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Long Term Management Contracts Between Condominium Associations and Developer-Controlled Management Corporations Held Not Violative of the Florida Condominium Act

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LONG TERM MANAGEMENT CONTRACTS BETWEEN CONDOMINIUM ASSOCIATIONS AND DEVELOPER-CONTROLLED MANAGEMENT CORPORATIONS HELD NOT VIOLATIVE OF THE FLORIDA CONDOMINIUM ACT

Plaintiff, a condominium association, brought suit against a management corporation owned and controlled by the original developers of the condominium, seeking, *inter alia*, a determination that the management contracts were void as against public policy and the requirements of the Condominium Act,[1] rescission for breach of contract, and an accounting. The original developers owned certain property upon which they created and developed a condominium project, for which four separate declarations of condominium were made, resulting in the formation of four condominium associations. Prior to the sale of the condominium units to the purchasers thereof, the developers caused long term contracts to be made between the associations and the developer-controlled management corporation for the management of the condominium associations. The individual condominium units were then sold subject to these long term management contracts. The trial court rejected the claims of plaintiff for an accounting and for rescission, but held that the management contracts were invalid in that they failed to comply with certain statutory requirements and contained provisions contrary to the direction and intent of the Condominium Act. On appeal, the District Court of Appeal, Third District, affirmed, holding that the contract in question operated to divest from the condominium association in a material and substantial degree the power and privilege granted it by statute to operate the condominium, and thus was invalid.[2] On conflict certiorari,[3] the Supreme Court of Florida, in quashing a portion of the decision of the district court of appeal, *held*, reversed: By placing in the condominium associations the power and duty to manage the condominium properties, the legislature did not intend to restrict the ability of the associations to contract for the management of the associations. *Point East Management Corp. v. Point East One Condominium Corp.*, 282 So. 2d 628 (Fla. 1973), *cert. denied*, 42 U.S.L.W. 3460 (U.S. Feb. 19, 1974).

The statutory condominium[4] has provided a form of real estate

1. FLA. STAT. ch. 711 (1971) [hereinafter referred to as the Condominium Act].

2. Point East Mgt. Corp. v. Point East One Condominium Corp., 258 So. 2d 322 (Fla. 3d Dist. 1972).

3. The case deemed in conflict was Lake Mabel Dev. Corp. v. Bird, 99 Fla. 253, 126 So. 356 (1930) [hereinafter referred to as *Lake Mabel*].

4. As provided by statute, a "[c]ondominium is that form of ownership of condominium property under which units of improvements are subject to ownership by one or more owners, and there is appurtenant to each unit as part thereof an undivided share in the common elements." FLA. STAT. § 711.03(7) (1971).

In the absence of an enabling statute, a common law condominium can be created by contract. Several common law condominiums were established in Florida prior to the adop-

development whereby an individual can evade today's high land cost and maintenance expense, and still retain the benefits of owning the fee to his unit.[5] The effect of limitations upon land use coupled with the pressures of population has made Florida a locus of condominium growth.[6] However, these same pressures have provided a market in which developers of condominiums can engage in various abuses, often forcing unconscionable obligations upon unwary purchasers.[7]

One such method of possible abuse consists of presubscription self-dealing.[8] By statute, the operation of the condominium is the responsibility of the condominium association.[9] The association may be incorporated, and if incorporated, may be either a corporation for profit or a corporation not for profit.[10] It is further provided that the members or stockholders of the association shall consist of the owners of units in the condominium.[11] Thus, after the developer has filed the declaration of condominium, and before any units in the condominium have been sold to the public, the developer retains complete control of the association, by virtue of the fact that he owns all the units in the condominium. At that time, the developer therefore has the power to bind the association by contract, and then sell the condominium units subject to that contract.[12] The power to contract might thus provide a power of abuse, in that the developer can bind the association to a management contract, or to land and recreation leases, with companies owned by or affiliated with the developer.[13]

Such management contracts might be attacked on numerous grounds: (1) the developer, as corporate officer of the condominium, assumes a fiduciary relationship with prospective members of the association, which relationship is breached by the self-dealing aspect of the management contract;[14] (2) a particular management contract is repugnant to the Condominium Act, in that it divests the association of its statutory right to manage the condominium; (3) since the association is incorporated, the officers of the corporation can delegate their statutory duty to manage

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tion of the Condominium Act. *See* McCaughan, *The Florida Condominium Act Applied*, 17 U. FLA. L. REV. 1, 1-2 (1964) [hereinafter cited as *McCaughan*].

