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Real Estate Finance - Installment Land Sale Contracts: Avoiding the Harshness of Forfeitures - Barker v. Johnson

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REAL ESTATE FINANCE—Installment Land Sale Contracts: Avoiding the Harshness of Forfeitures. Barker v. Johnson, 591 P.2d 886 (Wyo. 1979).

"Even in the absence of statute a mortgage relation inheres in every installment contract for the sale of land"[1]

"(A) buyer is required to show the intention of the parties that the transaction be regarded as an equitable mortgage, rather than an installment land contract as construed from their written agreement and surrounding circumstances"[2]

FACTS & FINDINGS

The attempted sale of the Lazy R Campground, located in Ranchester, Wyoming, by the Barker Brothers Company to Barbara and Gary Johnson was the subject of the Wyoming Supreme Court's most recent decision involving the treatment of installment land sale contracts.[3] On June 1, 1977, the parties entered into an Agreement for Warranty Deed for the campground.[4] The terms of the agreement called for a total purchase price of $50,500, to be paid in three installments. The first installment of $5,500 was paid and acknowledged with the signing of the agreement. Additional payments of $20,000 and $25,000, plus the accrued interest thereon at an annual rate of twelve percent, were due and payable on August 1, 1977 and October 1, 1977 respectively. The purchasers, the Johnsons, went into immediate possession, and the taxes were prorated as of that date. Sellers were required to furnish an abstract of title or a policy of title insurance for the buyer's examination upon execution of the agreement. After receiving the final payment on October 1, 1977, Barker Brothers were to deliver a good and merchantible title free of encumbrances to the Johnsons.[5] In case of default on any of the payments or nonperformance of any of the other

1. GLENN, 1 GLENN ON MORTGAGES 81 (1943).
2. Barker v. Johnson, 591 P.2d 886. 890 (Wyo. 1979).
3. Barker Brothers Company was comprised of six brothers: George J. Barker, Robert M. Barker, Joseph E. Barker, Gabriel B. Barker, Phillip R. Barker, and Eugene C. Barker, who held title to the property in co-ownership and apparently though of the Company as a type of partnership.
4. Barker v. Johnson, *supra* note 2, at 887.
5. Brief for Appellants at 47-49, Barker v. Johnson, 591 P.2d 886 (Wyo. 1979).

terms and conditions of the agreement, a forfeiture clause spelled out the rights of the parties:

> in the event Buyers default in any of the payments to be made hereunder or performance of any of the other terms and conditions of this agreement on their part to be kept and performed and such default continues for a period of (15) fifteen days after receipt of notice of default from Seller, then Seller shall have the right to terminate this agreement, retain all monies paid hereunder as liquidated damages and Buyers agree to peaceably surrender possession of the premises unto Seller.[6]

The installment of $20,000 plus interest, due on August 1, 1977, was not made on time.[7] However, the sellers, in the person of Phil Barker, had orally agreed to allow the buyers an extension of a "couple of days" to make the payment.[8] This extension was granted after the Johnsons had contacted the seller with a proposal to pay the entire balance due, $45,000 plus interest, as soon as they could arrange financing, but before October 1.[9] Payment was not tendered.

Notice of default was sent by the Barker Brothers Company's attorney to the Johnsons by registered mail on August 16, 1977—fifteen days after the default had occurred under the agreement. This notice specifically informed the Johnsons of the default, and the seller's right to declare a termination and retain all monies paid by the buyers if the required payment was not received within fifteen days as stipulated in the agreement.[10] Five days after the contractual cure provision had run, on September 7, 1977, the Johnsons', through their attorney, offered to tender full purchase price on the contract if the sellers would provide either title insurance or abstract of title. Barker Brothers Company refused this offer, instead choos-

6. Barker v. Johnson, *supra* note 2, at 888.
7. *Id.*
8. Brief for Appellants, *supra* note 5, at 4.
9. *Id.*
10. Barker v. Johnson, *supra* note 2, at 888.

