example, what assurance must the developer have before he is deemed to incur no liability on an immediate resale by buyer? That is, what statements from the buyer may be safely relied upon? Does the ultimate purchaser have recourse against the developer where the purchaser bought from the developer's buyer prior to building? If so, what elements of proof, if any, will be required from the remote buyer? These are questions which are bound to arise and which the regulations fail to clarify.

Further questions have arisen with regard to the 1702(a)(3) exemption. For example, must the building be *absolutely* completed within the two year period in order for the sale to qualify for the exemption? There seems to be no specific case law on this matter and no ruling out of OILSR. It appears to be the general contention of attorneys that one must look to the "intent and the reasonableness of the attempt to comply with this exemption".[51] For example, if a sale is being made where there is a *bona fide* obligation to construct a building within two years and a good faith effort to do so is made, then the exemption would be applicable if there was substantial completion of the structure. The language of the statute merely authorizes the exemption where there is a contract obligating the seller to erect the building. It does not absolutely require completion within two years.

The "homebuilder's" exemptions are illustrative of the type of pressure that can be applied on the Congress by powerful lobbyists. The Act itself grew out of hearings held by Senator Harrison Williams of New Jersey because of his concern over fraudulent practices involving the aged and retired.[52] There is no explanation for the two exemptions in the hearing reports. A substantial amount of testimony was taken during

50. Securities Act of 1933, 15 U.S.C. §§ 77*o* (1970).

51. Robert G. Krechter, *Federal Regulation of Real Estate Sales,* paper presented to a meeting of the California Bar Ass'n (May 29, 1969).

52. *1964 Hearings,* pt.1.

the hearings regarding property being offered in remote states where the individual purchaser had no real opportunity to inspect the property. Such offerings were in the swampy portions of Florida and Louisiana, or in the desert regions of Arizona and New Mexico. Apparently, the logic behind the exemptions was that the purchaser of a *home* would not purchase by mail without on-the-site inspection of his property. This logic is inconsistent with the purpose and intent of the Act. Even the purchaser of a home and lot who thoroughly inspects his property may not discover certain topographical features or drainage and flood control characteristics. Likewise, the home buyer who is unfamiliar with the general area may not be properly advised on utility facilities, municipal services, or the condition of the title. These are factors that a statement of record would disclose.[53] Should these exemptions apply, however, the homebuilder would have no obligation to furnish the purchaser with such a statement.

The final exemption to be considered in detail is that offered in subsection 1702(a) (10) of the Act. Like the two previous exemptions the legislative history of this exemption offers an interesting study in the legislative process. Lobbyists, aware of Congress's intent to regulate sight-unseen sales, argued for a personal inspection exemption, claiming that sight-unseen sales were the main motivation for legislation. During consideration of the Act by the Senate, Senator Fulbright introduced "on-site" exemption, subsection 1702(a)(10), which was later amended. The amended section as it now stands presents the OILSR with the problem of determining what are "beneficial property restrictions". It may well be that the determination of this question will have to be answered in each individual situation. If this is the case, then it would seem that the developer would have to file for an advisory opinion when seeking the on-site exemption. One wonders about the judgment demonstrated by the legislative body in incorporating this exemption into the Act. It is clearly adverse to the purpose of the Act which, by full disclosure in a property report, assures that purchasers will be exposed to material information considered essential in order to make a sound decision to buy.

The regulations demand that the property report include: (1) the extent to which a buyer might lose his property if the

53. 24 C.F.R. § 1710.105, pts. V-X (1971).

developer becomes insolvent; (2) the extent to which proposed improvements will be completed; (3) the availability of necessary utilities, stores, and educational facilities; (4) the nature of any blanket mortgage or other lien on the development; and (5) the extent to which any subsurface or fill work will be necessary.[54] Most of this information is not observable by on-site inspection. In the event of alleged fraud on the part of the developer, the purchaser would have to resort to pre-Act common law for a remedy. A better solution would be to rescind the entire exemption and require a registration and property report even where there is personal inspection. As noted above, the on-site exemption is inconsistent with the purpose of the Act and provides the means to circumvent the disclosure requirements.

Exemption Advisory Opinion

Several methods of approach are available to the developer in applying for an exemption. Where the developer has no reasonable doubt that the offering is exempt (e.g. the lots are cemetery lots or the offer is of only twenty-five lots with no future plans to develop more) then he need do nothing further than rely on the exemption and proceed to market his land. However, if the developer has any question as to the applicability of the Act he may request an advisory opinion from the Secretary.