5. *See* COOPERATIVES AND CONDOMINIUMS 219 (J. MCCORD ed. 1969).

6. R. REYNOLDS, FLORIDA CONDOMINIUMS 7-8 (1971).

7. P. ROHAN & M. RESKIN, CONDOMINIUM LAW AND PRACTICE § 4 (1965) [hereinafter cited as ROHAN & RESKIN]; Note, *Florida Condominiums—Developer Abuses and Securities Law Implications Create a Need for a State Regulatory Agency*, 25 U. FLA. L. REV. 350 (1973); Note, *Real Property—Georgia's Apartment Ownership Act—Its Scope Analyzed in View of Emerging Condominium Litigation in Other Jurisdictions*, 23 MERCER L. REV. 405 (1972).

8. See authorities collected at note 7 *supra*.

9. FLA. STAT. §§ 711.03(2), .12(1) (1971).

10. FLA. STAT. § 711.12(1) (1971).

11. *Id.*

12. FLA. STAT. § 711.12(2) (1971) provides that the association, acting through its officers, shall have the capacity of contracting, bringing suit, and being sued.

13. See note 7 *supra*.

14. *See* ROHAN & RESKIN, *supra* note 4, at § 4.03.

only to a limited degree,[15] and thus any management contract entered into by the condominium association which transgresses this limitation is violative of the statutory mandate and void. *Point East* effectively eliminates any attack based on the first two theories above, leaving only the last as an open alternative.

In *Fountainview Association, Inc. #4 v. Bell*,[16] the Supreme Court of Florida discharged a writ of certiorari on the grounds that the District Court of Appeal, Third District, had correctly decided the issue by holding[17] that an action against the developer would not lie merely because the contract arose from dealings of the developers with themselves at a time when they constituted all of the members of the condominium association and of the management corporation. The defendants had organized a nonprofit association incorporated pursuant to the Condominium Act. After becoming the sole officers and members of the association, they conveyed land to the association on inflated terms and caused the association to enter into the management contracts with third parties at allegedly exorbitant fees. Given the fact that the association could be incorporated either for profit or not for profit,[18] the district court held that principles of law relating to corporations for profit could be applied to the instant case, notwithstanding the fact that the association was a corporation not for profit. The court was thus bound by the decision of the supreme court in *Lake Mabel Development Corp. v. Bird*,[19] which held that a corporation cannot avoid a purchase of property sold to it by the promoters at a large profit, while the promoters held all the outstanding stock, since the corporation had full knowledge of the facts and the rights of innocent purchasers had not arisen.[20] Justice Ervin, dissenting from the supreme court's discharge of the petition for certiorari, argued in part that the *Lake Mabel* decision was inapplicable, in that *Fountainview* involved a situation where rights of third parties had arisen in the form of contract subscriptions.[21] Other jurisdictions have agreed with this position, holding that once the rights of third parties have arisen in the form of contract subscriptions, the developer then owes a fiduciary duty to such third parties, and cannot breach that duty by entering into self-dealing management contracts.[22]

Faced with the holding that the developer has the power to contract

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15. *See* 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 126.03 (1973); 2 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 496 (1969).

16. 214 So. 2d 609 (Fla. 1968) [hereinafter referred to as *Fountainview*].

17. Fountainview Ass'n, Inc. #4 v. Bell, 203 So. 2d 657 (Fla. 3d Dist. 1967).

18. FLA. STAT. § 711.12(1) (1971).

19. 99 Fla. 253, 126 So. 356 (1930).

20. *Id.* at 257, 126 So. at 358.

21. Fountainview Ass'n, Inc. #4 v. Bell, 214 So. 2d 609, 611-12 (Fla. 1968) (dissenting opinion).

22. *E.g.*, Northridge Cooperative Sect. No. 1 v. 32nd Ave. Constr. Corp., 2 N.Y.2d 514, 161 N.Y.S.2d 404, 141 N.E.2d 802 (1957). *See also* Old Dominion Copper Mining & Smelting Co. v. Lewisohn, 210 U.S. 206 (1907).

with himself at a time when he completely controls the association, the condominium association in *Point East* attempted to attack the validity of the management contracts in a more circumscribed fashion. Assuming arguendo that the manner in which the contract was formed did not invalidate it on its face, they argued that the terms of the particular management contract to which they were bound exceeded the scope of statutory authority as outlined in the Condominium Act, and thus the contracts were void.