ing to rely on their contractual forfeiture rights and treat the agreement as terminated. Thereupon, the Johnsons brought suit for specific performance; the sellers counterclaimed for enforcement of their rights under the agreement, and sought a judgment awarding possession and quieting their title.[11]

On cross-motions for summary judgment, the district court granted the Johnsons specific performance, subject to certain conditions. These conditions required the buyers to pay the remaining balance of $45,000 plus interest, the cost of preparation of the title abstract or certificate of title insurance, and seller's costs and attorneys fees, all within ten days.[12] Both parties appealed to the Wyoming Supreme Court, which affirmed the award of costs and attorneys fees to sellers as provided in the agreement, but reversed that portion of the lower court's judgment which granted the buyers specific performance.[13]

During the period of their possession, from June 1, 1977 until October 1, 1977, the Johnsons collected rents from the campground totalling $20,541.40.[14]

The court recognized that the buyers were in default on their obligation to pay $20,000 plus interest on August 1, 1977, that effective notice of default was given by the seller on August 17, 1977, including notification of seller's right and intention to declare a termination if payment was not made within fifteen days, and that buyer's offer to tender full purchase price plus interest on September 7, 1977 was not adequate compliance under the agreement.[15] The court then examined the facts to see if some equitable principle intervened which would preclude seller's exercise of its forfeiture rights under the agreement. No such intervening principle was found, and the court ordered the forfeiture provision be enforced according to its terms. It

11. *Id.*
12. Brief for Appellants, *supra* note 5, at 49-52.
13. Barker v. Johnson, *supra* note 2, at 887.
14. Brief for Appellants, *supra* note 5, at 7.
15. Barker v. Johnson, *supra* note 2, at 889.

specifically held that tender of the full purchase price after default and declaration of the forfeiture *does not* qualify as an equitable basis to ignore the default and order specific performance.[16] Finding no intention to create a security interest in the property under the terms and circumstances of the agreement, the court refused to treat the agreement as an equitable mortgage in keeping with prior case law.[17]

WYOMING PRECEDENT

Installment land sale contracts are generally enforced according to their terms by the Wyoming Supreme Court.[18] *Quinlan v. St. John*, a 1921 decision, established a strong precedent for strict enforcement of installment land contracts.[19] In that case, the court enforced a forfeiture clause in a contract for the sale of a boarding house against a buyer who paid $2,250 of a total price of $3,900, and made $900 worth of improvements. There was a single default on a monthly installment of $75. The court recognized that in a proper case a defaulting purchaser might be entitled to equitable relief from a forfeiture, but held that the pleadings in *Quinlan* stated insufficient facts to grant relief.[20]

Subsequent decisions have generally followed *Quinlan's* treatment of installment land sale contracts as being the same as any other contract.[21] The only apparent exception to this pattern of enforcement is when the court finds a waiver of the seller's right to declare a forfeiture upon buyer's default.[22] The Wyoming Supreme Court has long recognized the proposition that forfeitures are not favored, and every reasonable presumption is against a forfeiture.[23]

16. *Id.*
17. *Id.* at 890. See RUDOLPH, THE WYOMING LAW OF REAL MORTGAGES at 147 (1969).
18. Johnson v. McMullin, 3 Wyo. 237, 21 P. 701 (1889); Quinlan v. St. John, 28 Wyo. 91, 201 P. 149 (1921); Lawrence v. Demos, 70 Wyo. 56, 244 P.2d 793 (1952); Younglove v. Graham & Hill, 526 P.2d 689 (Wyo. 1974).
19. Quinlan v. St. John, 28 Wyo. 91, 201 P. 149 (1921).
20. *Id.* at 152.
21. Younglove v. Graham & Hill, *supra* note 18; Angus Hunt Ranch, Inc. v. REB, Inc., 577 P.2d 645 (Wyo. 1978).
22. Baker v. Jones, 69 Wyo. 314, 240 P.2d 1165 (1952); Jones v. Clark, 418 P.2d 792 (Wyo. 1966).
23. Baker v. Jones, *supra* note 22, at 1171-72; Younglove v. Graham & Hill, *supra* note 18, at 692.

