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DEVELOPER LEASES UNDER THE CONDOMINIUM AND COOPERATIVE ABUSE RELIEF ACT OF 1980

I. INTRODUCTION

The past two decades have witnessed the rise of two similar forms of home ownership: the condominium and the cooperative. Among the states, Florida, in particular, has experienced a substantial growth in both condominiums and cooperatives, a trend due primarily to shifts in population, the impact of inflation, federal income tax considerations, and other economic factors.

A condominium is generally defined as separate ownership of individual units in a multi-unit project. The unit owner acquires an interest in his individual unit and receives a deed. In addition to his interest in the individual unit, each owner is also a tenant in common in the underlying fee and in the spaces and building parts used in common with all the unit owners. See P. Rohan & M. Reskin, Condominium Law and Practice § 1.01, at 1-1 (1965); Comment, Legal Protection for Florida Condominium and Cooperative Buyers and Owners, 27 U. Miami L. Rev. 451, 451 n.1 (1973).

The most typical form of cooperative is the corporate cooperative. A corporation is organized and the land of the project is conveyed to it. Individuals own shares of stock in the corporation which executes a proprietary lease of a particular apartment to the tenant shareholder. The execution of a proprietary lease is vital and, in order to obtain it, the lessee must be a shareholder. The ownership of shares alone confers no right of occupancy. Id.

The 25 to 34 year old and the over 65 age groups are the two most rapidly growing segments of the population. The growth in the senior citizen population has increased the movement to Florida of these typically two person households which desire the convenience of condominium style living. Those in the 25 to 34 year old age group also find condominium style living desirable. Id.

During the 1970's, the average price of a new home rose more rapidly than the average family income in Florida. This, combined with the rapidly increasing cost of housing (which includes land, financing, construction costs and real property taxes), has reinforced the desire for smaller dwelling units, as opposed to more expensive single family housing. Id. at 11-12.

The Internal Revenue Code subsidizes home ownership by providing deductions for real estate taxes and mortgage interest, while no corresponding benefit is received by renters. I.R.C. §§ 163-64, 216 (Supp. 1986).

Factors such as equity buildup and price appreciation as well as depreciation deductions for certain investors increase the attractiveness of condominiums and cooperatives. In addition, the deteriorating value of the American dollar and the stability of the United States government have made real estate a relatively inexpensive investment opportunity for foreign investors. Id.
As the demand for condominiums and cooperatives increased, so have the abuses surrounding their sale and development. In Florida, condominium buyers were subjected to many flagrant abuses by developers. Moreover, the Florida courts involved in the litigation of these abuses adopted a minority approach, and were reluctant to help the condominium and cooperative associations. As a result, Florida's legislature has responded with remedial legislation.

Florida's Congressmen lobbied to enact federal legislation to aid Florida condominium owners, who were the objects of these abuses. Congress responded with the Condominium and Cooperative Abuse Relief Act of 1980. The Act is unique in that unlike other federal regulatory statutes it is not limited to disclosure but rather affects substantive contractual rights. Although specifically aimed at the abuses occurring in Florida, this Act was also designed to eliminate the adverse impact that condominium and cooperative conversions have on the low and moderate housing market. Although its potential effect is enormous, the statute has remained in obscurity and has been rarely used by condominium and cooperative associations. This Note explains the circumstances which lead up to the Act's enactment, analyzes how the Act has been recently applied, and explores possible future application.

II. THE FLORIDA SITUATION

In the years between 1960 and 1980, as the population of Florida increased by approximately five million people, condominium-style living became increasingly popular. In 1979 alone, approximately eighty-two thousand condominium units were filed with the Division of Florida Land Sales and Condominiums. As the popu-

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7. See infra notes 18-43 and accompanying text.
8. See infra notes 44-49 and accompanying text.
9. See infra notes 50-60 and accompanying text.
10. See infra notes 61-64 and accompanying text.
13. See infra notes 16-67 and accompanying text.
14. See infra notes 71-123 and accompanying text.
15. See infra notes 123-28 and accompanying text.
larity of condominiums increased, condominium developers were able to manipulate the statutory form of conversion to realize enormous personal profits by abusing the conversion plan at the expense of unwary purchasers.\textsuperscript{18}

A particularly egregious abuse is pre-election self-dealing,\textsuperscript{19} which typically occurs while the association is controlled by the developer, in the period prior to the sale of the individual units and the election of the association's board.\textsuperscript{20} During this time, developers generally execute "sweetheart" contracts\textsuperscript{21} or leases with developer owned or affiliated companies. When the units are sold, they remain subject to these agreements, which often impose a heavy financial burden on the unit purchaser.\textsuperscript{22}

A predominant type of developer self-dealing involves recreational leases.\textsuperscript{23} Developers typically convey title to the site on which

