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## MORTGAGE SUBSTITUTES—THE LAW IN ARKANSAS

*Glenn E. Pasvogel, Jr.\**

### I. Short History of Mortgage Law

A mortgage is a device whereby a creditor acquires an interest in a debtor's real property to secure repayment of a debt.<sup>1</sup> In the event of default in the repayment obligation, the creditor/mortgagee may have the real estate sold and the proceeds applied in satisfaction of the debtor/mortgagor's indebtedness.<sup>2</sup> Recording statutes protect the mortgagee against competing liens on the real estate and assure that the mortgage will not be defeated by a subsequent bona fide purchaser.<sup>3</sup>

The mortgage, as we know it today, did not exist during the early commonlaw periods. A lender who desired security in a debtor's real estate would require that the debtor actually convey the real estate to the lender, usually in the form of a fee simple upon condition subsequent.<sup>4</sup> By the terms of the conveyance, repayment of the obligation by a certain day (called the "law day") gave the mortgagor the right to reenter and terminate the lender's estate.<sup>5</sup>

The conveyance of a fee interest in the debtor's land gave the lender all the incidents of legal title to the real estate.<sup>6</sup> The lender was entitled to any accessions to the real estate and received compensation if the land was taken by eminent domain.<sup>7</sup> The property was subject to the dower rights of the lender's spouse and the claims of his creditors.<sup>8</sup> It passed to his heirs upon his death.<sup>9</sup> Most important, the lender had the right to possession (although the debtor customarily remained in

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1. G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW*, § 1.1, at 1 (2d ed. 1985).

2. *Id.* at 4.

3. R. KRATOVIL & R. WERNER, *MODERN MORTGAGE LAW AND PRACTICE*, § 6.18, at 81 (2d ed. 1981). For a thorough discussion of the purposes and types of recording acts, see 4 *AMERICAN LAW OF PROPERTY* § 17.5 (A. James Casner ed. 1952).

4. G. NELSON & D. WHITMAN, *supra* note 1, § 1.2, at 6.

5. R. KRATOVIL & R. WERNER, *supra* note 3, § 1.2, at 30.

6. G. NELSON & D. WHITMAN, *supra* note 1, § 1.2, at 6.

7. *Id.*

8. *Id.*

9. *Id.*

possession) and the right to rents and profits.<sup>10</sup> The lender's "fee" came out of the rents and profits because the charging of any interest on a loan was usurious and illegal.<sup>11</sup>

The above system frequently worked extreme injustice on the mortgagor. A balloon repayment was due on "law day."<sup>12</sup> If for any reason the payment was not made, the mortgagor forfeited all interest in the property even though he was still obligated to pay the debt.<sup>13</sup>

Equity eventually intervened to ameliorate this harshness.<sup>14</sup> If the mortgagor could show that failure to pay promptly was due to fraud or misrepresentation on the part of the lender, the chancellor would, upon payment of the debt in full, void the forfeiture and order the property returned to the mortgagor.<sup>15</sup> Eventually, equity allowed the mortgagor to redeem his property as of right without showing any special grounds for relief.<sup>16</sup> This right came to be known as the mortgagor's "equity of redemption" and became a recognized equitable estate in land.<sup>17</sup>

The recognition of an equity of redemption posed a serious threat to the stability of land titles since a mortgagor could recover the property at any time by paying off the underlying debt.<sup>18</sup> To remedy this, equity developed foreclosure as the formal proceeding that would cut off the equity of redemption.<sup>19</sup> The foreclosure decree ordered the mortgagor to pay the debt within a specified period of time or lose the right to redeem and suffer a forfeiture of the land in satisfaction of the obligation.<sup>20</sup> This type of "strict foreclosure" resulted in a vesting of clear title in the mortgagee in full satisfaction of indebtedness regardless of the value of the property.<sup>21</sup>

Depending upon the relationship between the value of the land and the amount of the debt, strict foreclosure frequently resulted in a windfall for one party or the other.<sup>22</sup> Thus, in the United States, the predominant method of foreclosure that evolved resulted in a public sale of

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10. *Id.* at 7.

11. G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES 13 (1951).

12. G. NELSON & D. WHITMAN, *supra* note 1, § 1.2, at 7.

13. *Id.* See also 4 AMERICAN LAW OF PROPERTY, *supra* note 3, § 16.5, at 17.

14. 4 AMERICAN LAW OF PROPERTY, *supra* note 3, § 16.6, at 17.

15. *Id.* at 17-18.

16. *Id.* at 18.

17. *Id.* The term "equity of redemption" first appears in *Duchess of Hamilton v. Countess of Dirlton*, 1 Ch. Rep. 165 (1654).

18. G. NELSON & D. WHITMAN, *supra* note 1, § 1.3, at 8.

19. *Id.*

20. *Id.*

21. 4 AMERICAN LAW OF PROPERTY, *supra* note 3, § 16.10, at 27.

22. *Id.* at 27-28.

the property after giving notice to all interested parties.<sup>23</sup> The mortgage debt was credited with the proceeds of the sale and the mortgagor was entitled to any surplus over the amount of the debt and expenses of foreclosure.<sup>24</sup> If the proceeds of the sale were insufficient to discharge the debt, the mortgagee was entitled to collect the deficiency from other assets of the mortgagor.<sup>25</sup>

In the United States, as in England, the mortgagor could redeem the property any time after default but before foreclosure by paying the mortgagee the accelerated debt plus accumulated interest.<sup>26</sup> The equity of redemption was considered so important that courts refused to enforce clauses in mortgage instruments wherein mortgagors purported to waive or modify the right.<sup>27</sup> This came to be known as the rule against "clogging the equity of redemption."<sup>28</sup>

## II. Attempting to Avoid Foreclosure and the Equity of Redemption—Mortgage Substitutes

In a pure mortgage transaction, the mortgagor gives the mortgagee (1) a promissory note promising to repay the loan according to specified tenure and (2) a mortgage giving the mortgagee an interest in the property to secure repayment. Upon default, the mortgagee must bring a foreclosure action in chancery, join all parties having an interest in the property, and have the property sold at public sale. The property may be redeemed by the mortgagor until sold<sup>29</sup> and, in most jurisdictions, may be redeemed for a statutorily prescribed period of time after the sale.<sup>30</sup> In order to be relieved from the time and expense of foreclosure and to deprive the mortgagor of the equity of redemption, lenders have long sought devices that would create security in real estate but which would not be treated as mortgages so as to require foreclosure or create an equity of redemption.

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23. G. NELSON & D. WHITMAN, *supra* note 1, § 1.4, at 9.

24. 4 AMERICAN LAW OF PROPERTY, *supra* note 3, § 16.10, at 28.

25. *Id.*

26. G. NELSON & D. WHITMAN, *supra* note 1, § 3.1, at 29-35.

27. R. KRATOVIL & R. WERNER, *supra* note 3, § 1.3(a), at 31.

28. See generally G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES §§ 96-99, at 227-38 (1951).

29. G. NELSON & D. WHITMAN, *supra* note 1, § 7.1, at 478; *Shinn v. Barrie*, 182 Ark. 366, 367, 31 S.W.2d 540, 541 (1930).

30. G. NELSON & D. WHITMAN, *supra* note 1, § 7.1, at 478. In Arkansas the statutory redemption period is one year, ARK. STAT. ANN. § 51-1111 (1971), unless waived by the mortgagor. *Shinn v. Barrie*, 182 Ark. 366, 31 S.W.2d 540 (1930).

### *A. Deed of Trust*

Probably the most common mortgage substitute is the deed of trust. The mortgagor/trustor conveys the real estate to a third party trustee to hold as security for repayment of the mortgage debt to the lender. The trust instrument will usually give the trustee a power of sale over the property in the event of default. The burdens of foreclosure are alleviated only to the extent that a state's regulation of powers of sale is less rigorous than judicial foreclosure.<sup>31</sup> Most jurisdictions, including Arkansas,<sup>32</sup> will treat a deed of trust like a mortgage for most purposes.<sup>33</sup>

### *B. Absolute Deed with Option to Purchase*

On its face, a deed of trust looks like a security device and is therefore treated like a mortgage. What many lenders really want is a device that can be used for security but which looks like something else entirely at the time it is most likely to be scrutinized by the court — after default. Instead of a mortgage, a lender may ask for a deed to the property, it being orally understood that the lender will reconvey to the borrower when the debt is paid. In the event of default, however, the lender will record the deed and hope to appear to all the world as a purchaser—no foreclosure, no equity of redemption. Since the timing of the payment, execution of the deed, and recording of the deed suggest so transparently a secured transaction rather than a sale, the transaction will usually be structured as a current and promptly recorded sale of real estate with the seller retaining an option to repurchase the property at some future date for some specified amount. Thus, at the time a dispute arises as to the character of the transaction, it will facially look like a sale of real estate.

#### *1. Presumptions and Burdens of Proof*

A, in need of money, approaches B for a loan. B takes a deed from A as security and advances A the money. B records the deed and agrees to reconvey to A upon A's repayment. A defaults and B sues to

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31. It would appear that in Arkansas foreclosure by power of sale is more onerous than that of judicial foreclosure. The property must be appraised by three disinterested appraisers, ARK. STAT. ANN. § 51-1113 (1971), and the property must be sold for at least two-thirds of its appraised value. ARK. STAT. ANN. § 51-1112 to -13 (1971). This restriction has been held not to apply to judicial foreclosures. *Gregory v. Rubel*, 184 Ark. 55, 60, 41 S.W.2d 771, 773 (1931).

32. *Turner v. Watkins*, 31 Ark. 429, 436-37 (1876).

33. G. NELSON & D. WHITMAN, *supra* note 1, § 1.6, at 11.

quiet title and regain possession. A, who has built up some equity in the property, claims the transaction was a mortgage and seeks to redeem.

The law is well-settled that a deed, absolute on its face, is presumed to be a conveyance.<sup>34</sup> However, where the parties intend a deed to be security for a debt, a court will admit evidence as to the true character of the transaction.<sup>35</sup> To overcome the presumption that a deed is intended to effect a conveyance, the party claiming it to be a mortgage must establish by clear, unequivocal, and convincing evidence that the deed was intended to secure a debt.<sup>36</sup>

## *2. Evidence Tending to Show a Deed is Operating as a Mortgage*

In *Beloate v. Taylor*<sup>37</sup> the Arkansas Supreme Court established a two-part test for determining whether a deed operated as a conveyance or a mortgage:

1. Did the grantor owe the grantee a debt at the time of the conveyance; and
2. If so, was the deed of conveyance intended to secure the debt?

An occasional Arkansas case has been decided upon the existence or nonexistence of a debt between the grantor and grantee at the time of the conveyance. For example, in *Rogers v. Snow Brothers Hardware Co.*<sup>38</sup> J.W. Rogers paid a debt owed by his son, W.L. Rogers. In return, W.L. Rogers executed a warranty deed conveying to his brothers the undivided one-fourth interest in lands owned by his father and which he expected to inherit. The deed was delivered to his father with

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34. *Clark-McWilliams Coal Co. v. Ward*, 185 Ark. 237, 242, 47 S.W.2d 18, 21 (1932); *Deloney v. Dillard*, 183 Ark. 1053, 1055, 40 S.W.2d 772, 773 (1931).

