10-4229-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

VASILIS BACOLITSAS, SOFIA NIKOLAIDOU,

Plaintiffs-Counter-Defendants-Appellees,

—against—

86TH & 3RD OWNER, LLC,

Defendant-Counter-Claimant-Appellant,

MICHAEL, LEVITT & RUBINSTEIN, LLC, Escrow Agent,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF *AMICUS CURIAE* OF THE REAL ESTATE BOARD OF NEW YORK IN SUPPORT OF DEFENDANTS-APPELLANTS AND URGING REVERSAL OF THE JUDGMENT OF THE DISTRICT COURT

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DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1, *amicus curiae* The Real Estate Board of New York ("REBNY") states that it is a not-for-profit corporation that has no parent corporation. No publicly held corporation holds more than 10% of the stock of REBNY.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

STATEMENT OF INTEREST 1

ARGUMENT 3

I. ILSA DOES NOT GIVE CONDOMINIUM PURCHASERS A UNILATERAL TWO-YEAR RIGHT OF REVOCATION MERELY BECAUSE THE PURCHASE AGREEMENT CANNOT BE RECORDED 3

A. ILSA is a Disclosure Statute 3

B. If the Developer Provides a Complete Description of the Property, the Purchaser Does Not Receive a Two-Year Right of Revocation 7

1. The Description Need Not Be Adequate to Convey a Unit 10

2. The Description Must Be in Recordable Form; the Purchase Agreement Need Not be Recordable 14

II. GIVING CONDOMINIUM PURCHASERS A TWO-YEAR RIGHT OF REVOCATION WOULD PARALYZE THE MARKET FOR CONDOMINIUM CONSTRUCTION 19

III. REQUIRING THAT ALL PURCHASE AGREEMENTS BE RECORDABLE WOULD ALSO SEVERELY DISRUPT THE CONSTRUCTION OF NEW CONDOMINIUMS 24

Case: 10-4229 Document: 50 Page: 4 02/11/2011 207981 40

Page

IV. THE DISTRICT COURT'S INTERPRETATION OF ILSA WOULD IMPEDE NEW CONDOMINIUM DEVELOPMENT WITHOUT ADVANCING THE STATUTORY PURPOSE 27

CONCLUSION...30

TABLE OF AUTHORITIES

Page(s)

CASES

An v. Leviev Fulton Club, LLC,
No. 09 CV 1937 (GBD), 2010 U.S. Dist. LEXIS 83795 (S.D.N.Y. Aug. 10, 2010) 5

Bacolitsas v. 86th and 3rd Owner, LLC,
No. 09 Civ. 7158 (PKC), 2010 U.S. Dist. LEXIS 99642 (S.D.N.Y. Sep. 21, 2010) 3, 4

Bodansky v. Fifth on the Park Condo. LLC,
No. 09 Civ. 4651 (DLC), 2010 U.S. Dist. LEXIS 7577 (S.D.N.Y. Jan. 29, 2010) 5

Cruz v. Leviev Fulton Club, LLC,
711 F. Supp. 2d 329 (S.D.N.Y. 2010) 5, 7

Entergy Corp. v. Riverkeeper, Inc.,
129 S. Ct. 1498 (2009) 15

Gregori v. 90 William St. Development Group LLC,
No. 09 CV 4753 (GBD), 2010 U.S. Dist. LEXIS 74314 (S.D.N.Y. July 20, 2010) 5

Griffith v. Steiner Williamsburg, LLC,
No. 09 Civ. 9747 (AJP), 2010 U.S. Dist. LEXIS 127694 (S.D.N.Y. Dec. 3, 2010) 5

Keefe v. Base Village Owner, LLC,
No. 09 CV 273 (Pitkin Co., Col. Aug. 31, 2010) 13

Long v. Merrifield Town Center Limited Partnership,
611 F.3d 240 (4th Cir. 2010) 3

Ransom v. FIA Card Servs., N.A.,
No. 09-907, 2011 U.S. LEXIS 608 (Jan. 11, 2011) 15

Page(s)

Smith v. Myrtle Owner, LLC,
No. 09-CV-1655 (KAM), 2010 U.S. Dist. LEXIS 59799 (E.D.N.Y. June 16, 2010)....................5

Stein v. Paradigm Mirasol, LLC,
586 F.3d 849 (11th Cir. 2009)....................6

Taplett v. TRG Oasis (Teo Tower), Ltd.,
No. 08-00541 (M.D. Fla. Apr. 30, 2009)....................13

Universal Church v. Geltzer,
463 F.3d 218 (2d Cir. 2006)....................15

Winter v. Hollingsworth Properties, Inc.,
777 F.2d 1444 (11th Cir. 1985)....................4

FEDERAL STATUTES AND RULES

15 U.S.C. § 1701, et seq. 1

15 U.S.C. § 1702(a)(2)....................4

15 U.S.C. § 1702(b)(1)....................4

15 U.S.C. § 1703 (a)(1)(B)....................8

15 U.S.C. § 1703(c)....................8

15 U.S.C. § 1703(d)....................16

15 U.S.C. § 1703(d)(1)....................*passim*

15 U.S.C. § 1705....................8

15 U.S.C. § 1707....................8

24 C.F.R. §§ 1710.105-118....................8

24 C.F.R. § 1710.105(c)....................9

Page(s)

