CONDO DEVELOPERS AND FIDUCIARY DUTIES: AN UNLIKELY PAIRING?

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ABSTRACT

“Condo Developers and Fiduciary Duties: An Unlikely Pairing?” provides an overview of the various fiduciary duty problems that abound when real estate developers (new and experienced alike) develop condominiums for residential use. In what is now becoming a commonplace scenario, contractors and developers purchase a parcel of real estate, make minor improvements and sell the realty to unsuspecting consumers all over the United States, labeling those minor improvements as “luxury” renovations. Later, when those same unsuspecting consumers realize after closing that the renovations were nothing more than cosmetic band-aids, their community associations are under-funded and ill-equipped to handle financial and building-related issues, and the developer has skipped out, it becomes clear that what was once a great deal, has possibly become a real estate disaster.

When developers abandon their buyers and the condominium association by failing to honor their fiduciary duties, the owners are in many instances left to pick up pieces of a broken project that was never capable of surviving the world into which it was born. This article exposes some old fundamental flaws in the nationwide legal perspectives on condominium law and developer obligations, and it highlights how some states in the Union, in the courts and the legislatures,
have brought about some meaningful change. Additionally, this article offers solutions that the author feels should become the next “standard” in condominium transactions. While not all states across the Union were examined, (because not all states reported appellate and supreme court cases on developer issues and fiduciary responsibilities), the author was able to find a good wealth and breadth of issues from near and far in order to expose the good and bad, and the ugly in the law of fiduciary duties in the condominium context.

I. INTRODUCTION

There comes a certain time in nearly every person or family’s existence, when purchasing real estate passes through the mental threshold. Whether it is eyeing some real property candy down the street, or enjoying a neighbor’s summer backyard party, or trading up from studio apartments to trendy downtown condos, or even into suburban spreads, we are all exposed to different types of realty on a daily basis. An increasingly popular option in terms of size, affordability and convenience, is the condominium.

Condominiums, coming in all shapes and sizes, are often located in central areas that are classically more expensive, which may allow purchasers to buy in areas that they might otherwise be unable to afford. Additionally, because a condo can come with all the amenities that a single family usually affords when the right deal comes along, developers and buyers alike have begun to view condominiums as excellent and viable options. However, like any real estate, a condominium can come along with a good number of issues absent from other types of real estate ventures. As such, when prospective purchasers (and indeed attorneys representing them) are charged with the task of evaluating the feasibility of a particular project, or extricating themselves from one gone bad, a related concept of the developer’s “fiduciary duty” must be explored in connection with the condominium.
A fundamental concept in condominium development nationwide, the fiduciary duty held by the developer brings up an often difficult obligation on the party who first creates the condominium, and who is typically the party responsible for initial sales. Later, after all first unit-owners have closed and are vested with the responsibility of ongoing maintenance, issues can arise involving the developer’s obligations from the past that were mishandled, or going forward that need to be addressed – all for the purpose of establishing a sound project, that is viable in terms of finances, sound construction and building principles, and that is minimally equipped to handle the business for which the master association was created. When problems are identified, and after the question arises of “who is running the show now?”, the developer’s role becomes one that is and should be, critically examined.

II. A BRIEF HISTORY OF CONDOMINIUMS

Most community associations such as condominiums and cooperatives, are created by a developer rather than through direct agreement of neighboring property owners. The developer in this context, typically executes and records a declaration of covenants, together with by-laws, which serve as the governing documents of the community association, and bind every unit owner upon purchase. The governing documents empower the association board to manage the association and to impose restrictions on owners while overseeing association affairs, also providing provisions for amendment, exercise of power, which are all tantamount to a community constitution. A copy of this “constitution” is delivered in some cases before purchase so that the prospective buyer can investigate the health of the community, but no later than closing where it is not previously provided. In general, homeownership in community

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3 Id.
4 Id.
associations is more popular because it offers [usually] a cheaper alternative to owning detached property, and it gives the unit owners the ability to dispense with some typical obligations of home ownership, including some maintenance and repair.  

Regulation of condominium ownership in early years was first formally outlined in the Code Napoleon of 1804, Article 664, which addressed separate ownership of floors and maintenance and repair issues relating to common elements. Article 664 provided in pertinent part that:

When the different stories of a home belong to different proprietors, if the titles of the Property do not regulate the mode of reparations and reconstructions, they must be made In manner following: The main walls and the roof are at the charge of all the proprietors, each in proportion to the value of the story belonging to him. The proprietor of the first Story erects the staircase which conducts to it; the proprietor of the second story carries The stairs from where the former ends to his apartments; and so of the rest.

Beginning in the 1920’s France, Belgium, Italy, the Netherlands, Germany and others, began passing legislation that was designed to clarify the rights and obligations of the owners of flats, especially in regards to their responsibilities toward common parts of the building. The United States’ model on condominium law came not from Europe, but from Puerto Rico, when, caused by a housing shortage coupled with a very high cost of real estate, led to the approval of the legality of the condominium form in 1951, known as the Horizontal Property Act. Following the passage of the Puerto Rico Act and the United States’ recognition of the condominium form of ownership in the 1961 National Housing Act, condominiums sprung up all over the country,

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5 Id.
6 Bennett, Donna S., Condominium Homeownership in the United States: A Selected Annotated Bibliography of Legal Sources, Northern Kentucky University, SSRN Abstract No. 1493368 (2010).
7 Id.
and legislative bodies alike codified laws regulating this ownership form, in nearly every jurisdiction across the country.\(^{10}\)

Now aptly a reflection of the wry humor that regretfully is part of current condominium development - is the idea that “upon turnover of the association to the unit owners, the first three things they do are raise the assessment, fire the manager and sue the developer.”\(^{11}\) That this statement is now more and more common, and is an unfortunate testament to the failure of many of the players in the game, to understand the nature of the responsibilities that are vested with the initial project developer and the resultant issues that many a condo unit owner and/or association inherit. As of late, in a workforce that has largely stopped caring about the bigger picture, and where each player in the real estate closing process simply looks at what is in front of him with an eye toward paper-pushing just to close this file and get to the next, a lot can be missed, creating problems for all involved.

In taking a birds-eye view of a typical condominium transaction, there are a multitude of individuals that impact and come into contact with a project, including (but not limited to): the developer, purchaser, architect, engineer, realtor/broker, inspector, municipal building department employee, attorney, title agent, insurance agent and lender. Where any one of these parties in a transaction fails to do their job or abrogates in a defined duty, the purchaser is or can be, caught in the cross-hairs. One party specifically though, that has the capacity to cover many of the bases in problem-avoidance, is the developer. Where the developer hits his mark, tends to his many obligations and delivers a well-built (or well rehabbed) and stable condominium project, then his job is usually done in large part. Conversely, where the developer fails to appreciate the matters that are dependent upon his sound judgment and duties to the eventual

\(^{10}\) Id., citing Cribbett, supra, at 1218.

consumers of his condominiums, he is dishonest or his bottom line is more important than the whole of the project, then the problem of breach of duty may arise.

III. THE FIDUCIARY DUTY

In a typical scenario, a developer or his agents advertise a condominium as being for sale, or upcoming, and a prospective purchaser find the unit, becomes aware of it and makes a decision with regard to investing in and purchasing the real estate. It is not usual that in the first instance, a purchaser views the developer as a fiduciary, or in other words, someone upon whom he or she is completely dependent upon. In contrast, while the buyer may very well think that the developer needs him or her, and the developer thinks that he may need the buyer in order to finish a project, often a developer can sell only a small portion of the whole before the project is essentially completed – which opens the door for completion problems and attracting buyers. In this country there is a clear difference of opinion in cities and towns alike, as to whether a developer has to deliver a completed, finished, and nearly perfect product before the sale, or whether he can or should be allowed to close a sale, pre-construction, or with some major items unfinished in units and/or common areas, thereafter closing deals with a promise that “he’ll get to it.” In the past quarter century, as condominiums have become a more popular option in terms of price, location and amenities, much scrutiny and attention have been focused on the developer and his obligations to his prospective purchasers, during the condominium lifecycle.

What is the “condominium life-cycle”? The phases are usually known as pre-contract, contract and post-closing. In the “pre-contract” and “contract” phases, the purchaser’s most important job is to document the particulars of the transaction, including the developer’s post-closing obligations, so that in the “post-closing” phase, the agreements are in place that define the duties and obligations of this developer. Legal counsel assisting the buyer should also be
procured, regardless of whether it is typical or not to use attorneys for closings in a particular jurisdiction.

With regard to the obligations of the developer, condominium developers as directors have a fiduciary responsibility to exercise ordinary care in performing their duties and are required to act reasonably and in good faith.\textsuperscript{12} This obligation is inherent in the transaction, but is sometimes outlined in greater detail in the condominium instruments, or in the related law of condominiums within the particular jurisdiction where the property sits. A “fiduciary” in the context of condominium management, is one who transacts business, or who handles money or property, which is not his or her own or for his or her own benefit, but for the benefit of another person, as to whom he or she stands in a relation implying and necessitating great confidence and trust on one part and a high degree of good faith on the other part.\textsuperscript{13}

Under some authority, a developer may have a fiduciary duty to a condominium association where it and its employees controlled the association initially, and where such owners’ association’s initial directors fail to exercise their supervisory and managerial responsibilities; [where they] act with a conflict of interest, they abdicate their obligations as initial directors and will or can be individually liable for breach of fiduciary duties of acting in good faith and exercising the basic duties of good management.\textsuperscript{14} This abdication, intentional or otherwise, comes from the inherent conflict of interest that abounds when one person or entity does too much, and assumes roles which are fundamentally opposing one another. In many scenarios, a real estate developer can wear a multitude of hats, acting as builder, vendor, builder, promoter, designer, and/or general contractor. This often happens when the developer takes on a number

\textsuperscript{12} (Glenn, J, et al. CJS §261 \textit{Duties and Liabilities as a Fiduciary} – 31 C.J.S. Estates §261 (2010)).

\textsuperscript{13} Id.

of different functions in relation to the project and is exemplified in numerous cases across the country.

Initially, when the developer gets past the purchase of the real estate and “develops” the property (as that term is loosely defined by most calling themselves developers), his next task is selling the property units for the purpose of developing a master association that will eventually manage itself. The selling entity makes money though sales, and hopes to cover not only costs, but make profit through the enterprise as a whole. After initial sales, when unit-owners become members of the association, a board of directors is later formed to manage the property, taking the management over from the developer who acted in theory and/or in name, as the initial “board of managers.” However, as a starting point, the developer in most states formally creates the association and becomes the “initial board,” starting the clock on the formation of his duties.

So what are these duties exactly? The fiduciary duty of an association board (whether the initial board or the later-elected unit owner board) consists of three elements: (1) the duty of loyalty; (2) the duty to treat all unit owners fairly and evenly; and (3) the duty of care. The duty of loyalty requires that board members act for the benefit of the association and not out of personal self-interest. The developer who personally, or through his agents, sits on an association’s board of directors, has all of the concomitant responsibility and potential liability of any other member (i.e. unit owner), and in such cases the effect may be, that the developer, during such a period has two distinct and separate loyalties: the operation of the association, and the development and marketing of the project (which thereby creates an inherent conflict of

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interest, for some decisions will of necessity have to made that benefit one loyalty, at the expense of the other).\textsuperscript{17}

Questions often arise as to when the fiduciary duty itself arises. There is not always a clear-cut answer. It has been held in various courts, that the fiduciary duty vested in the developer begins when the developer himself begins the process of creating the condominium and its association, and not when the first sale takes place.\textsuperscript{18} One issue identified in nationwide condominium authority, is that there are few opinions and indeed, questions of the parties, that boil down to any kind of cogent analysis on when the duty begins and ends. Because judicial opinions are shaped by the attorneys putting briefs before the court, one problem of outlining issues and areas of improvement is the fact that the questions that abound about real estate developers themselves, are hardly uniform. The same question may be asked in nine different ways, which in essence, helps to frame a confusing and indecipherable system of law. This, broadly put, needs to be changed, so that at a minimum, a general framework on a nationwide scale, can be created. Often it is the case that the parties don’t utilize the service of legal counsel, because it is not the “standard” practice in that jurisdiction, instead closing through a title company and using the information provided by the title agent or mortgage loan officer, as a substitute for the advice and guidance of a licensed attorney. It is the author’s recommendation that legal counsel, which can be procured for minimal cost, it an absolute necessity for all real estate transactions, and especially for condominium transactions regardless of the location or apparent simplicity.