35. The parole evidence rule is not violated by doing so. The rule only precludes introduction of evidence that would vary or contradict a written document. *Lane v. Pfeifer*, 264 Ark. 162, 167, 568 S.W.2d 212, 215 (1978). Any written or oral evidence is admissible to show that a deed absolute was intended as security. *Ehrlich v. Castleberry*, 227 Ark. 426, 429, 299 S.W.2d 38, 40 (1957). Such evidence does not vary or contradict the instrument, but only explains its purpose or function.

36. *Patterson v. Webster*, 252 Ark. 596, 598, 480 S.W.2d 328, 330 (1972). "The law presumes that a deed absolute on its face is what it appears to be, and the burden is on the one claiming it to be a mortgage to overcome this presumption by clear, unequivocal and convincing evidence." *Deloney v. Dillard*, 183 Ark. 1053, 1055, 40 S.W.2d 772, 773 (1931). The evidence "must be sufficient to satisfy every reasonable mind without hesitation." *Clark-McWilliams Coal Co. v. Ward*, 185 Ark. 237, 242, 47 S.W.2d 18, 21 (1932).

37. 202 Ark. 229, 233, 150 S.W.2d 730, 731-32 (1941).

38. 186 Ark. 183, 52 S.W.2d 969 (1932).

the express understanding that it should be returned should W.L. repay his father at any time before his father's death.

J.W. Rogers died without having been repaid and the deed, found among his papers, was later recorded. Snow Brothers, a creditor of W.L. Rogers, sued to set aside the deed in order to execute its judgment against the inheritance of W.L. Rogers. The Arkansas Supreme Court found that W.L.'s deed to his brothers was not effective as either a mortgage or a conveyance. Since W.L. owed no money to his brothers, there was no debt for the transfer to secure and for that reason there could be no mortgage.<sup>39</sup> The conveyance, however, was held to have been ineffective for lack of delivery of the deed to the grantees.

The second part of the *Beloate* test requires that the parties intend that the conveyance secure the debt. As early as 1852, the Arkansas Supreme Court stated the general rule for determining the intent of the parties:

And for the purpose of ascertaining the true intention of the parties, it is a well established rule, that the courts will not be limited to the terms of the written contract, but will consider all the circumstances connected with it; such as the circumstances of the parties, the property conveyed, its value, the price paid for it, defeasance verbal or written, as well as the acts and declarations of the parties, and will decide upon the contract and the circumstances taken together.<sup>40</sup>

Seldom do the parties come to court agreeing that a deed was intended as security,<sup>41</sup> nor will the grantor often have a witness to corroborate his testimony that the grantee promised to return the deed upon repayment of the debt.<sup>42</sup> Most often the court must look to circumstantial evidence to determine whether a conveyance was intended as security for a debt. Perhaps the most important evidence of intent to create a mortgage is the continuing survival of the debt following execution of the deed.<sup>43</sup>

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39. *Id.* at 186, 52 S.W.2d at 970. See also *Hershey v. Luce*, 56 Ark. 302, 19 S.W. 963 (1892), in which the court found that a transaction intended by the parties to be a mortgage was a conditional sale instead because there was no evidence of a debt or obligation between the parties when the transaction was entered into.

40. *Scott, White & Co. v. Henry & Cunningham*, 13 Ark. 112, 116 (1852). The *Scott* rule was quoted and followed by the Arkansas Supreme Court as recently as 1957 in *Ehrlich v. Castleberry*, 227 Ark. 426, 429-30, 299 S.W.2d 38, 40 (1957).

41. *Fuller v. Fuller*, 240 Ark. 475, 480, 400 S.W.2d 283, 286 (1966).

42. *Sturgis v. Hughes*, 206 Ark. 946, 950, 178 S.W.2d 236, 238 (1944). However, the transaction was found to be a conveyance for other reasons.

43. *Ehrlich v. Castleberry*, 227 Ark. 426, 299 S.W.2d 38 (1957); *Tyler v. Morgan*, 214 Ark. 667, 217 S.W.2d 606 (1949); *Gunnels v. Machen*, 213 Ark. 800, 212 S.W.2d 702 (1948); *Newport v. Chandler*, 206 Ark. 974, 178 S.W.2d 240 (1944); *Beloate v. Taylor*, 202 Ark. 229, 150

If A is indebted to B and conveys land to B in full satisfaction of the indebtedness, the transaction is in essence a sale, the consideration for the conveyance being the forgiveness of the debt. If A, in response to B's threats to sue A on the debt, conveys land to B and B agrees to "reconvey to A upon A's payment of the debt," the transaction is in substance a mortgage. B is primarily interested in being paid his debt and only secondarily interested in the real estate as security therefor. The primary distinction between the sale and the mortgage is the continued existence of the debt following the conveyance.

Assume that in the second situation above, instead of promising to "reconvey" to A, B gives A an option to repurchase the property any time within the next three years for the amount B paid for it (the debt) plus interest at twelve percent. The transaction serves the same function as a mortgage, but is technically a conveyance with option to repurchase.

In the early case of *Porter v. Clements*,<sup>44</sup> the Arkansas Supreme Court held that a conveyance wherein the grantor retains a right of defeasance will be construed as a mortgage only if the debt survives the conveyance; otherwise it will be deemed a conditional sale.<sup>45</sup> The rule was stated as follows in *Hays v. Emerson*.<sup>46</sup>

It is insisted, however, that, the consideration for the deed being a pre-existing debt owing by the grantor to the grantee, the contemporaneous agreement for an immediate resale of the property to the grantor on credit for the same price stamps the conveyance as a security for the debt merely, and not an absolute conveyance, regardless of the real intention of the parties. Such is not the law. The contemporaneous agreement for a resale and purchase does not, of itself, make the deed a mortgage. The conveyance must be judged according to the real intent of the parties. If there is a debt subsisting between the parties, and it is the intention to continue the debt, it is a mortgage; but if the conveyance extinguishes the debt, and the parties intend that result, a contract for a resale at the same price does not destroy the character of the deed as an absolute conveyance.<sup>47</sup>

Sometimes the continued existence of the debt after the convey-

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S.W.2d 730 (1941); *Clark-McWilliams Coal Co. v. Ward*, 185 Ark. 237, 47 S.W.2d 18 (1932); *DeLoney v. Dillard*, 183 Ark. 1053, 40 S.W.2d 772 (1931); *Brewer v. Yancey*, 159 Ark. 257, 251 S.W. 677 (1923); *Henry v. Henry*, 143 Ark. 607, 221 S.W. 481 (1920); *Hays v. Emerson*, 75 Ark. 551, 87 S.W. 1027 (1905); *Porter v. Clements*, 3 Ark. 364 (1841).

44. 3 Ark. 364 (1841).

45. *Id.* at 384 (citing *Poindexter v. McCannon*, 1 Dev. Eq. 273 (N.C.)).

46. 75 Ark. 551, 87 S.W. 1027 (1905).

47. *Id.* at 554-55, 87 S.W. at 1028.



ance is quite obvious, as when the grantor executes a promissory note to the grantee.<sup>48</sup> However, in most cases, the issue is not so easily resolved. As stated by Justice Knox in *Newport v. Chandler*: "In practice, the line of demarcation between a mortgage and a sale with a right of repurchase is shadowy, and it is frequently a matter of great difficulty to determine to which category a given transaction belongs."<sup>49</sup>

One test advanced by the Arkansas Supreme Court in *Newport* is whether, after the conveyance, there exists a reciprocity of rights between the parties.<sup>50</sup> In both a sale with option to purchase and a conditional sale the grantor may force a reconveyance through payment of a specified amount; however, the transaction can be a mortgage only if the grantee has the right to compel the grantor to pay the consideration named as the *quid pro quo* for the reconveyance.<sup>51</sup>

In *Newport* the appellants conveyed certain property to the appellees by warranty deed for a consideration of \$900. As part of the contract, the appellees agreed to reconvey the property to the appellants for \$900 plus eight percent interest if such sum was paid within nine months:

The said parties of the first part are to execute and deliver to the party of the second part a warranty deed to the above property together with the abstract of title, and same are to be held by the firm of Bare & Swett as an escrow item with the understanding and agreement that in the event the said parties of the first part (appellants) desire to do so, they can repurchase the property from the party of the second part at and for the sum of \$900 plus 8 per cent interest, provided, however, that they must make such purchase on or before nine months after this date. In the meantime, the parties of the first part bind themselves to maintain adequate insurance on said property to protect at least the value of the principal and interest mentioned herein and to pay all taxes legally assessed against said property during such period of time.

If the parties of the first part should fail or refuse to comply with all the stipulations hereinbefore mentioned at any time and during the life of this contract, then they hereby authorize the said Bare & Swett to deliver the deed and abstract to the party of the second part and bind themselves to promptly surrender possession of the property hereinbefore described to said party of the second part.<sup>52</sup>

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48. *Tyler v. Morgan*, 214 Ark. 667, 217 S.W.2d 606 (1949).

49. 206 Ark. 974, 980, 178 S.W.2d 240, 244 (1944).

50. *Id.* at 981, 178 S.W.2d at 244.

51. *Id.* at 981, 178 S.W.2d at 244-45.

52. *Id.* at 975, 178 S.W.2d at 242.

Relying on *Beloate v. Taylor*<sup>53</sup> and *Johnson v. Clark*,<sup>54</sup> the court ruled that the transaction was a conditional sale and not a mortgage because the appellee had neither expressly nor impliedly agreed to repay the money and there was consequently no surviving debt.<sup>55</sup> This was true although the grantors remained in possession and were responsible for taxes and insurance, the deed was placed in escrow during the option period, and the repurchase price was measured by the sale price plus "interest"—a term having meaning only in connection with the loan of money. The transaction was the functional equivalent of a mortgage and had all the earmarks of a mortgage save the one found controlling—the absence of an enforceable surviving debt.<sup>56</sup>

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53. 202 Ark. 229, 150 S.W.2d 730 (1941).

54. 5 Ark. 321 (1844). In determining that a transaction was a conditional sale and not a mortgage, the court in *Johnson* found the controlling factor to be the absence of an enforceable debt after the conveyance:

In the case at bar, Clark executes the conveyance, which he calls a "bargain and sale," and he accompanies the same by delivery, reserving to himself the right to repay the purchase money within twelve months. But he executes no covenant by which he acknowledges an indebtedness; nor can it be gathered from the instrument, that there is any certain obligation on his part to do so. By repaying the money, he had a right to demand possession of the negroes, but should he fail to do so, where was the remedy of Johnson? Had he any contract which he could enforce *in personam* or *in rem*? We are of opinion that he had not.

*Id.* at 342.

55. 206 Ark. at 981, 178 S.W.2d at 245.