24 C.F.R. §§ 1710.105(d)(2)(i) 8

24 C.F.R. §§ 1710.105(d)(2)(iii)(A) 8

24 C.F.R. § 1710.105(d)(2)(iv) 9

24 C.F.R. § 1710.109(d)(iii) 17

24 C.F.R. § 1710.109(d)(iv) 18

24 C.F.R. § 1710.109(g)(1) 11

24 C.F.R. § 1710.109(g)(1)(ii) 11, 12, 13

24 C.F.R. § 1710.209(e)(1) 12

61 Fed. Reg. 13,596 (Mar. 27, 1996) 4, 7

STATE STATUTES AND RULES

N.Y. Real Property Law § 294(4)(b) 24

N.Y. Real Property Law § 339-e(7) 11

N.Y. Real Property Law § 339-g 26

N.Y. Real Property Law § 339-o(1) 11

N.Y. Real Property Law § 339-o(2) 11

N.Y. Real Property Law § 339-p 11

13 N.Y.C.R.R. § 20.3 4

13 N.Y.C.R.R. § 20.3(e) 4

13 N.Y.C.R.R. § 20.3(q)(3) 21

13 N.Y.C.R.R. §20.7 4

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Out of Condo Deals,*
N.Y. Times, Oct. 21, 2010, at A31..6

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reprinted in 1979 U.S.C.C.A.N. 2317 ....4, 6

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Recoup Deposit*,
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for Condo Buyers*,
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The Real Estate Board of New York ("REBNY") respectfully submits this brief *amicus curiae* in support of Appellants. REBNY has received the consent of all parties to this filing.[1]

STATEMENT OF INTEREST

REBNY is a not-for-profit trade association comprised of more than 12,000 owners, builders, brokers, managers, banks, insurance companies, pension funds, real estate investment trusts, utilities, attorneys, architects, marketing professionals, and other participants in the New York City real estate industry. REBNY works to promote public policies that expand New York's economy and that encourage the development and renovation of residential and commercial real property. To accomplish these goals, REBNY regularly presents the views of the real estate community to public officials, reviews legislation affecting the real estate market, and, when appropriate, participates in litigation that raises legal issues of importance to the industry. In this appeal, REBNY asks the Court to consider its views with respect to the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701, et seq. ("ILSA").

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[1] This brief was not written, in whole or in part, by counsel to any party. No party, no party's counsel, and no person or entity other than REBNY, its members, or its counsel contributed money for the preparation or submission of this brief.

REBNY and its members have a strong interest in the outcome of this appeal because the District Court's ruling, if affirmed, would make it extremely difficult for developers to undertake new condominium projects. The District Court held that developers must either allow each buyer of a condominium unit in a development under construction (and not exempt from ILSA) to record his or her purchase agreement – thereby creating a lien against the property – or give each buyer a unilateral right to revoke the contract at any time within two years of its execution. Selling a large number of units well before the project is complete, often before construction has even started, is critical to the viability of new condominium developments, and especially to the ability of developers to obtain construction financing. Even in the best of economic times, neither the creation of multiple liens against the property through the recording of purchase agreements, nor the conversion of binding contracts into two-year options to buy, would be tolerable to construction lenders. In present circumstances, with banks already reluctant to lend, the requirement imposed by the District Court would likely paralyze the industry.

In addition, as explained below, the rule established by the District Court's opinion would impede new construction for other reasons, interfering with condominium buyers' ability to obtain mortgages and delaying their occupancy of newly-built apartments. Through this *amicus* brief, REBNY

hopes to show that such a rule is neither required by nor consistent with ILSA, and to explain the likely consequences if that rule were sustained by this Court.

ARGUMENT

I.

ILSA DOES NOT GIVE CONDOMINIUM PURCHASERS A UNILATERAL TWO-YEAR RIGHT OF REVOCATION MERELY BECAUSE THE PURCHASE AGREEMENT CANNOT BE RECORDED

A. ILSA is a Disclosure Statute

ILSA, which was modeled on the Securities Act, was designed to prevent false and deceptive practices in the sale of undeveloped land by requiring developers to provide prospective purchasers with the information they need to understand fully what they are buying. *Bacolitsas v. 86th and 3rd Owner, LLC*, No. 09 Civ. 7158 (PKC), 2010 U.S. Dist. LEXIS 99642, at *10-11; *see Long v. Merrifield Town Center Limited Partnership*, 611 F.3d 240, 245 (4th Cir. 2010) (ILSA was enacted "to protect unsuspecting and ill-informed investors from buying undesirable land"); Conf. Rep. 90-1785 (1968), *reprinted in* 1968 U.S.C.C.A.N. 3053, 3066 ("The purpose of full disclosure is to deter or prohibit the sale of land . . . through misrepresentation of material facts relating to the property").