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\item \textsuperscript{19} Note, supra note 18, at 353-55. These are not the only abuses practiced. Others involve the use of fraudulent misrepresentations, usually in the sales brochures, that often leave out or understate the monthly charges that a unit owner will have to pay. \textit{Id.} at 356-57. Another involves the misuse of buyer deposit money. Developers used deposit money collected from committed purchasers for their own purposes and, if the project failed, no money was returned. \textit{Id.} at 357-58. See, e.g., Hendler v. Rogers House Condominium, Inc., 234 So. 2d 128 (Fla. Dist. Ct. App. 1970); Brothers v. McMahon, 351 Ill. App. 321, 115 N.E.2d 116 (1953).
\item \textsuperscript{20} Note, supra note 18, at 353; Case Comment, \textit{Long Term Management Contracts Between Condominium Associations and Developer-Controlled Management Corporations Held Not Violative of the Florida Condominium Act}, 28 U. MIAMI L. REV. 451, 452 (1974). After the declaration of condominium has been filed, and before any units have been sold, the developer has complete control of the association because he owns all the units in the project. \textit{Id.} Similarly, with cooperatives during the same time interval the developer is the sole share-holder and only board member. Thus, the developer has the power to bind the owners' association by contract and then sell the units subject to those contracts.
\item \textsuperscript{21} Krebs, \textit{The Legislative Response to "Sweetheart" Management Contracts: Protecting the Condominium Purchaser}, 55 CHI.-KENT. L. REV. 319, 319 (1978); Note, supra note 18, at 353. These contracts are self-serving arrangements under which developers, acting as the condominium association, have contracted with themselves or with a corporation which they also control, at very lucrative terms and for extended periods. These agreements involve anything from management contracts to laundry room service agreements. \textit{Id.} See also West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 625 F. Supp. 934, 935 (S.D.N.Y. 1986) (developer executed contracts for commercial space, garage operation and laundry room), \textit{aff'd in part, rev'd in part}, 815 F.2d 188 (2d Cir. 1987).
\item \textsuperscript{22} See Krebs, supra note 21, at 319; Mandelkorn Krul & Galt, \textit{Condominium Litigation}, 33 U. MIAMI L. REV. 911, 919 (1979); Note, supra note 18, at 353; Comment, \textit{Areas of Dispute In Condominium Law}, 12 WAKE FOREST L. REV. 979, 981 (1976).
\item \textsuperscript{23} See generally Mandelkorn, Krul & Podoll, \textit{The Non-Unconscionability of Condominium Recreation Leases}, 34 U. MIAMI L. REV. 563 (1980). The recreational lease is the usual instrument by which the condominium association rents property from either the devel-
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the condominium structure is located to the condominium association, but retain title to the adjoining land where the recreational facilities are located. The developer then leases the adjoining land to the association. The association pays an annual rent for the use of the land while the developer retains ownership. The rents are divided proportionally among the unit owners and the lease is legally binding on all owners at the time of purchase, whether or not they use the facilities.

Often, recreational leases contain rental escalation clauses which are designed to keep pace with, or at least minimize, the effect of inflation on the developer's projected return. The escalation clauses are usually tied into a nationally recognized commodity index or a consumer price index and have terms of fifty years or more, with the most common terms being ninety-nine years. These escalation clauses constitute a significant portion of the total leasing cost. Moreover, since developers realize great profits from recrea-

oper or from a third party who has purchased the leasehold from the developer as an investment. It is a type of financing device that allows the unit owners to spread out his payments for the use of these recreational facilities. Among other things, the recreational facilities often include swimming pools, tennis courts, clubhouses, and exercise rooms. Title remains in the lessor owner and is not part of the common elements of the condominium project. See Lewis & Jessell, The Condominium Recreational Lease Controversy, 9 REAL EST. L.J. 7, 8 (1980); Mandelkorn Krul & Gait, supra note 22, at 919.

24. Mandelkorn, Krul & Podoll, supra note 23, at 565; Note, supra note 18, at 354 n. 35.
27. Mandelkorn, Krul & Podoll, supra note 23, at 565-66. An escalation clause provides for periodic increases in rent. The increases are determined by a set standard or formula at some stated periodic interval. See Lewis & Jessell, supra note 23, at 10; Mandelkorn & Krul, supra note 26, at 884.
28. Mandelkorn, Krul & Podoll, supra note 23, at 566. The association may also be required to bear the effects of inflation on other costs. If the lease is a "net-net" lease, in addition to paying the rental amount the lessee must pay the property taxes, insurance and maintenance expenses. Id. See Lewis & Jessell, supra note 23, at 11; Mandelkorn, Krul & Podoll, supra note 26, at 884.
29. Mandelkorn, Krul & Podoll, supra note 23, at 566. At stated intervals, "the lessee must pay the lessor an increased rental amount due to the rise in the cost of living as reflected in the price index." Id.
30. Id.
31. Id. When these escalation clauses were originally inserted into recreational leases the Consumer Price Index showed inflation averaging less than three percent. When the first few rent adjustments became due, the inflation rates had almost doubled. Id. at 567. See also Lewis & Jessell, supra note 23, at 10 (suggesting that leases tied to high rates of inflation are the cause of much consumer disenchantment).
tional leases, they often demand a very high "buy-out price" for the sale of their leases. A second variation of developer self-dealing involves long-term management contracts that the developer arranges while in control of the association. Management contracts are subject to virtually the same developer abuses as recreational leases. As in the case of recreational leases they also impose a substantial financial burden upon the condominium association and consequently result in a considerable amount of litigation.