The court has implied that even slight evidence of the seller's intention to relinquish his right to declare a forfeiture is sufficient to warrant a finding of waiver of the right.[24]

A rare example of a case in which enforcement was not granted is *Cook v. Moyle*.[25] In that case a defaulting buyer was granted relief on the ground that a seller must first remedy his own default before he can justly declare a forfeiture against the buyer.[26] In general, however, in the absence of some ground for equitable relief which would justify a court in refusing to enforce an installment land contract, such agreements have been strictly enforced according to their terms.

The burden of establishing the inequity of enforcing a forfeiture is upon the defaulting buyer, who must make an affirmative showing that he is entitled to relief.[27] The only ground upon which the court has excused default to date is waiver by the seller of his right to enforce the forfeiture term.[28] Exactly what else constitutes a sufficient equitable basis to grant relief from the harsh results of a forfeiture under an installment land sale contract has been left open by the court.

ANALYSIS

In the following sections this note will explore other potential avenues for equitable intervention to relieve the harsh results of strict enforcement of installment land sale contracts.

A. Restitution

The Wyoming Supreme Court appears to be sympathetic to the plight of defaulting buyers, especially those

24. Baker v. Jones, *supra* note 22, at 1172; Larsen Sheep Co. v. Sjogren, 67 Wyo. 447, 226 P.2d 177, 182 (1951).
25. Cook v. Moyle, 359 P.2d 58 (Wyo. 1961).
26. *Id.* at 61.
27. Quinlan v. St. John, *supra* note 19, at 152.
28. The effect of a waiver is that sellers cannot legally declare a forfeiture without first giving buyers notice of their intention to declare a forfeiture and a reasonable time after notice within which to perform or cure continuing defaults. Angus Hunt Ranch, Inc., v. REB, Inc., *supra* note 21, at 650.

who have a substantial investment in the property either in prior payments or improvements to the land. The court has indicated that in the proper case it would grant restitution to defaulting buyers in order to return the parties to their original positions.[29] Restitution has commonly been allowed by other courts where the results of enforcing the forfeiture would be "unconscionable".[30] Unconscionability may simply mean that a substantial windfall accrues to a seller if the forfeiture is enforced.[31]

In *Quinlan v. St. John*, the court, while refusing to grant relief to the buyer, outlined the form that relief might take, and what must be shown to obtain it.[32] When a seller forfeits the contract upon a proper showing of circumstances entitling the buyer to equitable relief, a court may intervene under its equity powers to attempt to return the parties to the status quo.[33] If buyers under installment land sale contracts are entitled to anything in these circumstances, it will be the difference between the purchase money paid, plus the enhanced value of the property due to his improvements, and the value of the buyer's use and possession of the property.[34] The defaulting buyer must make an affirmative showing that he is entitled to equitable relief, and he must be willing to restore possession and use of the property to the seller.[35]

Restitution was not available in *Barker* primarily because there was no forfeiture of the contract by the Barker Brothers Company. Barker Brothers, the seller, was seeking merely to enforce its rights under the contract terms. There was no attempt to abandon or rescind the contract on the part of the seller. Further, what the Johnsons desired was not a return to their original position but an enforcement

29. Angus Hunt Ranch, Inc. v. REB, Inc., *supra* note 21, at 649; Ballantine, *Forfeiture for Breach of Contract*, 5 MINN. L. REV. 329, 344-52 (1921) (cited with approval in Lawrence v. Demos, *supra* note 18, as pointed out in Younglove v. Graham & Hill, *supra* note 18, at 693).
30. Nelson and Whitman, *The Installment Land Contract—A National Viewpoint*, 1977 B.Y.U. L. REV. 541, 554-8 (1977).
31. *Id.* at 554.
32. Quinlan v. St. John, *supra* note 19.
33. *Id.* at 152.
34. *Id.* at 153.
35. *Id.* at 152.

of the contract while ignoring their own substantial default. Buyers made no showing of circumstances entitling equity to overlook their own default, and had not agreed to restore to seller the possession and use of the property if they were granted relief.