Also, another area that should be emphasized in real estate transactions as a general term, is risk of loss after the closing. In many typical construction contracts, a contractor and owner

\textsuperscript{17} Hyatt and Rhoads, \textit{supra}, at 973.
\textsuperscript{18} \textit{Id.}, at 975.
discuss and contract as to who shall bear the burden if something happens before or after completion of the project. However, in residential transactions, this contractual language is scarcely used. As a result of this, and because of the fact that for purchasers, the language in contracts for condominiums is very often on a “standardized form” used in that locale, or on forms drafted by the developer’s counsel, the inclusion of risk-of-loss provisions can be difficult to negotiate. A lacking principle in condominium transactions, is the increasing amount of claims that befall developers brought by consumers, who have post-closing claims against developers. As a result, it is suggested that contractual language which spells out the developer’s pre and post-closing obligations and acknowledged fiduciary duties, is employed and that certain minimum standards be fashioned for condominium purchase and sale contracts.

Similarly, because the tradition of *caveat emptor* (“let the buyer beware”) has been so ingrained in the law over our history, buyers of any kind of real estate, and especially for condominiums, have as of late, found themselves in quite a quandry when the purchase does not go as anticipated, or the condominium product does not turn out to be what was contracted for. One way to look at the issue is that, for a builder-vendor or developer-vendor engaged in the business of selling real estate, the construction and/or sale of real estate is a daily event, whereas for the buyer, the purchase of a home is a significant and unique transaction. The purchase of a home is not an everyday transaction for the average family and in many instances it is the most important transaction of a lifetime. Thus, when problems arise and legal action is instituted, it can be a slap in the face when a condominium unit owner (or association) claim is rejected, based upon the old rule of *caveat emptor*. As such, it is important that not only the purchaser engage in some very calculated due-diligence, but that the contractual language reflect the
inherent risk in the transaction, which is that the developer will not perform or honor his promises.

The *caveat emptor* rule is particularly offensive when the problems were the developer’s responsibility to avoid, yet because of the developer’s failure and refusal to tend to them, the purchaser and often the association or multiple unit-owners in a building, are forced to solve problems, or “re-rehab” the “rehab.” Where courts apply the rule of *caveat emptor* to an inexperienced buyer, and in favor of a builder who is daily engaged in the business of building and selling realty, has been cited as a manifest denial of justice.\(^\text{19}\) It is in fact, a manifest denial of justice when after purchasing a home and obligating oneself to the transaction of a lifetime, that code violations and plumbing disasters (or whatever is the problem *du jour*), the purchaser finds herself, obligated to fund a considerable repair!

As such, given the modern realities and this disparity, a home buyer should be able to place reliance on the builder or developer who sells him a house.\(^\text{20}\) Some courts reason that implied warranties will inhibit the unscrupulous, fly-by-night, or unskilled builder and… discourage much of the sloppy work and jerry-building that has become perceptible over the years.\(^\text{21}\)

Unfortunately, this line of thinking, although appropriate under certain circumstances, in recent years it has been replaced with a more hard-line approach, focusing on the developer’s obligation to avoid the pitfalls that a developer is most capable of avoiding, rather than allowing an unfair burden to be shouldered by buyers, who are ill-prepared to take on hurdles of bad construction, underfunded community associations, and market fluctuations.

In initially considering the nature and purposes of the condominium association, membership in the association (in an interest proportionate to the owner’s percentage of ownership in the

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property as a whole), is usually a general requirement not capable of being waived. Functioning as a “mini-government” the association provides to its members in almost every case, [some] utility services, maintenance, street and common area lighting and refuse removal, in addition to water, insurance, and possibly storage. All of these functions are financed through the assessments or taxes levied upon the members of the community, with powers vested in the board of directors, council of co-owners, board of managers, or other similar body analogous to the governing board of a municipality. The officers and directors of that governing body must then concern themselves, as in any business, with details such as finances, asset and property management, taxation, insurance, employee relations, among other things. Where a developer becomes involved in structuring these governing boards, and then sitting himself at the helm, liability can (and should) arise when it is determined that the developer has abrogated in his duties to the project, the association and its members.

As a result of these considerations then, it is important for purchasers, counsel, lenders, title companies and developers alike (not to mention the judges, juries, and legislatures), to understand and create a system of uniform applications and systems, for the conveyance of condominiums to buyers from developers, with an eye toward avoiding the pitfalls that can and do often accompany these kinds of transactions. So where should this uniformity be placed? In what capacity is anyone looking at these issues? How is the law shaped? First and foremost, where a rule is put in place for a real estate developer to follow, his compliance with that rule or proscription can pave the way for the remaining players in the system to follow suit. The main focus of this article is to outline the issues that arise as the result of developer’s liability in condominium transactions for fiduciary duty violations.

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22 Id., at 918.
23 Id.
24 Id., at 919.
IV. DEVELOPER LIABILITY

For the inexperienced, assuming that a developer’s potential liability suddenly ends once the developer relinquishes control of the homeowner’s association to the members, would be erroneous. In many cases, problems allegedly caused by the developer’s acts [or omissions] during the pre-contract, or pre-transition period are often not ascertained until well after the time that control of the owner’s association passes to the owners. Unit owners and prospective purchasers must understand that in the case of a condominium development, whether a new build or rehabbed, the developer maintains control until a certain number of units have been sold, which then allows the control to pass from the developer to those unit owners. The issue of control then, is paramount in terms of understanding and eyeing breaches of a fiduciary duty.

Developer liability can arise from actions taken in the pre-transition or post-transition period, and if a developer assumes the role of builder, he or she is potentially liable for construction defects in the same manner as any other builder. Historically, the doctrine of *caveat emptor* resulted in the purchaser assuming all of the risk in real estate transactions, and the doctrine placed the duty of inspection and knowledge squarely on the shoulders of the purchaser. As stated above however, the idea that a purchaser must bear all that risk is slowly evaporating into thin air. Who then, is or should be responsible to lead the project after someone purchases a condominium?

The short answer is: the condominium board. The “board” is a group of unit owners that is called upon to manage the property as a whole, including all common areas. Before all units have been sold, and the developer still owns part of the property, the developer typically assumes

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26 Id., at 2-3.
27 Id.
28 Id., at 3.
the role of board member, either himself or through appointed agents. Duties held by the board members then, are also tied to duties that flow from the developer to unit owners. A developer-controlled board, as any other homeowner association board, owes a fiduciary duty to unit owners. While courts and academics alike often agree about this concept in general, what is less clear is where the duty originates. Why should this matter?

The issue of where the fiduciary duty in real estate matters originates is important because our laws must be crafted and eventually enacted, with the practical realities of the real estate end-user in mind. Also, the understanding of the duty on the part of the players in the process (the aforementioned lender, realtor, title company and building inspector) would, no doubt, not only streamline the process, but it would go a long way toward ensuring that if everyone were to perform their job functions correctly, then the likelihood of developer-caused issues would very likely decrease. The problems arise, in large part, because blind eyes are turned away from the obvious. If no condominium could be sold in any city, town or district, without the benefit of a municipally mandated inspection, which such inspection was geared toward purchaser protection and avoidance of incomplete or unfinished real estate, then it stands to reason that the issue of a fiduciary duty would be hitting the radar with less and less frequency where such measures were employed.

Regardless, when examining the duty itself, it is important to understand where the duties typically arise in the eyes of the law. Historically, corporate law has been the starting point of fiduciary duty law as it has been applied to real estate. Despite this, when the developer controls the community association, the strict scrutiny of trust law (rather than the business judgment rules [of corporate law]), may be appropriately applied to the developer-appointed officers and

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directors, to the extent the employees are acting within the scope of their employment. The association has all the features of a trust while the developer controls it, because the developer has dominion and control over the association (trust property), to carry out the general plan of development (the settlor’s instructions), for the benefit of the association’s present and future members (the beneficiaries). In most cases, the association’s creator is also its controller and is not subject to any direction from its members. Because then, the developer and its appointed officers and directors could easily take advantage of the members, the courts have begun to apply to them the same rigidly defined duties, high standards of conduct, and strict scrutiny applied to trustees under the general principles of trust law.

What are these duties, and are they different from “traditional” fiduciary duties? Developer-appointed members of the board must act with the utmost good faith, for the sole good of the beneficiaries of the board’s governance (the individual unit owners who make up the association), and they are required to deal with the unit owners impartially.

In most jurisdictions, where the developer’s units remain unsold, the developer must assume the rights and obligations of a unit owner in the developer’s capacity as owner of condominium interests not yet sold, including the obligation to pay common expenses attaching to those interests, from the date the declaration is filed or recorded, even if the construction of the units and the appurtenant common elements subject to those interests has not started or is not complete.

Most states and cities where condominiums and common interest communities are found, have

30 Id.
31 Id.
32 Id.
33 Id., citing Hyatt and Stubblefield, supra, fn. 148, at 633.
34 Sandgrund, R., When the Developer Controls the Homeowner Association Board: The Benevolent Dictator?, 31 Jan Colo.Law.91, 93 (2002).
statutes and laws that affect development, ownership and maintenance of these units, and specific statutes that make mention of developer obligations.

For example, South Carolina courts have recognized that a developer does stand in a fiduciary relationship with unit owners prior to the creation of the association and the conveyance of common areas to the association. In various cases in South Carolina, courts have held that because a purchaser reposes special confidence in a developer so that that latter, in good conscience, is bound to act in good faith and with due regard to the former’s interests. As such, where that special confidence is or should be obvious because of the trust needed to complete a transaction such as the purchase of a home, it should be automatically imputed to the developer and his agents, and affirmed by the legislature and courts. It has been held that where a developer fails to maintain common areas and to establish a sufficient fund to maintain those areas until assessments were adequate, the developer has breached its fiduciary duty toward the owners and the association.

Similarly, homeowners’ associations and their directors (of which the developer is typically the first in line as initial director) owe a fiduciary duty to property owners also with regard to the financial health and integrity of the association. In layman’s terms, the developer as the initial creator of the association has an obligation to dot his I’s and cross his T’s, vis-à-vis the building and the bank account. A fiduciary relationship arise from the nature of the business relationship between the developer and the unit owners, or because of the nature of the control relationship. Where a developer or sponsor totally dominates the association, or where the

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38 *Id.*
40 Hyatt and Rhoads, *supra*, at 923.
methods of control by the membership are weak or nonexistent, closer judicial scrutiny may be felt appropriate, and the principles of fiduciary duty established with business corporations may exist for holding those exercising actual control over the group’s affairs to a duty not to use their power in such a way as to harm unnecessarily, a substantial interest of a dominated faction.41

In most jurisdictions it is well established that absent fraud, self-dealing and betrayal of trust, directors of condominium associations (including those that are developer-appointed), are not personally liable for the decisions they make in their capacity as directors in condominium associations.42 Often the association has master insurance covering acts or omissions by the board or its individual members. Although it is not stated in most master building policies whether or not the coverage can be utilized on a forward basis only (i.e. in favor of the unit-owner board) or if it applies to any director, thus including the initial director/developer entity in its coverage, it is important to consider that there may not be uniform coverage or indemnity obligations in connection with the policy of insurance, and that it matters greatly in the event of a breach of duty, if a breach is allocated to a developer board, or a unit-owner board. In that courts typically accept different levels of scrutiny depending on those particulars, the risk allocation then may be an important analysis which should be provided for in the contract.