Congress enacted ILSA in response to evidence of "extensive fraud in the land sales industry," frequently involving unscrupulous promoters

who promised out-of-state buyers that their land was "suitable for homesites and easily resaleable," when in fact it was "under water or useful only for grazing purposes." H.R. Rep. No. 96-154, at 30 (1979), *reprinted in* 1979 U.S.C.C.A.N. 2137, 2346; *see also Winter v. Hollingsworth Properties, Inc.*, 777 F.2d 1444, 1447 (11th Cir. 1985).

Despite this focus on raw land, it is settled that ILSA applies to condominium units. 61 Fed. Reg. 13,596, 13,602 (Mar. 27, 1996).[2] Condominium sales, however, are not subject to many of the same problems as raw land – e.g., discovering that "the land is uninhabitable because water is unavailable or the land is not suitable for septic tanks." H.R. Rep. No. 96-154, at 38, 1979 U.S.C.C.A.N. at 2354. Furthermore, condominiums are generally subject to strict regulation under state laws that both require comprehensive disclosure from sellers and provide remedies for aggrieved buyers.[3]

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[2] There are statutory exemptions likely to be available to small condominium projects, such as those with fewer than 100 units, 15 U.S.C. § 1702(b)(1), or those in which the seller is obligated to complete construction within two years after sales begin, 15 U.S.C. § 1702(a)(2). Such exemptions will seldom insulate the large developments characteristic of major urban markets from the statute.

[3] Under New York law, a condominium offering plan must contain complete information on all aspects of the project, *see* 13 N.Y.C.R.R. § 20.3, and, in particular, an exhaustive description of the property. *See* 13 N.Y.C.R.R. §§ 20.3(e) and 20.7.

As a result, in part, of the extensive state regulation of condominium sales, there has been, until very recently, almost no ILSA litigation in this Circuit. In the last two years, however, there has been a surge in new cases.[4] The reason for this sudden search for arguable ILSA violations is easy to divine; it is not that large numbers of condominium developers have recently ceased providing full and accurate disclosure, but that the price of real estate has fallen. As a number of press reports have explained, buyers who signed purchase agreements before the dramatic shift in the market, and who face the obligation to close after prices have declined, are seeking whatever means may be at hand to get out of their agreements.[5] As a result, ILSA has

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[4] *See, e.g.*, *Griffith v. Steiner Williamsburg, LLC*, No. 09 Civ. 9747 (AJP), 2010 U.S. Dist. LEXIS 127694 (S.D.N.Y. Dec. 3, 2010); *An v. Leviev Fulton Club, LLC*, No. 09 CV 1937 (GBD), 2010 U.S. Dist. LEXIS 83795 (S.D.N.Y. Aug. 10, 2010); *Gregori v. 90 William St. Development Group LLC*, No. 09 CV 4753 (GBD), 2010 U.S. Dist. LEXIS 74314 (S.D.N.Y. July 20, 2010); *Smith v. Myrtle Owner, LLC*, No. 09-CV-1655 (KAM), 2010 U.S. Dist. LEXIS 59799 (E.D.N.Y. June 16, 2010); *Cruz v. Leviev Fulton Club, LLC*, 711 F. Supp. 2d 329 (S.D.N.Y. 2010); *Bodansky v. Fifth on the Park Condo. LLC*, No. 09 Civ. 4651 (DLC), 2010 U.S. Dist. LEXIS 7577 (S.D.N.Y. Jan. 29, 2010).

[5] *See*, *e.g.*, Robbie Whelan, *Property: Opinion May Deliver Help for Condo Buyers*, Wall Street Journal, May 11, 2010, at A28 (since market meltdown, "hundreds of potential buyers who laid out hefty deposits to buy condos have tried to use an obscure 1968 federal law . . . to recoup their deposits and back out of their purchase contracts"); Leigh Remizowki, *Luxe Complex Sued, Dozens Bid to Recoup Deposit*, N.Y. Daily News, Nov. 18, 2010, at 35 (lawyer for condominium buyer calls ILSA a "pearl straight out of the ocean" for buyers

become "an increasingly popular means of channeling buyer's remorse into a legal defense to a breach of contract claim." *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849, 852 (11th Cir. 2009). As counsel for plaintiffs in this case told the New York Times, "desperation inspired creativity." Christine Haughney, *After Bust, Using '60s Law to Get Out of Condo Deals,* N.Y. Times, Oct. 21, 2010, at A31.

Like those in many recent ILSA cases, the plaintiffs here do not allege that they were deceived in any way. They do not claim that the developer misrepresented or omitted any "fact that was important enough that a reasonable person would have relied upon it in making a decision to purchase." H.R. Rep. No. 96-154, at 35, 1979 U.S.C.C.A.N. at 2351. To the contrary, plaintiffs knew precisely what they were buying; the purchase agreement they signed contained a description of the property with which the District Court found no fault.

However, like all or virtually all purchase agreements for condominiums, the contract here could not be recorded. As a result, plaintiffs

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who cannot get financing in the wake of the mortgage crisis); Lois Weiss, *Judge Gives Condo Buyers Bargaining Chip*, N.Y. Post, Aug, 12, 2010, at 33 (lawyers expect condominium buyers to use an ILSA ruling "as a bargaining chip to get lower prices or to get deposits back).

argued, the contract ran afoul of § 1703(d)(1) of ILSA, which provides that contracts for the sale of land must include "a description of the lot which makes such lot clearly identifiable and which is in a form acceptable for recording."