Classical restitution theory has been replaced by notions of unconscionability. That is, the proponent of restitution need not show that the other party has repudiated his bargain. Instead, he need only show that he is suffering under a harsh result.[36] *Barker* was not a case in which the defaulting buyer sustained an unconscionable loss as the result of the enforcement of the forfeiture. On the surface, *Barker* would appear to be a very harsh decision, as the buyer lost not only their contract rights to the property, but their down-payment of $5,500 as well. If the term of an earlier lease-purchase agreement between the parties, which provided for monthly rentals of $500, is taken as representative of the fair value of the buyers' use and possession of the property, it would appear that the Barker Brothers Company reaped a windfall of $3,000 by declaration of a forfeiture and retention of the downpayment under the contract.[37] This analysis, however, ignores the substantial amount of rentals collected by the Johnsons during the period of their possession of the campground. No unconscionable loss was sustained, since the rents collected by the buyers from campground operations, $20,571, were more than $14,000 greater than the amount retained by seller upon buyer's default.[38] The court was not faced with a case in which the law had become "the passive accessory of any Shylock who chooses to wrest from a purchaser an estate which he has almost paid for by reason of some minor default".[39] *Barker* involved a commercial transaction between competent parties in which there was no equitable basis to refuse to enforce the forfeiture term and grant restitution.

36. Nelson and Whitman, *supra* note 30, at 554.
37. Brief for Appellants, *supra* note 5, at 7. The Johnsons remained in possession of the property from June 1, 1977, until October 1, 1977, a period of five months.
38. *Id.*
39. Ballantine, *supra* note 29, at 347.

B. Installment Land Sale Contracts as Equitable Mortgages

The view of the Wyoming Supreme Court and the majority of jurisdictions is that installment land sale contracts are to be enforced as written unless some equitable principle intervenes to mitigate the harshness of forfeiture provisions.[40]

The harshness inherent in strict enforcement of forfeiture terms in installment land sale contracts is readily apparent when it is recognized that the economic purpose and effect of such contracts are identical to those of purchase money mortgages—the financing by the seller of the unpaid portion of the purchase price of the property. If forfeiture provisions commonly found in installment land sale contracts are enforceable as written, and do not cloud seller's title, then sellers under such agreements appear to have a remedy similar to foreclosure under mortgage law, but buyers do not have parallel rights to the equitable protections offered mortgagors, such as redemption.[41] In this manner, sellers are able to circumvent the usual equitable and statutory protections developed by mortgage law for purchasers of real estate.[42]

To illustrate how this treatment provides the seller with a very favorable remedy, a comparison of the ability of the Barker Brothers Company to terminate all of the Johnsons' interest in the campground within fifteen days of notice of default with a mortgaor's right to redemption after foreclosure under Wyoming law is enlightening. In Wyoming, a defaulting mortgagor has up to three months *after* the foreclosure to redeem his real estate, in contrast to the fifteen days after notice of default under the contract.[43] To allow the rights of defaulting purchasers to hinge so dramatically on how the underlying transaction is styled,

40. Annot. 55 A.L.R.3d 10, 13 (1973). *Also* Nelson and Whitman, *supra* note 30.
41. Nelson and Whitman, *supra* note 30, at 543. *Also* Comment, *Forfeiture: The Anomaly of the Land Sale Contract*, 41 ALBANY L. REV. 71, 73-4 (1977).
42. See OSBORNE, NELSON AND WHITMAN, REAL ESTATE FINANCE LAW, at 5-10 (1979). *Also* OSBORNE, MORTGAGES, 36 (2d. Ed. 1970).
43. WYO. STAT. §31-18-103(a). If the land is designated agricultural in the mortgage the period of redemption is nine months or before November 1, whichever is longer. WYO. STAT. §31-18-103(b).

a mortgage or installment contract, seems to elevate mere form over substance.