A third type of self-dealing by developers involves ground leases. Initially, state condominium law required that a condominium could only be developed on land owned in fee. Many jurisdictions, including Florida, statutorily changed this requirement and thereby permitted condominium development on leaseholds. The advantage of a leasehold condominium is that it allows the developer to offer the units at a lower price than a condominium developed on land owned in fee. Often these leases are not adequately disclosed to a purchaser and have the potential for developer abuses similar to

32. A "buy-out" is a contractual arrangement whereby a condominium association or the individual owners purchase the recreational facilities referred to in the recreational lease from the developer or third party who owns the lease hold. The buy-out had proven to be a popular means of resolving recreation lease controversies. A major problem with the buy-out is the determination of an agreeable buy-out price. Developers are concerned with keeping their valuable stream of future income and generally condominium associations are only willing to pay replacement costs less depreciation. Mandelkorn, Krul & Podoll, supra note 23, at 594.


34. In management contracts, the developer or a third party contracts with the owners association to assume the daily operation of the complex. Case Comment, supra note 18, at 354; see Note, supra note 20, at 451.

35. Note, supra note 18, at 354. Management contracts generally involve long periods of time and exorbitant fees. Id. Management contracts are, however, free from the potential abuse of escalation clauses since their use is prohibited in Florida. See Fountainview Ass'n, Inc. v. Bell, 203 So. 2d 657 (Fla. Dist. Ct. App. 1967).


37. Note, Recent Innovations In State Condominium Legislation, 48 St. John's L. Rev. 994, 995-97 (1974). A condominium built on property that the condominium association does not own but rather leases is called a leasehold condominium. Id. at 995.

38. See, e.g., N.Y. REAL PROP. LAW § 339-a(11), -f (McKinney 1967).


40. Note, supra note 37, at 996.
those that occur in the recreational lease situation.\textsuperscript{41} The information pertaining to the ground leases is often buried somewhere in the condominium documents,\textsuperscript{42} even though it is of particular importance when the lease is about to end and a purchaser is considering buying a condominium unit.\textsuperscript{43}

Condominium unit owners challenged both the management contracts and recreational leases in the Florida courts but were consistently unsuccessful.\textsuperscript{44} For example, in \textit{Fountainview Association v. Bell},\textsuperscript{45} several condominium associations sued the developer of the condominium complex in an attempt to recover any unconscionable profit made on the lease of the land and for relief from any fees under the management contract.\textsuperscript{46} The plaintiff association argued that the developers were fiduciaries of the prospective buyers and that they breached their fiduciary duty by entering into these contracts.\textsuperscript{47} The court reasoned, however, that the developer's activities did not violate any fiduciary duty because at the time the agreements were executed there were no other members belonging to the condominium association; therefore, there was no one to whom a duty was owed.\textsuperscript{48}

In adopting this position, the Florida courts followed the minority view of casting condominiums in a corporate framework and al-

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\item\textsuperscript{41} See \textit{id.} at 997.
\item\textsuperscript{42} \textit{Id.} at 996; Comment, supra note 1, at 455.
\item\textsuperscript{43} Comment, supra note 1, at 455. Even when the buyer is aware of the leasehold arrangement as time progresses the condominium owner may have difficulty in reselling his unit because the unexpired term of the lease will have become substantially shorter than when it was originally purchased. Note, supra note 37, at 997. State laws often do not provide adequate requirements with regard to the term of the ground lease. \textit{Id.} at 996-97. For a discussion of the inadequacies of state law in this area, see \textit{id.} at 995-98.
\item\textsuperscript{45} 203 So. 2d 657 (Fla. Dist. Ct. App. 1967), \textit{cert. dismissed}, 214 So. 2d 609 (Fla. 1968).
\item\textsuperscript{46} \textit{Id.} at 658.
\item\textsuperscript{47} \textit{Id.}
\item\textsuperscript{48} \textit{Id.} at 659. The court reasoned that the Florida Condominium Act did not distinguish between a corporation for profit and a corporation not for profit and therefore the legislature wanted both to be treated equally and governed by the same rules. \textit{Id.} The court then followed the holding in \textit{Lake Mabel Development Corp. v. Bird}, 99 Fla. 253, 126 So. 356 (1930), which held that a corporation cannot, while its promoters hold all its outstanding stock, request equitable relief to avoid a purchase of property sold them by the promoter at a large profit. 203 So. 2d at 658-59.
\end{itemize}
allowing developers to bind future purchasers to contracts executed when the developer had total control over the board. Conversely, the majority view treats the developer as a fiduciary when acting on behalf of unknown future association members.\textsuperscript{49}