The advisory opinion may be obtained in either of the following ways:

(1) The developer may file a Statement of Record as provided in section 1710.20 of the regulations setting forth the specific *modus operandi* by which he disposes or intends to dispose of the lots. The developer must include a filing fee, a statement of facts and applicable law under which the developer believes the offer to be exempt. If the Secretary concludes that the offer is exempt, the developer will be notified of the opinion, otherwise the provisions of section 1710.20 apply;

(2) The developer may file a *partial* Statement of Record along with the filing fee. As in the first alternative, the developer must state the facts and applicable law under which the developer believes the offer to be exempt.

54. *ILSFDA* §§ 1705, 1707(a); 24 C.F.R. §§ 1710.105-.110 (1971); 34 Fed. Reg. 5933, 5938 (1969).

The advantage of the partial method of filing is a substantial reduction in the amount of material that would initially be required to be filed as well as in the fee that would be paid. Normally, in the case of a partial filing the developer would receive from the OILSR, a letter merely restating the Statement of Facts which he submitted and, based on these submitted facts, the Secretary's approval or disapproval of the exemption. Where there is a complex factual situation or unusual circumstances a full filing would appear to save time and assure that material information was disclosed.

A developer can simply ignore the possibility of an exemption and file a Statement of Record complying with the Act. From a conservative viewpoint this is the most advisable approach. The OILSR has repeatedly stated that a determination by it that a development is exempt does not *effectively* "preclude or abrogate a purchaser's rights under the Act should the development subsequently prove in fact not to be exempt".[55] Also, despite a prior favorable exemption opinion, a developer who *willfully* deviates from the Act would apparently still be subject to criminal prosecution under subsection 1703(a)(2). Furthermore, the filing of a statement provides *prima facie* evidence of the developer's representations. A developer who has filed an effective Statement of Record may represent to the public, through the Property Report, that he has filed with the Office of Interstate Land Sales Registration. However, a developer who is exempt or claims exemption may not represent to the public through a Property Report or other means that he has so filed with the OILSR.[56] Finally, once a developer files a Statement of Record and it becomes effective he is relieved of any further concern regarding the filing except to keep OILSR advised of any material changes in the development or in its operation.[57]

V. REMEDIES OF THE AGGRIEVED

Administrative and Criminal

The developer who violates the Act is subject to administrative, criminal, and civil sanctions. The administrative and criminal sanctions provided for in the Act and Regulations

55. Ray Walsh, *Consumer Protection in Land Development Sales,* Informational release by OILSR (no date).

56. *ILSFDA* §§ 1707(b).

57. 24 C.F.R. §§ 1710.20(c) (1971).

give the statute "backbone" and needed sting. However, it is the private civil liabilities which offer the defrauded purchaser the most direct means to make himself whole. It is these remedies which will be given the greater emphasis in the remaining portion of this article.

The Secretary has broad investigative and injunctive power and has authority to invoke these powers when he finds any person to have violated the Act or suspects that the Act is about to be violated. The Secretary has authority to subpoena witnesses, take evidence, and require the production of any books, papers, or other relevant material.[58] The Secretary may invoke the aid of any court to issue an order, pursuant to his authority to subpoena and investigate, demanding the witness to comply. If a witness refuses to comply with the court order he shall be held in contempt. A witness may not refuse to appear and give evidence or be excused from producing relevant material on the ground that the testimony or evidence required may tend to incriminate him. However, if he claims the protection of the Fifth Amendment and continues to testify, he cannot later be subject to criminal prosecution because of that evidence. This does not mean that he would be immune from civil liability or injunctive relief based upon such evidence.

The power of the Secretary to investigate and grant injunctive relief is of prime importance and a great improvement over pre-Act methods. The Secretary is able to utilize his investigative powers to acquire evidence which will be helpful to defrauded parties in subsequent civil actions. Many times in the past the expense involved in undertaking an investigation was economically impractical for the injured purchaser. Perhaps a more important power given the Secretary is the power to commence injunctive proceedings against persons who have violated the Act, or who are about to violate the Act.[59] Prior to the Act the FTC and Postal Department had injunctive power, but only after a long and lengthy investigatory process and the show of actual intent to defraud.

Under section 1717 of the Act a person who willfully violates any provisions of the Act or the Regulations, and is convicted may be fined up to $5000 and imprisoned for five years.

58. *ILSFDA* §§ 1714(c).
59. *ILSFDA* §§ 1714(a).