Similarly, the Uniform Condominium Act (the “Act”) originally drafted to try to create a nationwide system for condominium administration to be adopted state-by-state, reflects provisions that impose a different standard of care for developer-boards than unit-owner boards, holding the former to a higher standard.43 Many Section 3-103 of the Act provides that “higher

41 Id., citing Note, Judicial Control of Actions of Private Associations, 76 Harv. L.Rev. 983, 1004 (1963).
43 Id., at 31. The Uniform Condominium Act was originally a part of the Uniform Land Transactions Act, but was separated from that Act for further consideration at the 1975 annual meeting of the National Conference of Commissioners on Uniform State Laws. This Act was approved at the annual meeting of the Conference in Vail, Colorado in August 1977. Since promulgation of the Act in 1977, and approval by the American Bar Association in
standards for appointed board members is imposed, because the board is vested with great power over the property interests of unit owners and great potential for conflicts of interest exist between owners and developers.\textsuperscript{44}

On the other hand, elected-directors, which are voted in after the control of the association has shifted to the unit owners, have much less potential for experiencing a conflict of interest with other unit owners or the association.\textsuperscript{45} This is or may be because the elected unit owners all face the same direction in terms of interest in the community as opposed to developer-board interest, which is inward. The conflict of interest may typically be found in the developer’s corner where a higher standard is imposed and not in the unit owner corner, because if an incoming unit owner would assume the responsibility of board service and be held to a higher standard of care than the developer is, including a fiduciary duty and the potential exposure to personal liability, it would conceivably be difficult to find anyone to serve as an association director or officer.\textsuperscript{46} Thus, the willingness to serve on a condominium board inherently comes as a by-product of the lesser-applied obligations toward elected directors, rather than those appointed by the developer.

Although the nationwide perspective on condos is similar in theory, the issue and the point here, is that the lack of uniformity in defining standards and in putting avoidance measures in place which can help to avoid fiduciary duty issues in condo developments, causes unit-owners and prospective purchases to be unsure of how to protect themselves from developer

\textsuperscript{44} Id.  
\textsuperscript{45} Id.  
\textsuperscript{46} Id.

1978, the Act has received widespread legislation attention. The Act was enacted in its uniform version in Minnesota, Pennsylvania, and West Virginia during the 1979-80 legislative year, and was enacted with substantial amendments in Louisiana in 1978-79. By 1980, it had also been introduced in the legislatures of Arizona, Colorado, Connecticut, Idaho, Illinois, Massachusetts, Missouri, Tennessee, Vermont, and Wyoming.
problems. The issues are not limited to the pre-contract or post-closing timelines. Indeed, some courts have held that developers are in breach of fiduciary duties to owners’ associations where they fail to turn over the property in good condition and they fail to provide enough funds in association accounts to remedy any problematic conditions.\textsuperscript{47} This would fall into the post-closing/pre-turnover period – one in which it is often difficult to determine who should be in charge. The myriad of issues that can arise then, including control of financial accounts, tax returns, maintenance and collection of assessments, on top of building and capital improvement issues – all leave wide open a gap that gets filled by the ever-present fiduciary duty obligation held by the developer. This imposes upon him, the duty to be omnipresent and ever-mindful of the state of the union, even whilst possibly preparing his exit scheme.

When evaluating the acts and omissions of developers, counsel should be aware of the possible claims that can be levied, and the various avenues through which these claims may arise. A breach of fiduciary duty cause of action may involve, among other things, the following: (a) conflict of interest allegation; (b) failure to properly determine an operating budget (such as an attempt to secure sales by understating the reserve and operating costs); (c) failure to fund and maintain an adequate reserve account; or (d) failure to enforce the association declaration, by-laws or rules.\textsuperscript{48} The types of problems that can arise are as numerous and varied as the condominiums they involve. Most problems, while involving the developer in general, do start with the common interest community’s financial health.

\textbf{A. BUDGETARY CONCERNS}

One of the major reasons that condominiums are attractive options for many people is that they are under the impression that it is cheaper than single-family living. While true in some

\textsuperscript{47} Pardon, Lisa M., \textit{Advising Developers in Operating Community Associations}, 77 MAR WILAW 12, 52 (2004).

\textsuperscript{48} Miller and Bojic, \textit{Handling Construction Defect Claims: Western States} §5.07 (2010).
cases, what may be more the more correct statement, is that where the community is operating in
the black and is well-managed and well-funded, problems are less likely than where the opposite
is true. Where a developer fails to fund reserves or implement an operating budget, or where he
insists upon timely payment of assessments, where there are acts or omissions that constitute
abandonment of the traditional rules, those failures may result in disastrous consequences for a
condominium association.

This is especially true where the common areas of a building are in a state of disrepair.
Reserves, as they are known, are forced savings for inevitable repairs or replacement of major
items such as roofs, exterior siding, furniture, fencing, pool resurfacing, driveway, walkway
repair, etc.\(^49\) The idea that “things come up” is an accepted adage for anyone owning real estate,
solely or in a common manner. What is a lesser recognized concept though, is that “things will
come up and those things result in a special assessment.” Nary is there a new condo buyer who
can approach the concept of an unknown assessment without some trepidation. What will it be
for? How much will I have to pay and for how long? How much time will I have to come up
with the money? All are common questions, and rarely is there any true capacity to see into the
future. As such, developer responsibility at the pre-contract and post-contract stages is key to
making a determination of whether or not breaches of a fiduciary nature are possible and/or
likely.

Tensions will mount certainly when a developer or other vendor of real estate commits
fraud, abandons its obligations and fails to fulfill contractual and statutory duties to unit-owners.
This scenario in condominium living, however, is becoming more and more commonplace. Thus
the focus on the various operating principles and the participation of the other players, or lack
thereof, leaves quite a bit to be examined. More than a chicken or egg problem, the idea of who

\(^{49}\) *Id.*, at 165.
has to be the “first responsible” in terms of condominium development is a key issue, which should be evaluated more stringently, by all involved, including the lenders, title companies, courts and legislators who make our laws. This is because if municipalities were properly watching, then no closings would take place where a particular condominium had major problems (or even minor ones if everyone is really looking), and the developers would be forced into doing better, where better is key to closing successful long-term transactions.

On the other side of the country, in a state which can call itself a leader in condominium law and statutory codification of developer and board duties, the California Civil Code requires a condominium association’s board (in certain circumstances) to review condominium financials quarterly – which although is uncommon in many other states, represents an advanced and unit-owner friendly attitude toward common interest communities. These requirements, while not only being considered by many to be forward thinking as they should be, are unfortunately all too often rebuked as too strict, in terms of pre or post-sale requirements in condominium projects. Like many other states though, California has adopted the fiduciary concept – which has been explored ad nauseum in its many condo-related reported decisions.

What is no doubt similar among the various kinds of claims, is the issue of common area problems, which affect all or most unit owners in a given building. Where the association is charged with the responsibility of taking responsibility, or where issues arise and those in charge are not able to immediately remedy them, (whether due to financing issues, or issues of who is responsible to do so)(where there is the claim that the association inherited something from the developer that it should not have), then necessarily an exploration of potential solutions becomes critical.
B. COMMON AREA ISSUES

Many actions are brought by unit owners against a homeowners’ associations, are for property damages arising from the assertion that the association failed to maintain and repair the common areas properly, causing damage to units.\(^5^0\) To the extent that a declarant-developer fails to timely investigate, or fails to timely pursue viable claims against those responsible for the construction defects, liability may attach for its breach of fiduciary duty and negligence, among other legal issues.\(^5^1\) Similarly, issues can arise where the developer denies that the problem existed during his tenure. Because of this, increasingly, condominium conversions are particularly fertile ground for developer problems because there is ample room for over or underestimating useful life of existing building components and the negligent repair or replacement of necessary building components (such as electrical or mechanical or plumbing systems).\(^5^2\)

Although it is still the purchaser’s responsibility to inspect (and utilize the services of a licensed inspector where appropriate), the developer is still vested with the responsibility to make himself aware of the conditions of all building and system components, so that disclosure can be made to the prospective buyer. In these scenarios, it is incumbent on developers to make it clear to prospective buyers what specific building components they have touched, improved, remodeled, installed, etc. in conversion or rehab scenarios. Likewise, it is important for an incoming purchaser to refuse to assume that everything is new, code-compliant, or was rehabbed. Where too many assumptions are competing with one another, the recipe for misinformation and

\(^{50}\) Id., at 29.


\(^{52}\) See generally, Miller and Bojic, *Handling Construction Defect Claims: Western States* §5.07, at 168 (2010).
failure to investigate can lead to many common area problems, many of which have their origins in breach of fiduciary duties.

As a matter of pre-sale or pre-contract (or even post-closing) due diligence, not only must an incoming unit-owner board carefully review the budget when it is first handed down by the developer, incoming purchasers should be suspect where no property report or engineer’s report exists or is provided by the developer. This is because a corresponding breach of fiduciary duty may be found where the developer fails to inform himself of the existing state of the building and its major components, instead assuming the code-compliance of each, or failing to ascertain the remaining useful life (even in situations where the original components are not initially in need of repair or replacement). In some jurisdictions, there are minimum requirements for determining when the existence or preparation of a “property report” (or another similar type report) is called for and mandated to be provided to prospective purchasers, although not all jurisdictions impose this requirement. This is one area where the author feels that significant nationwide agreement and uniformity, is necessary.

Where a municipality fails to require the developer to make himself aware of the actual condition of the building, then it is all too simple for a developer to refuse to do it – thus creating the first defense in failure to disclose cases (i.e. “what I didn’t see, I couldn’t disclose to a buyer”). Since most disclosure requirements go to actual knowledge, where a developer or vendor doesn’t know about an adverse condition, then the issue of intentional conduct makes way for negligent conduct – which in many cases is limited by tort law the economic loss rules. However, where there is an affirmative obligation and a defined list of typical building and system components (i.e. roof, masonry, electrical, hvac, etc.), and that list is uniform and it becomes a standard in the industry – and indeed a standard in every jurisdiction - then no excuse
can be offered by a developer in any case, for the failure to affirmatively know, inspect, and report on the state of a particular parcel of real estate. All too common is the “head in the sand” syndrome coupled with exculpatory language in a contract which proclaims that what the builder didn’t touch, he doesn’t warrant.

While a developer naturally should not be held accountable for something he didn’t create, is it not fair to expect that a developer would be responsible to determine the state of all systems? Doesn’t it suggest, that if a developer doesn’t inspect the electrical system, and then doesn’t determine it should have been upgraded, and then after failing to know what should be known, that his failure is tantamount to a false representation that all electrical systems are code-compliant – when in fact, the opposite may be true? Is it acceptable, that when the purchaser himself makes this discovery that something is false when it should have been true - that a false or negligent or possibly fraudulent representation has been made by the vendor to the vendee? In addition to an unequivocal “yes”, the author notes that the issue with this issue, is that because the typical contract cannot protect the parties from every conceivable problem that may arise (insofar as traditional tort principles are in conflict with traditional contract principles) there is a gap into which many unsuspecting purchasers fall – one where an unfulfilled promise of the “benefit of the bargain” is lost… all because of the law. What is suggested then, apart of the necessary overhaul and suggested uniformity in these kinds of transactions, is that the law catch up with what is happening on the street.