By statute, the operation of the condominium is the responsibility of the association, the name of which is stated in the declaration of condominium.[23] Further, "operation of the condominium" is defined to include the administration and management of the condominium property.[24] The stockholders or members of this association are to consist of owners of units in the condominium.[25] It thus seems clear that through the association, the intention of the legislature was to establish an entity responsible for the operation of the condominium, and responsive to the condominium owners.

Contrasted to the duty imposed upon the association by statute, the management contracts in question left the association with little or no authority,[26] in effect reducing them to a shell, "incapable of responding to or representing the needs or desires of their members."[27] As stated by the association in its brief:

> The ASSOCIATIONS do not even retain the basic power of fiscal control through the use of budgetary implementation. Any "control" is illusory since the MANAGER retains absolute discretion as to personnel, salaries and the purchase of equipment, with absolute power to request and force increased assessments to meet the cost of salaries and equipment without regard to any previously approved budget.[28]

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23. FLA. STAT. § 711.12(1) (1971).

24. FLA. STAT. § 711.03(12) (1971).

25. FLA. STAT. § 711.12(1) (1971).

26. The terms of the management contract give to the manager, in part, the following powers: (1) The right to hire, supervise, and fire, in its absolute discretion, such persons as are required to fulfill its duties under the management contract; (2) the power to carry on normal maintenance and repair, and expenditures up to $30,000 can be made for any item of repair without the authorization of the association; (3) the right to purchase such equipment, tools, vehicles, appliances, etc., as are reasonably necessary to perform its duties; (4) the right to maintain, supervise, direct and conduct all programs at the Point East Community Facilities, subject only to the veto power of 51 percent of the association members; (5) the right to retain and employ any experts or professionals whose services the manager may reasonably require to effectively perform its duties; (6) the right to require the association to establish an assessment sufficient to meet all of the costs and expenses of the association and to adequately fund reserves. 282 So. 2d at 631-32 (dissenting opinion); *see also* Respondent's Brief on the Merits at 7, Point East Mgt. Corp. v. Point East One Condominium Corp., 282 So. 2d 628 (Fla. 1973).

27. Respondent's Brief on the Merits at 18, Point East Mgt. Corp. v. Point East One Condominium Corp., 282 So. 2d 628 (Fla. 1973).

28. *Id.* at 19.

The association did not contend that the statutory language invalidated all management contracts. Rather, they argued that a management contract must leave the association responsible as a self-autonomous group for the administration of the property and for the maintenance of supervision and control over the managing party. Since the instant contracts fail to leave such control in the association, they should be voided.

In response to this argument, the trial court concluded that:

> The Management Agreements in this case, considered in light of their specific provisions and the length of their terms, completely and effectively delegate and abdicate the responsibility and control of the plaintiff, Condominium Associations to the defendant. This delegation and abdication of responsibility and control exceeds the bounds of statutory authority and defeats the purposes of the Condominium Act.
>
> While these Management Agreements are not contrary to public policy, they are clearly in violation of the intent, purposes, and authority of the Condominium Act and are, therefore, unlawful and void.[29]

This holding was affirmed without substantial modification by the District Court of Appeal, Third District.[30]

The supreme court summarily dismissed the argument presented by the association, the trial court, and the district court of appeal. After declaring that rescission of the contracts would not lie merely because they arose from dealings of the developers with themselves while they constituted all of the members of the condominium associations and of the management corporation, a point not disputed in the trial court or on appeal, the court stated:

> We cannot agree with the District Court of Appeal that the Legislature, by placing in the condominium associations the power and duty to manage the condominium properties, intended to restrict the ability of the associations to contract for the management of the associations.[31]

In support of this conclusion, it was argued that since the legislature enacted a remedial statute which allowed the owners of condominium units to cancel initial management contracts by a vote of 75 percent,[32] it must be assumed that the legislature recognized the existence of and chose not to abolish such management contracts. This reasoning is at

29. Point East Mgt. Corp. v. Point East One Condominium Corp., 258 So. 2d 322, 324 (Fla. 3d Dist. 1972).

30. *Id.*

31. 282 So. 2d at 630.