56. One case stands out as something of a contradiction to the rule that a deed will be construed as a mortgage only if an intent to secure debt be shown by clear, unequivocal, and convincing evidence, and that no deed can be construed as a mortgage unless an enforceable debt survives the transaction. In *DeLoney v. Dillard*, 183 Ark. 1053, 40 S.W.2d 772 (1931), DeLoney executed a deed to Davis for a recited consideration of \$700. By contemporaneous written agreement Davis gave DeLoney an option to repurchase:

Witnesseth: That it is agreed that at any time on or before October 15, 1930, the said Hillie Davis will execute and deliver to I.L. DeLoney, or to Cecil Byrd, a warranty deed free from any and all liens and encumbrances caused by him to the lands this day deeded to the said Hillie Davis by I.L. Deloney, a copy of which is attached hereto and made a part of this contract as 'exhibit A' upon the payment to the said Hillie Davis the sum of \$700 with 10 percent interest thereon from this date, and the further payment to the said Hillie Davis any taxes which he may pay on said lands.

It is further agreed that the said I.L. DeLoney shall have and enjoy the possession of the said lands and receive the rents and profits thereof for and during the year 1930.

*Id.* at 1054, 40 S.W.2d at 772. The court found the above language to constitute a mortgage notwithstanding any explicit evidence of subsisting debt. The only evidence of such debt, and that upon which the court based its finding that the debt survived the transaction, was the following excerpt from the cross-examination of DeLoney:

Q. Did you ever pay or offer to pay Mr. Hillie Davis the \$750 and interest on this land that you borrowed from him, according to the terms of your contract? A. No, sir, I haven't had it to pay. Q. You haven't paid it or offered to pay it, have you? A. I haven't had it to pay. Q. You can answer that question. Have you paid it? A. No, sir. Q. Have you offered to pay it? A. I guess not; no sir.

Another factor courts frequently use to determine whether a deed should be construed as a mortgage is the value of the land as compared to the amount of the "purchase price." For example, in *Clark-McWilliams Coal Co. v. Ward*<sup>57</sup> the Arkansas Supreme Court found that a deed reciting a consideration of \$20,400 (the amount of the debt to the grantee) was in actuality a mortgage, largely because the property was worth between \$120,000 and \$175,000. In *Wimberly v. Scoggin*<sup>58</sup> the court determined that a deed to property worth \$5000 transferred for consideration of \$879.45 was actually a mortgage. Both cases were decided primarily on the basis of the gross disparity between the value of the land and the consideration given in exchange for the deed. Conversely, one factor persuading the court in *Newport v. Chandler*<sup>59</sup> that a deed was not a mortgage was the approximate equivalence between value and consideration.<sup>60</sup>

While the presence or absence of a surviving debt and the relationship between the value of the land and the consideration paid are the two most important factors a court will consider in deciding whether or not a deed is a mortgage, other facts and circumstances can bear on the issue. For example, the use of the term "redeem" in the contract giving a grantor the right to repurchase has been held significant (if not controlling) in one Arkansas case<sup>61</sup> holding a deed to be a mortgage, since redemption is a term used to denote recovery of land from a mortgage in default. However, a later case<sup>62</sup> held the use of the term

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*Id.* at 1055, 40 S.W.2d at 773.

Note that the thrust of the questioning was whether DeLoney paid Davis money, not whether it had been borrowed. Certainly one could not predicate a finding that a debt existed based upon a negative answer to the question of whether money had been paid. It may not have been paid because it was never owed. At any rate, the question is misleading and whatever evidence there was of a debt consisted of the words of the questioner, not the witness.

57. 185 Ark. 237, 47 S.W.2d 18 (1932).

58. 128 Ark. 67, 193 S.W. 264 (1917).

59. 206 Ark. 974, 178 S.W.2d 240 (1944).

60. Other cases wherein the value of the land compared to the consideration for the deed was held to be a factor include: *Sturgis v. Hughes*, 206 Ark. 946, 178 S.W.2d 236 (1944); *Buffalo Stave & Lumber Co. v. Rice*, 187 Ark. 731, 62 S.W.2d 2 (1933); *Brewer v. Yancey*, 159 Ark. 257, 251 S.W. 677 (1932), and *Dicken v. Simpson*, 117 Ark. 304, 174 S.W. 1154 (1915).

61. *Dicken v. Simpson*, 117 Ark. 304, 174 S.W. 1154 (1915). The court, however, pointed to numerous other factors evidencing a mortgage rather than a conditional sale: the agreement prohibited either party from selling the property during the year following consummation of the contract; the grantee under the contract could "take" the property (buy it) during the year at any price offered by the grantor; and the consideration for the deed was considerably less than the value of the land.

62. *Matthews v. Stevens*, 163 Ark. 157, 259 S.W. 736 (1924).

The word, "redeem," however, has no definite significance. It means to repurchase, or to regain, and does not necessarily imply the existence of a valid existing indebted-

"redeem" insignificant, as meaning no more than "repurchase," at least where there was no surviving indebtedness from which to redeem.

Other factors courts will consider include prior transactions between the parties,<sup>63</sup> which party pays taxes and insurance after the conveyance,<sup>64</sup> and whether the deed was recorded immediately after being executed or only after default.<sup>65</sup>

### *C. Installment Land Contracts*

The most commonly used mortgage substitute in seller-financed sales of real estate is the installment land contract. The buyer agrees to purchase real estate for a certain price according to a certain payment schedule. Rather than executing a deed and taking a mortgage in return as security, the seller retains title and agrees to deliver it only upon payment of the final installment. The contract will invariably make time of payment "of the essence" and provide that should the buyer fail to make timely payment of any installment or breach any other provision of the contract, the seller will have the option to cancel the contract and retain all payments previously made as liquidated damages. The principal differences between the purchase money mortgage and the land sale contract are: (1) the buyer builds up no equity in the property until successful completion of the final payment and (2) since the buyer has no equity of redemption, there is nothing to foreclose and thus no right to redeem by a buyer in default who is able to refinance and pay the accelerated debt.

The extreme remedy of forfeiture is justified by proponents of land sale contracts as the social price paid to make real estate available to a person unable to come up with a downpayment or meet the standards of creditworthiness needed to qualify for a conventional mortgage. A contract seller is usually willing to sell with no money down and is not overly concerned with the buyer's ability to pay because the worst that could happen in the event of default is that the contract would retroactively be converted into a lease. For the buyer who defaults, however, the price paid for the opportunity to have acquired property is severe.

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ness. The mere use of the word "redeem" is not sufficient to make a contract for reconveyance a defeasance. If it be shown there was no debt from which redemption might be made and that the debt has, in fact been extinguished, then the word will be construed as repurchase.

*Id.* at 161, 259 S.W. at 738.

63. *Nelson v. Nelson*, 267 Ark. 353, 357, 590 S.W.2d 293, 295 (1979).

64. *Buffalo Stave & Lumber Co. v. Rice*, 187 Ark. 731, 62 S.W.2d 2 (1933).

65. *Gunnels v. Machen*, 213 Ark. 800, 212 S.W.2d 702 (1948).

A buyer who has paid fourteen years on a fifteen year contract has substantial "potential equity" since he is only one year's payment shy of a fee simple. Yet, one payment not made on time and he may just as well have rented for fourteen years.

A fairly typical forfeiture case is *Carpenter v. Thornburn*.<sup>66</sup> There, Thornburn agreed to "lease" certain land to Carpenter for five years at \$190.70 per year. At the end of that time, upon payment of the last installment, Carpenter had an option to purchase the land for an additional \$8. Time of payment was made "of the essence" and the agreement provided that should any payment not be made when due, Carpenter would forfeit all rights under the agreement — including the option to purchase. Because the option could be exercised for nominal additional consideration, Carpenter was accumulating equity in the property. Thus, the contract was really an installment sale rather than a lease.

The first four "lease" payments were timely made; the fifth was not, allegedly because Thornburn would not deliver a deed upon tender of the final installment. The court held that the contract clearly required the seller's tender of a deed only after prompt payment of all five installments and the additional tender of the \$8 option price — a condition not complied with.<sup>67</sup> Thus, time being "of the essence," equity would not relieve Carpenter of the forfeiture. Had this agreement been a mortgage, or had time not been "of the essence," Carpenter could have saved the land by paying his debt anytime prior to foreclosure. Failing this, foreclosure sale proceeds over and above the amount of the debt would have been returned to Carpenter.

The Arkansas Supreme Court has often expressed a reluctance to permit forfeitures: "Equity abhors forfeitures and will seize upon slight circumstances indicating a waiver, to avoid or prevent them."<sup>68</sup> Not only will an express or implied waiver of default bar enforcement of a forfeiture clause, but a court will also refuse enforcement if time is not made "of the essence," or if the land seller has engaged in conduct which would make enforcement of the contract inequitable.

For example, in *Triplett v. Davis*<sup>69</sup> the Arkansas Supreme Court found that acceptance of two late payments without invoking a forfei-

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66. 76 Ark. 578, 89 S.W. 1047 (1905).

67. *Id.* at 582, 89 S.W. at 1048.

68. *Cordell v. Enis*, 162 Ark. 41, 44, 257 S.W. 375, 376 (1924). *See also* *Berry v. Crawford*, 237 Ark. 380, 373 S.W.2d 129 (1963); *Vernon v. McEntire*, 232 Ark. 741, 339 S.W.2d 855 (1960).

69. 238 Ark. 870, 385 S.W.2d 33 (1964).

ture clause precluded a land vendor from declaring a forfeiture the next time a payment was late. The court reasoned that acceptance of the late payments "lulled" the buyer into believing that further late payments would be accepted without invoking the forfeiture clause.

Waiver of prompt performance may be shown either by acquiescence in late payment or by conduct indicating the seller's intent not to strictly enforce the contract. For example, in *Tyree v. Fowler*<sup>70</sup> a land seller who had cashed an earnest money check after the time stipulated for the buyer to perform was held to have waived the buyer's lack of timely performance.

Once a vendor has engaged in conduct amounting to a waiver, the right to enforce a forfeiture clause may only be reinstated by giving clear and unequivocal notice to the vendee that the vendor will not again acquiesce in future late payment or other default and by allowing the vendee a reasonable time to cure the default.<sup>71</sup>

The harshness of forfeiture has also been tempered somewhat by judicial construction of land sales contracts that do not make time "of the essence." Unless time is either expressly or impliedly made "of the essence," a land buyer may avoid forfeiture by curing default before the seller expressly declares a forfeiture.<sup>72</sup>

Time may be made "of the essence" by express contractual language or by implication arising from the nature of the breach or from the circumstances of the parties.<sup>73</sup> In *White v. Page*<sup>74</sup> the Arkansas Supreme Court inferred time to be "of the essence" in a land sale contract calling for the buyer to keep the premises insured, pay taxes, and make monthly mortgage payments:

These three matters were essential and "time was of the essence" as to them: a fire occurring during lapsation (sic) of insurance might destroy most of the security and leave no funds for re-building (sic); failure to pay taxes might lead to loss of all the property; and Mrs. Crandall testified that she insisted that the monthly payments be promptly made on her mortgage.<sup>75</sup>

While the installment land contract is the only real estate security

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70. 247 Ark. 312, 445 S.W.2d 99 (1969).

