

1-1-1975

Toward Abolishing Installment Land Sale Contracts

D. Robert Lohn

Follow this and additional works at: <https://scholarworks.umt.edu/mlr>



Part of the [Law Commons](#)

Let us know how access to this document benefits you.

Recommended Citation

D. Robert Lohn, *Toward Abolishing Installment Land Sale Contracts*, 36 Mont. L. Rev. (1975).

Available at: <https://scholarworks.umt.edu/mlr/vol36/iss1/8>

This Note is brought to you for free and open access by ScholarWorks at University of Montana. It has been accepted for inclusion in Montana Law Review by an authorized editor of ScholarWorks at University of Montana. For more information, please contact scholarworks@mso.umt.edu.

John Toward Abolishing Installment Land Sale Contracts

TOWARD ABOLISHING INSTALLMENT LAND SALE CONTRACTS

D. Robert Lohn

INTRODUCTION

The installment land sale contract¹ has been a commonly used security device in Montana. While mortgages and deeds of trust must be foreclosed if the vendee defaults, installment land sale contracts may be simply terminated, leaving the vendee's equitable interest adjudicated. This simplicity is both the beauty and the bane of installment land sale contracts.

On one hand, the speed and low cost of the vendor's remedies on default means the vendor needs only a small "cushion" to protect his investment from the costs of default. Thus, he can settle for a low down payment, and still be reasonably secure. The low down payment is important to vendees who have little money saved, or who need their savings for other purposes.² A low down payment means more people are able to buy land and houses.

On the other hand, the absence of foreclosure means that the vendee has little protection in the event he defaults. There is the frightening possibility that he may both lose his home, and a substantial equity. While the vendor has the possibility of windfall enrichment, there is perhaps a greater chance of costly and time-consuming litigation over the vendee's unextinguished interest. Default under the contract may leave neither party in a desirable position.

Traditionally, the difficulties attendant to the installment land sale contract have been tolerated because no other security devices allowed the vendor to pursue post-default remedies at comparable low cost. But times have changed; since 1963, the Small Tract Financing Act³ has

¹These contracts have been previously considered in Note, *Forfeiture of Payments Under a Land Purchase Contract in Montana*, 19 MONT. L. REV. 50 (1957). An installment land sale contract is a contract whose principal object is the long-term financing of a real estate purchase by allowing payment of the agreed price in installments over time, with the title to the real estate reserved to the vendor as security. These are sometimes known as contracts for deed.

Installment land sale contracts should be distinguished from marketing contracts, where the consideration is given as "earnest money", and which simply act to preserve a buy-sell agreement until the vendee can complete his financial arrangements for the purchase.

²It appears that installment land sale contracts are important in two types of purchases:

(1) Farm and ranch land, where the vendee needs his capital for equipment and supplies. See Hines, *Forfeiture of Installment Land Contracts*, 12 U. KAN. L. REV. 475 (1964).

(2) Low income housing, where the vendee has little money saved for a down payment. It is estimated that 15% of the houses sold in California in 1972 were purchased by installment land sale contract. See Note, *Reforming the Vendor's Remedies for Breach of Installment Land Sale Contracts*, 47 S. CAL. L. REV. 191 (1973), at 191.

³Ch. 4, Title 52, REVISED CODES OF MONTANA (1947). [hereinafter cited as R.C.M. 1947].

offered a security device which is also low in cost, without having the drawbacks of an installment land sale contract. The question becomes: Should installment land sale contracts still be permitted?

This note will consider the positions of vendor and vendee under installment land sale contracts, and under the Small Tract Financing Act. It will then look to the viability of installment land sale contracts.

THE VENDOR'S POSITION UNDER AN INSTALLMENT LAND SALE CONTRACT

When a vendee defaults, holding him to the contract is an almost worthless option for the vendor. Normally the vendee has little money, else he would not have defaulted in the first place. The vendor's best course usually lies in declaring the contract at an end, quieting title, and reselling.

If the contract is unrecorded and the vendee cooperates by leaving promptly, the vendor can resell immediately. If the contract is recorded, the vendor may be able to persuade the vendee to sign a quitclaim deed. If these measures fail, the vendor has an arsenal of effective actions based on the contract with which to terminate the agreement, and remove the cloud on his title.⁴ Unless the vendee counterclaims, the vendee's interests simply remain unadjudicated. Unless challenged, the vendor keeps all payments made by the vendee.