The District Court accepted this argument and held that, because the contract could not be recorded, the purchasers were entitled to revoke it for any reason or no reason, before closing or even after, within two years of its execution. Turning binding purchase agreements into unilateral option contracts unfairly punishes developers who have done nothing to mislead buyers, it serves no valid statutory purpose, and it does obvious violence to the legitimate expectations of the parties. As discussed in Point B, below, it is respectfully submitted that the Court reached this result by misconstruing the governing statute.

B. If the Developer Provides a Complete Description of the Property, the Purchaser Does Not Receive a Two-Year Right of Revocation

ILSA, together with regulations enacted by the Secretary of Housing and Urban Development ("HUD"), require that, prior to executing a purchase agreement for any lot,[6] the developer provide the prospective

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[6] A condominium unit is a lot within the meaning of the statute. 61 Fed. Reg. 13,596, 13,602 (Mar. 27, 1996) (defining "lot" as any unit of land, including "a condominium or cooperative unit"); *see also Cruz v. Leviev Fulton Club, LLC*, 711 F. Supp. 2d 329, 331 (S.D.N.Y. 2010) (collecting cases).

purchaser with a Property Report that contains comprehensive information about the development. *See* 15 U.S.C. §§ 1705, 1707; 24 C.F.R. §§ 1710.105-118. Selling a lot (unless it is exempt from the statute) without providing the Property Report before the contract is signed is unlawful, 15 U.S.C. § 1703(a)(1)(B), and the buyer may revoke any purchase agreement signed before receipt of the Property Report within two years. 15 U.S.C. § 1703(c).

In addition, unless the deed to the unit is provided to the buyer within 180 days of the execution of the purchase agreement (which would not be possible with respect to sales more than six months before construction is complete), the agreement must contain, *inter alia*

> a description of the lot which makes such lot clearly identifiable and which is in a form acceptable for recording by the appropriate public official responsible for maintaining land records in the jurisdiction in which the lot is located.

15 U.S.C. § 1703(d)(1). A contract that does not include the required description may be revoked by the buyer within two years. *Id.* The HUD regulations likewise provide the buyer with a two-year right of revocation if the contract does not include a "legally sufficient and recordable lot description." 24 C.F.R. §§ 1710.105(d)(2)(i) and 1710.105(d)(2)(iii)(A).

The HUD regulations also provide for disclosure to the buyer of the applicable revocation rules. The Property Report must state that the buyer

will have two years to revoke the purchase agreement if the Report was not provided before the agreement was signed. 24 C.F.R. § 1710.105(c). Similarly, if the contract does not contain an adequate description of the lot, the developer must disclose the two-year right to revoke. 24 C.F.R. § 1710.105(d)(2)(iv).

Here, the developer provided the plaintiffs with the Property Report (A. 330), and the purchase agreement clearly identified and described the unit they were buying. The contract specified that plaintiffs were buying Unit 20A and contained a floor plan for that unit. (A. 65, 94). In addition, the contract incorporated the Condominium Offering Plan (the "Plan") (A. 73), which was also provided to plaintiffs. (A. 73, 330). The Plan described the land on which the condominium was being built and, with respect to each unit, provided the layout and a detailed floor plan, square footage, ceiling height, percentage of common interest, projected common charges and taxes, the form of deed that would be provided, and all other material information. (A. 423-32, 517-643).

Notwithstanding the detailed description of the unit in the purchase agreement and the Plan, plaintiffs argued before the District Court that the description was inadequate because it was not in a "form acceptable for recording." Plaintiffs' principal argument was that, under New York law, the description would not be sufficient for a *deed*, i.e., sufficient to convey the unit.

(A. 15-17.) In a reply brief, they also argued that the description was inadequate because the contract in which it was contained could not itself be recorded with the New York City Register. (A. 799-801.) As a matter of statutory construction, neither the first argument, which the District Court did not reach, nor the second, which the Court accepted, is sound.

1. The Description Need Not Be Adequate to Convey a Unit

ILSA states that the description must make the unit "clearly identifiable," and that it must be "in a form acceptable for recording." 15 U.S.C. § 1703(d)(1). The statute does *not* provide that the description must be adequate for a deed, or adequate to convey the unit, and there are compelling reasons not to read that requirement into the statute. To begin with, aside from the fact that the relevant provision simply does not mention either a deed or a conveyance, it will often be impossible to provide a description adequate for those purposes in a purchase agreement executed before the development is finished ("pre-completion sales"). Until a condominium is formally established under applicable state law, individual units do not even exist as independent real property and they cannot be conveyed.

Under New York law, for example, condominium units cannot be conveyed until final floor plans showing what has actually been built, and reflecting that tax lot numbers have been assigned to each unit, have been

recorded. N.Y. Real Property Law § 339-p. In addition, the deed must contain the unit description set forth in the declaration of condominium – the instrument which, when recorded, creates the condominium as a legal entity, *see* N.Y. Real Property Law § 339-e(7) – and it must contain the liber, page and date of the recording of the declaration. N.Y. Real Property Law § 339-o(1) and (2). As a matter of universal practice, the declaration is not finalized and recorded until construction is complete and the "as built" floor plans are recorded.