In terms of problem solving and analyzing what should be done and when, a declarant-controlled board, due to its “insider” status, may be better positioned to get the declarant-developer to voluntarily address remediation of construction defects [as opposed to an
Some declarant-developers may be inclined to take the most conservative view of the problems and, if repairs are affected, to adopt the least expensive (which may translate into the least effective) method of repair. In addition, they may rely on judgment of the very design professionals and subcontractors responsible for creating the defects for guidance as to their severity, the appropriate method(s) of repair and the cost. Such reliance may be unwise, as it may not provide disinterested comment upon which the board can base a proper decision as to whether and how to pursue those responsible for the identified defects. When a real estate developer is just “doing his best” in terms of the project, trying to balance his profit with responsible and workmanlike practices, his judgment may not always come into play. When problems arise however, in the fiduciary duty context, an examination of what is proper business judgment is often appropriate.

C. BUSINESS JUDGMENT RULE

The business judgment rule is one of the most fundamental doctrines in corporate law, which is the notion that directors, rather than shareholders or judges, manage the business affairs of a corporation, and it operates as a presumption that directors make business decisions on an “informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.” Under the rule, directors are usually free of liability due to “imprudence or honest errors of judgment” and traditionally, to overcome the presumption a plaintiff had to present sufficient evidence that a director, or the board as a whole, breached “any

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53 Sandgrund, Robert N. and Smith, Joseph F., supra, at 93.
54 Id., at 94.
55 Id.
56 Id.
one of the triads of their fiduciary duty – good faith, loyalty or due care.” In the context of residential community associations, a minority of jurisdictions apply the business judgment rule in reviewing disputes brought by association members against association board actions, with a majority using a “reasonableness” standard. This is where some cogent analysis may be necessary – because a determination should be made globally, as to whether the business judgment rule is appropriate for condominium, and indeed, real estate transactions.

To receive the business judgment rule protection, a board or association must not breach its fiduciary duties to the unit owners. The business judgment rule is generally inapplicable to boards of property owners associations, because unlike a corporate board (whose function is usually acquisition), a property owners board is expected to protect and preserve property values. Conduct and judgments that would be permissible among business persons may be impermissible for officials of a property owner association. Although the duty of good faith traditionally has been subsumed with the obligation of loyalty, the obligation of good faith cannot be treated as unique to or characteristic of fiduciaries because most courts imply a duty of good faith and fair dealing in every contract. Where the fairness of a fiduciary transaction is challenged the burden of proof is upon the fiduciary to prove by clear and satisfactory evidence that such transaction was fair and done in good faith.

Issues abound though, when a unit-owner or association brings litigation against a developer, and the corporate entity is defunct, fails to defend, or refuses to produce information

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58 Id., citing Cox, James D. and Hazen, Thomas L., Corporations § 10.01, at 184 (2d ed. 2003)(citing In re Reading Co., 711 F.2d 509, 517-18 (3d Cir. 1983).
63 Id., at 14.
64 Unrau, supra, at 16.
that could go to establishing proper or improper business decisions. While the burden may rest with the fiduciary to prove certain decisions were fair and unimpeded by personal interests, or at an “arm’s length”, costs in litigation mount quickly when utilizing the court system to raise both the argument and defense. As such, while it is imperative to document carefully in pre-turnover matters, what may be more important is to carefully document before closing, and to require substantial completion if not completion itself, before closing. Indeed, where the developer has the buyer’s funds, his motivation significantly decreases in terms of finishing the project, because he’s no longer forced to work, if he’s been paid before finishing. Consequently, one key idea in changing the system is definitely, to prevent and/or make illegal, pre-construction closings. While even Trump Tower could be cited for the failure to finish all construction before selling off units, where any developer is allowed to close units before his work is done, after a closing, the burden shifts unfairly to the buyer, who is almost always ill-equipped, to solve problems. Eliminating closings before final finish is but one method of solving this problem.

V. DEVELOPER BEGINNINGS

Next, in the common situation where the developer is able to sell units before the project is completed, and in his staying close to the project to continue operations toward completion, the issue of the developer taking initial control over the project necessarily arises. In pondering the question of why a developer might want to retain control over a development when other unit owners are there to do so, there are many justifications for this, during the period of developer control “pre-turnover.” In some cases, a developer may want to oversee the finances or to avoid unnecessary capital projects from being commenced (and thus bankrolled [by him]) during the period of the developer’s maintenance “guaranty”. 65 Moreover, the developer can avoid

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litigation during the sales process, prevent unit owners from levying a special assessment to fund a litigation war-chest, and maintain access to the common areas and sales office, and prevent amendment of the governing documents.\textsuperscript{66} Many developers hold on to control by giving the false impression that they are still working, or they stall the turnover, so that they can continue to project the image that all will be completed “soon.” While this is usually dangerous to believe unless seen, it is not unusual for unit owners to hold off on taking any kind of action against a developer where the image is created that he is still there to take on and solve problems. Unfortunately, when the developer is in ultimate control in the beginning, his own initial budget may be the initial first cause of the impossibility in problem solving, when issues with the real estate come up.

\textbf{A. LOWBALLING MAINTENANCE FEES TO ATTRACT BUYERS}

One issue in development and marketing of a condominium is making the determination of what budgetary requirements are minimally necessary for the day-to-day operation and administration of the property. An “assessment” or “HOA Fee” is commonly imposed on a monthly or quarterly basis, which provides funding to the association. Covered or purchased by this assessment are typically such necessities as: insurance, water, trash removal, snow removal and utilities. While some properties include cable or security, the main idea is that the assessment, and indeed the initial budget which outlines it, are created and utilized for the purpose of day-to-day administration. Where inadequate for the monthly or quarterly costs to the association, the developer has abrogated in his duty to set up a mini-corporation which is capable of the business for which it was created: the continuation of a viable property. Developers are often accused of “lowballing” association fees, undercharging owners and subsidizing operations to keep assessments low, and at an artificially low level, in order to attract

\textsuperscript{66} \textit{Id.}
sales.\textsuperscript{67} In many (and indeed most) jurisdictions, developers are required to disclose the annual budget to prospective purchasers pre-sale. In many cases however, because there is temptation on the part of the developer to manipulate the budget to achieve the low maintenance fees, regardless of the danger and likely risk that there may be later fraud and misrepresentation claims where the developer fails to disclose the actual costs of property operations, [developers underestimate the costs to unit owners because they want to be competitive in the market].\textsuperscript{68}

In lowballing circumstances, the declarant commonly intends that after a certain initial sales period, the initial services that were previously provided by the developer himself as a way to keep costs low, will become expenses of the association, thereby substantially increasing the periodic common expense assessments which association members must ultimately bear.\textsuperscript{69} Although it is not a requirement in all states, some developers under the applicable condominium statutes, set aside fund reserves for the future maintenance, repair, replacement and/or preservation of the project’s common elements.\textsuperscript{70} Not only is this a good practice, spreading the cost of large repairs over time can have the effect of lessening burdens upon owners in relation to large assessments.\textsuperscript{71} The issue then, is at what point is the developer obligated to repair or replace when issues come up during the period of his control? Is it sound for the developer to sell units when problems exist that may impact buyer financing? Issues are created where municipalities allow closings, in the face of the knowledge that as soon as the developer obtains closing proceeds, the impetus for completion significantly decreases. Alternatively, if the developer is allowed to let problems lie (where the end result is that the association will later be

\begin{flushleft}
\textsuperscript{68} \textit{Id.}
\textsuperscript{70} Pardon, Lisa M., \textit{Advising Developers in Operating Community Associations}, 77 MAR WILAW 12, 13 (2004).
\textsuperscript{71} \textit{Id.}
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forced to implement an assessment intended to cover the costs of the needed work) then the implication is that the buyer is not protected, and unscrupulous developers will continue to sell units in incomplete projects, thus ensuring a continuing stream of post-closing litigation involving developers.

In California, courts have required developers to not only establish a reserve fund during the period of developer control, but to account for the fund without offsets or credits for maintenance or construction expenditures.72 Illinois courts have similarly ruled, finding that a developer has a fiduciary duty to fund reserves.73 What is unusual and even dangerous in the author’s mind is the fact that there is a good deal of resistance in codified law books and in courtrooms all over this country, to require the developer to consider the impact of the actual condition of the property when developing. In jurisdictions where no property report is required, in truth, people purchase real estate on the blind faith in the heavens that nothing will happen that will be that expensive. Conversely, where such pre-development and pre-sale requirements are not only imposed but actually met the likelihood and impact of large-scale projects can be more fully evaluated, which in turn, protects the purchaser and gives them and the developer more rope from which to hang themselves.

B. PRE-SALE REQUIREMENTS AND DISCLOSURE

As perhaps an up and coming measure to head off coldhearted developers who could later be accused of lowballing projects or making material misrepresentations about real estate, as stated above, some jurisdictions have introduced inspection and disclosure requirements even before a project may be offered for sale, or a building is granted approval of final inspections or green lights for sale. This is an excellent requirement and one which could prevent a significant

amount of problems with real estate transactions. In South Dakota, for example, the legislature has codified a requirement of a developer to have and obtain a final inspection and approved report from the state’s Real Estate Commission even before a condominium project or unit is put up for sale. The state’s Commission must approve a project and a public report on a project before the developer may take reservations or offers for sale may take place. The Commission is the only party that can waive the inspection, and no developer is allowed to enter into a binding contract until a copy has been provided to a purchaser and a ten (10) day period has elapsed, to allow for the purchaser’s review. This kind of codification can go a long way toward ensuring that fraud and misrepresentation claims are avoided, and the concept can certainly create some new posts at the local building department.

Similarly, South Dakota law contains an enforcement provision that provides for misdemeanor liability in the event of a failure to disclose pertinent information by the developer or his agents. What is interesting about this most-stringent application of bureaucracy in condominium sales, is that based upon its population, South Dakota has better measures in place to avoid problems than many states in the Union, despite the fact that it may have less than a quarter of the population of other states. This kind of forward thinking, as in California, should be adopted nationwide.

In Ohio, a developer is required to furnish a two (2) year warranty covering the full cost of labor and materials for any repair or replacement of roof and structural components, and mechanical, electrical, plumbing, and common service elements covering the condominium property or additional property as a whole, occasioned or necessitated by a defect in material or

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74 South Dakota Codified Laws §§ 43-15A-17.
75 Id.
77 Id., at 43-15A-25.
workmanship. Relating to unit-specific issues, Ohio developers are further required to provide one (1) year warranties relating to defects in materials or workmanship, commencing on the closing date. What is significant about this, is that while a longer warranty period is absolutely beneficial to the purchaser, where the warranty language is or may be allowed to contain exclusions or exculpatory language which does not ultimately protect the purchaser from the typical problems in condominium buildings, or indeed problems that the developer ought to have remedied before the sale or at least before turnover, such warranty requirements do very little to protect the consumer.

As in South Dakota, Ohio developers are also subject to pre-sale disclosure requirements, including pertinent information about the developer, narrative descriptions relating to the property as a whole, construction status; financing terms offered by the developer; warranties offered for common and units; two-year budget projections; reports on condominium conversion (if applicable) including remaining useful life of all integral condominium components (including an estimate of repair and replacement costs projected out for five years; existence of reserve funds, existence of management contracts; terms of encumbrances or liens of any kind; escrow details; and statements of litigation, if any, *inter alia*.