While this may sound like an idyllic situation for vendors, there are a few drawbacks. The vendor's low costs are dependent on the vendee's acquiescence. With increasing public awareness of legal remedies, and the greater availability of legal services for low-income persons, that acquiescence is no longer assured.

With a minimum of vendee effort, the vendor's costs can be substantially increased. A vendee who refuses to vacate can delay resale and force the vendor to take the action into court. If the vendee's equitable interests in the property is small, there is a real incentive for him to refuse to budge. Since the vendor who terminates an installment land sale contract cannot recover for payments due under the contract,⁵ staying put may cost the vendee nothing additional, and gain him a few month's worth of housing at the vendor's expense.

⁴In Spencer, *Remedies Available Under a Land Sale Contract*, 3 WILLAMETTE L. J. 164 (1965), the author suggests that there are eight possible remedies based on the contract:

- (1) Action at law for breach of contract
- (2) Action at law for deceit
- (3) Rescission
- (4) Suit in equity to reform
- (5) Suit in equity for specific performance
- (6) Action at law for purchase price
- (7) Suit in equity for foreclosure
- (8) Declaration of forfeiture.

⁵De Young v. Benepe, 55 Mont. 306, 176 P. 609 (1918).

If the the vendee contests the vendor's action, a relatively inexpensive summary proceeding can turn into an expensive full-scale trial. It may well be that the vendee's payments on the contract, less reasonable interest costs for the money which the vendor has tied up in the property, will not cover the cost of this kind of trial.

In addition, there is the problem of lingering equities. If the vendee's interest is not foreclosed, it is not extinguished. Sooner or later, the vendee's right to his equitable interest will be barred by laches or the statutes of limitation, but in the interim the vendor can never be sure that any profit from the default is his to keep. In a recent case, a successor in interest to the vendor found himself trying to remove a tax lien on the vendee's interest, five years after that vendee had quit-claimed his rights to the land.⁶

A vendor under an installment land sale contract is in an uncomfortable position. The vendor is left with the possibility of subsequent suits to determine the vendee's interest; the vendor's costs at default are governed by the person least likely to be sympathetic, the defaulting vendee.

THE VENDEE'S POSITION UNDER AN INSTALLMENT LAND SALE CONTRACT

While default leaves the vendor in an uncomfortable position, it can leave the vendee in an intolerable one. The vendee runs the risk that all his payments may be forfeit, however great his equity and however small the balance payable. Section 17-102, REVISED CODES OF MONTANA,⁷ provides that when a party to an agreement incurs a forfeiture "he may be relieved therefrom." The key word is "may"; relief is a matter of discretion and not right. Further, relief does not follow as a matter of course; it is up to the vendee to request it.

Forfeiture, as used in Section 17-102, has two possible meanings: first, the loss of the right to purchase the land, and second, the loss of the payments made under the contract. The Montana courts have given relief from both kinds of forfeiture.

THE VENDEE'S EQUITY OF REDEMPTION

The courts seem inclined to liberally grant the vendee the right to redeem his interest by tendering full compensation within a reason-

⁶Greenup v. U.S., 239 F. Supp. 330 (D.C. Mont. 1965).

⁷Hereinafter cited as Section 17-102. This section provides:

Relief in Cases of Forfeiture. When, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty.

able time. In 3 of the 4 cases in which the vendee requested the right to redemption, relief was granted.⁸ The fourth case is easily distinguished by the vendee's unappealing reasons for default, and his failure to offer full compensation.⁹

THE VENDEE'S RIGHT TO RESTITUTION

If the vendee is unable or unwilling to tender full payment for the land, he may still be able to secure the return of his payments, less a reasonable charge for his use of the land. In the 12 Montana cases in which restitution has been requested under Section 17-102, relief has been granted in 5,¹⁰ and denied in 6,¹¹ with one decision postponed for further fact-finding.¹²