71. *Ashworth v. Hankins*, 248 Ark. 567, 452 S.W.2d 838 (1970).

72. *Riley v. Warner*, 217 Ark. 901, 233 S.W.2d 626 (1950); *Feibelman v. Hill*, 141 Ark. 297, 216 S.W. 702 (1919); *Smith v. Berkau*, 123 Ark. 90, 184 S.W. 429 (1916); *Butler v. Colson*, 99 Ark. 340, 138 S.W. 467 (1911).

73. *Three States Lumber Co. v. Bowen*, 95 Ark. 529, 129 S.W. 799 (1910).

74. 216 Ark. 632, 226 S.W.2d 973 (1950).

75. *Id.* at 638, 226 S.W.2d at 976.

device wherein the secured party may effect a complete forfeiture upon the buyer's default, the earliest cases in Arkansas treated a species of executory land sale contract—the “bond for title”<sup>76</sup>—as a mortgage for all purposes. In *Smith v. Robinson*<sup>77</sup> certain land buyers agreed to purchase property for a stipulated price payable in annual installments. The land seller executed a bond for \$80 to the first purchaser, payable in the event the seller failed to deliver a valid deed upon payment.<sup>78</sup> The seller executed an instrument to the second purchaser wherein they agreed to be “bound to the said A.P. Smith, his heirs and assigns, to convey the aforesaid lots by title deed” upon payment of all the installments when due.<sup>79</sup>

Both agreements were eventually assigned to Cummings, who went into possession of the land. Cummings then conveyed all his interest in the property to trustees to secure payment of a \$484.19 promissory note payable to Robinson. The deeds were properly recorded. Thereafter, Cummings assigned his interest under the land contracts to Hiram Smith, who paid the contract sellers and received deeds in return. When Cummings defaulted on his note to Robinson, the trustees conveyed all their interest in the lots to him. Robinson then sued to quiet title. The court found Robinson's title superior to any interest of Smith even though at the time Cummings executed the deed of trust, he had received no deeds from the land seller.

The court first noted that the contract to convey land had at that time (1840's) largely replaced the mortgage as the predominant security device for seller-financed land sale transactions. Furthermore, the court believed such contracts were not executory at all:

In general, these brief instruments, neither in their own purport, nor in that of the usual terms of their assignment, by which they are commonly transferred from hand to hand, by any means indicate an

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76. A bond for title has been distinguished from an installment land contract in that the latter is a promise to convey at a later date while the former is a present conveyance coupled with the promise to deliver a deed at a future date. *Pulaski Federal Sav. & Loan Ass'n v. Carrigan*, 243 Ark. 317, 321-22, 419 S.W.2d 813, 816 (1967) (Fogleman, J., dissenting).

77. 13 Ark. 533 (1853).

78.

Now should the above bound commissioners upon the payment of the said consideration by the said John R. Beeson, make, or cause to be made, a good and valid deed of conveyance to the said John R. Beeson, or his assigns, for the above described lot or parcel of ground, conveying all the interest in them vested as commissioners, then and in that event this obligation to be void and in no force.

*Id.* at 536.

79. *Id.* The second agreement did not include a bond, payable in the event the seller failed to convey.

executory contract, but an executed one. On the contrary, most commonly, they recite an actual sale and purchase, its terms as to the credit given, and express, in some form, an obligation to make title to the vendee or his assignees, upon the payment of the whole or some portion of the purchase money. . . .<sup>80</sup>

The court went on to divine that the real intention of the parties was the immediate conveyance of an estate encumbered with a lien. The consequence of the contract being characterized as executed was that it became, in substance, a mortgage and was treated as such for all purposes. The vendee's interest could not be terminated except by foreclosure of the equity of redemption.<sup>81</sup>

Since 1853, whether a contract to convey land was treated by the Arkansas courts as a mortgage (in which case the buyer accumulated equity and was vested with an equity of redemption which could only be divested through foreclosure) or was viewed as an installment land contract (in which case the buyer's interest could be forfeited on default without foreclosure) depended primarily on whether the agreement between the parties was denominated an executory land contract or a bond for title. Numerous cases following *Smith v. Robinson* have generally held that the bond for title be treated as a mortgage.<sup>82</sup> What distinguishes the two security devices as to justify the disparate treatment? The short answer is nothing — except form.

The only attempt by the Arkansas Supreme Court to distinguish a bond for title from an executory land contract occurred in Justice Fogleman's dissent in *Pulaski Federal Savings & Loan Association v. Carrigan*.<sup>83</sup> The Court had held that a judgment lien that attached to the debtor's real estate was subject to a prior executory contract to sell the land. This meant that the buyer would take the real estate free of the lien. Justice Fogleman's main point was that an executory contract to sell did not vest the buyer with or divest the seller of any real estate

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80. *Id.* at 539-40.

81. *Id.* at 541.

82. *Weaver v. Gilbert*, 214 Ark. 800, 218 S.W.2d 353 (1949); *Williams v. Baker*, 207 Ark. 731, 182 S.W.2d 753 (1944); *Fine v. Dyke Bros.*, 175 Ark. 672, 300 S.W. 375 (1927); *Judd v. Rieff*, 174 Ark. 362, 295 S.W. 370 (1927); *Warren v. Henson*, 171 Ark. 162, 283 S.W. 19 (1926); *Fairbairn v. Pofahl*, 144 Ark. 313, 222 S.W. 16 (1920); *Higgs v. Smith*, 100 Ark. 543, 100 S.W. 990 (1911); *Roach v. Richardson*, 84 Ark. 37, 104 S.W. 538 (1907); *Davie v. Davie*, 154 Ark. 633, 18 S.W. 935 (1892); *Scheaff v. Dodge*, 33 Ark. 340 (1878); *Garrett v. Williams*, 31 Ark. 240 (1876); *Hall v. Denckla*, 28 Ark. 506 (1873); *McGehee v. Blackwell*, 28 Ark. 27 (1872); *Newsome v. Williams*, 27 Ark. 632 (1872); *Lewis v. Boskins*, 27 Ark. 61 (1871); *Kelly v. Dooling*, 23 Ark. 582 (1861); *Maxwell v. Moore*, 18 Ark. 469 (1857); *Harris v. King*, 16 Ark. 122 (1855); *Moore & Cail v. Anders*, 14 Ark. 628 (1854).

83. 243 Ark. 317, 321, 419 S.W.2d 813, 816 (1967) (Fogleman, J., dissenting).



interest. According to Justice Fogleman, the fictional relationship of mortgagor and mortgagee often ascribed to vendor and purchaser arose out of the bond for title.<sup>84</sup> The difference between the two types of documents is that a title bond constitutes a present conveyance with a promise to deliver a deed at a later date, while the executory contract is a present promise to convey real estate in the future. It is difficult to verify this from the cases as a universal principle; the critical language is simply not usually reproduced.

In *Smith v. Robinson*<sup>85</sup> the promise of the seller was "to convey" the property by deed upon payment by the buyer. However, Justice Scott, in characterizing the transaction as a mortgage, stressed that the overriding intent of the parties was to effect an immediate conveyance.<sup>86</sup> Title was only formally withheld as security for the vendee's payment. Other cases suggest that the language of the particular transaction was one of current conveyance.<sup>87</sup> In any event, Justice Fogleman seems wrong in stressing the language; Scott seems right in looking to the intent of the parties to effect a present conveyance as determinative of whether the withholding of title as security should be treated as a mortgage. Viewed in this way, the land sale contract clearly should be viewed as a mortgage since the parties envision a current sale with title withheld only to secure payment of the price.

One Arkansas case, not relying on any precedent and apparently never followed nor cited for the particular point again, essentially equated the executory contract and the bond for title. In *Williams v. Baker*,<sup>88</sup> Baker, the owner of certain real estate, contracted to sell it to Bryant for \$443.92 payable, \$100 cash, and the balance in four annual installments. The contract provided that if any installments were not paid when due, "then all of said notes and deferred payments become due and payable, and any sums paid by him shall be considered rentals."<sup>89</sup> Bryant took possession, made some payments, and apparently defaulted. Baker then brought an ejectment action in circuit court to obtain possession of the property and recover damages of three years' rents.<sup>90</sup> The lower court found for Baker on both counts.

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84. *Id.*

85. 13 Ark. 533, 536 (1853).

86. *Id.* at 540.

87. *Moore & Cail v. Anders*, 14 Ark. 628, 632 (1854). Occasionally a document will both "convey" and "promise to convey." See *Kelly v. Dooling*, 23 Ark. 582 (1861).

88. 207 Ark. 731, 182 S.W.2d 753 (1944).

89. *Id.* at 733, 182 S.W.2d at 754.

90. The three years' rents in question was the rental income apparently collected by the buyer from his tenants. *Id.* at 736-37, 182 S.W.2d at 755-56.

On appeal to the Arkansas Supreme Court, the defendant argued that ejectment was an improper remedy and that the case should have been transferred to equity. The basis of the argument does not appear in the opinion other than an oblique reference by the circuit judge to certain "equities" that could only be adjudicated by an equity court.<sup>91</sup> At any rate, in an opinion by Justice McFaddin, the supreme court found it unnecessary to decide the point because no motion to transfer was ever made at the trial level.

The defendant next argued that ejectment was an improper remedy for recovering possession and damages under an installment land contract in default and that the plaintiff should have foreclosed the contract in equity. Justice McFaddin disagreed and sustained the lower court's jurisdiction to have decided the case. In so doing, he found it necessary to equate land contracts and bonds for title. His reasoning was generally a four-step process: 1) a mortgagee may maintain an ejectment action to recover possession of property after default; 2) the relationship between vendor and vendee under a bond for title is the same as that of mortgagor and mortgagee; 3) an executory contract for the sale of real estate is to be treated the same as a bond for title; and 4) therefore ejectment is an appropriate action for the recovery of possession of real estate under an installment land sale contract in default.

When Baker and Bryant made the contract, whereby Baker agreed to sell, and Bryant agreed to buy, the property, and Bryant executed notes for the deferred payments, the transaction was the same, in law and equity, as if Baker had made Bryant a bond for title. We have repeatedly held that the relation between the parties in a bond for title is the same as mortgagor and mortgagee; and that a mortgagee—on condition broken—may maintain ejectment proceedings to recover possession.<sup>92</sup>

Apparently, Justice McFaddin was equating installment land contracts with bonds for title in order to sustain the trial court's jurisdiction to decide the matter rather than remand to chancery for a retrial. However, this may have been unnecessary because *Cleveland v. Aldridge*<sup>93</sup> stands for the proposition that ejectment is an appropriate

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91. *Id.* at 734, 182 S.W.2d at 754.

92. *Id.* at 734-35, 182 S.W.2d at 754.