An additional harsh result is that forfeitures often can lead to substantial losses to buyers and windfall gains to sellers. Where previously received installments are kept by the seller as liquidated damages upon breach, enforcement of forfeiture provisions becomes increasingly more burdensome as the contract approaches completion and buyer's investment becomes increasingly large.[44] Not only does a defaulting buyer lose the land, the market value of which has in most cases risen during his possession, but he also loses his prior investment as well, including any improvements he has made. As long as the rental value of the property while in the buyer's possession is exceeded by the value of the installment payments, the value of improvements made by the buyer, and incremental increases in market value, a windfall gain to the enforcing seller will result.

To further highlight the harshness of enforcing forfeitures in installment land sale contracts one needs only to remember that the effect of a mortgage foreclosure is to force a sale of the real estate in order to pay any remaining indebtedness on the mortgage. Unlike foreclosure sales, when a forfeiture is declared the buyer does not receive any net proceeds of the sale which reflect his equity in the property. Seller not only reaps the windfall of retaining contract payments upon default, but he also regains property of a substantially higher market value.

The similarities between mortgages and installment land sale contracts seem to call for correspondingly similar treatment. Several states, by statutes and judicial decisions have moved toward this goal in an effort to alleviate some of the harshness of automatic forfeiture.[45] The most sweeping legislation is that of Oklahoma which in effect treats land sale contracts in which the usual provision for imme-

44. OSBORNE, NELSON AND WHITMAN, *supra* note 42, at 81.
45. Nelson and Whitman, *supra* note 30, at 544.

diate possession by the purchaser is made as mortgages.[46] Indiana, in *Skendzel v. Marshall*,[47] adopted a similar approach by judicial interpretation. The national trend is against automatic enforcement of forfeitures in such contracts. It has been concluded that, "while forfeiture provisions are still occasionally enforced, it nevertheless can be safely stated that in no jurisdiction today will a vendor be able to assume that forfeiture provisions will be automatically enforced as written."[48]

In Wyoming, the concept of construing installment land sale contracts as mortgages has been accepted in limited circumstances.[49] To establish a prima facie case for an equitable mortgage theory, a defaulting buyer has to show, from the terms of the agreement and surrounding circumstances, that the parties' intent was to create a security interest in the property.[50] However, in *Barker* the court found that there was no intention to create a security interest in the property.

C. Forfeitures as Liquidated Damages

Still another potential line of attack, to enable defaulting buyers to stave off strict enforcement of forfeiture clauses, would be to show that the liquidated damages provision is a penalty, and hence unenforceable. In order for a liquidated damages provision in any contract to be enforceable there are two basic requirements: first, at the time the contract was made it was impracticable or extremely difficult to fix what actual damages would arise in case a breach occured; and second, the amount finally provided was the result of a reasonable attempt by the parties to estimate probable actual losses.[51]

46. OKLA. STAT. ANN. tit. 16, §11A (West Supp. 1976). For fuller discussion of the legislation and its possible interpretation *see* Comment, *The Decline of the Contract for Deed in Oklahoma*, 14 TULSA L. J. 557 (1979).
47. Skendzel v. Marshall, 261 Ind. 226, 301 N.E.2d 641, *cert. denied*, 415 U.S. 921 (1973).
48. OSBORNE, NELSON AND WHITMAN, *supra* note 42, at 81.
49. RUDOLPH, *supra* note 17, at 147.
50. Barker v. Johnson, *supra* note 2, at 890; Baldwin v. McDonald, 24 Wyo. 108, 156 P. 27 (1916).
51. Dunbar, *Drafting the Liquidated Damages Clause—When and How*, 20 OHIO ST. L. J. 221, 223 (1959). *Also* CORBIN, 5 CORBIN ON CONTRACTS 1059-63 (1975).