Pre-completion sales are ubiquitous and, as discussed below, essential to condominium construction financing. Those facts are well known to HUD, and the regulations therefore expressly contemplate that the description of a unit may *not* be adequate for conveyance. 24 C.F.R. § 1710.109(g)(1) acknowledges that the "plats of specific units" – the floor plans in the case of condominiums – may not have been approved by the regulatory authorities and may not, therefore, have been recorded. That section expressly notes that, in such case, the description of the units may not be "legally adequate for the conveyance of land in the jurisdiction in which the subdivision is located." 24 C.F.R. § 1710.109(g)(1)(ii).[7]

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[7] By way of contrast, the regulations expressly provide that the description of the land on which the condominium will be built, as opposed to the

If the description of the property is not adequate for conveyance, the Property Report must include a disclosure to that effect, and a statement that a description that *is* adequate for conveyance will not be available until the plat (i.e., for a condominium, the floor plan) is approved and recorded. *Id.*[8] The regulations do *not* provide that, in this circumstance, the buyer receives a two-year right of revocation, and they do *not* provide for any disclosure to that effect.

In sum, the absence of any reference to a deed or conveyance in the sections of the statute and regulations governing the description of the unit that must be included in the contract; the contemplation in the regulations that a description adequate for conveyance may *not* be available; the inclusion in the regulations of the disclosure that is required in that circumstance, which does

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description of specific units, "shall be adequate for conveying the land." 24 C.F.R. § 1710.209(e)(1).

[8] Here, the Property Report contained precisely that disclosure: "**NEITHER THE FLOOR PLANS NOR THE DECLARATION HAVE BEEN SUBMITTED TO THE [REAL PROPERTY ASSESSMENT BUREAU OF THE CITY OF NEW YORK]. UNTIL THE FLOOR PLANS ARE FILED AND THE DECLARATION IS RECORDED THE DESCRIPTION OF THE UNITS IS NOT LEGALLY ADEQUATE FOR CONVEYANCE OF THE UNITS. THEREAFTER EACH UNIT WILL BE LEGALLY DESCRIBED BY REFERENCE TO ITS UNIT AND TAX LOT NUMBER AS SET FORTH IN THE RECORDED DECLARATION AND FILED FLOOR PLANS.**" (A. 107.) (Bold and capitalized in original).

not include disclosure of a two-year revocation right; and the fact that the impossibility of providing a description adequate for conveyance in most pre-completion purchase agreements would convert such agreements into unilateral options if the statute were read as plaintiffs suggest, all demonstrate that the description of the unit required to be included in the purchase contract need *not* be adequate for conveyance.

The court reached precisely this conclusion in *Keefe v. Base Village Owner, LLC*, No. 09 CV 273 (Pitkin Co., Col. Aug. 31, 2010) (SPA. 110-17), where the plaintiffs made the same argument plaintiffs make here – even though the developer made the disclosure required by 1710.109(g)(1)(ii), the description was not in a form acceptable for recording because the final plat had not been recorded. The court rejected the argument:

> Allowing a buyer to rescind the contract simply because the plat is not recorded does not promote the purpose of the Act if the seller has fully disclosed that the plat has not been recorded. There is little reason for requiring sellers to provide notice that the plat is unrecorded unless Congress envisioned that many lots would be sold before the plats are approved and recorded. The statute is designed to protect buyers from false and deceptive practices in the sale of unimproved lots, and giving advance notice to a potential buyer that the plat is unrecorded serves that purpose.

Id. at 5; *see also Taplett v. TRG Oasis (Teo Tower), Ltd.*, No. 08-00541, at 20-23 (M.D. Fla. Apr. 30, 2009) (A. 871-93) (rejecting argument that description

in contract was inadequate under ILSA because condominium declaration had not yet been recorded and description therefore did not and could not contain information on the recording of the declaration required by state statute for description of condominium unit).

2. The Description Must Be in Recordable Form; the Purchase Agreement Need Not be Recordable

The District Court did not hold that the description needed to be adequate for conveyance, and it found no other flaw in the *form* of the description. Rather, after correctly observing that a description of property "standing independently from the legal instrument in which it is contained is generally not considered to be a recordable document," *Bacolitsas*, 2010 U.S. Dist. LEXIS 99642, at *15, the Court concluded that ILSA should be interpreted to mean what it does not say – that the *purchase agreement* must be recordable. *Id.* Here, the contract was not recordable, both because it was not acknowledged in the manner required for recording and because it expressly provided that "Purchaser may not record this Agreement or a memorandum thereof." (A. 82.) In holding that the ILSA requirement that the purchase agreement contain a "description of the lot . . . in a form acceptable for recording," 15 U.S.C. § 1703(d)(1), translates into a requirement that the purchase agreement itself be recordable, we respectfully submit, the District Court erred.

The starting point must be the plain words of the statute, *see Universal Church v. Geltzer*, 463 F.3d 218, 223 (2d Cir. 2006), and ILSA simply does not provide that a purchase agreement must be recordable. Rather, it says that the *description* of the lot must be in a form acceptable for recording. There is no ambiguity here. It is the description of the unit, not the sales contract, that must be in recordable form.