93. 94 Ark. 51, 125 S.W. 1016 (1910). However, the three cases upon which the court in *Williams* relied as authority, *Fears v. Merrill*, 9 Ark. 559 (1849); *Smith v. Robinson*, 13 Ark. 533 (1852); and *Newsome v. Williams*, 27 Ark. 632 (1872) were all bond for title cases. Oddly enough, Mr. McFaddin himself relied on *Aldridge* for authority. Thus, there was really no need to equate bonds for title with installment land contracts to sustain the trial court's jurisdiction.

remedy for recovery of possession under an installment land contract in default. Furthermore, to maintain an action in ejectment requires only that the plaintiff have both title and the right to possession,<sup>94</sup> conditions that would be met in the case of a vendor under an installment land contract in default.

Having affirmed the lower court's decision restoring possession to the vendor, the court in *Williams* went on to apply mortgage law to the contract. The court held that a vendor has no claim to rents prior to default, and after default has the right to rents and profits only for the purpose of applying them to the debt:

We hold that so much of the judgment as awarded rents was in error. Baker's right to possession was to enable him to become a mortgagee in possession, and thereby apply the rents and profits against the indebtedness. He could not in the same suit take possession from the mortgagor, and then have judgment for rents for three years previous, because the rents, as such, were not included in the mortgage. The right of Baker to possession as mortgagee under condition broken was not final until the judgment of the circuit court. The judgment fixed his right to possession, and he could not recover rents prior to that judgment.<sup>95</sup>

What is important about *Williams* is not so much the result, but that it was achieved by applying mortgage law to an installment land contract.

*Williams* was apparently and inexplicably an aberration. Six years later in *White v. Page*<sup>96</sup> the same Justice McFaddin refused to apply mortgage law to an installment land contract in default. Emphasizing that the agreement between the parties was not a bond for title (which could not be terminated without foreclosure), McFaddin sustained the lower court's enforcement of a forfeiture clause since such was the intent of the parties and equity would not rewrite the contract.<sup>97</sup>

### III. Installment Land Contracts: The Need for Reform

The protection given the buyer of real estate under a mortgage (or bond for title) essentially serves two purposes. First, the requirements that the mortgage be foreclosed, the property sold, and the proceeds applied to the debt with any surplus paid to the mortgagor assures that

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94. *Beloate v. Hathcoat*, 208 Ark. 1100, 188 S.W.2d 619 (1945).

95. *Williams v. Baker*, 207 Ark. at 737, 182 S.W.2d at 755.

96. 216 Ark. 632, 226 S.W.2d 973 (1950).

97. *Id.* at 637, 226 S.W.2d at 975.

the mortgagee will be compensated for his damages but receive no windfall. He will recover exactly what was bargained for—the purchase price, interest, and cost of collection. Second, the recognition of a mortgagor's equity of redemption allows a mortgagor to retain the property by obtaining refinancing and then paying the purchase price prior to foreclosure. In both cases the primary expectations of the parties are being protected—the buyer gets his property and the seller gets his money.

The primary expectations of buyer and seller under an installment land contract are no different. The seller is selling, wants his money, and is willing to finance the sale. The buyer wants the property but does not have, or is unwilling to make, a down payment. The seller retains title as security for the purchase price. This is clearly the functional equivalent of a purchase money mortgage or any other security device that courts have treated as a mortgage.<sup>98</sup> Enforcement of forfeiture clauses clearly frustrates rather than advances the primary goals of both parties to an installment land contract.

Institutional lenders supplying purchase money for real estate are primarily interested in two things: first, the likelihood that the loan will be repaid in a timely fashion and second, if there is a default, that the sale of the collateral will produce enough money to pay off the loan. The latter interest is served by loan-to-value ratios limiting the percentage of appraised value that may be loaned for the acquisition of real estate. The buyer's down payment provides equity that both cushions against a foreclosure sale at less than appraised value and provides the buyer with sufficient stake in the property to encourage maintenance and upkeep. Legislative or judicial reform is needed to ameliorate the harshness of forfeiture while at the same time protecting the interests of lenders. This can be done without depriving poor people of the opportunity for no-money-down home ownership.

The installment land contract providing for forfeiture has been justified as providing a low income consumer who cannot save the down payment as his only hope for owning a home.<sup>99</sup> In the event of default under these contracts, the seller retains his property and the "rental" payments received and forfeited as liquidated damages have presumably provided an adequate return on his investment. Since the recovered property belongs to the seller and she can do with it whatever she

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98. See *supra* pp. text accompanying notes 31-37.

99. See, e.g., *Jenkins v. Wise*, 58 Hawaii 592, 596, 574 P.2d 1337, 1340 (1978); Comment, *Forfeiture: The Anomaly of the Land Sale Contract*, 41 ALB. L. REV. 71, 75 (1977); Power, *Land Contracts as Security Devices*, 12 WAYNE L. REV. 391, 399 (1966).

wishes, the property should either produce appraised value or a return on appraised value, rather than the forced sale value of a foreclosure. There is thus no need in an installment land contract for the protective cushion of the down payment.

It should be obvious that the above "substitute for down payment" justification makes sense only so long as it takes to serve the purpose. This would occur when the purchase price has been paid down to the point where an appropriate loan-to-value ratio exists. Indeed, forfeiture is not so harsh during the early years of the contract. It is only after the buyer has built up substantial equity that forfeiture becomes particularly harsh, and at that time the original justification for forfeiture no longer exists.<sup>100</sup>

### *A. Unconscionability of Forfeiture Clauses*

Enforcement of forfeiture clauses has also been justified as furthering the legal imperative that contracts be enforced as written.<sup>101</sup> This makes sense only when the agreement reflects the voluntary intentions of persons of relatively equal bargaining power. Increasingly, the doctrine of unconscionability has been employed by courts in striking down contracts where persons of superior bargaining power overreach persons with little choice over the matter and extract grossly unfair concessions.<sup>102</sup> While the doctrine has a long history,<sup>103</sup> its codification in the Uniform Commercial Code for the sale of goods<sup>104</sup> has caused

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100. Ohio has recognized this in regard to installment land contracts for residential real estate. Contracts are classified in two ways: those less than five years old and on which less than 20% of the principal amount of the purchase price has been paid, and those more than 5 years old or on which more than 20% of the principal has been paid. The former may be forfeited. The latter must be foreclosed as mortgages. OHIO REV. CODE ANN. §§ 5313.05-.08 (Anderson 1981). Arizona gives a buyer a grace period within which to cure default. The length of the grace period varies according to amount of the purchase price that has been paid, ranging from 30 days where 20% of the purchase price has been paid to 9 months where 50% or more has been paid. ARIZ. REV. STAT. ANN. §§ 33-741, 742 (Supp. 1986).

101. See, e.g., *White v. Page*, 216 Ark. 632, 226 S.W.2d 973 (1950).

102. E. FARNSWORTH, *CONTRACTS* § 4.27 (1982); J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* §§ 9-39 to -40 (2d ed. 1977).

103. J. CALAMARI & J. PERILLO, *supra* note 102, § 9-38.

104. See, e.g., ARK. STAT. ANN. § 85-2-302 (1961):

Unconscionable contract or clause.—(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in

courts to become increasingly vigilant in protecting consumers from unconscionable contracts,<sup>105</sup> not only under the Code, but in non-Code contracts as well.<sup>106</sup>

Perhaps the most famous statement of the meaning of unconscionability was made by Judge Skelly Wright in *Williams v. Walker-Thomas Furniture Co.*<sup>107</sup> According to Judge Wright, unconscionability involves "an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party."<sup>108</sup> While presence or absence of meaningful choice was to be determined by looking at all the circumstances surrounding the contract, two factors were considered particularly important: 1) gross inequality of bargaining power; and 2) whether the person seeking to avoid the contract had reasonable opportunity to discover and understand its terms.<sup>109</sup> The court was finally to determine whether the terms of the contract were so unfair as to justify refusal of enforcement: "The test is not simple, nor can it be mechanically applied. The terms are to be considered 'in the light of the general commercial background and the commercial needs of the particular trade or case.'"<sup>110</sup>

Under this test of unconscionability a court would have some difficulty finding a typical land sales contract unconscionable. The court would have to find that the particular buyer was unable to acquire traditional financing and had no real choice in the type of financing device used.<sup>111</sup> Second, the court would have to find that the buyer did not know nor have the opportunity to determine that forfeiture was the penalty for default. Finally, the court would have to determine that forfeiture as a remedy was so unfair as to withhold enforcement. This would be unlikely, at least in Arkansas, given the widespread use and acceptance of land sale contracts. Most of the reported cases have followed Wright's definition of unconscionability—usually requiring a su-

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making the determination.

105. J. CALAMARI & J. PERILLO, *supra* note 102, § 9-39; E. FARNSWORTH, *supra* note 102, § 4.28.

106. For example, in *Ellsworth Dobbs, Inc. v. Johnson*, 50 N.J. 528, 236 A.2d 843, (1967), the New Jersey Supreme Court held unconscionable a brokerage agreement which made a seller liable for the broker's commission where a sale failed to be consummated solely because of the buyer's default. The court implied that § 2-302 of the Uniform Commercial Code was an expression of public policy that could be applied to all contracts.

107. 350 F.2d 445 (D.C. Cir. 1965).

108. *Id.* at 449.

109. *Id.*

110. *Id.* at 450 (quoting U.C.C. § 2-302 comment 1 (1962)).

111. It would seem that many buyers do have a choice. While they may be able to afford conventional financing, they are persuaded that a no-money-down deal is a better one.

perior bargaining position coupled with some disability toward being able to discover or understand the onerous terms of the contract.<sup>112</sup>

Arkansas appears to follow the *Walker-Thomas* rule. Two Arkansas Court of Appeals cases have briefly discussed the meaning of unconscionability, (without holding the contract in issue unconscionable) and one Arkansas Supreme Court case has held a contract unconscionable without discussing why. In *McLarty Leasing System, Inc. v. Blackshear*,<sup>113</sup> the court of appeals held that a lease contract between two corporations was not unconscionable because there was no showing the parties were of unequal bargaining power, and in *Arkansas National Life Ins. Co. v. Durbin*,<sup>114</sup> the court of appeals stated that two important considerations in assessing unconscionability were "gross inequality of bargaining power between the parties to the contract and whether the aggrieved party was made aware of and comprehended the provision in question."<sup>115</sup> The Arkansas Supreme Court's holding in *Davis v. Kolb*<sup>116</sup> that a timber sale contract was unconscionable is not helpful in that 1) the court concluded unconscionability from the facts without explaining its reasoning and 2) the conduct of the seller amounted to fraud. It is thus unlikely that an Arkansas court would strike down forfeiture clauses as unconscionable per se.

### B. Judicial Reform

Several courts have recognized the inequity of forfeiture and have required that land sale contracts be treated as mortgages and foreclosed. The most common justification involves the duty of equity to intervene and prevent the unfairness and injustice of receiving liquidated damages that greatly exceed actual damages. Typically, these courts are more willing to disrespect the sanctity of a contract which provides for the unjust enrichment of one of the parties.