These statistics might suggest that the Montana courts have granted restitution only grudgingly. However, close reading of the cases indicates that in 5 of the 6 cases where relief was denied, the vendees simply failed to show that they had paid more than the reasonable rental value of the land. The remaining case can be distinguished by the extraordinary time at which it came before the court.¹³

FACTS APPEALING TO THE CONSCIENCE OF A COURT OF EQUITY

Section 17-102 was quickly held to mean that the vendee must show "facts appealing to the conscience of a court of equity."¹⁴ While no one case states precisely which facts are appealing, when considered together

⁸Blackfeet Tribe of Blackfeet Indian Reservation v. Klies Livestock Co., 160 F. Supp. 131 (1958); Yellowstone County v. Wight, 115 Mont. 411, 145 P.2d 516 (1943); Williams v. Hefner, 89 Mont. 361, 297 P. 492 (1931).

⁹Huffine v. Lincoln, 87 Mont. 267, 287 P. 629 (1930). The vendee tendered only the payments due to date. He had been four years in possession of land which had a possible crop of \$10,000 per year in grain, but had paid only \$2,000 in taxes and interest, and nothing on the principal.

¹⁰Lewis v. Peterson, 127 Mont. 474, 267 P.2d 127 (1953); Herman v. Herman, 123 Mont. 39, 207 P.2d 1155 (1949); Huston v. Vollenweider, 101 Mont. 156, 53 P.2d 112 (1935); Fontaine v. Lyng, 61 Mont. 590, 202 P. 1112 (1921); Cook-Reynolds Co. v. Chipman, 47 Mont. 289, 133 P. 694 (1913).

¹¹Joy v. Little, 138 Mont. 110, 354 P.2d 1035 (1960); Estabrook v. Sonstelie, 86 Mont. 435, 284 P. 147 (1929); Freidrichson v. Cobb, 84 Mont. 238, 275 P. 209 (1925); Suburban Homes Co. v. North, 50 Mont. 108, 145 P. 2 (1914); Fratt v. Daniels-Jones Co., 47 Mont. 487, 133 P 700 (1913).

¹²Greenup v. U.S., *supra* note 6.

¹³Estabrook v. Sonstelie, 86 Mont. 435, 284 P. 147 (1929). The vendee showed that the value of his payments and improvements on the land easily exceeded reasonable rental value. He alleged that his breach was due to lack of money because of the greatly depressed agricultural market. The court tersely said that it did not find facts which appealed to the conscience of a court of equity.

Very possibly there was more on the conscience of the court than the bare facts of the case. The case was decided on January 23, 1930, at the outset of the great depression. Had the vendee been granted restitution, the case would have been ruinous precedent for vendors, because few of them had the cash necessary for restitution, and the land itself was worth little or nothing on the market. If "hard cases make bad laws", surely hard times might have a similar effect.

¹⁴Fratt, *supra* note 11 at 703. Similar language appears in virtually every subsequent case.

the cases suggest that there are three elements essential to recovery. The vendee should show:

- (1) that he stands to incur a forfeiture;¹⁵
- (2) a. (if redemption is requested) that he has tendered full compensation within a reasonable time;¹⁶
 - b. (if restitution is requested) that he has paid more than the reasonable rental value of the land;¹⁷
- (3) that he has reasonable grounds for breaching the contract.

The third element has been the most troublesome to vendees. Literally, Section 17-102 requires that the vendee's breach be not "grossly negligent, willful, or fraudulent." The "facts appealing to the conscience of a court of equity" standard is potentially more flexible, since it simply looks to the vendee's grounds for breach, and determines whether the vendee comes to equity with clean hands.

Perhaps the most appealing case yet was made by the vendee who demanded the return of a check he had paid as a first installment, claiming that he did not know what he was doing at the time of the agreement.

"... it appears from the evidence that such incompetency was due to existing mental sickness which resulted from a series of incidents occurring over a period of time prior to September 8, 1949, namely: he saw his first wife burn to death; he had a mental breakdown which put him in a Denver hospital for six weeks; he was struck by lightning; an 8,000 gallon tank of gas hit him and

¹⁵The forfeiture is either the loss of the right to buy the land, or the loss of payments made under the contract. The forfeiture may include taxes and other payments necessary to maintain the land. See, for example, *Huston*, *supra* note 10. However, it does not include the vendee's loss from improvements he had made on the land (*Suburban Homes*, *supra* note 11) unless these improvements were requested by the vendor, as in *Herman*, *supra* note 10.