In \textit{Wechsler v. Goldman},\textsuperscript{50} the unit owners sought to cancel or modify their ninety-nine year recreational lease, which the developers had negotiated amongst themselves when they had complete control over the condominium association.\textsuperscript{51} The income generated by the recreational lease was far in excess of the value of the property.\textsuperscript{52} The trial court held that the rights of the plaintiffs had been affected by their knowledge of the lease at closing, and by their express acceptance of the lease in their closing contracts, notwithstanding the fact that they were not advised of the lease earlier.\textsuperscript{53} The district court of appeals affirmed the trial court’s determination on the basis of the \textit{Fountainview} decision,\textsuperscript{54} reasoning that the plaintiffs were neither “harassed” nor “bullied” into signing a contract or purchasing their units.\textsuperscript{55} Despite enormous profits received under the lease by the developer, the district court of appeals refused to cancel or modify the recreational lease.\textsuperscript{56}

The same District Court of Appeals, in \textit{Point East Management Corp. v. Point East One Condominium Corp.},\textsuperscript{57} denied another attempt to cancel a recreational lease. The court agreed with the trial court’s finding that the defendant developers had given full disclos-


\textsuperscript{50} 214 So. 2d 741 (Fla. Dist. Ct. App. 1968).

\textsuperscript{51} \textit{Id.} at 744.

\textsuperscript{52} \textit{Id.}

\textsuperscript{53} \textit{Id.} See also Riviera Condominium Apartments, Inc. v. Weinberger, 231 So. 2d 850 (Fla. Dist. Ct. App.) (upholding the validity of the management contract on the grounds that the unit purchasers had prior knowledge of it and could not subsequently rescind), \textit{cert. dismissed}, 238 So. 2d 424 (Fla. 1970).

\textsuperscript{54} 214 So. 2d at 744. The court also suggested that what had happened in both this case and the \textit{Fountainview} case may indicate a need for legislative action to amend the Florida Condominium Act to prevent unfair dealing by promoters of condominium associations. \textit{Id.}

\textsuperscript{55} \textit{Id.} at 743. The court reasoned that the unit owners had constructive notice of the terms of the lease because all the documents were recorded and contained in an abstract which was made available to all purchasers on request prior to closing. \textit{Id.}

\textsuperscript{56} \textit{Id.} at 744.

ure to purchasers regarding the facilities and the recreational lease, and concluded further that at the time of the sale of the units the purchasers had appropriate knowledge and information to make an informed decision. As a result, the lease was ratified and could not be cancelled. On appeal, the Supreme Court of Florida approved this portion of the decision.

The Florida legislature responded by enacting statutes in an attempt to curb developer self-dealing by mandating more stringent disclosure requirements. The Florida legislature also enacted a statute that allowed cancellation of any initial or original maintenance or management contract as long as there was concurrence of at least seventy-five percent of the individual unit owners at any time after they assumed control of the association. Furthermore, in 1975 the Florida legislature enacted legislation which prohibited the inclusion of escalation clauses in recreational leases which were tied to a nationally recognized price index. The legislature did not, however, prohibit fixed price increases in the original agreement. The Florida legislation, although able to prevent some future abuses, was unable to provide relief to present condominium owners subjected to these abuses.

58. Id. at 325-26.
59. Id.
60. 282 So. 2d 628, 628 (Fla. 1973). The Point East case also involved the validity of a 25 year management contract between the developer and the condominium association. At trial, the plaintiffs argued that the management contracts did not conform to Florida's Condominium Act because they divested the association of control of the condominium complex. The trial court invalidated the contract on those grounds and the district court of appeals affirmed. Point E. Management Corp. v. Point E. One Condominium Corp., 258 So. 2d 322, 324-25 (1972). The Supreme Court of Florida quashed the portion of the decision which invalidated the management contract. The court held that the legislature did not intend "to restrict the ability of the associations to contract for the management of the associations." 282 So.2d at 630. See Case Comment, supra note 20, at 451.
In Schlytter v. Baker, the United States Court of Appeals for the Fifth Circuit upheld the prospective validity of the Florida legislation prohibiting the inclusion of escalation clauses in condominium and cooperative recreational leases. In Fleeman v. Case, however, the Florida Supreme Court held that the legislative prohibition of escalation clauses could not be applied retroactively to leases entered into before the statute's effective date. Thus, condominium and cooperative owners bound to pre-1975 recreational leases were without relief and became the focus of considerable public attention. Consequently, in 1978 the Florida Congressmen in Washington began seeking help for these aggrieved condominium owners.