The criminal sanctions of the Act apply regardless of other remedies open to the Secretary or the purchaser.

Purchaser's Civil Remedies

The Act imposes civil liability on the developer for injury to a purchaser in a variety of different situations. The Act does not cut off the purchaser's right to avail himself of any other remedies to which he is entitled at law or in equity.[60] For example, the purchaser may want to take advantage of state statutes regulating the sale of land or actions for damages based on common law fraud. If the purchaser is successful the court may grant damages under the Interstate Land Sales Act and punitive damages based on common law fraud and misrepresentation. This provision of the Act is very attractive to the defrauded purchaser and, where desirable, should be given strong consideration by the purchaser's attorney. Under the Act the plaintiff may bring his suit in either federal or state court.[61] Because of nation-wide service of process and broad venue provisions, which provide that suits may be brought in any district where "the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place", the federal court would seem to be more advantageous.[62]

The most meaningful way to understand the protective scope of the private civil remedies offered to the defrauded purchaser is to compare them with common law and equitable remedies. Generally speaking, the Act has eliminated the traditional elements required in order to rely upon various remedies. There are two common law fraud actions under which one might seek relief: (1) rescission which seeks to restore the purchaser and seller to his respective status prior to the transaction; and, (2) deceit which allows a more generous measure of recovery.[63]

Each of these common law remedies presented a heavy burden to the defrauded or misinformed purchaser. The diagram below, figure (1), illustrates the elements which had to be shown in each case.

60. *ILSFDA* § 1713.
61. *ILSFDA* § 1719.
62. *Id.*
63. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 102 (3d ed. 1964).

ELEMENTS OF PROOF

Common Law Fraud Action	Misrepresentation	Material Fact	Reliance	Privity	Scienter	Retender	Damage	Defenses
Rescission	Yes	Yes	Yes	Yes	No	Yes	No	Laches, estoppel
Deceit	Yes	Yes	Justifiable reliance by plaintiff	No	Yes	No	Yes	waiver and ratification not subject to equitable defenses.

Figure (1)

It is obvious that the requirements for proving deceit are greater than the required elements to support rescission. If in the case of common law deceit punitive damages are sought, then the plaintiff must show *malice*. However, since scienter (i.e., that the defendant knowingly made a false statement to induce reliance) was required anyway this did not present too great an additional burden.

As stated earlier, Congress felt the common law remedies were not adequate to protect the buyer. Thus, Congress equipped the Interstate Land Sales Act with machinery which does not rely on these elements in order to obtain relief. For purposes of simplicity figure (2) illustrates remedial measures that the Act covers, along with time limitations and the measure of damages allowed.

The Act makes the sale or lease of land prior to the effective date of the Statement of Record unlawful.[64] Likewise, the Act prohibits the sale or lease of land prior to the purchaser's receipt of a property report. If the developer violates these provisions the purchaser *may* rescind the agreement or sue for damages.[65] The only burden placed upon the purchaser is to show that he signed the contract before he received the property report. None of the common law requirements enumerated in figure (1) are necessary.

Subsection 1703(b) provides a safety measure which assures the purchaser that he is not only to receive a property report before signing, but that he must have it forty-eight hours before signing. If the property report is provided to the purchaser less than forty-eight hours prior to signing the sales contract then the purchaser has forty-eight hours in which to

64. *ILSFDA* §§ 1706(a). Effective date is *normally* the thirtieth day after filing.

65. *ILSFDA* §§ 1703(b), 1709(b) and (c).