Provisions for liquidated damages in an installment land sale contract are void in Montana. § 13-804, R.C.M. 1947. If such provisions are present in a contract, their effect is to leave the parties where they would be if no stipulation had been made. *Fratt*, *supra* note 11; *Cook-Reynolds*, *supra* note 10. Provisions for payments to be held as stipulated rental in the event of default are also void, since the parties were not in a landlord-tenant relationship when the money was paid. *Fontaine*, *supra* note 10.

¹⁶"Full compensation" has not been explicitly defined, but in the three cases where relief was granted (*supra* note 8) the vendee tendered the balance payable on the contract, not just the payments due to date. However, in *Gamble-Skagmo Inc. v. McNair Realty Co.*, 98 F. Supp. 440 (1951), *aff'd* 193 F.2d 876 (1952), a case involving forfeiture of a lease, "full compensation" was the rent due to date, not the total rent payable under the lease.

"Reasonable time" varies with the case. It appears that the time does not begin to run until after the vendor has served notice on the vendee of his default. It is suggested that tender by the vendee any time before the vendor goes to trial on the contract will be adequate. See *Wight*, *supra* note 8 at 518.

¹⁷In all of the cases where the value of the vendee's interest in the land was computed (*Herman*, *Huston*, *Fontaine*, and *Cook-Reynolds*, *supra* note 10), the interest was determined by subtracting the reasonable rental value of the land, plus interest, from the vendee's payments, plus interest. This standard gives the vendee no credit for any appreciation in the land value. It is possible that a determination based on the market value of the land at default would also be accepted in Montana. The vendee has been given a choice of either standard, in proceedings under an identical statute in California. See *Ward v. Union Bond and Trust Co.*, 243 F.2d 476 (9th Cir. 1957).

smashed his combine; he lost 25 head of cattle in a big storm; and 'got hailed out. . . . Everything felt like I was on air I just couldn't take any more.'¹⁸

Other successful, but less spectacular, grounds have included: breach or apparent breach of agreement by the vendor,¹⁹ reasonable doubts about the vendor's ability to convey good title,²⁰ and misrepresentation by the vendor.²¹

Relief has been denied when the vendee alleged misrepresentation, but waited two or more years after discovery to bring the action;²² when the vendee paid no taxes, "forgot" that payment was due, and continued to forget for 4 months;²³ and when the vendee had alleged a breach by the vendor, but had defaulted before the breach was known.²⁴

It is not at all clear whether financial inability to perform is grounds for relief. One of the most recent cases arising under Section 17-102 states that "The holding in the *Estabrook* case is that financial inability is not sufficient to appeal to the conscience of a court of equity."²⁵ Perhaps this announces a new rule, for the prior cases do not support this conclusion. *Estabrook* is a carefully worded opinion, and close reading shows that the court never states why relief was denied, except to say that the facts do not appeal to the conscience of a court of equity.²⁶ In a case prior to *Estabrook*,²⁷ and in a case subsequent to it,²⁸ relief was granted to a vendee who breached because of his financial inability.

THE PROBABILITY OF RELIEF FROM FORFEITURE

If a vendee breaches an installment land sale contract, his chances of recovering his equity in the property are unimpressive. He must (1) take action on his own, at least by counterclaiming in the vendor's suit to terminate the contract, since the vendor can quiet title without determining the vendee's interest; (2) make out a case which appeals to the conscience of a court of equity. It is not clear, but it may well be that the typical vendee, who breaches through financial inability to make the payments when due, will not be able to make out a case which appeals to a court of equity. Even if the vendee meets these two conditions, relief is granted to him as a matter of discretion, rather than right.

¹⁸Lewis, *supra* note 10 at 129.

¹⁹Blackfeet Tireb, *supra* note 8; Herman, *supra* note 10; Huston, *supra* note 10.

²⁰Williams, *supra* note 8.

²¹Fontaine, *supra* note 10.

²²Friedrichson, Edwards, *supra* note 11.

²³Fratt, *supra* note 11.

²⁴Joy, *supra* note 11.