III. THE FEDERAL STATUTE

United States Senator Richard Stone testified at House hearings regarding the repeated attempts by his state to nullify escalation clauses in leases. In particular, he depicted the futility of Florida's attempts to provide retroactive relief to unit owners, arguing that federal legislation was necessary to eliminate the types of abuses plaguing Florida's housing market and to insure the continued use of the condominium and cooperative as an integral part of that market. In response, Congress enacted the Condominium and Cooperative Abuse Relief Act. In its final form, the Act specifically addresses the dilemma confronting Florida condominium owners subject to

65. 580 F.2d 848 (5th Cir. 1978).
66. Id. at 850.
67. 342 So. 2d 815 (Fla. 1976).
68. Id. at 817-18. Although the court did not consider the issue it hinted that there might be a cause of action for the unconscionability of recreational leases. Id. at 818. The doctrine of unconscionability appeared to be one of the few causes of action that the Florida courts left open to unit owners. For a more detailed discussion of the unconscionability doctrine in relation to recreational leases, see Mandelkorn, Krul & Podoll, supra note 23, at 578-88; Lewis & Jessell, supra note 20, at 11-14. The unit owners also attacked recreational leases under both federal and state anti-trust laws. For a discussion of the anti-trust implications of recreational leases see Mandelkorn, Krul & Podoll, supra note 26, at 888-910.
69. Housing and Community Development Amendments of 1979: Hearings Before the Subcomm. on Housing and Community Development of the Committee on Banking, Finance, and Urban Affairs, 96th Cong., 1st Sess. 416, 417 (1979). Senator Stone testified that although Florida's attempt to provide retroactive relief for the condominium owners burdened by these leases and management contracts has been held unconstitutional, the federal government has the power to provide such relief. Id. at 425. He presented to the House an extensive bill (referred to as the Condominium Act of 1979) which would have had a tremendous effect on condominium development and would have relieved condominium owners of unconscionable recreational leases. The Act eventually enacted was not as extensive as the original bill proposed by Senator Stone.
pre-1975 recreational leases as well as providing a means of preventing similar abuses in the future.\footnote{71}{The Act applies only to contracts entered into on or after October 8, 1980. 15 U.S.C. § 3607 (1982). Section 3608, however, which applies to leases, also requires that the lease had to be entered into prior to June 4, 1975 before any action may be maintained under that section. 15 U.S.C. § 3608(a)(6) (1982).}

The Act applies only to cooperative and condominium conversions with five or more residential units,\footnote{72}{15 U.S.C. § 3603(5) (1982) (condominium project); 15 U.S.C. § 3603(10) (1982) (cooperative project).} and, to establish jurisdiction, requires that the sale or lease of the units be accomplished through the "use of any means or instruments of transportation or communication of interstate commerce or the mails."\footnote{73}{15 U.S.C. § 3603(5) (1982).} Exempt from the Act's provisions are cooperative or condominium units sold by the federal government, and condominium or a cooperative projects in which all units are restricted to non-residential purposes.\footnote{74}{Section 3607 of the Act allows the condominium or cooperative association or unit owners to terminate certain self-dealing contracts without penalty.\footnote{75}{15 U.S.C. § 3607(a) (1982) determines which self-dealing contracts can be terminated under the Act. It states: Any contract or portion thereof which is entered into after October 8, 1980, and which

(1) provides for operation, maintenance, or management of a condominium or cooperative association in a conversion project, or of property serving the condominium or cooperative unit owners in such project;

(2) is between such unit owners or such association and the developer or an affiliate of the developer;

(3) was entered into while such association was controlled by the developer through special developer control or because the developer held a majority of the votes in such association; and

(4) is for a period of more than three years, including any automatic renewal provisions which are exercisable at the sole option of the developer or an affiliate of the developer,

may be terminated without penalty by such unit owners or such association.\footnote{76}{15 U.S.C. § 3607(c) (1982). The vote must be of not less than two-thirds of the units other than those owned by the developer or an affiliate of the developer.\footnote{Id.}}}

Section 3607 of the Act allows the condominium or cooperative association or unit owners to terminate certain self-dealing contracts without penalty.\footnote{76}{15 U.S.C. § 3607(c) (1982). The vote must be of not less than two-thirds of the units other than those owned by the developer or an affiliate of the developer.\footnote{Id.}} The termination must be accomplished by a vote of at least two-thirds of the unit owners.\footnote{76}{Following the unit owners' vote, the termination becomes effective ninety days after it is deliv-
The chief attribute of this section is the avoidance of the pre-election abuses that occurred in Florida involving management contracts and recreational leases. For a contract to fall within the reach of section 3607 all four of the statutory elements must exist. The section requires the termination to occur only during the two-year period beginning either on the date on which special developer control is terminated or when the developer owns twenty-five percent or less of the units in the project, whichever comes first. Additionally, only contracts and leases between the unit owners and an "affiliate of the developer" can be terminated. The term "affiliate of the developer" is defined in the Act to include any person who controls, is controlled by, or is under common control of the contract or lease with the developer. The Act also provides a "mathematical test" to be used in determining when a person controls a developer or is controlled by a developer.