The fact that descriptions, standing alone, *cannot* be recorded does not support the conclusion that the purchase agreement must be recordable, something neither the statute nor the regulations provide. Rather, the inclusion of the phrase "in the form" – which would be superfluous if the description had to be recordable – provides the interpretive key. *See Ransom v. FIA Card Servs., N.A.*, No. 09-907, 2011 U.S. LEXIS 608, at *23-24 (Jan. 11, 2011) (rejecting petitioner's interpretation because, *inter alia*, it "would render the term 'applicable' superfluous"); *Entergy Corp. v. Riverkeeper, Inc.*, 129 S. Ct. 1498, 1506 (2009) (rejecting respondent's interpretation because, if correct, "the statute's use of the modifier 'drastic' is superfluous"). The logical inference is that the statute is concerned with the form, that is, with the adequacy, of the description, not with the immediate ability to record it. In other words, the description must be in a form that, if attached to a recordable instrument, would be acceptable to the appropriate public official.

The description here was in a form more than sufficient to be recorded if attached to any appropriate instrument. As discussed above, it would not be sufficient for a conveyance, but that is irrelevant. The contract contained a complete and comprehensive description of the property as a whole, and of the specific unit in particular, and it could certainly have been recorded as part of any recordable instrument.

By holding that the contract itself must be recordable, the District Court added a provision that is not in the statute, but that certainly could have been had Congress so intended. Section 1703(d) lays out ILSA's requirements with respect to purchase agreements, and it would have been simple enough to include a requirement that the agreement be recordable. Instead, Congress said that the *description* (not the contract) had to be in a *form* acceptable for recording. One can presume that the drafters knew that property descriptions, standing alone, are not recordable. They addressed that not by requiring that the contract be recordable, but instead by focusing on the *form* of the description. In that way, and in a manner consistent with the full-disclosure approach of the statute as a whole, Congress ensured that the purchaser would have full information before committing to buy.

The conclusion that ILSA does not require that the purchase agreement be recordable is buttressed by the HUD regulations, which

acknowledge that the contract may *not* be recordable because the developer will not permit it or because it may be impossible as a matter of local law. 24 C.F.R. § 1710.109(d)(iii) provides that:

> If the developer or subdivision owner will not have the sales contract officially acknowledged or if the applicable jurisdiction will not record sales contracts, state that sales contracts will not be recorded and why they will not be recorded.

If the District Court's reading of the statute were correct, then in any jurisdiction that will not record sales contracts, *all* buyers would get an automatic two-year right of revocation, as would buyers anywhere purchasing pursuant to contracts that cannot be recorded for any other reason. The regulations certainly do not say that – they do not instruct the developer to inform the buyer that he or she has a revocation right, but merely to state *why* the buyer cannot record the contract – and it is most unlikely that Congress intended such a result without saying so explicitly in the statute.

In addition, the regulations go on to require further disclosure if the contract will not be recorded. The developer is required to provide an explicit warning:

> Unless your contract or deed is recorded you may lose your lot through the claims of subsequent purchasers or subsequent creditors of anyone having an interest in the land.

24 C.F.R. § 1710.109(d)(iv). Again, however, the regulations do not instruct the developer to tell the buyer that, in these circumstances, he or she has a two-year right to rescind the agreement.

In short, the analysis with respect to the contention that the purchase agreement must be recordable is the same as that with respect to the contention that the description of the unit must be adequate for conveyance. Neither the statute nor the regulations say that, the regulations explicitly contemplate the contrary, the regulations prescribe precise disclosure where the contrary is the case, and the prescribed disclosure does *not* include disclosing a two-year right of revocation. Accordingly, as a matter of statutory interpretation, ILSA should not be read to require that purchase agreements be recordable, any more than it should be read to require a description of the unit adequate for conveyance.

* * *

The District Court did not discuss the implications of its holding that pre-completion condominium purchase agreements are revocable by the buyers for two years, unless they can be recorded. As discussed below, such a rule would have severe, adverse consequences for new condominium construction.

II.

GIVING CONDOMINIUM PURCHASERS A TWO-YEAR RIGHT OF REVOCATION WOULD PARALYZE THE MARKET FOR CONDOMINIUM CONSTRUCTION

For the reasons discussed in Point III, virtually all condominium purchase agreements contain an express prohibition on recording. If such agreements contravene § 1703(d)(1), then most pre-completion sales contracts will become two-year unilateral options to buy, and the construction of new, large-scale condominium developments will likely come to a halt.