For example, in *Skendzel v. Marshall*,<sup>117</sup> the Indiana Supreme Court refused to enforce a forfeiture of the land and all payments made where the buyer had made timely payments for nearly six years and had paid a total of \$21,000 out of a contract price of \$36,000. The court ordered the contract foreclosed as a mortgage. No one legal the-

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112. J. CALAMARI & J. PERILLO, *supra* note 102, § 9-40; E. FARNSWORTH, *supra* note 102, § 4.28.

113. 11 Ark. App. 178, 183, 668 S.W.2d 53, 56 (1984).

114. 3 Ark. App. 170, 623 S.W.2d 548 (1981).

115. *Id.* at 174-75, 623 S.W.2d at 551.

116. 263 Ark. 158, 563 S.W.2d 438 (1978).

117. 261 Ind. 226, 301 N.E.2d 641 (1973).

ory or principle underlay the court's decision; rather, an array of reasons, which can be summarized as follows, was offered:

1. Equity abhors forfeitures. Where a forfeiture is designed to secure payment of a debt, and, upon default, damages can be ascertained, a court of equity will relieve the forfeiture upon the buyer's compensating the seller for the breach by paying the debt.<sup>118</sup>
2. Under the facts of the particular case, a forfeiture of \$21,000 as liquidated damages is wholly disproportionate to the seller's loss and is therefore void as a penalty.<sup>119</sup>
3. Under an installment land contract the seller holds title merely as security for repayment. Equitable title is in the buyer and the seller has a lien on the real estate for the purchase price. There is no reason to treat a device which is the functional equivalent of a mortgage any differently than a mortgage.<sup>120</sup>
4. Forfeiture under installment land contracts is nearly identical to the mortgage remedy of strict foreclosure where the mortgagee simply retains the property in satisfaction of indebtedness. Strict foreclosure has been prohibited in all but a few jurisdictions. Courts should not allow the prohibition to be circumvented through the use of installment land contracts.<sup>121</sup>

*Skendzel* stopped short of requiring that all installment land contracts be foreclosed as mortgages. The court indicated that forfeiture would be appropriate where the vendee had abandoned the property or where the vendee had paid very little on the contract.<sup>122</sup>

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118. *Id.* at 231, 301 N.E.2d at 644. The court did not analyze extensively why the \$21,000 was a penalty rather than fair compensation for breach. Rather, the court quoted at length from Annotation, *Provision in Land Contract for Forfeiture of Payments as One for Liquidated Damages or Penalty*, 6 A.L.R.2d 1401 (1949) to make two points. First, while there are a number of abstract tests for differentiating between damages and penalties, "the ultimate catalyst is the court's belief as to the equities of the case before it." *Id.* at 1405. Second, as a general rule, forfeiture of payments early in a contract where the total amount paid has been small will generally be construed as damages while forfeiture later in the contract where a high percentage of the contract price has been paid will generally be construed as a penalty. *Id.*

119. 261 Ind. at 233-34, 301 N.E.2d at 646-49.

120. *Id.* at 234, 301 N.E.2d at 648. See also G. NELSON & D. WHITMAN, *supra* note 1, §§ 7.9-.10.

121. 261 Ind. at 240, 301 N.E.2d at 649-50.

122. At least two other courts have held that installment land contracts must be treated as mortgages. In *Sebastian v. Floyd*, 585 S.W.2d 381 (Ky. 1979), the court held that forfeitures would no longer be enforced and henceforth all installment land contracts would have to be foreclosed like mortgages. In *Honey v. Henry's Franchise Leasing Corp. of America*, 64 Cal. 2d 801, 415 P.2d 833, 52 Cal. Rptr. 18 (1966), the California Supreme Court implied that the buyer



Several jurisdictions, while stopping short of equating installment land contracts with mortgages, have allowed a vendee one last chance to avoid the forfeiture by paying the vendor the remaining debt. These courts have in effect given the vendee an equity of redemption. For example, forfeiture will be denied in Hawaii if the seller can be compensated with money damages. In *Jenkins v. Wise*<sup>123</sup> the buyer purchased two parcels of real estate for \$100,000 and a little over a year later contracted to sell them for \$151,000. He had paid the seller \$16,000 and was in default on two \$4,000 payments. While there was some evidence of bad faith on the part of the seller,<sup>124</sup> and some evidence that the seller waived late payment, the court based its decision on equity's preference for compensation for injury rather than forfeiture:

The penalty of forfeiture is designed as a mere security, and if the vendor obtains his money or his damages, he will have received the full benefit of his bargain. Accordingly, where the vendee's breach has not been due to gross negligence, or to deliberate or bad-faith conduct on his part, and the vendor can reasonably and adequately be compensated for his injury, courts in equity will generally grant relief against forfeiture and decree specific performance of the agreement.<sup>125</sup>

Since the buyer was asking for specific performance and was willing and able to pay the remaining principal, the court was in effect giving the buyer an equity of redemption. The court stopped short of decreeing that such a rule be followed any time a buyer has committed an unintentional default, but held that a court may exercise discretion to order specific performance depending on whether "forfeiture would be harsh and unreasonable under the circumstances."<sup>126</sup> The court then gave a list of factors to be considered.<sup>127</sup>

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under an installment land contract in default could require the seller to foreclose the contract as a mortgage.

123. 58 Hawaii 592, 574 P.2d 1337 (1978).

124. He neglected after request to supply certain information needed to clear the title. *Id.* at 600, 574 P.2d at 1343.

125. *Id.* at 597, 574 P.2d at 1341 (citations omitted).

126. *Id.*

127.

The amount already paid in relation to the total purchase price; the amount and length of the default; the reasons for the delay; the nature and extent of the improvements, if any, made upon the premises by the vendee in possession; the expenditures incurred by the purchasers in good faith reliance upon the agreement of sale; the value of the land as security for the unpaid balance of the purchase price; and the conduct and equities of the parties are among the considerations in determining whether a forfeiture would

The greatest obstacle to a court's giving a defaulting buyer an equity of redemption is the "time-is-of-the-essence" clause. Theoretically, such a clause contractually justifies the seller's refusal to accept late payment not only of installments but also of the accelerated debt. In *Rothenberg v. Follman*<sup>128</sup> the Michigan Court of Appeals found the equivalent of an equity of redemption by refusing to give effect to such "boilerplate" language. However, the equities so overwhelmingly favored the vendee that the court may have been simply looking for a legal theory to support doing equity rather than indicting time-of-the-essence clauses as contracts of adhesion.

In *Rothenberg*, at the time of default the buyers had paid \$32,500 principal and \$9,319.76 interest on property they had purchased for \$40,000. The buyers failed to make a \$1725 payment due May 9, 1965. The owners notified the purchasers of their intent to declare a forfeiture if the default was not cured by September 27. Forfeiture was declared on October 1. On December 10, the buyers offered to pay the contract price in full but the seller refused. The lower court ordered specific performance of the contract and the court of appeals affirmed.

To state the rule of the case simply, a court of equity will relieve a buyer from a default and order specific performance by the seller when "to do otherwise would result in an unreasonable forfeiture."<sup>129</sup> What is unreasonable will vary according to the facts of each case, but among the factors to be considered are "the amount and length of the default, the amount of the forfeiture, (*i.e.*, the sum of the amounts paid to the seller and the value of the property at the time of the forfeiture less the contract price), the reason for the delay in payment, and the speed with which equity's aid was sought."<sup>130</sup> All of these factors were resolved in favor of the buyer in *Rothenberg*.<sup>131</sup> However, in doing so, the court found it necessary to justify its failure to strictly enforce the time-of-the-essence clause.

The court seemed at one point to say that such a clause was essentially meaningless—timing of payments being important only if truly

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be harsh and unreasonable under the circumstances.

*Id.* at 598, n.3, 574 P.2d at 1343 n.3. See also *Kaiman Realty Inc. v. Carmichael*, 65 Hawaii 637, 655 P.2d 872 (1982); *K.M. Young & Assoc. Inc. v. Cieslik*, 4 Haw. App. 657, 675 P.2d 793.

128. 19 Mich. App. 383, 172 N.W.2d 845 (1969).

129. *Id.* at 389, 172 N.W.2d at 848.

130. *Id.*

131. *Id.* at 390, 172 N.W.2d at 849. The buyers had substantial equity in the property which made the forfeiture severe, the buyers tendered full payment of the remaining balance within two months of the forfeiture, the buyers sought equity's aid within a relatively short time after forfeiture, and the amount of default was small.

important, separate, and apart from the contract's assertion that it is important: "Just because the parties have declared that time shall be of the essence does not necessarily make it so. The parties cannot by use of labels convert an apple into an orange. It is the business of courts to look through form to substance."<sup>132</sup> The court also looked at the clause as an invalid attempt to oust a court of equity of its jurisdiction.<sup>133</sup> Such a clause was "but one of the factors to be taken into consideration in determining whether equity will intervene,"<sup>134</sup> and in conjunction with a forfeiture clause, an unreasonable attempt to liquidate damages.<sup>135</sup> Cutting through all the scattershot, the court seemed to be saying that the demands of equity supersede any time of the essence language in a land sale contract.

Other states that have apparently recognized an equity of redemption in installment land contracts include Missouri,<sup>136</sup> Florida,<sup>137</sup> and perhaps California,<sup>138</sup> depending on the court's view of the equities of the parties.

The provision of an installment land contract which provides that in the event of default the vendee forfeits not only the land, but all

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132. *Id.* at 391, 172 N.W.2d at 849-50. The court went on to say in a footnote:

Based on our own professional experience as practicing lawyers, we take judicial notice of the fact that time is generally not regarded as of the essence in the ordinary land contract and that no greater diligence in payment is expected or in fact forthcoming depending on whether a printed form containing the time essence clause or one without it happens to have been used.

*Id.* at 391 n.14, 172 N.W.2d at 850 n.14.

133. *Id.* at 391-92 n.14, 172 N.W.2d at 850 n.14.

134. *Id.* at 392, 172 N.W.2d at 850.

135. *Id.* at 393-94, 172 N.W.2d at 851.

136. In *Parkhurst v. Lebanon Publishing Co.*, 356 Mo. 934, 204 S.W.2d 241 (1947), the Missouri Supreme Court refused to enforce a forfeiture where an installment payment was seven days late, the vendor's actual damages were 15-20 cents, and the buyer stood to lose an investment of around \$4,000. The court cited *Cheney v. Libby*, 134 U.S. 68 (1890), for the proposition that even if time is made of the essence, equity will forgive a short delay in making a payment if no circumstances have intervened as to render specific enforcement of the contract inequitable. While both *Parkhurst* and *Cheney* involved payment of the accelerated debt, to avoid the forfeiture, the language of *Cheney* can be read as giving the buyer the right to avoid forfeiture by curing default within a reasonable time. *Parkhurst* was followed in *Nigh v. Hickman*, 538 S.W.2d 936 (Mo. App. 1976) (buyer had paid 35% of contract price and was 15 days late in tendering payment). In *Key v. Gregory*, 553 S.W.2d 329 (Mo. App. 1977) the court refused to enforce a forfeiture where the buyer had paid \$83,000 of the purchase price and owed \$5,633.28. The court neither relied on nor mentioned *Parkhurst* or *Cheney* and rested its decision on the conclusion that the forfeiture amounted to damages grossly disproportionate to loss and was thus an invalid penalty.