Despite this requirement, Ohio courts have held that a condominium association may not maintain an action against a developer for breach of fiduciary duty absent an understanding by both parties that a special trust and confidence have been reposed in the developer by the association members. This a unique twist on the law, because of the unfortunate likelihood that no developer would agree to language in the contract that created such a special confidence

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79 *Id.*
80 *Id.*, at §17 (2010).
81 *Belvedere Condominium Unit Owners’ Assoc. v. R.E.Roark Companies, Inc.*, 67 Ohi St.3d 274, 617 N.E.2d 1075 (Ohio 1993).
between developer and buyer (at least if their counsel were carefully watching). As a result, by the inclusion of this language in the jurisprudence, Ohio courts have very possibly blocked any meaningful advance that was likely intended by this aspect of the law in fiduciary cases involving developers.

In Michigan, a developer’s pre-sale disclosure requirements include such interesting components as the names, addresses and prior experiences with condominium projects of each developer and any management agency, real estate broker, residential builder and residential maintenance and alteration contractor. Where a project is a conversion in Michigan, developers are required to provide the following: (i) a statement if known, of the condition of the main components of the building, including the roofs; foundations; external and supporting walls; heating; cooling; mechanical ventilating; electrical, and plumbing systems; and structural components; If the condition if any component is unknown, the developer shall fully disclose that fact; (ii) A list of any outstanding building code violations or other municipal regulation violations and the dates the premises were last inspected for compliance with building and housing codes; and (iii) The year or years of completion of construction of the building(s).

These Michigan requirements impose not only an affirmative obligation on the developer’s part to inform himself of the various issues in order to comply with these disclosure requirements, it provides a fair amount of information that a prospective purchaser, who travels with his eyes open, to use to fairly and honestly evaluate the viability of the condominium and its association. This information then, should be required everywhere. If applied nationally, then the court’s continued reliance on caveat emptor would be justified, and the burdens shouldered, would reflect a greater equality.

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82 M.C.L.A. 559.184a.
83 Id.
Escaping the Midwest, in the Washington case of *Kelsey Lane Homeowners’ Assoc. v. Kelsey Lane Co., Inc.*, a developer was not required to include construction defects in a pre-sale offering statement where it was established that the declarant was unaware of construction defects by virtue of his relationship with the general contractor, since neither was the agent for the other.\(^8^4\) Although the developer could be held liable for misrepresentations under the Washington Condominium Act’s public offering statement requirements, there, a declarant is not held responsible under a “should have known” standard, and instead where actual knowledge cannot be established, it is not imputed to the developer under traditional rules of agency.\(^8^5\) Also, in *Kelsey Lane*, because the association itself was not “formed” until the construction was completed and the defective portion sealed within the overall project, it was found that the declarant could not have known about the defects to disclose them to anyone, since they were concealed before the association was formed and a duty to disclose arose.\(^8^6\)

As such, collection and analysis of key information such as a developer’s date of purchase of the property and the date of recordation of a declaration of condominium, and additional information about a developer’s knowledge of the property (including appraisal and inspection documents) in addition to the knowledge of its lender who may order or create such information and share it with the developer for purposes of imposing requirements in funding, may be crucial for purposes of discovery, litigation and establishing liability in the context of proving what a developer or his agents “knew” and when they knew it. All of this information is critical, for ensuring the success of not only a lawsuit, but for making decisions long before the closing table.

\(^8^5\) *Id.*
\(^8^6\) *Id.*
C. PRE-TURNOVER FIDUCIARY DUTIES OF A REAL ESTATE DEVELOPER

Now after closing but before the developer has tendered control over the building or project to the unit owners, there are still fiduciary duties held by the developer which relate to the building and the finances. Whether injected onto the scene by whatever condominium act is employed in a particular jurisdiction, in some cases, the Uniform Condominium Act (“Act”) has conferred a fiduciary duty on the developer, by using a statutory section to impose a fiduciary duty upon the association’s governing body that is appointed by the developer.\(^\text{87}\) Although not adopted by all states, the Act does nonetheless provide a model for jurisdictions to explore the provisions of their governing documents in relation to condominiums. Surprisingly, the Act does not provide a general fiduciary duty to purchasers.\(^\text{88}\) It does provide, however, that such a duty runs from members of the governing body of an association who are appointed by the developer.\(^\text{89}\) This then, makes clear (or tries to), that the developer as a developer, does not or may not be viewed to have or owe others, a fiduciary duty in the developer/unit-owner sense. Only in the case of a developer-appointed board member vis-à-vis the unit-owner, does such a duty arise.

If we are to analyze this from the real-world perspective however, what we must examine is, the traditional trajectory of a transaction, and the ideas that we have about the developer, and the ideas that the purchaser has, about the developer. Although the developer may be wearing the “association director hat”, he is not typically thought of as a director of an association when a unit-owner is dealing with him. To them, he’s nothing more than the developer. As such,


\(^{88}\) Id.

\(^{89}\) Id.
whether through email or phone or attorney-drafted correspondence, the emphasis is usually placed on the developer as “developer” and not the developer as the “association leader.” Consequently, the Act’s use of the terms and its implications suggest that for jurisdictions that follow the Act, little attention may be paid to the developer’s acts and omissions as a developer, in favor of placing emphasis on what was or was not done, on association letterhead. These may be very dangerous, and costly, distinctions.

In some jurisdictions, such as Pennsylvania, a developer’s fiduciary duty arises when an initial public offering document or disclosure is filed with the municipality, rather than when a declaration is filed.\(^90\) In *Greencort Partners Condo. Assoc. v. Greencort Partners*, the question presented was when did a fiduciary relationship arise – before or after the filing of the condominium declaration, when a public offering statement had been filed.\(^91\) The holding, in conflict with the statutory language of the Pennsylvania Condominium Act (FN 68 P.S. § 3101, *et seq.*), provided that a condominium was created at the time a declaration was filed.\(^92\) Like other jurisdictions, the Pennsylvania Condominium Act listed various pre-sale disclosures and delineates between new builds and conversions.\(^93\) The issue was one of timing however, in relation to the filing of pre-sale disclosures and recordation of condominium instruments. There is some room to say, however, that for a court to put emphasis on the date of recordation as opposed to the date of filing the instruments, in the case where regardless of the two dates the developer was responsible to know the condition of his own real estate before selling it, is manifestly unjust, and the wrong issues were (or may have been) put before the court.

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91 Id., at 3.
92 Id., citing 68 P.S. §3201.
93 Id., at 4, citing 68 Pa.C.S. §3404 (requiring pre-sale disclosures of known conditions, pertinent dates of major repair, useful life calculations, age and present condition of all building components, replacement cost assessments and listing of any outstanding and/or uncured code violations). Id. at 68 Pa.C.S. §3404 (a)(1-3).
Regardless of the law, until the owners take control, the developer is [typically] responsible for and controls all aspects of the project’s operations through the appointed directors. 94 Responsibilities include property maintenance, covenant enforcement and financial management. 95 Difficulties can arise because during this period of developer control, the developer is also still developing and marketing the property and thus he or she is simultaneously charged with the dual aims of promoting sales within the project and governing it on behalf of the present and future owners. 96 Of course, the developer’s goal is to enjoy a profit on his investment; however, if this profit is realized at the expense of depriving the owners of a fully functioning, financially sound and well-maintained project, then the developer can find itself in a lawsuit. 97

The Restatement Third, Property (Servitudes) §6.20 suggests that the developer’s duty depends on the particular role it is playing. 98 In the role of purveyor of real property, the developer has no fiduciary duty to potential purchasers, because the developer-purchaser relationship is an arm’s length transaction. 99 However, when in control of the unit owner’s association, the developer has a fiduciary duty of case in operating and managing the project, with the basis of the duty coming from corporate legal principles (wherein a developer has been likened to a corporate promoter). 100 As a promoter, the developer is not allowed to do anything that hinders the viability of the organization that it has created. 101 Courts have held that

95 Id., at 13.
96 Id.
97 Id.
98 Restatement Third (3d) Servitudes 602 (ALI 2007)
99 Id., at 13-14.
developers have breached their duties when they have turned over to owners control of a project that is in a state of disrepair with underfunded accounts.\textsuperscript{102}

In Illinois, it is accepted that there is fiduciary duty held by developers, whether as directors of a not-for-profit or as the developer-controlled board of managers.\textsuperscript{103} Illinois courts will allow a fiduciary finding absent an analysis of the developer’s role in the association, because Illinois courts have found that a real estate developer, in and of himself, is a fiduciary vis-à-vis the unit-owners.\textsuperscript{104} In Colorado, developers may be subject to actions for negligent misrepresentation in circumstances where people or property are harmed, or in the course and conduct of commerce where there is a financial loss.\textsuperscript{105} Statutorily, a developer-builder is put under a duty to disclose all material facts known that “in equity and good conscience should be disclosed” when marketing any kind of common interest community, including town-homes and condominiums.\textsuperscript{106} Additionally, when deceptive trade practices are involved, the developer-builder may be liable to purchasers of its units under Colorado’s Consumer Protection Act (“CCPA”).\textsuperscript{107}

Not all jurisdictions impose broad, unfettered duty upon developers though.\textsuperscript{108} In the case of Belvedere Condo. Ass’n v. Roark, the Ohio Supreme Court held that developers were not fiduciaries, and recognized that the developer’s right to protect its own interest in promoting its project was tempered only by buyers’ rights to employ consumer protection statutes in their

\textsuperscript{103} 8 Illinois Real Property § 43:100, citing Wolinsky v. Kadison, 114 Ill.App.3d 527 (1st Dist. 1983).
\textsuperscript{106} Id.
\textsuperscript{107} Id., citing CRS § 6-1-101, et seq.
favor for alleged breaches, instead of having claims of breach of fiduciary duties. The majority reasoned that the state legislature provided inherent statutory consumer protections (such as the association’s ability to cancel developer contracts, and the phasing out of developer control over time).

The dissenting opinion in Belvedere, suggests that the majority’s decision (denying a fiduciary duty claim against the developer), was akin to permitting the developer to engage in self-dealing with impunity, while operating the owners’ association (therein disputing the Ohio legislature’s intent in that regard). Somewhat candidly Justice Douglas in his dissent, stated that in connection with the majority’s requirement that a special trust be reposed between the parties in order for a fiduciary duty to attach that, “let all who will henceforth, enter into a construction agreement with a developer-builder now be aware that they should get, carved in stone, an “understanding” that they can have rust and confidence in their builder to be honest with them.” The author suggests that in the age of social media and internet ratings and commentary about business transactions, all one need really do is “google” their particular developer, and the commentary (if any be found) should be more than enough to assuage fears about moving forward, or more than enough to direct the immediate cancellation of the contract.

The failure of a court of law to recognize the imbalance by sanctioning such a requirement does not suggest the judiciary is moving forward. Just the opposite seems true in some cases. For example, the State of Utah does not recognize an independent duty to comply with building codes, with Utah courts holding that developers have no duty to act without

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109 Id., at 14.
110 Id.
111 Id., citing Belvedere at 242.
112 Id., at 291.
negligence in the construction of homes. Utah courts have found that because a condominium association had no direct contractual relationship with either the developer, the builder or any other party, it lacked the requisite connection for any independent duties to attach.

The issue with this is, of course, whereas an association is typically empowered by the declarations to act on behalf of unit owners, and does not itself exist but for the owners and members that it serves and which comprise it, why should a court require privity to establish a fiduciary relationship, when such a relationship is recognized in Utah (and other jurisdictions) between the developer and purchaser of real estate? To discriminate because likely the association filed suit rather than the members themselves (regardless of the fact that the members themselves fund the association and likely pay the legal fees needed to maintain such an action) is tantamount to blindly ignoring the real legal and equitable issues. Turning a blind eye toward an unsuspecting purchaser who trusted an obvious fiduciary, especially in current economic times where housing values have tanked, puts undue pressure and financial hardship onto a purchaser, who is often pushed to the brink of financial ruin when involved with a real estate transaction gone bad. The courts can and should, do better.