77. 15 U.S.C. § 3607(d) (1982). This section provides that notice to the parties of the contract must be either hand delivered or by prepaid U.S. mail.
78. See supra notes 34-36 and accompanying text.
79. See supra note 75.
80. 15 U.S.C. § 3603(22) (1982), provides that: "[s]pecial developer control" means any right arising under State law, cooperative or condominium instruments, the association's bylaws, charter or articles of association or incorporation, or power of attorney or similar agreement, through which the developer may control or direct the unit owners' association or its executive board. A developer's right to exercise the voting share allocated to any condominium or cooperative unit which he owns is not deemed a right of special developer control if the voting share allocated to that condominium or cooperative unit is the same voting share as would be allocated to the same condominium or cooperative unit were that unit owned by another unit owner at that time....

Id.
83. Clurman, supra note 74, at 20, col. 1.
84. 15 U.S.C. § 3603 (1). The test to determine when a person controls a developer is whether that person:
   (A) is a general partner, officer, director, or employer of the developer,
   (B) directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, owns, controls, holds with power to vote, or holds proxies representing, more than 20 per centum of the voting interests of the developer;
   (C) controls in any manner the election of a majority of the directors of the developer, or
   (D) has contributed more than 20 per centum of the capital of the developer.
This test is crucial and should be reviewed by both the attorney representing the developer and the attorney representing the owners' association. The developer's attorney should determine which contracts executed by the developer, while in control of the owners' association, may be affected by the Act. The attorney representing the condominium or cooperative association should evaluate the association's potential rights to terminate the various agreements which the developer executed while in control of the owners' association.

Additionally, the contract in question must provide for the operation, maintenance or management of the owners association or of property serving the unit owners. This requirement brings the characterization of the property affected into particular importance. For the Act to be applicable, the leased premises must be "property serving the condominium or cooperative unit owners." The Act does not provide any further definition of such property, but it might include contracts or leases affecting commercial property, common rooms, a health club, parking garage, or pool.

Section 3608 attempts to assist the Florida unit owners bound by pre-1975 recreational leases. The section provides the unit own-
ers' association with an action for a judicial determination that a lease or a portion of the lease was unconscionable at the time it was executed. In order to establish a cause of action under this section six conditions must be met, including that the lease be executed prior to June 4, 1975. By this last requirement the use of section 3608 is effectively restricted.

A rebuttable presumption is created in favor of the owners' association if they establish the existence of the factors set out in section 3608. Once having found that any lease or portion of the lease is unconscionable, the court can exercise its authority to grant relief to avoid an unconscionable result. If, however, the court determines that the cause of action filed by the plaintiffs is "frivolous, malicious,

91. 15 U.S.C. § 3608(a) (1982). The section also provides that the action must be authorized by the unit owners through a vote of not less than two-thirds of the unit owners other than those units owned by the developer of affiliate of the developer.

92. 15 U.S.C. § 3608(a)(6) (1982). The other requirements to bring an action under section 3608 are that the lease must have the following characteristics:

- it was made in connection with a cooperative or condominium project;
- it was entered into while the cooperative or condominium owners' association was controlled by the developer either through special developer control or because the developer held a majority of the votes in the owners' association;
- it had to be accepted or ratified by purchasers or through the unit owners' association as a condition of purchase of a unit in the cooperative or condominium project;
- it is for a period of more than twenty-one years or is for a period of less than twenty-one years but contains automatic renewal provisions for a period of more than twenty-one years.
- it contains an automatic rent increase clause.
- it creates a lien subjecting any unit to foreclosure for failure to make payments;
- contains provisions requiring either the cooperative or condominium unit owners or the cooperative or condominium association as lessees to assume all or substantially all obligations and liabilities associated with the maintenance, management and use of the leased property, in addition to the obligation to make lease payments;
- contains an automatic rent increase clause without establishing a specific maximum lease payment; and
- requires an annual rental which exceeds 25 percentum of the appraised rental value of the leased property as improved.

93. See supra note 83.

94. 15 U.S.C. § 3608(b) (1982). A rebuttable presumption of unconscionability exists if it is established that, in addition to the characteristics in subsection (a) of this section, the lease

95. 15 U.S.C. § 3608(d) (1982). Such relief may include but is not limited to recission, reformulation, restitution, the award of damages and reasonable attorney's fees, and court costs. Id. Section 3609 of the Act provides that any clause in a contract governed by § 3607 or § 3608, which requires the owners' association to reimburse, regardless of outcome, the developer or an affiliate of the developer for attorney's fees, is void as against public policy.
or lacking in substantial merit,” the defendant can recover reasonable attorney’s fees.\(^6\)

The unit owners’ association cannot seek a judicial determination that a lease or any portion of it is unconscionable under this section if the unit owners, or the association representing them, have reached an agreement, which amounts to an out of court settlement, with the holder of the lease.\(^7\) Thus, if the agreement sets forth the terms and conditions under which the lease will be purchased by the owners’ association, or reforms any clause in the lease which contains an automatic rent escalation clause, the owners association will not be allowed to seek a judicial determination that the lease was unconscionable.\(^8\)

