"Equitable Adjustment" In Real Estate Contract Foreclosures: Victory for the Contract Vendee or Death of Installment Land Contract Financing?

by

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Originally published in SOUTH DAKOTA LAW REVIEW
35 S. D. L. REV. 402 (1990)

"EQUITABLE ADJUSTMENT" IN REAL ESTATE CONTRACT FORECLOSURES: VICTORY FOR THE CONTRACT VENDEE OR DEATH OF INSTALLMENT LAND CONTRACT FINANCING?

Courts have exhibited an increased willingness to award restitution to defaulting vendees in executory contracts for the sale of land. The South Dakota Supreme Court has recently joined this trend, departing from many years of strict adherence to the express terms of contract default provisions. These changes, however, have not arrived without controversy. In Beitelspacher v. Winther, *a divided court could neither settle on an appropriate forfeiture remedy, nor agree on an adjustment method which they found equitable to both parties. Further, present purchaser protections may prove inconsequential as current ambiguities in forfeiture guidelines threaten to impede the court's recent progress. Moreover, existing uncertainties may contradict the purpose for which the protections were adopted by depriving future contract purchasers of an important source of low-equity financing.*

I. INTRODUCTION

The installment land contract has played a special role in real estate practice, most notably for its tax advantages to the retiring seller and as an alternative financing vehicle for purchasers who lack equity and the credit rating to obtain conventional mortgage financing.[1] Traditionally, the vendor's rights under a contract sale have been greater than those of a conventional third-party mortgagee because the vendor could quickly and reliably enforce a forfeiture clause that was almost always inserted into the contract.[2] When enforced, these clauses enabled the vendor to terminate the contract, recover the property, and retain all installments paid when the purchaser defaulted.[3] Because the forfeiture remedy was less costly and time-consuming than mortgage foreclosure, the contract vendor could assume a higher risk of possible purchaser default.[4] Further, the vendor could accept a lower down payment since prompt foreclosure would avoid the losses and costs that can rapidly accumulate during a lengthy foreclosure proceeding.[5] As such, courts routinely enforced these provisions in favor of the vendor, and rationalized their decisions

1. *See generally* Clark and Richards, *Installment Land Contracts in South Dakota, Part II*, 7 S.D.L. REV. 44 (1962); Note, *Default Clauses in the Contract for Deed: An Invitation to Litigation?*, 28 S.D.L. REV. 467 (1983); Freyfogle, *Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. 609, 610 (1988). *See also* 7 POWELL ON REAL PROPERTY ¶ 938.20[2], 84D-7 (P. Rohan ed. 1989) [hereinafter 7 POWELL] ("the installment land contract is often said to offer four benefits: a low down payment, low closing costs, easy credit requirements, and a short time until the purchaser takes possession").

2. 7 POWELL ¶ 938.20[2], at 84D-7 (cited in note 1).

3. *Id.* ¶ 938.20[1], at 84D-3.

4. *Id.* ¶ 938.20[2], at 84D-7.

5. *Id.* The vendor in most states can retain the property and need not, like the mortgagee, sell the property through foreclosure. The defaulting purchaser cannot insist that the property be sold and cannot, in most states, seek restitution of his installment payments except to the extent that his payments *considerably* exceed the vendor's losses. *Id.* at 84D-6.

as a desire to carry out the expressed intentions of the parties, even though forfeiture often resulted in a substantial loss to the vendee and in a windfall gain to the vendor.[6]

Today, however, the landscape looks much different.[7] Courts and legislatures have recognized that strict adherence to forfeiture provisions can cause harsh consequences for a buyer.[8] This is especially true where the contract nears completion and the vendee's cash investment becomes increasingly substantial.[9] Instead of rigorously enforcing installment contracts according to their terms, courts are borrowing from mortgage law and crafting a body of protections specially designed for the installment sale setting.[10] New rules give the purchaser additional time to reinstate the contract and redeem the property, while diminishing the adverse consequences of unavoidable forfeiture.[11] A few states have even gone so far as to treat the installment land contract as the functional equivalent of a mortgage, extending to the purchaser the full range of mortgagor protections.[12] As a result, forfeiture is now a much less reliable remedy for vendors, and purchasers everywhere face a lesser risk of substantial, inequitable loss.[13]

