ALERTS AND UPDATES

Florida District Court Ruling on Condo Buyers' Deposits Opens Door for Canceled Contracts and Refunds

April 21, 2010

On March 30, 2010, the U.S. District Court for the Southern District of Florida—in *Double AA International Investment Group, Inc. v. Swire Pacific Holdings, Inc.*[1]—held that a condominium-unit purchaser may rescind its contract as a result of the developer's failure to hold deposits in excess of 10 percent of the purchase price in an escrow account separate from the escrow account in which the initial 10-percent deposit was held, as mandated by Florida Statutes. The district court held that the developer's apparent use of separate accounting of escrow funds while using only one bank account was insufficient, despite state agency interpretation and, what has been described as, common practice and custom in the industry. Condominium-unit purchasers have maintained numerous grounds to try to rescind their contracts and obtain a return of their deposits in the current real estate market. The ruling in this case offers condominium-unit purchasers another avenue to obtain a return of their deposits.

Section 718.202 of the Florida Condominium Act (the "Act") requires developers to place deposits of *up to* 10 percent of the purchase price of a condominium unit that is not completed in an escrow account with an independent escrow agent. In addition, the Act requires that deposits *in excess of* 10 percent of the purchase price be placed "in a special escrow account," from which funds may be withdrawn and used by the developer for actual construction and development of the condominium, if provided in the contract between the developer and the condominium-unit purchaser.

In this case of first impression, the court examined the escrow requirements on condominium developers and a purchaser's remedy in the event the escrow requirements are not followed. In this case, the purchaser's entire 20-percent deposit was placed in a single escrow account. Based on a statutory provision providing that the developer's failure to comply with the Act's escrow requirements would render the contract between the developer and the condominium-unit purchaser voidable by the buyer, the purchaser in this case sought to rescind the contract and demanded a refund of its deposit.

The court rejected the developer's and escrow agent's contentions that: (1) Florida law does not require deposits to be kept in two separate accounts, (2) not holding the 20-percent deposit in two separate accounts was only a "technical" violation and did not violate the purpose and intent of the statute, and (3) it is customary in the industry to hold all deposits in one account and use separate accounting of escrow funds to distinguish between the different deposits. The court determined that the escrow requirements of the Act were not strictly followed, and as a result, the purchaser was entitled to cancel the contract and receive a refund of its entire deposit, including one-half of the deposit already used by the developer for construction of the project, plus interest and legal fees.

The court examined both the legislative history and the wording of the Act's escrow requirements, and recognized that the escrow requirements "may not be the simplest, the best, or even the most efficient method of protecting buyers' deposits." The court also reviewed a memorandum from the State of Florida Department of Business and Professional Regulation, Office of the General Counsel, that was addressed to the chief of the Bureau of Condominiums, which stated that "the separate accounting of special escrow funds would comply with the mandates of the statute even if the funds are held by the escrow agent in the same bank account." Despite the previous state agency memorandum—and neither a showing of damages sustained by the purchaser nor a showing that the deposits were lost or misused—the court indicated that the legislature imposed strict liability on the developer and concluded that a condominium-unit purchaser's initial 10-percent

deposit must be held in a separate account from other deposit funds. If the initial deposit is not held in a separate account, a purchaser would be entitled to cancel the contract and receive a refund of its *entire* deposit.

The court determined that the Act's escrow requirements mandate that a condominium developer establish three separate escrow accounts, all of which must be under the control of an independent escrow agent:

1. an escrow account for a buyer's deposit up to 10 percent of the purchase price;
2. a special escrow account for deposits in excess of 10 percent of the purchase price; and
3. an escrow account for reservation deposits.

The Florida House and Senate—in HB 561 and SB 1196, respectively—are currently considering an amendment to the Act that, if passed, would authorize all deposits to be placed in a single escrow account as long as the escrow agent maintains separate accounting records for each purchaser and for each deposit amount in excess of 10 percent of the purchase price. The bills, which indicate that they are to clarify existing law, specifically provide that separate accounting records would constitute compliance with the Act's escrow requirements. Moreover, these bills, if enacted, would correct the inequitable result obtained in the *Swire* case.

Unless successfully appealed by the developer or if the Act is amended by the Florida legislature, the court has offered an opportunity for condominium-unit purchasers to cancel their contracts and obtain a refund of their deposits due to a developer's failure to maintain these separate escrow accounts. It is important to note that this course of action is available to a purchaser only until the earliest of the following occurs: (a) a proper termination of the reservation agreement or purchase agreement by the purchaser, (b) a default by the purchaser under the purchase agreement or (c) a closing on the unit.

For Further Information

If you have any questions about this *Alert* or would like more information, please contact Jeffrey R. Margolis, Steven M. Klein, any other member of the Real Estate Practice Group or the attorney in the firm with whom you are regularly in contact.

Note

1. *Double AA International Investment Group, Inc. and Daymi Rodriguez v. Swire Pacific Holdings, Inc. and Lawyers Title Insurance Corporation*, 2010 U.S. Dist. LEXIS 30931 (S.D. Fla., Mar. 30, 2010).