32. FLA. STAT. § 711.30 (1971). By its express terms, this statute is applicable only to original management contracts entered into by the association subsequent to January 1, 1971, and thus does not provide a basis for relief to the association in the instant case.

best a non sequitur. Though this argument might support the proposition that the association has the power to contract, it offers no answer as to whether that power is limited. As argued by Justice Ervin in his dissent, the fact that the legislature became more aware of the problem inherent in such management contracts and acted to provide remedies against future injustice does not mean that the courts are powerless to strike down a contract clearly violative of other provisions of the Condominium Act.[33] Finally, the court concluded that since the terms of the management contract were available to all who purchased units in the condominium, enforcement of the contract against them cannot be said to work a hardship.

The question that demands further attention is the degree to which the association should be limited in its ability to delegate to outsiders the authority conferred upon it by statute. An analogous situation is found in the general limitation placed upon the board of directors of a corporation to abdicate its total authority.[34] By statute, the directors are given the duty and authority to manage corporate affairs.[35] In making delegations of such power, they are generally required to retain at least supervisory control.[36] Thus, management contracts are unenforceable if they involve abdication by the directors of the statutory duty to manage. Those management contracts which have been invalidated on this ground generally involve agreements which are of long duration,[37] where the board of directors does not retain important duties,[38] and where the board does not retain the power to terminate the agreement when in its judgment such action is necessary.[39] In certain circumstances, however, broad delegation has been permitted.[40]

The statutory duty placed upon the association and its officers to manage the condominium can thus be seen as the equivalent of the statutory duty placed upon the board of directors to manage a corporation. The limitations placed on the latter should be applicable to the

33. 282 So. 2d at 633.

34. See authorities cited at note 15 *supra.*

35. FLA. STAT. § 608.09(1) (1971).

36. Kennerson v. Burbank Amusement Co., 120 Cal. App. 2d 157, 260 P.2d 823 (1953); Adams v. Clearance Corp., 35 Del. Ch. 459, 121 A.2d 302 (Sup. Ct. 1956); Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948). Florida courts have recognized that the directors of a corporation are given wide discretion in the exercise of business judgment, although their authority to delegate powers involving the exercise of discretion and judgment is not unlimited. *See* Yarnall Warehouse & Transfer, Inc. v. Three Ivory Bros. Moving Co., 226 So. 2d 887 (Fla. 2d Dist. 1969).

37. Long Park, Inc. v. Trenton-New Brunswick Theatres Co., 297 N.Y. 174, 77 N.E.2d 633 (1948).

38. Abercrombie v. Davies, 35 Del. Ch. 599, 123 A.2d 893 (Ch. 1956).

39. Sherman & Ellis, Inc. v. Indiana Mut. Cas. Co., 41 F.2d 588 (7th Cir.), *cert. denied*, 282 U.S. 893 (1930).

40. *See* Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964), where delegation was permitted by a close corporation, the court finding that, as a matter of public policy, strict adherence to statutory requirements was not necessary since there was no threat of harm to the public, to creditors, or to shareholders who were not parties to the agreement.

former. This view is supported by the fact that even if not incorporated, the association is accorded certain essential attributes of a corporation.[41]

Even if the two situations are not analogous, it can be argued that the limitations placed upon the board of directors to abdicate their authority to manage the corporation are applicable, for in the instant case the condominium association is a corporation incorporated pursuant to statute.[42] Just as *Fountainview* was decided on the basis of relevant principles of corporate law, the court holding that the corporate aspect was relevant as long as it did not conflict with the provisions of the Condominium Act,[43] so too *Point East* could rest on a corporate foundation. Though raised by respondent in its brief,[44] the court refused to consider this argument as controlling, and thus indirectly refused to follow its own line of reasoning in *Fountainview*.