²⁵Kovacich v. Metals Banks and Trust Co., 139 Mont. 449, 365 P.2d 639, 640 (1960). *Kovacich* was not an installment land sale contract case, but involved an installment sale contract for a mobile home.

²⁶See *supra* note 13.

²⁷Cook-Reynolds, *supra* note 10.

²⁸Wight, *supra* note 8.

THE SMALL TRACT FINANCING ACT

THE TRUST INDENTURE

The Small Tract Financing Act was created in 1963 out of a need for a security instrument not subject to all the provisions of the mortgage laws.²⁹ It provides for a type of trust indenture to be used in the sale of real property of fifteen acres or less in area.³⁰ A person having title to real property, known in the act as the grantor, transfers this title in trust to secure the performance of an obligation incurred by the grantor. The trustee can be (a) a lawyer, (b) a bank, trust company, or savings and loan association, or (c) a title company.³¹ When the obligation is performed, the trustee reconveys to the grantor.

The principal virtue of the act is its efficient method of foreclosure.³² No judicial proceedings are required. If the grantor defaults on the obligation, the trustee may sell the property on 120 days notice, and apply the proceeds to the obligation. The trust indenture creates a relationship similar to a mortgage with a power of sale, except that legal title is in trustee, rather than nominally in the mortgagee.

The parties to land sale contract can easily be changed into parties to the trust indenture provided in the act. The vendee can become a grantor if the vendor conveys to the vendee, in exchange for the vendee's

²⁹R.C.M. 1947, § 52-402.

³⁰While the fifteen acre limit includes most housing sales, it might exclude sales of farm or ranch land. Two points should be noted regarding sales of land exceeding fifteen acres in actual area.

(1) It seems possible to bring land sales of greater than fifteen acres under the act by use of a simple fiction, a statement in the trust indenture to the effect that "for the purpose of complying with Chapter 4, Title 52, R.C.M. 1947, and only for this purpose, the parties agree that the real property shall be deemed as not exceeding fifteen acres in area." The act seems to encourage such fictions. See § 54-403(5), R.C.M. 1947.

(2) If the Small Tract Financing Act is considered not to include parcels of land over fifteen acres in actual area, a similar security device can be created by use of a mortgage with a power of sale, as provided in § 52-112, R.C.M. 1947.

³¹R.C.M. 1947, § 52-405.

³²Basically, there are seven steps in a foreclosure under the act:

(1) A notice of sale is prepared by the trustee, describing the property, the parties involved, the default, the sum owing, and the date and location of the sale. The sale may be held at the trustee's usual place of business.

(2) The notice of sale is filed with the clerk and recorder of the county where the property is located, 120 days prior to sale.

(3) Copies of the notice of sale are mailed to the grantor and other interested parties, 120 days prior to sale.

(4) A copy of the notice of sale is posted in a public place, and advertised for three successive weeks in a newspaper of general circulation, at least 120 days prior to sale.

(5) Affidavits showing the above mailing, posting, and publication are filed with the clerk and recorder on or before the date of the sale.

(6) The property is sold by the trustee at public auction to the highest bidder, with the purchaser taking both the trustee's title, and all of the grantor's interests in the property. The vendor may bid in to protect his interest at this sale.

(7) The proceeds of the sale are applied first to the costs of the sale, then to the obligation secured by the trust indenture. Any surplus is either given directly to the grantor, or deposited with the clerk and recorder, subject to the order of the district court.

promise to (1) perform his obligation to the vendor, and (2) to convey the title to a trustee to be held for the benefit of the vendor, until the obligation is discharged.

THE COSTS OF DEFAULT

The legal costs at default are minimal under a trust indenture. Three documents are involved. A brief notice of sale is prepared, copies of which are recorded, mailed, posted, and advertised. Then, an affidavit is recorded, showing that these things have been done. Finally, a deed is written, conveying all interests in the property to the foreclosure sale purchaser.