Sales of new condominium apartments almost always begin long before the development is fully built and, in many cases, before construction even starts. There are numerous reasons why early sales are essential. First and foremost, the cost of construction is so great that few if any developers can undertake a project without borrowed funds. Lenders will not commit the tens or hundreds of millions of dollars involved without some certainty that the project is viable and that the developer will have the money to repay the loan. Lenders get that certainty from pre-completion sales. In most parts of the country, construction lenders will insist that between 25 and 50 percent of the units (depending on the market and the project) be subject to binding sales contracts before they will approve a loan. Needless to say, if the money to

build a condominium depends on binding commitments to buy the units, sales must start before construction can begin.[9]

Just as construction lenders routinely require a substantial number of sales before committing their funds, mortgage lenders will not finance apartment purchases unless a significant majority of the units are subject to binding contracts. Different banks have different rules, but the key benchmark is Fannie Mae's requirement that 70% of the units be subject to bona fide sales agreements before it will guarantee any mortgage. *See* Fannie Mae, Selling Guide, https://www.efanniemae.com/sf/guides/ssg/sg/pdf/sel012711.pdf, at 586 (last visited, Feb. 1, 2011); Fannie Mae, Project Eligibility Review Service and Changes to Condominium and Cooperative Project Policies, https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2008/0834.pdf, at 6 (last visited, Feb. 1, 2011). Given Fannie Mae's critical role in the mortgage market, this rule effectively requires that 70% of units be subject to binding contracts before most buyers can obtain a mortgage and close on a purchase. Accordingly, sales must begin long before construction is complete or the

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[9] Even in those markets where, prior to the bursting of the bubble, loan agreements were signed before sales began, lenders required binding contracts for 25-50% of the units before they would allow the condominium declaration to be filed and the offering plan to become effective.

finished apartments would sit empty – and the flow of funds to repay the construction loan would not start – until 70% were subject to binding sales contracts, allowing buyers to obtain the financing to close.

In New York (and other jurisdictions with similar rules), pre-completion sales are also important to the regulatory process. A condominium offering plan cannot become effective, and no sales can close, until at least 15% of the units are subject to binding purchase agreements. 13 N.Y.C.R.R. § 20.3(q)(3). If sales began only after construction was complete, early purchasers would be unable to take possession of their finished apartments, as a matter of law, until 15% of all units had sold. As noted, construction loan agreements generally do not allow an offering to become effective until 25-50% of units are sold, and most buyers will not have access to the money needed to close until sales reach 70%, so the wait would actually be far longer.

Pre-completion sales subject to the buyer's unfettered two-year right to rescind would serve none of the purposes of binding pre-completion sales. Lenders could take no comfort from such "sales" because they would have no assurance that any would close. To the contrary, in a period of declining prices, lenders could be certain that buyers would insist on

renegotiating their contracts or refuse to close at all.[10] With no guarantee that apartments would sell for the prices on which the viability of the project was premised, or that they would sell at all, lenders would likely refuse to provide construction loans.

A two-year right to revoke would wreak similar havoc on mortgage lending to condominium buyers. In light of the Fannie Mae rules, buyers would be unable to obtain financing until two years after 70% of the units had gone to contract. That period would only grow longer if any of the buyers revoked their contracts, as some would doubtless do in any two-year period, and many would do in bad economic times. Finished apartments ready for occupancy might sit vacant for many months until two years passed from the crossing of the 70% threshold and buyers could finally obtain the money to close. Moreover, given that many condominium purchase agreements do not contain mortgage financing clauses allowing buyers to abandon the purchase if

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[10] The median price of existing condominiums in the United States dropped by 22.4%, from $226,300 to $175,600, between 2007 and 2009. National Association of Realtors, National Sales Price of Existing Homes, http://www.realtor.org/wps/wcm/connect/43b7618044c8039e9291d25d6aeab3b5/REL1010TS.xls?MOD=AJPERES&CACHEID=43b7618044c8039e9291d25d6aeab3b5 (last visited Feb. 1, 20011). To state the obvious, in such circumstances, buyers would use their right of revocation to sharply reduce the purchase price, or to get out of the contract altogether.

they cannot obtain a mortgage, purchasers who did not revoke within two years, and who wanted to close, might be unable to do so, subjecting them to a loss of their down payments. And even buyers who did not need mortgage financing would be unable to close until two years after 15% of the units went to contract (longer if any contracts were revoked) because the offering plan would not be effective until then. In fact, given the restrictions on declaring a plan effective contained in most construction loan agreements (in those markets where a construction loan is available at all before a significant number of units are subject to binding contracts), even all-cash buyers would have to wait until two years after 25-50% of the units went to contract (longer if any contracts were revoked).

In addition to interfering with construction financing, mortgage financing, and buyers' ability to take possession, a two-year revocation right would change the economics of condominium construction by placing all the risk of a declining market on the developer. If prices rose in the two years after a prospective purchaser signed a contract, the purchaser would hold the developer to the bargain and reap the benefit. If prices fell, the purchaser would insist on a lower price or rescind the agreement. The fundamental purpose of pre-completion sales contracts, to lock in sales at prices that make the project viable, would be undermined.

For all of these reasons, a regulatory regime in which binding pre-completion sales were impossible – in which developers could do no more than give purchasers a two-year option to buy – would make no sense, and it would likely make the development of significant new condominium projects impossible.

III.

REQUIRING THAT ALL PURCHASE AGREEMENTS BE RECORDABLE WOULD ALSO SEVERELY DISRUPT THE CONSTRUCTION OF NEW CONDOMINIUMS

Construction lenders will not commit millions of dollars to a condominium project if there will be any impediment to foreclosure in the event the developer defaults. They will not, therefore, provide a loan to a developer if the property that stands as collateral is encumbered, and construction loan agreements prohibit the developer from creating or permitting any lien against the property after the loan is made. A recorded purchase agreement creates a lien, *see*, *e.g.*, N.Y. Real Property Law § 294(4)(b), and for that reason, condominium purchase agreements contain a prohibition on recording.