137. *Hoffman v. Semet*, 316 So. 2d 649 (Fla. App. 1975).

138. Compare *Barkis v. Scott*, 34 Cal. 2d 116, 208 P.2d 367 (1949) and *MacFadden v. Walker*, 5 Cal. 3d 809, 488 P.2d 1353, 97 Cal. Rptr. 537 (1971) with *Kosloff v. Castle*, 115 Cal. App. 3d 369, 171 Cal. Rptr. 308 (1981).

payments previously made, may be challenged as an unlawful penalty rather than a reasonable attempt to liquidate damages. The general rule is that to qualify as valid liquidated damages rather than a penalty, the prospective damages must 1) appear uncertain or difficult to ascertain, and 2) be either a reasonable estimate of anticipated future damages or a reasonable forecast of damages that have actually occurred.<sup>139</sup> Thus, if damages for breach are difficult to anticipate or estimate at the time the contract is entered into, the liquidated damages of retention of payments already made will be sustained even though at the time of breach the damages are easily calculable and are less than the liquidated damages. Some jurisdictions following the majority rule will take a "second look" and evaluate reasonableness at the time of the breach in two situations. The first is when no actual damages are sustained even though the estimate in the contract was reasonable.<sup>140</sup> This will often be the case in executory real estate sales agreements which commonly provide for forfeiture of earnest money in the event of the buyer's default.<sup>141</sup> Any default will occur so soon after entering the contract that the seller will suffer little if any damage from depreciation of the property or loss of possession. Courts may also take a "second look" where actual damages turn out to be grossly disproportionate to liquidated damages.<sup>142</sup> Arkansas generally appears to follow the majority rule by refusing to order restitution of the amount that liquidated damages exceed actual damages. For example, in *Nelson v. Jonesboro*,<sup>143</sup> the Arkansas Supreme Court enforced a forfeiture of \$500 where it was claimed actual damages were only \$30. And in *Blackwood v. Liebke*,<sup>144</sup> the court stated the general rule:

It is argued that the landowner is not damaged. That his trees have increased in value, and that he is seeking to exact a higher price therefor than they were worth at the time he made the contract, and yet retain the trees. And it is further argued that where the damages are capable of ascertainment, the amount fixed will be disregarded, although declared to be liquidated damages. But the question is not as to the status of the parties at the time when the contract terminated,

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139. RESTATEMENT (SECOND) OF CONTRACTS § 356 (1979); J. CALAMARI & J. PERILLO, *supra* note 102, § 14-31, at 565; C. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES §§ 149-150 (1935); 22 AM. JUR. 2D *Damages* § 214 (1965).

140. J. CALAMARI & J. PERILLO, *supra* note 102, § 14-31 at 566.

141. See, e.g., *Williams v. Cotten*, 14 Ark. App. 80, 684 S.W.2d 837, (1985); *McIlvenny v. Horton*, 227 Ark. 826, 302 S.W.2d 70 (1957).

142. *Stonebroker v. Zinn*, 286 S.E.2d 911 (W.Va. 1982).

143. 57 Ark. 168, 20 S.W. 1093 (1893).

144. 87 Ark. 545, 113 S.W. 210 (1908).

but as to the status of the parties at the time they made the contract. It may be, as the contract works out, that it would be easy to ascertain the damages for the breach of it, or to prove that there were none. But if the status of the parties at the time of the contract was such that it would be difficult or impossible to have anticipated the damage for a breach of it, and there was a positive element of damage, then under the authorities there is no reason why that may not be anticipated and contracted for in advance.<sup>145</sup>

If, however, the disparity between actual damages and liquidated damages is too great, the court is likely to take a "second look" and invalidate the clause as punitive and not compensatory.<sup>146</sup>

Several jurisdictions have recognized a vendee's right to restitution in cases when a vendor's damages are less than the liquidated damages of the combined forfeiture of the land and all amounts already paid under the contract. When a vendee fails to perform a land sales contract, the vendor is injured in that he has lost whatever benefit his contract would have produced. Thus, the measure of the vendor's damages would be that amount which would "put the plaintiff in the position he would have been in had the contract been fulfilled."<sup>147</sup> Had the contract been completed, his benefit would have been the contract price with interest for the privilege of paying it in installments. Since he must now enter a new contract to reap this benefit, his damages will be the difference between the contract price and the market value of the property at the time of the breach.<sup>148</sup> The vendor is also entitled to compensation for the loss of the use of the property for the time the vendee is in possession of the property—usually measured by its fair rental value.<sup>149</sup> Other consequential damages would include expenses of any subsequent resale, such as the cost of an abstract, real estate commission, revenue stamps, escrow fee, and costs of surveying the property.<sup>150</sup>

As a general rule, a vendee in default is not entitled to a return of

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145. *Id.* at 553, 113 S.W. at 212-13.

146. *See, e.g., Williams v. Cotten*, 14 Ark. App. 80, 684 S.W.2d 837 (1985) (forfeiture of \$20,000 on \$120,000 contract when damages nominal); *McIlvenny v. Horton*, 227 Ark. 826, 302 S.W.2d 70 (1957) (forfeiture of \$1,200 on \$6,300 contract when actual damages \$460).

147. *J. CALAMARI & J. PERILLO, supra* note 102 § 14-4; *C. MCCORMICK, supra* note 139, § 137.

148. *C. MCCORMICK, supra* note 159, § 186; 77 AM. JUR. 2D. *Vendor and Purchaser* § 489 (1975).

149. *See Graves v. Winer*, 351 S.W.2d 193 (Ky. 1961); *see also D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES* § 12.11 (1973).

150. *See, e.g., Ashurst v. Rosser*, 275 Ala. 163, 152 So. 2d 240 (1963); *McIlvenny v. Horton*, 227 Ark. 826, 302 S.W.2d 70 (1957).

any amount he has paid, even in the absence of a forfeiture clause.<sup>151</sup> This has been justified by reasoning that a down payment was an incentive to perform rather than a penalty,<sup>152</sup> or that a party ought not be given a cause of action based on his own default.<sup>153</sup> In many jurisdictions, however, courts are increasingly willing to allow a vendee to recover in restitution any sum by which the amount he has paid under the contract exceeds the vendor's damages. These courts reason that such damages are an invalid penalty,<sup>154</sup> as involving the unjust enrichment of the seller,<sup>155</sup> or as producing an "unconscionable" result.<sup>156</sup>

Idaho courts will order restitution to a defaulting vendee where liquidated damages are found to be disproportionate to actual damages. In *Graves v. Cupic*<sup>157</sup> the vendees paid \$14,500 as a down payment on a restaurant/tavern which they agreed to buy for \$50,000. The remainder was to be paid out in monthly installments. The contract contained the usual "time-of-essence" and forfeiture clauses. When the vendee applied for a transfer of the liquor license, she was turned down because she was a resident of Alaska. She then sued to rescind on the ground of mental incompetence and fraudulent misrepresentation. The defendant-seller generally denied the allegations of the complaint, and, since the plaintiff had ceased making payments when she was told she could not have a liquor license, counterclaimed for breach. The lower court found for the defendant and ordered that all money paid by the plaintiff could be kept by the defendant as liquidated damages. The Idaho Supreme Court reversed, holding that the liquidated damages amounted to an invalid penalty.

The court cited the earlier Utah cases of *Perkins v. Spencer*<sup>158</sup> and *Bramwell Inv. Co. v. Uggl*<sup>159</sup> for the proposition that a contract providing for liquidated damages is enforceable only if they are not dispro-

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151. See 77 AM. JUR. 2D. *Vendor and Purchaser* § 499 (1975); Annotation, *Modern Status of Defaulting Vendee's Right to Recover Contractual Payments Withheld by Vendor as Forfeited*, 4 A.L.R.4TH 993 (1981); *Scott v. Foppe*, 247 N.C. 67, 100 S.E.2d 238 (1957); *Seekins v. King*, 66 R.I. 105, 17 A.2d 869 (1941).

152. *Linster v. Regan*, 108 Ill. App. 2d 459, 248 N.E.2d 751 (1969).

153. *Lawrence v. Miller*, 86 N.Y. 131 (1881).

154. *Graves v. Cupic*, 75 Idaho 451, 272 P.2d 1020 (1954).

155. *Vines v. Orchard Hills, Inc.*, 181 Conn. 501, 435 A.2d 1022 (1980).

156. *Johnson v. Carman*, 572 P.2d 371 (Utah 1977). Other authorities take the position that the defaulting vendee may be entitled to restitution in a particular case. 5A A. CORBIN, CONTRACTS § 1122 (1964); 12 S. WILLISTON, CONTRACTS § 1473 (3d ed. 1970).

157. 75 Idaho 451, 272 P.2d 1020 (1954).

158. 121 Utah 468, 243 P.2d 446 (1952).

159. 81 Utah 85, 16 P.2d 913 (1932).

portionate to the damages actually sustained.<sup>160</sup> Here, since there was no depreciation of property value during the interim between the execution of the contract and its breach, the only damage sustained by the seller was the loss of the use of the property during the time the vendee was in possession. This was calculated to be \$3,714.98—the fair rental value of the property. The \$14,500 retained by the seller as liquidated damages was clearly disproportionate and the court ordered restitution of \$10,758.02.

Defaulting vendees in cases since *Cupic* have been less successful. In *Miller v. Remior*<sup>161</sup> the buyer had paid \$10,578.76 out of a total contract price of \$29,844.25. The buyer was denied restitution because the rental value of the property for the four years that the buyer was in possession amounted to \$7,600, but because of some evidence of additional property damage to the seller, the liquidated damages were held not disproportionate to the actual damages. In another case, it appears that the vendees would have been awarded restitution had they asked for it.<sup>162</sup> Two other cases were remanded to the trial court with instructions to determine whether amounts forfeited under the contract were invalid penalties warranting restitution to the vendee.<sup>163</sup>

Utah will also grant restitution to a defaulting vendee in an appropriate case. The first case to reach this conclusion was *Malmberg v. Baugh*<sup>164</sup> where a total of \$4,450 was paid on a \$10,000 contract that had no forfeiture or liquidated damages clause. The court found that the vendees' breach had been occasioned by a good-faith belief that the sellers had induced their entry into the contract through misrepresentations, and held that the vendees could recover in restitution the excess of their payments over the sellers' damages.<sup>165</sup>

Several years later, the Utah Supreme Court refused to enforce a

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160. 75 Idaho at 457, 272 P.2d at 1024.

161. 86 Idaho 121, 383 P.2d 596 (1963).