Regardless of whether the developer himself stands as a fiduciary to the owners, his appointed directors do have a common law fiduciary duty to the association as directors or a corporation. Individual directors may breach their duties for failing to enforce association covenants against the developer, or for failing to disclose developer misconduct. The issue of developer misconduct begs the questions of whether or not errors and omissions liability insurance policies (also known as director’s and officer’s or “D&O” policies) would cover acts.

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114 Id., at 245.
115 Pardon, Lisa M., supra, citing e.g. Rose v. Schantz, 56 Wis.2d 222, 201 N.W.2d 593 (1972).
116 Id.
and omissions by the developer who set up the policy, if they cover the developer as the controlling “association member” or if such policies are intended to be a forward looking policy, applicable only to the unit-owner elected board members rather than the developer in control of the association. When principals of the developer entity place themselves into association affairs (as if often the practice), they may be removing themselves from any corporate entity shields held by the development entity.\textsuperscript{117}

It is the author’s opinion that the typical condominium association director’s and officers errors and omissions policies are forward-thinking, and thus only applicable to unit-owner-members of the board (not to developer-appointed board members). This idea does not appear to have been fleshed out in the case law, at least in Illinois, but if true, it should then create the impetus in the developer to self-insure for his acts and omissions (including construction negligence), which are typically excluded from a traditional commercial general liability policy held by the developer. Again, where there could be a requirement in place for ensuring proper insurance coverage, if a developer were not allowed to close on unit sales without it, there would be far fewer uninsured or underinsured developers (providing a corresponding benefit for the unit owner, the insurance companies and the title agents who are closing these transactions).

As is outlined in Wisconsin and other states, the condominium laws typically clarify the developer’s responsibilities during the period of their control (which is usually one to three years from the filing of the declaration or a certain time period after 75\% of the units have been sold).\textsuperscript{118} A developer, in some instances, can be charged with the failure to take action at a time when it is prudent to do so.\textsuperscript{119} The failure to act can take many forms and is particularly true in instances where the developer retains control of the association for a period of time and is

\textsuperscript{117} Id., at 14.
\textsuperscript{118} Hinkston, Mark R., Wisconsin Lawyer Vol. 77, No. 9, Sept. 2004.
\textsuperscript{119} Hyatt and Rhoads, \textit{supra}, at 937.
unwilling or fails to make or enforce rules for fear of endangering the sales program, the lack of desire to engage in any dispute with unit owners, or the false sense of security that is often associated with the false notion that the developer doesn’t have to do anything until his last unit is about to be sold.

The principles of fiduciary duties and the requirement to avoid conflicts of interest do not automatically mandate that a decision be made to avoid dealing with such members; however the officers and directors [of an association] must clearly understand that their office is a position of trust which is not to be abused for personal advantage or to be exploited for any kind of personal gain or satisfaction, and in fact, it should be realized that the avoidance of the appearance of abuse is or may be, as important as avoiding the abuse itself.\(^\text{120}\) While this concept is so often avoided in condominium transactions, the key issues of course can still be avoided with meticulous inspection and pre-purchase due diligence, along with of course, the hopeful changes to the real estate purchase and sale rules and regulations, which are and should be followed by all of those aforementioned “players” in the real estate and condominium game.

VI. COMMON CAUSES OF ACTION AGAINST DEVELOPERS

Apart from doing one’s best to avoid problems from the beginning, where necessary to analyze solutions from a legal perspective, common causes of action against developers should be explored. Associations and unit-owners, and indeed counsel representing them, when faced with building, unit or common area problems relating to a particular property, must inform themselves about the available causes of action that can be sustained against a recalcitrant developer and their agents. Usually where counsel is retained, an evaluation must be made of whether claims are individual or common, whether the association entity should make claims on behalf of unit owners, and whether contractual provisions prohibit recovery in any areas.

\(^{120}\) Id., at 945.
Regardless of what claims are ultimately levied, success or failure depends heavily on the proofs that can be collected against developers or their agents, and it is incumbent upon parties and their counsel, to be aware of what their local and often neighboring jurisdiction may allow.

A. WARRANTY BREACHES, DECEPTIVE TRADE PRACTICES, AND FRAUD

Many states have what are generally known as consumer protection acts or deceptive trade practices acts. In general these acts broadly provide that unfair business practices in the course and conduct of trade and commerce may give rise to liability. A corporate officer or agent [of a developer] may be held personally liable for damages caused by his fraud and deceit, to the person directly injured thereby. Also, an equitable accounting is or may be proper where a fiduciary relationship exists between the parties, where fraud or misrepresentation is alleged, or where accounts are mutual or complicated and plaintiff does not possess and adequate remedy at law.

In Indiana, courts have found as a “matter of law” that a developer owed a purchaser a “duty of fair dealing and honesty” and a “duty of good faith and fair dealing”, holding that where evidence established constructive fraud and fraud and the developer’s failure to meet its contractual duties, even where statements were of a future regard (rather than as to present facts that typically support claims of fraud or constructive fraud) because of the fiduciary nature of the relationship between real estate developer and the consumer of real estate, a constructive fraud

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122 Id.
123 Hyatt and Rhoads, supra, at 972, citing 3A W. Fletcher, Private Corporations §1143 at 207 (perm. ed. rev. 1975).
finding was appropriate.\textsuperscript{125} Where unqualified statements were made, in order to induce the buyers to purchase the real estate, such inducement and resulting damages can amount to constructive fraud.\textsuperscript{126}

In most courts, fraud claims require very specific allegations, the establishment of facts to meet required factors, and ultimate proofs of intentional conduct. Where real estate developers are involved, although it is often hard to prove intentional conduct in relation to business decisions, where business judgment in general results in unfinished buildings, dissatisfied unit-owners and a failure to follow municipal rules regarding licensure, permitting and codes, would-be plaintiffs can outline contractual provisions which cover some of these bases in support of fraud and contractual claims. Apart from what is or may be embodied in the contract, implied terms and warranties are often applicable to protect purchasers.

\begin{enumerate}
\item \textbf{IMPLIED WARRANTIES}
\end{enumerate}

Other than what is be outlined in a condominium sale contract, in the sale of new homes the vast majority of states recognize an implied warranty of habitability between buyer and seller in real estate transactions.\textsuperscript{127} Multiple types of warranties exist, including the implied warranty of habitability, the implied warranty of fitness for a particular purpose and the implied warranty of good and workmanlike construction.\textsuperscript{128} Some jurisdictions also allow an implied warranty that a home will comply with the applicable building code.\textsuperscript{129} In construction contracts it is usually implied, unless there is an express contract or agreement to the contrary, that a building will be

\textsuperscript{125} Yeager v. McManama, 874 N.E.2d 629, 636 (Ind.Ct. App. 2007)(although the court did not require a fiduciary relationship to exist to base the constructive fraud finding).
\textsuperscript{126} Id., at 642.
\textsuperscript{129} 31 Jan Colo.Law.91, \textit{supra}. at 92.
erected in a reasonably good and workmanlike manner, and it will be reasonably fit for its intended purpose.\textsuperscript{130}

But what if the prospective homeowner does not hire the builder to build the house, but buys one from him already built? Because the increasing complexity of construction techniques and limitations on access to the property during various building stages may prevent inspection, over time courts have recognized that buyers have to rely on the skills of the builder.\textsuperscript{131} The Iowa Supreme Court, relying on the Missouri Supreme Court decision of \textit{Smith v. Old Warson Dev.Co.} (sitting \textit{en banc}) noted the following:

“Although considered to be a real estate transaction because the ownership of land is Transferred, the purchase of a residence is in most cases, the purchase of a manufactured product: the house. The land involved is seldom the prime element in such a purchase… certainly not in urban areas… The structural quality of a house, by its very nature, is nearly impossible to determine by inspection after the house is built, since many of the most important elements of its construction are hidden from view. The ordinary “consumer” can determine little about the soundness of the construction, and must rely on the fact that the builder-vendor holds the structure out to the public as fit for use as a residence, and being of reasonable quality. Certainly … no determination of the existence of a defect [the settling of the house] could have been made without ripping out the slab that settled, and maybe not even then…. The defect was latent and not capable of discovery by even a careful inspection… common sense tells us that a purchaser under those circumstances should have at least as much protection as a purchaser of a new car, or a gas stove, or a sump pump or a ladder.”
7 \textit{Kirk v. Ridgeway}, supra, at 494

Thus, it is imperative, if meaningful change can be made to our “system” of overseeing real estate transactions, that there is imposed the requirement that the developer hire an independent engineer to evaluate the property and for the developer to make known publicly, the findings of said engineer. Only then can it be fairly said that what the true professionals didn’t find or know about, the developer couldn’t disclose. In that scenario, where the buyer didn’t go into the wall or under the house, he might be fairly required to take his chances where he buys a home already

\begin{footnotes}
\footnote{\textit{Busker v. Sokolowski}, 203 N.W. 2d 301, 303 (Iowa 1972).}
\footnote{\textit{Kirk v. Ridgeway}, 373 N.E.2d 491, 494 (Iowa 1985).}
\end{footnotes}
built, when there also existed the option for him to build one himself. Apart from the cost-differences that make these options less a choice for most people, the real issue is that for there to be a uniform system involving the developer, so too must there be one relative to the buyer. If we are to think that a home purchase in Wyoming is just as special as in Virginia, then so too must there be a uniformity in the approaches to the risks of home purchasing, one that fairly balances the rights of the vendor as against the consumer.

The Uniform Land Transactions Act (“ULTA”) reflects the current trend toward refusing to apply the traditional doctrine of *caveat emptor* where injustice will occur, by providing in part that an implied warranty will cover all purchases from “sellers in the business of selling real estate”. The ULTA applies to all real estate, not just houses, and warrants that the building will be suitable for the ordinary uses of real estate of its type and is (1) free from defective material and (2) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner.

As an added measure, an implied warranty also takes into account the equitable consideration that between two innocent parties, the one in the better position to prevent the harm ought to bear the loss. While a builder-vendor certainly has the opportunity to notice, avoid, or correct [latent] defects during the construction process, a similar opportunity exists for the developer-vendor. As one court reasoned,

> “Purchasers from a developer-vendor depend on his ability to hire a contractor capable of building a home of sound structure. Where the buyer has no control over the seller-developer’s choice of contractor, the developer-seller stands in the best position to know whether the contractor he has hired can complete the work adequately. By protecting the innocent home purchaser by holding the developer-seller liable the law is coming to

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recognize that the purchaser of a home does not stand on equal footing with the builder-vendor or developer-vendor.”

The essence of the transaction is an implicit engagement upon the part of the seller to transfer a house suitable for habitation – or else if the purchaser expected anything less, there would be no sale. An express written warranty may not provide sufficient protection concerning latent defects, as suggested supra, inasmuch as a buyer who has no knowledge, notice or warning of defects is in no position to exact specific warranties from a developer, and any written warranty demanded in any case would necessarily be so general as to be difficult to enforce. Issues can arise as well, when a developer does not undertake all repairs that are listed in common warranty documents provided by their counsel, so that the unit-owner may invariably feel a false sense of security when in fact, items not improved by the developer form the foundation of warranty claims.

Purchasers and counsel must carefully align inspection lists with implied warranty exclusions, so that defective or unfinished items are included in the developer’s obligatory fixes. Again, where there is a requirement upon the developer to disclose in a engineer-prepared property report, all of the good and the bad, then similarly, where a condominium buyer is careful and conservative about the transaction and informs himself about the true condition of the property, then problems are minimized, thus lessening the negative effects of condominium ownership.

ii. EXPRESS WARRANTIES – PRIVITY ISSUES

Apart from implied warranties, in those instances where express warranties have been made, either orally or in writing, they are generally enforceable under basic theories of contract.