SUMMARY OF REMEDIES OF AGGRIEVED PURCHASERS

Prohibited Acts	Purchaser's Remedies	15 USC Sect.	Time Limitation	Measure of Damages
1. Statement of Record not effective or property report not furnished purchaser prior to sale.	(A) Rescission or (B) Suit for Damages	1703 (b) 1709 (b)(1)	n/s Same as 6 below	n/s Same as 4 below
2. Property report furnished but within 48 hours of sale.	(A) Revocation or (B) Suit for Damages	1703(b) 1709(b)(1)	Within 48 hrs. after sale Same as 6 below	n/s Same as 4 below
3. Property report furnished but sale contract does not contain right of rescission clause.	(A) Rescission or (B) Suit for Damages	1703 (b) 1709(b)(1)	n/s Same as 6 below	n/s Same as 4 below
4. Property report furnished contains untrue statement or omission.	Suit for Damages	1709(b)(2)	1 year after discovery but not more than 3 after sale	Difference in amounts paid less actual value or sale price of lot
5. Statement of Record contains untrue fact or omits fact at time it becomes effective.	Suit for Damages	1709(a)	1 year after discovery but not more than 3 after sale	Difference in amount paid less actual value or sale price of lot
6. Material fact becomes untrue or omitted after Statement of Record becomes effective.	Suit for Damages	1709(b)(1)& 1703(a)(1)	1 year after discovery but not more than 2 after sale	Same as 4 above
7. Lot sold to Purchaser during period Statement of Record suspended.	Suit for Damages	1709(b)(1)& 1703 (a)(1)	Same as 6 above	Same as 4 above
8. Lot sold by fraudulent advertising or practices or misrepresentation relied on by purchaser.	Suit for Damages	1709(b)(1)& 1703(a)(2)	Same as 6 above	Same as 4 above

*n/s = none specified

Figure (2)

revoke the contract. The required forty-eight hour time period may be waived by the purchaser if: (1) he has received the property report and inspected the property prior to signing the contract; and (2) he acknowledges in writing that he has inspected the property and read and understood the report.[66]

Subsections 1709(a) and (b)(2) of the Act impose liability if the Statement of Record, on the effective date, or the property report, at the time of sale, "contained an untrue statement of a material fact or omitted to state a material fact required to be stated". The Act imposes express duties on the developer to use a high degree of care in preparation of the Statement of Record and property report. Where a subdivision is covered by the Act, the developer is liable for any false statements, half-truths, omissions, misrepresentations, and ambiguities which he might make or which might have reasonably been interpreted from his written statement. The Act requires the developer to disclose specifically designated items of information. It is conceivable that the Act is not completely exhaustive in its requirements and that the developers may omit a material fact. In such a situation the purchaser would have to resort to a common law remedy.

The Act further relieves the burden previously on the purchaser of showing intent on the part of the developer. An essential element in order to recover for common law deceit was proving *scienter* on the part of the developer. The question of the intent of the developer under the Act is no longer an issue. Thus, in the event of an omission, half-truth, or ambiguity the developer is left absolutely accountable. Even if the developer could not have ascertained the truth by reasonable investigation, he is still held liable. Of course, the common law defenses in an action for rescission are not open to the developer; but he may, however, plead the running of the statute of limitations.

The developer has one other form of affirmative defense open to him under the Act. In many respects it resembles the common law notion of ratification. While reliance by the purchaser is not necessary to assert a claim against the developer, nonreliance may be used by the developer as a defense. That is, subsection 1709(a) shifts the burden and allows the developer a defense if he can show that, at the time of the sale,

66. *Id.*

the purchaser knew of the falsity or omission. It should be pointed out, however, that this defense is only applicable to the Statement of Record and does not apply to falsity or to omissions in the property report.[67] Because the defense is not open to the developer who makes false statements or omissions in the property report, the importance of this defense is questionable. The normal purchaser will never see the Statement of Record which is on file with the Secretary. Thus, it is unlikely that he would have knowledge of the correctness or incorrectness of any claim made in it. Even if the purchaser did perceive that a statement made in the property report was false, this knowledge could not be used as a defense by the developer. From a practical standpoint, therefore, the only effect that such a situation would have would be to permit recovery only for a violation under subsection 1709(b)(2).[68]

It appears that privity *is* a required element of both subsection 1709(a) and (b)(2). Recovery under subsection 1709(a) may only be had by a "person acquiring . . . from the developer or his agent" and in subsection 1709(b)(2) a purchaser may only recover against the "developer or agent, who sells or leases a lot".

The remedies under subsections 1709(a) and 1709(b)(2) are limited to falsities or omissions made in an effective Statement of Record and a property report. If misrepresentation is made other than in these two documents these subsections offer no relief. The Act places no restraint on the dissemination of advertising literature prior to filing a Statement of Record or prior to the effective date of the statement. It has been suggested by various writers that a developer could so condition a prospective purchaser with favorable "propaganda" that the purchaser would disregard the property report when received and be psychologically committed to purchase the land.[69] Another tactic used by a developer might be to minimize the importance of the property report by making certain verbal claims or assertions to the prospective purchaser.

Mr. Manuel F. Cohen, then chairman of the Securities and Exchange Commission, prior to the Act, when it appeared that

67. *ILSFDA* §§ 1709(b)(2).

68. *Id.* This subsection applies where the sale is "by means of a property report which contained an untrue statement of a material fact . . . ."