162. *Clampitt v. A.M.R. Corp.*, 109 Idaho 145, 152, 706 P.2d 34, 41 (1985). *Ellis v. Butterfield*, 98 Idaho 644, 570 P.2d 1334 (1977). Default occurred during the sixth year of the ten-year contract. A total of \$8,000 principal and \$7,000 interest had been paid on property purchased for \$17,000 and for which the total of payments would have been \$24,000. *Id.* at 657, 570 P.2d at 1347 (Bistline, J., dissenting). The vendees' offer to redeem after default by tendering the accelerated debt of \$9,000 plus costs was refused, and the vendees sued for specific performance. Restitution was not asked for on appeal. The latest Idaho decision found that the seller's damages roughly equalled the amount forfeited and therefore held that enforcement of the forfeiture clause was not unconscionable.

163. *Walker v. Nunnenkamp*, 84 Idaho 485, 373 P.2d 559 (1962); *Howard v. Bar Bell Land & Cattle Co.*, 81 Idaho 189, 340 P.2d 103 (1959).

164. 62 Utah 331, 218 P. 975 (1923).

165. *Id.* at 341, 346, 218 P. at 979-80.

forfeiture and liquidated damages clause where the vendee had paid \$6,300 on a contract price of \$6,500.<sup>166</sup> The court's opinion may be read either as denying enforcement of liquidated damages clauses in any case where damages may easily be ascertained, or as denying enforcement because the amount of liquidated damages compared to the damages sustained was "not in accord with equity and good conscience."<sup>167</sup>

By 1952, the Utah Supreme Court had adopted a traditional liquidated damages/penalty doctrine and refused to sustain a forfeiture where \$2,725 had been paid on a contract price of \$10,500, and default occurred only four months after the contract was executed.<sup>168</sup> The court, purporting to follow the *Restatement*,<sup>169</sup> found both that the amount forfeited was not a reasonable forecast of actual damages and that the actual damages suffered could be readily determined.<sup>170</sup> A concurring opinion argued that, under the *Restatement*, no liquidated damages could ever be awarded for breach of an installment land contract since damages are always easily susceptible of ascertainment when that type of contract is breached.<sup>171</sup>

In later cases, the Utah Supreme Court has seemed to adopt a much harsher attitude toward defaulting vendees, refusing forfeiture only when the disparity between liquidated and actual damages is so great as to shock the conscience of the court. In *Carlson v. Hamilton*<sup>172</sup> the trial court's award of restitution to a defaulting vendee, where his payments exceeded the seller's damages by \$2,119.94 (the buyer had paid \$6,680 on a \$22,000 contract), was reversed by the supreme court on the ground that the result was not "so unconscionable that no decent, fairminded person would view the ensuing result without being possessed of a profound sense of injustice. . . ."<sup>173</sup>

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166. *Croft v. Jensen*, 86 Utah 13, 40 P.2d 198 (1935).

167. *Id.* at 21, 40 P.2d at 202.

168. *Perkins v. Spencer*, 121 Utah 468, 243 P.2d 446 (1952).

169. *RESTATEMENT OF CONTRACTS* § 339 (1932).

(1) An agreement, made in advance of breach, fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for the breach, unless (a) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (b) the harm that is caused by the breach is one that is incapable or very difficult of accurate estimation.

*Id.*

170. *Perkins*, 121 Utah at 477-78, 243 P.2d at 450-51.

171. *Id.* at 479, 243 P.2d at 453-54 (Wolfe, C.J., concurring.)

172. 8 Utah 2d 272, 332 P.2d 989 (1958).

173. *Id.* at 275, 332 P.2d at 991.



However, in *Johnson v. Carman*,<sup>174</sup> the Utah Supreme Court sustained an order of restitution to a defaulting buyer where actual damages were \$25,650, liquidated damages were \$34,596.10, and the total contract price was \$170,000. The court, while purporting not to establish any benchmark, held the liquidation of damages provision unconscionable because the seller would retain an amount thirty-four percent greater than the actual damages sustained.<sup>175</sup> The court also relied on the *Restatement's* position that liquidated damages should be disallowed where exact damages are calculable, since calculated damages almost always produce a fairer result than estimated damages.<sup>176</sup>

One interesting feature of *Johnson* is the manner in which the lower court calculated the seller's loss of use damages. Traditionally, courts compensate the seller for his loss of use of the property for the time the buyer was in possession by offsetting the fair rental value against the payments made by the buyer.<sup>177</sup> In *Johnson*, the trial judge measured the loss-of-use damages by giving the seller interest on the unpaid portion of the purchase price. This was approved as an appropriate way to measure damages.<sup>178</sup>

### C. Legislative Reform

In recent years legislatures have become increasingly concerned with alleviating the harshness of forfeiture. The legislative trend, like the judicial trend, is to treat installment land contracts as mortgages.

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174. 572 P.2d 371 (Utah 1977).

175. *Id.* at 373.

176. *Id.* (citing RESTATEMENT OF CONTRACTS § 339 (1932)).

177. See *Graves v. Winer*, 351 S.W.2d 193 (Ky. 1961); see also D. DOBBS, *supra* note 149.

178. 572 P.2d at 374. The dissenting opinion by Justice Ellett in *Johnson* argued that rental value should have been used. While no findings as to rental value had been made by the trial court, Ellett applied a "rule-of-thumb" that rent is calculated at 1% of the value of the property per month of use (12% per year). *Id.* at 374 (Ellett, C.J., dissenting). This would result in net damages to the purchaser of \$3,845 which was only 2.2% of the purchase price—an amount that should not have shocked the court's conscience. Why Ellett chose a ratio of net damages to total purchase price as an unconscionability benchmark was not stated. It should be noted that the use of Ellett's fair rental value as the measure of the seller's loss would lower the majority's benchmark of actual damages as a percentage of liquidated damages from 34% to 13%—an amount the majority would likely have found acceptable. Other Utah cases have produced little in the way of guidance as to what is or is not unconscionable. In *Morris v. Sykes*, 624 P.2d 681 (Utah 1981), the buyer had paid \$23,216 (\$3,507 interest and \$19,709 principal) on a contract price of \$40,000. The Utah Supreme Court sustained the lower court's order that the vendor repay the vendee \$14,121, the amount by which actual damages exceeded liquidated damages. In *Soffe v. Ridd*, 659 P.2d 1082 (Utah 1983), the court affirmed an order of restitution where liquidated damages were \$20,725 and actual damages \$5,895.

Florida<sup>179</sup> and Oklahoma<sup>180</sup> require such contracts to be treated the same as mortgages for all purposes. This means that the interest of the buyer can not be forfeited, but must be foreclosed. Ohio requires foreclosure (with excess proceeds over and above the debt payable to the buyer) if more than twenty percent of the purchase price has been paid.<sup>181</sup> In Washington, the court has discretion to block forfeiture and order foreclosure if it finds that the fair market value of the property substantially exceeds the unpaid price owed by the buyer.<sup>182</sup>

A number of states have enacted arrearages statutes.<sup>183</sup> A buyer in default may prevent a forfeiture by paying off all money due and owing as of the time of default. The length of time within which cure may be made varies from 30 days in Iowa<sup>184</sup> up to a possible one year in North Dakota.<sup>185</sup>

#### IV. Conclusion

When a buyer and a seller enter into an agreement for the conveyance of land, each have different intentions and expectations. The buyer hopes to receive protection for the equity he is building up over the course of the contract and, upon making the last payment, expects to receive good title to the property. The seller, on the other hand, intends to sell his property for a particular price. He calculates the payments to provide an appropriate rate of return as compensation for deferral of payment. The seller's expectation is to receive his calculated rate of return.

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179. FLA. STAT. ANN. § 697.01 (West 1969).

180. OKLA. STAT. ANN. tit. 16, § 11A. (West 1986).

181. OHIO REV. CODE ANN. § 5313.07 (Anderson 1981).

182. WASH. REV. CODE ANN. § 61.30.120 (Supp. 1987).

183. Arizona—ARIZ. REV. STAT. ANN. § 33-742(D) (Supp. 1986) (If the amount paid is less than 20% of the contract price, 30 days; if between 20% and 30%, 60 days; if between 30% and 50%, 120 days; if over 50%, 9 months); Iowa—IOWA CODE ANN. §§ 656.2, .4 (West Supp. 1986) (30 days); Minnesota—MINN. STAT. ANN. § 559.21 (West Supp. 1987) (30 to 90 days depending on when contract entered into and the amount of contract price paid); North Dakota—N.D. CENT. CODE § 32-18-04 (1976) (6 months if the amount due on contract is more than 66 2/3% of original indebtedness; in all other cases, one year); Ohio—OHIO REV. CODE ANN. §§ 5313.05, .07 (Anderson 1981) (Forfeiture permitted after 30 days only where contract less than five years old and less than 20% of price paid); Oregon—OR. REV. STAT. § 93-915 (1985) (60 to 120 days depending on percentage of purchase price paid); Pennsylvania—PA. STAT. ANN. tit. 68, § 904 (Purden 1965) (30 days where default was failure to make payment when due; 60 days for other defaults); Texas—TEX. PROP. CODE ANN. §§ 5.061-.063 (Vernon 1984) (15 to 60 days depending on percentage of contract price paid); Washington—WASH. REV. CODE ANN. § 61.30.070 (Supp. 1986) (90 days unless a greater period is specified in the contract).

184. IOWA CODE ANN. § 656.2 (West Supp. 1986).

185. N.D. CENT. CODE § 32-18-04 (1976).

The traditional mortgage furthers these different intentions and expectations. Upon default, the buyer's equity is protected by being given an opportunity to redeem the property before foreclosure and the seller, in the event the buyer does not redeem, may have the property sold to recover his money. The buyer is then entitled to keep any excess over the amount of the debt. Payments received have compensated the seller both with interest and a return of principal.

Enforcement of forfeiture clauses in installment land contracts does fundamental injustice to these expectations and effectively converts the agreement into a lease. Had the seller wished to rent the property at the outset, the rental payments would presumably have been lower than those necessary to retire the indebtedness created under the contract. Allowing the seller to retain the purchase payments as a substitute for loss of rent overcompensates the seller. More importantly, enforcement ignores the buyer's acquisition of equity and works an extreme injustice on the buyer, especially in the late years of the contract. The justification that forfeiture is the price paid for no-money-down financing has weight only in the very early years of the contract. After that the seller has effectively received his down payment.

The courts have protected these interests in deeds intended as security, deeds of trust, and bonds for title by treating them as mortgages. The Uniform Commercial Code treats all personal property security devices as security interests.<sup>186</sup> Only the installment land contract has evaded similar treatment. This can only be justified as blind adherence to history and tradition since the installment land contract serves the same purpose as a seller held mortgage. If the installment land contract were treated as a mortgage, the seller would get what he bargained for, the principal amount of the indebtedness plus interest, without the windfall of forfeiture; and the buyer would get what he bargained for—protection of his equity and title to the property upon completion of the contract. Many jurisdictions have addressed the problem and it is time for the Arkansas courts and the legislature to follow suit and reform the installment land contract so that the seller receives no more than his bargain and the buyer is adequately protected.

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186. U.C.C. § 9-102(1)(a) (1972).