Liquidated damages clauses in installment land sale contracts may be held unenforceable for violating either or both of the requirements, depending on the circumstances of each case. Actual damages may be easily ascertainable at the time of contracting for the sale of certain real property, especially where there is an established rental value for the same or similar property, i.e. residential property. Damages to sellers from a default under the agreement can be determined by the value of the possession and use of the property during the term of the contract. This determination may be made in light of the situation of the parties at the time of contracting.

The sale of income producing or commercial property as in *Barker* often presents a situation in which damages are not easily estimated because of the conjectural value of income from the property. The parties at the time of contracting have no means of foreseeing whether there will be substantial rental income during the term of the contract or not, therefore actual damages are inherently incapable of prior estimation. The campground involved in *Barker* was property of this sort. A further problem both for commercial and residential property is that changes in the market value of real property are difficult to anticipate. The longer the term of the contract and the more dynamic the local real estate market, the more uncertain damages are, hence, the greater justification for a liquidated damages clause.

Even assuming that this initial requirement of impracticality of estimating damages caused by the breach is met, to be enforceable the amount fixed must be a reasonable forecast of just compensation for damages caused by the breach. The method or formula used by the parties to set liquidated damages must be reasonable and not arbitrary. Judged by this test, the liquidated damages called for in installment land sale contracts may be open for attack.

Using the contract in *Barker* as an illustration, suppose that instead of defaulting on the payment of $20,000 due on August 1, 1977, the Johnsons had made that payment but

were incapable of meeting the next payment of $25,000 due on October 1, 1977. The effect of declaration of a forfeiture at that time would have led to the seller keeping $25,500 as liquidated damages under the contract, whereas a month earlier liquidated damages were only $5,500. The passage of a single month leads to an increase in liquidated damages of $20,000. Surely such an increase does not reflect a reasonable pre-estimate of damages by the parties at the time of contracting. Assuming that actual damages were difficult to ascertain because of the commercial nature of the property involved, the liquidated damages provision should be denied enforcement as being arbitrary and unreasonable. How the Wyoming Supreme Court would view this argument is a question beyond the scope of this note.

CONCLUSION

In its most recent decision involving installment land sale contracts, the court tended to analyze these arrangements in the same manner as any other contract. It indicated that buyers will be held to their obligations under their agreements unless some ground of equitable cognizance is presented which would justify the court in refusing to enforce the contract according to its terms.[52] The court has steadfastly refused to modify its position on equitable mortgages that an intention to create a security interest must be shown from the parties' written agreement and the surrounding circumstances.[53] The tender of the total purchase price after notice of default has been given and the agreed upon period of grace has run is not an equitable reason to excuse a defaulting buyer from forfeiture under the contract.[54]

The court has, however, indicated a willingness to find other remedies in the proper case for defaulting purchasers.[55] It should be remembered that *Barker* and other recent decisions of the Wyoming Supreme Court have involved the sale

52. Barker v. Johnson, *supra* note 2, at 890.
53. *Id.* at 889-90.
54. *Id.*
55. Angus Hunt Ranch, Inc. v. REB, Inc., *supra* note 21, at 649.

of commercial properties, involving parties of equal bargaining power, and not the sale of a private residence.[56] Unconscionability of enforcement may be a possible reason for the intervention of equity in other circumstances.

While the court may in the proper case be ready to intervene to prevent harsh results under a forfeiture, the area of installment sale contracts and their relation to mortgage law is ripe for legislative action. Until either the court or legislature decides to act, circumvention of mortgage law will continue. As increasingly recognized, to allow the rights of real estate purchasers to hinge so dramatically on the type of transaction used is to exalt substance over form in the development of real estate finance law.

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56. Barker v. Johnson, *supra* note 2, (sale of trailer court campground to experienced real estate investors); Angus Hunt Ranch, Inc. v. REB, Inc., *supra* note 21 (sale of commercial swine operation); Younglove v. Graham & Hill, *supra* note 18 (sale of land to be used as gravel pit).