The vendor's greatest cost is the 120 day period prior to the sale, in which the defaulting vendee has occupancy, but makes no payments. The remaining costs—advertising, mailing, and compensation for the trustee (who may also be the vendor's attorney)—are minimal. It is suggested that a down payment of 5% of the purchase price will be sufficient to meet the vendor's costs at default.³³

THE VENDOR'S POSITION UNDER A TRUST INDENTURE

Part I of this note identified two difficulties faced by vendors under installment land sale contracts: (1) that the vendee's interests were never determined, and thus never cut off, and (2) that the vendor's costs at default were controlled by the vendee. The trust indenture solves both difficulties. The trustee's sale is conclusive of the vendee's interests; nothing lingers on after the sale. The vendor's costs are fixed at a predictable low level. The defaulting vendee can do nothing to increase these costs.

In exchange for these substantial advantages, the vendor gives up the possibility of windfall enrichment, and the possibility of a lower cost retaking of the land if the vendee cooperates by vacating promptly and signing a quitclaim deed. As suggested earlier, neither possibility is overwhelming. A vendee who has a substantial equity in the property seldom defaults. Even if he does, there is a chance the vendee will get his equity back by an action under Section 17-102. A vendee who has a low equity has little incentive to vacate until ordered off the property by a court, since he stands to gain free housing until the date of the court order.

THE VENDEE'S POSITION UNDER A TRUST INDENTURE

Under an installment land sale contract, the vendee faces three difficulties: (1) there is no requirement that the vendee's interest be determined at all, (2) relief from forfeiture is a matter of judicial discretion, not right, and (3) it is not certain that a vendee who defaults

³³Note, *Reforming the Vendor's Remedies for Breach of Installment Land Sale Contracts*, 47 S. CAL. L. REV. 191 (1973), at 224. The author bases his estimate on a 111 day foreclosure period, rather than the 120 day period provided by § 52-409, R.C.M. 1947.

through financial inability can recover anything. The trust indenture protects the vendee against all of these difficulties.

The grantor under a trust indenture has a statutory right of redemption. If at any time prior to the trustee's sale, the grantor tenders the amount then due, including reasonable costs, the default is cured.³⁴ The grantor is not required to tender the entire amount payable under the indenture.

The grantor who does not elect to redeem has the assurance that he will have his interest determined within 120 days, according to the fair market value of the property. After the obligation has been satisfied and costs of sale not exceeding 5% have been paid, any money left passes either directly to the grantor, or to the county, subject to the grantor's action to claim the money.³⁵ In the event that the proceeds of the sale are not sufficient to cover the obligation and costs of sale, the grantor is protected from deficiency judgments.³⁶

TOWARD ABOLISHING INSTALLMENT LAND SALE CONTRACTS

Installment land sale contracts have been tolerated in Montana because they allowed low down payment land purchases. While they have undoubtedly fulfilled a need, their history has been a rather sordid one, of vendors who faced unpredictable legal costs at the whims of their vendees, and of vendees who stood to lose substantial interests, according to the conscience of a court of equity.

Installment land sale contracts need be tolerated no more. The Small Tract Financing Act creates a superior security instrument, offering reasonable protection to both parties, without working mischief to either. The only interests better protected under installment land sale contracts are those of the unscrupulous vendor who seeks windfall gains, and of the conniving vendee, who anticipates rent-free months before a court-ordered eviction. Neither interest merits protection.

Vendors are free to voluntarily use trust indentures for financing. Vendees, however, often have little control over which agreement is used to finance a low down payment land sale. Thus, the matter rightfully falls to the Montana Legislature. With a short, simple statute,³⁷ the legislature

³⁴R.C.M. 1947, § 52-412.

³⁵R.C.M. 1947, § 52-413.

³⁶R.C.M. 1947, § 52-414.

³⁷For example, the following section could be added as § 13-812, R.C.M. 1947:
Contracts for Installment Sale of Real Property Void.

Every contract for the sale of real property, in which the consideration for the real property is payable in installments over a period exceeding one year, and which provides that title to the real property shall remain in the vendor for any time beyond the first year of the contract, shall be deemed void. Provided, that this section shall not apply to any contract consummated prior to July 1, 1975.

can put an end to the inequities of installment land sale contracts. They can act with the assurance that low-cost security agreements with reasonable protections for all parties will be available to finance land purchases, homes, and business expansion in Montana.

interfere with option contracts, since (1) they are not for the sale of real property, but rather for the right to enter into such sales, and (2) the consideration is given for this right, rather than for the real property itself.