Since the Act’s inception in 1980, litigation involving it has been sparse. In *Bay Colony Condominium Owners Association v. Origer*,\(^9\) however, the Act withstood a constitutional challenge. The condominium owners’ association brought suit seeking injunctive relief and damages under the Act to relieve itself from a ninety-nine year recreational lease.\(^10\) The defendant developer moved to dismiss the claim on the grounds that Congress exceeded its power under the Commerce Clause and that the Act deprived parties to recreational leases their contractual rights without due process of law.\(^11\) The court dismissed the defendant developer’s claim,\(^12\) stating that there was a rational basis for Congress’ finding that recreational leases affect interstate commerce.\(^13\) In addition, with regard to the due process claim the court held that since the remedies under the Act were directed solely to unconscionable lease provisions, there was no interference with a valid contractual right.\(^14\)

More recently, in *West 14th St. Commercial Corp. v. 5 West 14th Owners Corp.*,\(^15\) a condominium association was denied relief

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98. Id. Unless the agreement was entered into while the leaseholder or an affiliate held a majority vote in the owners’ association, in which case relief can be sought.
100. Id. at 31.
101. Id. at 32.
102. Id. at 31.
103. Id. at 33.
104. Id. at 34.
under the Act. The plaintiffs, three separate but related corporations, brought suit to enjoin defendant owners' association from terminating certain contracts and leases. The plaintiff corporations were created by the original owner and developer of the building prior to the conversion of the building into cooperative status. Each of the corporations was a party to a lease or contract with the owners' association.

Immediately upon receiving news that the owner was considering conversion, the tenants formed a tenant association to present the owner with a united front in negotiating. The tenant association persuaded sixty-five percent of the tenants to enter into "no-buy pledges" and negotiated very strongly with the owner of the building. It was not until the owner issued a third amendment to his original offer that he was able to obtain the required number of pledges. The tenant group did not succeed in eliminating the plaintiff's contracts, but they did succeed in having the purchase price per share lowered and in increasing the association's income from the contracts.

After the new board of directors was elected, the defendant as-

106. \textit{Id.} at 943.
107. West 14th St. Commercial Corp. had a contract which allowed it to lease to the public, at any price it could obtain, space for four stores on the building's ground floor. The contract was for a twenty year period, with an option to renew for an additional twenty year period. West 14th Garage Corp. had a similar renewable lease authorizing it to operate a parking garage in the building. West 14th St. Laundry Corp. had a fifteen year concession to provide and service washing machines for the building's residents. \textit{Id.} at 935.
108. \textit{Id.}
109. \textit{Id.} at 937.
110. A "no-buy" pledge is an agreement signed by all the tenants stating that they will not buy their apartments unless certain specified conditions are met by the sponsor. \textit{Id.} at 939. This shifts the negotiating power back to the tenant because a majority of the tenants is needed to approve the conversion. \textit{Id.}
111. The developer's first offer had two provisions that are of particular importance. First, it provided that the proposed corporation's stock would be priced at $80.00 per share, making a typical two bedroom apartment cost approximately $85,000. Second, the proposal suggested that the corporation enter into contracts with the three named plaintiffs. The tenant association expressed opposition to the three contracts at the beginning of the negotiations. They either wanted to eliminate the contracts or increase the income the association would receive under them. The developer also had a vital interest in the contracts to the extent that he could assure himself of future revenue from the plaintiff corporations and, therefore, might be more receptive to the tenants' demand for lower prices for their apartments. After three amendments to the first offering the developer was able to get the requisite number of votes. The final amendment reduced the price per share by 40 percent and increased the income the owners' association would receive under the contracts. \textit{Id.} at 937-39.
112. \textit{Id.} at 938.
113. \textit{Id.}
association attempted to cancel the contracts under section 3607 of the Act.\textsuperscript{114} In holding that the owners' association could not terminate the contracts,\textsuperscript{115} the district court reasoned that the contracts did not meet any of the criteria set out in section 3607 of the Act and were in no sense self-dealing,\textsuperscript{116} but rather, were the result of arms-length bargaining and "the subject of extensive and serious negotiations between [the owner] and the legal representative of an organized tenants association . . ."\textsuperscript{117} The district court concluded that although the leases were \textit{formally} between the the sponsor and the cooperative association they were \textit{actually} between the sponsor and the tenants association and therefore did not meet one of the section 3607 requirements.\textsuperscript{118} In addition, the district court disregarded the sponsor control requirement of the Act because in its judgment even an independent board would have signed the contracts rather than risk losing the conversion plan.\textsuperscript{119}