It seems clear that the *Fountainview* and *Point East* decisions, when considered together, serve to validate any management contract entered into by the association, regardless of whether such contract was entered into when the developer controlled both the association and the management corporation, and regardless of the specific terms of such contract.[45] Further, by refusing to find the specific terms of the management contract in *Point East* violative of the provisions of the Condominium Act on the grounds that all purchasers took with notice of those terms, the court fell back upon a traditional view of caveat emptor, in effect rejecting the notion that it is the court's responsibility to remedy the unconscionability brought about through contracts of adhesion. The court "completely ignores the reality of unequal bargaining positions between individual apartment purchasers and a multimillion dollar corporation intent on foisting long-term management contracts of adhesion upon them, contrary to regulatory law."[46] The attitude of the court is best stated by Justice Ervin in his dissent to *Point East*:

> The majority has seized upon an irrelevant, outmoded case [*Lake Mabel*] decided long before condominiums and their statutory regulation were contemplated in Florida law and

41. FLA. STAT. §§ 711.11, .12 (1971). *See McCaughan, supra* note 4, at 25.

42. FLA. STAT. § 711.12(1) (1971).

43. Fountainview Ass'n, Inc. #4 v. Bell, 203 So. 2d 657, 659 (Fla. 3d Dist. 1967).

44. Respondent's Brief on the Merits at 23-24, Point East Mgt. Corp. v. Point East One Condominium Corp., 282 So. 2d 628 (Fla. 1973).

45. Such holdings might have the indirect effect of making securities regulations applicable to certain sales of condominiums. A particular interest has been labeled a security when it involves an investment of money in a common enterprise with profits to come solely from the efforts of others. SEC v. W.J. Howey Co., 328 U.S. 293 (1946). Since ownership of a condominium unit involves membership in the association, the resulting participation has, in the past, negated the necessary reliance on third parties. However, with the validation of long-term management contracts involving complete delegation of authority, such reliance might be found. *See* Note, *Florida Condominiums-Developer Abuses and Securities Law Implications Create a Need for a State Regulatory Agency*, 25 U. FLA. L. REV. 350, 360-61 (1973).

46. 282 So. 2d at 632-33 (dissenting opinion).

used it as the conflict basis to quash the relief afforded below. In vain have the Legislature and the lower courts attempted to provide remedies to condominium associations for patent developers' fraud and overreaching, always running afoul of curiously irrelevant decisions at this level.

The enigmatic formulation of another ill-founded decision in this area of the law only serves to put Florida further out of touch with the holdings of most jurisdictions.[47]

MARC COOPER

GARAGEMAN'S LIEN: APPLICATION OF PROCEDURAL DUE PROCESS SAFEGUARDS

Appellant, the owner of an automobile, was served with a notice of sale advising him that in the event a bill for repairs was not paid, his car, which was in the possession of a garageman, would be sold at a public auction under the New York garageman's lien statute.[1] The owner contended that the repairs were not only unauthorized, but that the amount charged by the garageman was unreasonable. After efforts to mediate the dispute over the cost of repairs failed, appellant filed a complaint in the District Court for the Eastern District of New York seeking a declaratory judgment that the statute violated the due process clause of the fourteenth amendment, and an order enjoining the garageman from foreclosing the lien.[2] The complaint was dismissed and the automobile was sold without a prior judicial determination of the amount claimed by

47. 282 So. 2d at 634.

1. N.Y. LIEN LAW §§ 184, 200-02, 204 (McKinney Supp. 1973).

2. Hernandez v. European Auto Collision, Inc., 346 F. Supp. 313 (E.D.N.Y. 1972). The jurisdiction of the district court was invoked under 42 U.S.C. § 1983 (1970) and 28 U.S.C. § 1343(3) (1970). 42 U.S.C. § 1983 (1970) provides:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress.

28 U.S.C. § 1343(3) (1970) provides that the district court shall have original jurisdiction over any civil action:

> To redress the deprivation, under color of any State law, statute, ordinance, regulation, custom or usage, of any right, privilege or immunity secured by the Constitution of the United States or by any Act of Congress providing for equal rights of citizens or of all persons within the jurisdiction of the United States . . . .

28 U.S.C. § 2281 (1970), providing for a three-judge court in actions challenging the constitutionality of a state law, was held inapplicable since no state officer was named as a party defendant to the law suit. Hernandez v. European Auto Collision, Inc., 346 F. Supp. 313, 316-317 (E.D.N.Y. 1972).