Oral warranties, of course, may be rendered unenforceable through the Statute of Frauds, however, the “part performance exception” may be implicated where work relates to common elements of a condominium project. In the State of Virginia, in the case of Luria v. Board of Directors of Westbriar Condominium Unit Owners’ Association, there was no fiduciary duty vis-à-vis the developer (through his entities) and the condominium association because the association was not a “creditor” of developer. Therein, the Virginia Supreme Court, relying on tort law and the law of fraudulent conveyances, determined that a creditor who was duly noticed of a potential warranty claim under the statutory warranty scheme of the Virginia Condominium Act, could be held for a breach of a fiduciary duty for self-dealing.

Although the Virginia court determined that the developer in Luria was not put on actual notice of defects that could withstand a claim for statutory warranty relief under the Virginia Condominium Act, refused to find that the developer was a creditor who owed the unit owners a fiduciary duty for their self-dealing. The opinion does not mention any other possibilities of imposing a fiduciary duty in Virginia against a recalcitrant developer, suggesting that as of 2009, since that was a case of first, impression, that there is no applicable authority on the issue. As such, what is clear at a minimum, is that express warranties must be drafted and also edited in the negotiation phase of the transaction – to reflect actual property conditions, in order to hold the developer to the standard that the purchaser and indeed the law, typically expects.

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138 Hyatt and Rhoads, supra, at 955, citing e.g. 3 S. Williston, Contracts § 526 (3d ed. W. Jaeger, ed. 1963).
140 277 Va. 359, 672 S.E.2d 837 (Va. 2009).
141 Id., at 840.
142 Id.
iii. LIABILITY BASED ON FRAUD

Speaking of expectations, it is fair to say that no one would purchase a condominium if they thought that the developer was engaging in outright fraud. As in other causes of action against a developer, a developer-builder or a developer-seller can also be held liable under a theory of fraudulent misrepresentation if the characteristics or quality of a home or unit are expressly misrepresented.\textsuperscript{143} In many instances a developer’s fraud does not consist of express misrepresentations, rather it is made up of the developer’s silence when the facts demand disclosure of his knowledge to the purchaser.\textsuperscript{144} This often occurs when the developer has knowledge of important material facts concerning a home or unit and he fails to disclose this knowledge to the buyer.\textsuperscript{145}

California courts have held that fraudulent concealment occurs when a developer conceals from a purchaser a material fact of the subject matter on which the transaction is based, which the developer had a duty to disclose, imposing an affirmative duty upon the developer to disclose to buyers information that would affect, or might affect, the value of the homes which they sought to purchase.\textsuperscript{146} The Courts’ rationale was that a developer’s duty then, hinged on the disclosure of what was, what could be, or what might be, in terms of value, safety, structural integrity, and promises as made.\textsuperscript{147}

In Ohio, developers have been held strictly liable for fraudulent failure to make (whether directly or indirectly) statutorily required disclosures of all material circumstances or features affecting the development in a readable and understandable written statement, which may not

\textsuperscript{144} Id., at 8.
\textsuperscript{145} Id.
\textsuperscript{146} Id., citing Barnhouse v. City of Pinole, 183 Cal.Rptr. 881, 884, 890 (Ct. App.1982).
\textsuperscript{147} Id.
omit or exclude any material facts or otherwise contain any untrue statements of material fact.\textsuperscript{148} Ohio remedies are available to actual and prospective purchasers, and the plaintiff in such actions is not required to show damages caused by any violation of a developer’s disclosure provisions before recovering damages (calculated by a statutory formula).\textsuperscript{149} Moreover, the Ohio legislature forbids a developer’s waiver or exculpatory language in a condominium declaration (i.e. “opt out”), even where such a provision is or was adopted and/or ratified by an owner’s association (insofar as such a release of liability is contrary to and in conflict with the statute and invalid).\textsuperscript{150} These are examples where a state imposes an authoritative rule on would-be developers and takes a “no prisoners” attitude toward shoddy construction. This attitude should be embraced.

**B. NEGLIGENCE**

In some jurisdictions purchasers or associations may have viable actions for negligence against the developer pertaining to the design or construction of real estate or to common areas within association boundaries.\textsuperscript{151} To be successful against a developer under a negligence theory, the plaintiff must essentially demonstrate that the developer negligently created a defective or unsafe condition, insofar as one who develops land is required to exercise that degree of skill, care and ability which is, under similar conditions and like surrounding circumstances, ordinarily employed within that geographical area, and when that duty is breached, a negligence action may arise.\textsuperscript{152} The fiduciary duty (often referred to as a “limited

\textsuperscript{148} \textsuperscript{11} 16 Ohio Jur. 3d Condominiums, Etc. §16 (2010).
\textsuperscript{149} Id., at §19.
\textsuperscript{150} Id. See also, Springer v. Koehler Bros., 69 Ohio.App.3d 592, 591 N.E.2d 316 (3d Dist. Hancock County 1990).
\textsuperscript{152} Id., citing McKernan, supra at fn. 24; See also, Hyatt, Wayne S. and Rhoads, James B., Concepts of Liability in the Development and Administration of Condominium and Homeowners Associations, 12 Wake Forest L.Rev. 915, 962 (1976).
duty” in some states that decline to accept that a general duty exists vis-à-vis developers and purchasers and associations) between a developer and an association or its members constitutes a type of special relationship that gives rise to an independent duty [in tort].\(^{153}\) Many courts have recognized that fiduciary relationships such as attorney-client, doctor-patient, insurer-insured – automatically trigger independent duties of care.\(^{154}\) Cases of negligence *per se* and non-compliance with a building code, do not arise from a fiduciary duty, and thus may be precluded by the economic loss rule.\(^{155}\)

While not all states allow negligence actions, some have allowed causes sounding in negligence where there was alleged a duty on the part of the developer who was not the builder, to ensure that work on a condominium was completed in a workmanlike manner (as if he were the builder himself).\(^{156}\) Courts have held that the developer was under an obligation to oversee the details of the construction and to ensure [sic] the condominium complex was build in a non-negligent manner and with quality materials.\(^{157}\) This gives rise to what might be known as a duty to supervise work, or a cause of action for negligent supervision.

General contractors have also been held to a duty to ensure that the sprinkler sub-contractor had constructed the sprinkler system in a good and workmanlike manner with quality materials, and the fact that a subcontract existed between the general and the subcontractor was irrelevant to the court.\(^{158}\) This creates the potential for a complication in the generally accepted definition of “independent contractor” vis-à-vis “employee”, whereby traditional notions of

\(^{153}\) See, Davencourt, supra, at 246.
\(^{154}\) Id., at 247.
\(^{155}\) Id.
\(^{156}\) Kennedy, Richard E. and de Haan, Ellen H., supra, at 10; See also, *Point East Condominium Owners Assoc. v. Cedar House Assoc.*, 663 N.E.2d at 356-47.
\(^{157}\) Id.
\(^{158}\) Id., at 353.
independent work can come into conflict with generally accepted legal principles relating to worker’s compensation, mechanic’s lien issues and contractual liability, among other things.

In some instances the developer does not act as the actual builder, and he instead contracts with a general contractor or construction manager.\textsuperscript{159} This does not mean however, that the unit owners or association would have no recourse against the developer in this scenario; rather, increasingly courts have recognized that the developer merely impliedly warrants that it will develop in a good and workmanlike manner, and such implied warranties are actionable.\textsuperscript{160} Where a developer claims that liability for faulty work or building issues should not attach because he was not the builder, courts have found that the developer’s implied warranties require development and construction in a good and workmanlike manner with quality materials.\textsuperscript{161} The \textit{Luker} court reasoned:

\begin{quote}
“We hold that the developer is in a better position to prevent loss …. Further, most purchasers do not have responsibility or experience to determine lot size… or deed restrictions… They must rely on the developer’s expertise in this area. Finally the developer is more able to absorb the cost of damages associated with inferior development than the individual consumer.”\textsuperscript{162}
\end{quote}

Indeed, where the developer has obtained substantial loan proceeds or sales proceeds, he should be deemed to be in the better position to avoid property and building related issues \textit{vis-à-vis} the buyers, and where municipal or statutory provisions do not afford consumer protections, it is incumbent upon the purchaser to fully inspect and fully document the transaction to cover all bases.


\textsuperscript{160} \textit{Id.}

\textsuperscript{161} \textit{Id.}, at 11, citing \textit{Luker v. Arnold}, 843 SW 2d at 109.

\textsuperscript{162} \textit{Id.}, citing \textit{Luker} at 117.
C. LENDER LIABILITY

Apart from a focus on the developer, what about the entity that funds his work? What happens in situations when the developer is potentially liable to a homeowners’ association or to an individual unit owner, but the developer is insolvent?\(^\text{163}\) If the developer is insolvent, potential plaintiffs may want to sue the developer’s lender because, after all, they assume, financially speaking, that lenders have deep pockets. \textit{Id.} Where the plaintiff can establish that the lender participated in the construction, or possessed certain specific rights of control over the project, courts have found that the lender could be liable for the plaintiff’s damages.

A distant California decision, \textit{Connor v. Great Western Savings & Loan Ass’n.}, illustrates the fact that a lender may be subject to liability if it actively participates in the development.\(^\text{164}\) Where the lender has the right to control disbursement of funds and the right of refusal when work is non-conforming to codes or plans and specifications, and the lending agreement provides certain rights favorable to the lender, then it may be found that the lender has gone far beyond its traditional role as mere financier, and instead could be found to be a joint venturer, or partner with regard to the development\(^\text{165}\).

Additionally, when a lender forecloses and finishes a project or a unit, it may be held responsible under the developer or builder’s standards and duties, because where a lender becomes involved in a project other than as a mere lender, the lender becomes liable for its own acts and omissions and for any obvious and discoverable construction defects caused by the original developer or builder.\(^\text{166}\) In \textit{Chotka v. Fidelco Growth}, a lender foreclosed on property

\(^{163}\) \textit{Id.}, at 32.
\(^{164}\) \textit{Id.}, at 33, citing \textit{Connor v. Great Western Savings & Loan Ass’n}, 447 P.2d 609 (Cal. 1968).
\(^{165}\) \textit{Id.}, at 33-34 (2004)); \textit{Connor, supra}, at 616.
\(^{166}\) \textit{Id.}, at 35 (2004)). \textit{See also, Chotka v. Fidelco Growth}, 383 So.2d 1169 (Fla. Dist. Ct. App. 1980).
that had been substantially completed by the developer, excepting recreational areas and lobbies.\textsuperscript{167}

There, the lender also undertook to complete some individual units, and later certain unit owners sued for acts and omissions related to the construction.\textsuperscript{168} The lender denied knowledge of the defects at the time of foreclosure and denied that it was a developer of the project.\textsuperscript{169} Looking beyond the characterization of the lender as a mere money lender, the court reasoned that the defendant became more than a lender when it took title to the project by virtue of the foreclosure, and finished the outstanding work left to be done by the original developer.\textsuperscript{170}

As in Chotka, where a lender takes title to a project, completes construction, holds itself out as developer and owner of the project and markets and sells units, it steps into the shoes of the developer and is liable to the same degree and in the same manner, as the original developer.\textsuperscript{171} Buyers and counsel then, must be wary of projects with lender involvement, and due diligence including public record and title searches that include collateral assignments and documents evidencing a lender’s ownership and/or right to manage the property can often times signal that the developer had problems, which may not be too far from the surface. Where a developer could not adequately fund construction to completion such that a lender was forced to take over, one should be extra weary of the state of the union in real time, and not just on paper.