Nevertheless, the district court's decision not to allow the owners' association to terminate all three contracts was reversed in part.\textsuperscript{120} On appeal, the Second Circuit Court of Appeals affirmed the district court's decision not to allow cancellation of the commercial leases, by holding that the commercial stores were not property serving the condominium unit owners,\textsuperscript{121} and, therefore, did not fall

\begin{itemize}
  \item \textsuperscript{114} \textit{Id.} at 940.
  \item \textsuperscript{115} \textit{Id.} at 941.
  \item \textsuperscript{116} \textit{Id.} at 942.
  \item \textsuperscript{117} \textit{Id.} at 942 n.12. \textit{But see} West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188, 201 (2d Cir. 1987) (holding that negotiations are not a relevant factor in considering whether a termination of a contract satisfies the requirements of § 3607).
  \item \textsuperscript{118} 625 F. Supp. at 942-43. On appeal, the second circuit disagreed with this conclusion, stating that a lease is only between those who sign it. The tenants' association did not sign the lease and, therefore, the leases were between the owners' association and the sponsor. West 14th Street Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188, 199-200 (2d Cir. 1987).
  \item \textsuperscript{119} 625 F. Supp. at 942-43. On appeal the second circuit also disagreed with this conclusion stating that the crucial question was whether the cooperative was free from sponsor control when its obligation began under the leases. 815 F.2d at 200.
  \item \textsuperscript{120} 815 F.2d 188 (2d Cir. 1987).
  \item \textsuperscript{121} \textit{Id.} at 199. The court, after concluding that "Congress aimed to protect property providing services primarily for the benefit of the unit-owners," reasoned that although the availability of commercial stores may be deemed to "'relate directly to the ease, comfort and economy of the cooperative shareholders . . .' they do not serve as an integral benefit to the unit-holders in the same respect as on-site parking." \textit{Id.} at 198-99 (quoting Phoenix Tenants Ass'n v. The 6465 Realty Co., 119 A.D.2d 427, 435, 500 N.Y.S.2d 657, 663 (1986) (Asch J., dissenting). The Court conceded that "it may be more convenient for unit-owners to have easily accessible banks, cleaners, drug and grocery stores . . . [b]ut these services are not the sort that a tenant should reasonably expect as an essential adjunct of an apartment complex." \textit{Id.} at 199.
\end{itemize}
within the Act. With regard to the garage lease and the laundry leases, however, the Court of Appeals reversed, holding that those leases were for property serving the unit owners and met the other requirements of section 3607(a). Thus, the cooperative association was allowed to terminate only the garage and laundry lease.

IV. CONCLUSION

The federal statute has great potential for helping condominium and cooperative associations in large cities where the lucrative real estate market increases the likelihood of abuse. Frequently, in condominium and cooperative conversions of high rise apartment buildings in large cities, prior to converting the project, the developer leases the commercial units in a building to himself at a low rent and for a long period of time. The developer then sub-leases the space on the market for amounts far greater than the rent he is paying the owners' association. Given the present state of the rental situation in many large cities, the developer is in a position to make a considerable profit from the rental of the commercial space to the exclusion of the owners' association. The Act may support a cause of action by the owners' association. Thus, the owners' association can terminate the lease that the developer has executed for himself, provided the association can succeed in having the property characterized as serving the condominium or cooperative.

Similarly, developers often execute long-term leases of garage space to affiliated companies in which they are either sole owners or

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122. Id. at 198. The Court held that "an on-site parking garage is property providing a service primarily for the benefit of the cooperative. A parking garage, with or without tenant preferences, provides a service that tenants might reasonably expect as an essential adjunct of their apartment complex." Id. at 198-99.

123. See supra notes 117, 118.


125. A counter argument, however, is that when a developer knows he will be making money in the future, he is often more willing to sell the individual units at lower prices, thus saving the owners money on the purchase price. Therefore, under this argument a developer should be allowed to keep the profits himself.

126. See Clurman, supra note 74, at 20, col. 1. But see West 14th St. Commercial Corp. v. 5 West 14th St. Owners Corp., 815 F.2d 188 (2d Cir. 1987) (holding that commercial property was not property serving the unit owners). Although rejected in the second circuit, the argument still exists in other circuits that commercial property is property serving the condominium project.
partners. In most large cities parking is a valuable commodity, and the developer who has this garage space can conceivably make large amounts of money. Subject to the same difficulty of having the property characterized as serving the unit owners, an owners' association might be able to terminate a lease of garage space executed by a developer during the period when he controlled the association.

As courts begin to recognize the importance of this federal legislation, so too should attorneys, particularly those representing owners' associations or condominium and cooperative developers. Developers often consider the future profits from these long-term leases in determining the offering price of a conversion and are more likely to lower the offering price as a result. Given the holding in West 14th Street developers are likely to take negotiations with the tenants more seriously and will be less likely to make concessions in the offering price in exchange for concessions on long-term leases.

Salvatore LaMonica

128. See West 14th St. Commercial Corp., 815 F.2d at 198; supra notes 121-23 and accompanying text.