If pre-completion purchase agreements were recorded, developers would have to convince each buyer to sign a subordination agreement whereby the buyer would acknowledge that the construction lender's lien against the condominium was superior to his or her own lien. Buyers, however, would

have no incentive to consent to subordination, and either would refuse to do so or would extract a price from the developer in exchange for their consent. Negotiating tens or hundreds of such subordination agreements would be impractical, expensive, and unpredictable.

There is no reason to believe that lenders would alter their stance on this fundamental issue. Lenders simply cannot be expected to provide the large sums needed for construction if there are scores of liens against the property. In the event of a default by the developer, they would have to name every purchaser with a recorded contract in any foreclosure proceeding, and all of the purchasers would have the right to participate in the case. The lenders' ability to quickly gain control of the property, and to dispose of it, would be significantly impaired, and costs and delays would multiply.

Separate and apart from construction finance problems, recorded contracts would create intractable difficulties for developers trying to sell condominium units. As discussed above, prior to the recording of the condominium declaration, individual apartments do not exist as separate units of real property. As a result, every recorded pre-completion sales contract appears as a lien against the entire condominium. As a matter of course, every prospective purchaser or mortgage lender performs a title search before signing a purchase agreement or issuing a loan. These searches would reveal the liens

created by every recorded contract. Such clouds on title would likely be unacceptable to the buyer and almost certainly would be to the buyer's bank. Each time a unit was sold, the developer would therefore need to clear or subordinate the lien represented by every earlier-recorded contract, but those earlier purchasers would have no reason to cooperate. If any purchaser defaulted, clearing the lien represented by that purchaser's recorded contract would likely require litigation.

Once a condominium is built, and the declaration and floor plans recorded, each condominium apartment, like a free-standing home, becomes real property. *See, e.g.*, N.Y. Real Property Law § 339-g. At that point, the recording of a purchase agreement would create a lien with respect to that individual unit, not the entire condominium, and would present a lesser problem for developers. The recording of pre-completion sales contracts, however, would make construction financing impossible or, at the very least, substantially more expensive, as lenders, developers and purchasers factored in the uncertainty and delay they would confront in protecting their interests in the face of as many liens as there are purchase agreements.

In sum, in the context of condominium developments, recording pre-completion purchase agreements is little better than giving every pre-completion purchaser a two-year option to rescind the contract. While new

construction might not be altogether impossible, the increased risk, complexity, and delay that would follow from the need to litigate over, or obtain subordination agreements with respect to, a long series of liens against the property would unquestionably increase borrowing costs and legal costs, expenses ultimately passed on to buyers.

IV.

THE DISTRICT COURT'S INTERPRETATION OF ILSA WOULD IMPEDE NEW CONDOMINIUM DEVELOPMENT WITHOUT ADVANCING THE STATUTORY PURPOSE

ILSA is designed to ensure that all relevant information is disclosed to buyers of undeveloped property so that they can make informed decisions. The statute is not intended to change the fundamental economics of condominium development or to abrogate contracts between developers and purchasers entered into in good faith, based on full information. The statute provides for a two-year right of revocation only when complete disclosure is *not* made – when the purchaser is induced to sign a contract before being given the Property Report, or when the contract does not contain a thorough description of the lot (or unit) the purchaser is contracting to buy.

The rule prescribed by the District Court's opinion would not provide any additional data to a condominium buyer, or otherwise make the purchaser's buying decision more informed. But it would, for the reasons

discussed above, change the economics, and interfere with the functioning, of the market for condominium development. There is no reason to believe that Congress intended such a profound, adverse impact on the market, and no reason to sustain a rule that would have those consequences unless the plain language of the statute requires it. It does not.

The statute does not say that contracts must be recordable and the regulations recognize that they may not be, by operation of law or by the terms of the agreement. The regulations dictate what must be disclosed in that circumstance and do *not* mandate disclosure of a two-year right to revoke. In light of these provisions, an interpretation of ILSA requiring recordable contracts is not mandated and, indeed, is not supported by the statutory or regulatory language.

ILSA does say that the description of the unit must be in a *form* acceptable for recording, but, as the District Court noted, descriptions, standing alone, are never recordable. Given that fact, the statute is best read as requiring a description of sufficient specificity and detail that it would be recordable if attached to any recordable instrument. That reading harmonizes all of the relevant factors: the statutory language requiring a description in recordable form, the fact that descriptions alone cannot be recorded, the absence of statutory language requiring that contracts be recordable, and the regulatory

provision dictating certain disclosure – but not disclosure of a two-year right of revocation – if the contract cannot be recorded. Of equal importance, that reading is consistent with the fundamental statutory purpose, to make sure that purchasers know exactly what they are buying.

CONCLUSION

For the reasons stated herein, the judgment of the District Court should be reversed.

Dated: New York, New York
February 11, 2011

Respectfully submitted,

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/s/ Robert D. Kaplan
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