69. 21 CASE W. RES. L. REV., *supra* note 31, at 62.

the SEC would administer proposed bill S-275, asked for the power to promulgate rules controlling the seller's informal promotional materials.[70] This power was never specifically given then or under the Interstate Land Sales Act. To some extent this problem may be handled by subsection 1703(a)(2)(B), which makes it unlawful "to obtain money or property by means of a material misrepresentation with respect to any information contained in the Statement of Record or the property report or with respect to *any other* information pertinent to the lot or the subdivision and upon which the purchaser relies". It appears that this subsection offers the only remedy for fraudulent information given by means other than the Statement of Record and property report. A considerable problem is presented, however, because the subsection would appear to require reliance by the purchaser.[71] It is also unclear whether subsection 1703(a)(2)(B) refers to half-truths and omissions. It should probably be presumed that by prohibiting "misrepresentations" it was the intent of Congress (consistent with the disclosure requirements) to require that the purchaser be given full, complete and accurate information.

Another question arises concerning the broadness of subsection 1703(a)(2)(B). That is, does the subsection place restraints on the technique of "puffing" which has consistently been sheltered by the common law? The common law allowed the enthusiastic salesman to express his "opinion" regarding certain matters pertaining to the property which he was marketing. The courts looked upon puffing as an accepted business practice which should be recognized as such and taken lightly. This placed a hardship on the defrauded purchaser, who, not being able to rely on such statements, found it difficult to recover.[72] If recent developments under the Securities Act carry over in the interpretation of subsection 1703(a)(2)(B) then the common law regarding puffing should be significantly affected.[73] Excluding recent SEC cases, it is inconsistent with the full disclosure policies of the Act that purchasers should not be entitled to rely on the truth of such statements.

70. *1967 Hearings* 52-53.

71. *ILSFDA* §§ 1703(a)(2)(B).

72. W. PROSSER, *supra* note 63, at 736-47.

73. 3 L. LOSS, SECURITIES REGULATION 1437-38 (2d ed. 1961).

If a developer attempts to discourage prospective purchasers from reading the property report he *may* violate other sections of the Act. Subsections 1703(a) (2) (A) and (C) prohibit deceptive business practices of any type. The extent to which these provisions might be used to restrain high pressure sales tactics is questionable, but clearly they would encompass any "device" or "scheme" used to underplay the property report. The Interstate Land Sales Act has eliminated the common law requirement of showing a causal connection between misrepresentation and damages. The Act has seemingly applied strict liability and made material misrepresentation the sole prerequisite for recovery.

The legislators decided to apply the so-called "out of pocket" rule to the Act's damage provision. Subsection 1709(c) of the Act permits recovery for the difference between the purchase price, plus the reasonable cost of any improvements, and the lesser of (1) the value of the land at the time of suit; (2) the price obtainable before suit was brought; or, (3) the fair market price at which the property could have been sold after suit was filed, but before judgment. Generally, this manner of appraising the measure of damage allows the purchaser to take advantage of a rising market; however, if the land value should decline he could take a substantial loss.

VI. SOME CONCLUDING REMARKS

There is no doubt that the federal government has entered the land sales industry with awesome force, but the Act is ridden with problems relating to procedure, interpretation, and validity. The nature and scope of the Act has not been made known to the general public and this lack of publicity has created additional problems: (1) the buyer has no knowledge of his rights and obligations under the Act; (2) the unscrupulous developer knows of the buyer's lack of knowledge and takes advantage of it in his advertising scheme; (3) misleading and undersirable "rumors" regarding the nature and scope of the Act are published by the news media. The government could lessen the impact of this incorrect information upon the public if it would adopt a program educating the public to the purpose and scope of the Act.

Besides offering extensive force on the federal level to combat fraud and misrepresentation in the sale of land, the Act and Regulations also encourage state legislators to enact

similar state control. Section 1708 of the Act requires cooperation with state authorities regulating the sale of lots in subdivisions; and section 1710.25 of the Regulations recognizes, as valid for purpose of this Act, registration statements filed under approved state Acts. This is but one means by which the Act has influenced outside authorities to take the necessary action to combat shady transactions in the marketing of land. It is suspected that the land industry itself will place tighter controls on the developer in an effort to conform to the intent of the Act. The next few years will prove to be interesting ones in the area of land sales. The Interstate Land Sales Full Disclosure Act should help make it a safer time for the buyer and a more fruitful period for the honest developer.