\textbf{VII. VACANT REAL ESTATE}

An oft unheard of legal writing, the Interstate Land Sales Full Disclosure Act applies to property for sale or lease, including condominium properties, conveyed through interstate commerce that is divided and/or is proposed to be divided for the purpose of sale or lease as part

\textsuperscript{167} Id.
\textsuperscript{168} Id.
\textsuperscript{169} Id.
\textsuperscript{170} Id.
\textsuperscript{171} Id., at 36; \textit{See also}, McKnight v. Board of Directors, 512 N.E.2d 316, 319 (Ohio 1987).
of a common promotional plan. Omitting many variables that are required in traditional causes of action, a claim under this act doesn’t require a wronged plaintiff to prove reliance, or the defendant’s fraudulent intent, which is different than most fraudulent misrepresentation claims or consumer fraud causes. Instead, the claimant must establish material omission or misrepresentation (even innocent or unintentional) by the developer. This statute however, applies only to unimproved lots, and it is not intended to apply to a parcel of land that is already developed or improved. Usually applies to claims made by purchasers claiming they were induced to buy land as a result of false promises and misrepresentations. Because this scenario is often experienced by out of state claimants and those who invest a substantial sum in furtherance of lofty property goals, utilization of the Act is a definite go-to tool in any legal arsenal, when eyeing possible causes of action against developer wrongdoing.

VIII. AFFIRMATIVE DEFENSES COMMONLY ASSERTED BY DEVELOPERS

Because no trip into the land of developer lawsuits would be complete without at least a cursory mention of the defenses that could be asserted by a developer, it is important to note that although it may be obvious, even where a developer has abrogated from his duty to a purchaser, where an appropriate and applicable defense is asserted, the developer may escape full liability to a plaintiff-purchaser. Surprisingly, some courts will strongly consider affirmative defenses held by the developer when posed with questions about developer liability for acts and omissions during their control over real estate. In Raintree Homeowners’ Assoc. v. The Dreyfus Interstate

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Dev. Corp., the Minnesota appellate court granted summary judgment in favor of the developer, relying on three affirmative defenses of: lack of notice, statute of limitations and laches.\textsuperscript{173}

In that case, the developer Dreyfus undertook to build 336 condominiums, and within the declarations it was provided that the developer would remit payment to the association for all undeveloped units.\textsuperscript{174} The association was responsible to annually calculate each owner’s assessment and send written notice of the amount due, in addition to the provision that unpaid assessments were to be automatically treated as liens upon the property.\textsuperscript{175} After building only 172 units, the developer sent notice to the association. Nineteen years later, after the lapse of all notices regarding the assessments for subsequent years, the association brought suit against the developer for the unpaid yearly assessments, alleging breach of contract and breach of fiduciary duty, seeking declaratory relief, and damages for the unpaid assessments, interest and legal fees.\textsuperscript{176}

The Court, concluding that the developer’s failure to be notified for 19 years after the initial notice was an acceptable affirmative defense, cited to the declaration that required annual notice of all assessments as its foundation for denying relief in the years where no notice was mailed.\textsuperscript{177} Finding that the developer was essentially denied due process and an opportunity to be heard, the giving of notice was deemed to be a prerequisite to an assessment were notice provisions in the declaration required it.\textsuperscript{178} Additionally, the Minnesota court relied upon the state’s condominium act and alternatively by the doctrine of laches, because the applicable act provided a three (3) year period in which to collect assessments.\textsuperscript{179} Laches was also relied upon

\textsuperscript{173} 2001 WL 712019 (2001).
\textsuperscript{174} Id., at 1.
\textsuperscript{175} Id.
\textsuperscript{176} Id.
\textsuperscript{177} Id.
\textsuperscript{178} Id., at 2.
\textsuperscript{179} Id., citing Minn.Stat. §515A.3-115(d)(2000),
for the proposition that an unreasonable delay and prejudice would befall the developer, because
the association could have reasonably prevented the accumulation of damages in the face of the
possibilities that if the developer had been earlier notified about the association’s intention to
enforce the provision that undeveloped property would still garner an assessment, it could have
sold the land, it could have amended the declaration to remove that provision, or it could have
brought a challenge to any assessment levied.¹⁸⁰

Concluding that those three defenses were sufficient to bar all claims, the court declined
to further analyze additional defenses and it upheld the trial court’s grant of summary
judgment.¹⁸¹ This provides an association broad spectrum impetus to communicate clearly on
the issue of outstanding fees and assessments and financial matters, in addition to the need for
annual accounting of condominium fiscal operations, in addition to the timely collection of
whatever sums might be deemed unpaid by the board of managers.

VIX. RESTATEMENT VIEW

As compared to many jurisdictions and mentioned supra, the Restatement view on the
topic of developers and fiduciary duties is more restrictive. Specifically, under the Restatement
Third of Property, the developer should not be held to the standard of a trustee, and should be
viewed more as a corporate promoter, if anything.¹⁸² Under this view, treating the developer
and its appointee to the board as trustees overstates the fiduciary component of the
relationship.¹⁸³ The developer cannot be expected to act solely in the interests of the association
and the homeowners.¹⁸⁴ Conflicts of interest are inherent in the developer’s role while it retains

¹⁸⁰ Id.
¹⁸¹ Id.
¹⁸² See generally, McConnel, Rick, You Can’t Always Get What You Want – But If You Try Sometimes, You Might
Find, You Get What You Need: The Search For Single Family Homeowner Protections In Missouri, 69 UMKC
¹⁸³ Id.
¹⁸⁴ Id.
control over the association. The Restatement goes into a lengthy listing of the duties that do exist, a number of which are specifically related to maintaining common area property, turnover to the unit owners.

What may be questionable about the Restatement view, is that it accepts as “acceptable” the conflict of interest, yet it makes no mention of any disclosure requirements that could be put to the developer about this conflict. While certainly there are obligations to tend to common areas, and it may be obvious that the developer has his own bottom line, it is not necessarily clear in many developer-condo cases in this country, as to where the line is or should be drawn when it comes to this conflict. The Restatement offers little in the way of bridging this gap.

The Restatement also provides that one of the developer’s duties is to enforce the condominium governing documents (i.e. the declaration and by-laws, if adopted), including design controls. While the duty only appears to extend until turnover to the owners’ association, different opinions exist as to what extent the developer’s participation (or lack thereof) in the management of the association, can be cured post-turnover. If at all, such fiduciary duties, as above, should have application or extension past the turnover mark, when outstanding items on the “to-do” list remain unfinished (other than the handover of funds, documents, and information). One option is to outline the developer’s duty contractually, but inserting language in the contract or addenda outlining repair, maintenance or financial obligations, although that may not be feasible or agreed upon in every case.

However, in that this can be less uniformly applied if left only to purchaser’s counsel, the better option is for state condominium or community association laws, to outline timelines and obligations for developers including, but not limited to: minimum disclosure requirements,

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185 Id., at 419.
186 Id., at 420.
completion of necessary capital improvements before conveyance, the creation and enforcement of permitting and inspection guidelines, and the requirement of financial participation in the association by the developer both during, and after turnover, especially where developer-owned units are still unsold.

Although the Restatement accepts at least a limited fiduciary duty – whereby because of the developer’s control of an association (which require of him management and oversight of certain interests not his own) - he should be bound to exercise and provide limited protection of the association and its members. This is certainly an area where the Restatement could use expansion and clarification in light of the dangerously common trends. If a developer is not required to manage and have oversight of interests not his own, then likely is the scenario that the mismanagement becomes the rule, rather than the exception. Only where there is a requirement of such oversight and management is the developer more likely to participate, engage and honor his obligations to finish what was started by his own “declaration”. Despite this gap in the law, the developers are not solely to blame, because the municipal authorities, nationwide, have failed in many respects, to see that purchasers are not in any position to navigate municipal and legal waters when it comes to purchasing real estate, and especially condominiums. The state of the law of condominiums and developer obligations is ripe for change.

X. CONCLUSION

Over the last decade, state legislatures and jurists are identifying and recognizing fiduciary duty issues vis-à-vis real estate developers, which is a significant improvement over the prior. However, there is much more needed in order to get to what anyone would safely call a “uniform” system or approach to these issues. In light of the Restatement and the competing

\[\text{188 Davencourt at Pilgrim's Landing Homeowners' Assoc. v. Davencourt at Pilgrim's Landing LC, supra, at 246.}\]
judicial viewpoints, it should be incumbent upon the bench and the bar to create authority that would help shape the law in this area.

In jurisdictions that do recognize a fiduciary duty, which is an independent duty of care, courts should also recognize that any tort claims that are brought under the duty fall outside the scope of the economic loss rule.\textsuperscript{189} This would create good separation in the courts in cases that can be brought along a straight-line fiduciary duty claim and those that must stay within traditional contract principles. Without bright-line rules or tests in fiduciary duty claims, parties and courts alike will be required as before, to meander their way through the court system to try to outline and narrow issues, in the hopes that the law will refine itself over time.

Because the Restatement viewpoint is, to this author, outdated and antagonistic to realistic power-plays and factual scenarios that are landing in court, the old methods of solving condominium-developer-purchaser disputes should not fall to the “usual” risk-shifting analysis that ultimately requires that buyers shoulder more, and the developer less. Instead, the parties in control of the funds, of the permits and of the municipal checklists, should be forced to disclose problems, repair defects, sell condominium developments that are financially viable, and to follow the rules. Anything less is a recipe for disaster.

Finally, as in South Dakota and California and other jurisdictions, whose forward-thinking version of the right way to legislate condominiums, creates the mandate for developer-vendors to publish and draft documents that are government cross-checked and offered as “pre-sale” memoranda, this author agrees that stricter disclosure and recordation requirements put in place well before a condominium declaration is recorded or even drafted, would go a long way toward avoidance of building condition and failure-to-disclose issues. If the powers that be were

\textsuperscript{189} Davencourt at Pilgrim’s Landing Homeowners’ Assoc. v. Davencourt at Pilgrim’s Landing LC, supra, at 247.
to couple these changes with a stricter requirement of oversight by title companies that close these transactions and are the last checkpoint before the jumping off point (i.e. closing), then there would be no doubt that purchasers, lenders, developers and all of those engaged in some aspect of real estate work, would all be held to a higher standard. Higher standards, once we are all used to them, are typically better for everyone involved.

Where savvy buyers and those less inclined to perform adequate due diligence are given access to information that the developer is required to deliver (rather than left abandoned to his own selfish financial or “I forgot to investigate” devices), then indeed both sides can be held to their losses in the event a project does not go as planned. Conversely, where municipalities don’t require inspections or where they fail to take action in the pre-closing phase in order to ensure inspections and building conditions are on par, then the buyer shouldn’t be forced to shoulder the resultant financial burdens of repair and maintenance of buildings that should have been inspected by the municipality and in fact, complete and finished pre-sale. More certainty in the state or municipal requirements of condominium developers as to timelines, financial contributions, permits, inspections and deliverables to purchasers would, in nearly all scenarios, result in a more informed public, better qualified participants in the real estate developer game, and less traffic in the courthouses – nationwide.

All in all, although there is certainly more ground to cover in the area of condominium law, certainly states and municipal authorities can do more. Indeed it is accepted and understood that parties need to be more sophisticated and advised, and there are a good number of states that don’t typically use legal counsel in real estate transactions. Thus, where consumers are informed and advised and condominium developers are monitored and forced to put their toes and dollars closer to the line than before, then nearly all the parties in the condominium purchase and sale
process will be flying on a higher plane – which, in this current economy could be nothing but good.