However, one danger that accompanies this change of attitude, particularly in contracts for the sale of land, is that relief may be given too readily in a manner that results in injustice to the innocent party.[14] Further, when judicial relief is needed to bring an installment contract to an end, the primary benefits of the contract format are removed.[15] There thus exists little reason for a vendor to choose an installment land contract over a sale with a vendor mortgage loan.[16] Understandably, the demise of installment land contract financ-

6. G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 3.27, at 87-88 (2d ed. West 1985) [hereinafter G. NELSON & D. WHITMAN] (citing Note, *Forfeiture and the Iowa Installment Land Contract*, 46 IOWA L. REV. 786, 788 (1961)). *See also* Clark and Richards, 7 S.D.L. REV. at 44 (cited in note 1); Note, 28 S.D.L. REV. at 467 (cited in note 1).

7. Freyfogle, 1988 DUKE L.J. at 610 (cited in note 1).

8. G. NELSON & D. WHITMAN § 3.27, at 88 (cited in note 6).

9. *Id. See also* 7 POWELL ¶ 938.20[3], at 84D-10 (cited in note 1) (the loss may seem especially harsh if the purchaser's default is a minor one and if the purchaser, soon after default, stands ready to cure it).

10. 7 POWELL ¶ 938.20[3], at 84D-14 (cited in note 1). *See infra* text accompanying notes 176-96.

11. Freyfogle, 1988 DUKE L.J. at 610 (cited in note 1). *See infra* text accompanying notes 176-96.

12. *Id.*

13. 7 POWELL ¶ 938.20[3], at 84D-14 (cited in note 1).

14. 1 G. PALMER, THE LAW OF RESTITUTION § 5.5, at 598 (1978) [hereinafter 1 G. PALMER].

15. 7 POWELL ¶ 938.20[3], at 84D-15 (cited at note 1).

16. *Id.* Sometimes a vendor chooses an installment contract form out of a belief that it offers benefits in the way that the income from the sale is taxed. Installment sales reporting does offer benefits to many vendors, but vendors often mistakenly believe that these benefits are available only if an installment contract is used. While the Internal Revenue Code rules on installment sales reporting regularly change, the rules typically provide no reason to prefer an installment contract form over a vendor-retained mortgage loan or other forms of vendor financing. Tax rules allow installment reporting whenever the vendor receives payments spread over several years. The periodic payments can be in the form of installment contract payments or payments on a vendor-retained mortgage loan. Thus, tax rules typically provide no reason to prefer the installment contract format over other forms of vendor financing. *Id.* at 84D-9 (citing I.R.C. §§ 453(b)(1) and 453(f)(3)) ("the seller's receipt of a promissory note from the buyer, whether or not secured by a mortgage, is not a 'payment' to the seller unless the note is payable on demand").

ing begets no winners. The contract seller is denied a quick and reliable remedy upon default, and purchasers are deprived of a significant means of low-equity financing.

This dilemma was most recently addressed in South Dakota in 1983, when the *South Dakota Law Review* detailed the willingness of South Dakota's First Judicial Circuit to strike down a default clause and order restitution to defaulting vendees.[17] At that time, however, the South Dakota Supreme Court had not taken the opportunity to address this important issue.[18] This casenote summarizes an important line of recent supreme court opinions on the defaulting purchaser's developing rights to restitution in real estate installment sales contracts. The opinions include *Dow v. Noble*,[19] in which the supreme court adopted its current formula for adjusting the rights of the parties after purchaser default, and the most recent decision, *Beitelspacher v. Winther*,[20] in which the court permitted retroactive application of the *Dow* balancing formula. Additionally, this note will review the court's current balancing process, examine an alternative method of balancing the competing interests of the parties in a contract forfeiture, and propose options for vendors who wish to avoid court-ordered equitable adjustment. Finally, the note surveys the winners and losers in contract forfeitures, examines why real estate contract financing is important and why it faces impending extinction if existing ambiguities in South Dakota's developing case law are not addressed.

II. FACTS AND PROCEDURE

On September 30, 1977, Reuben O. and Ruth Beitelspacher (Sellers) and Elden L. and Antoinette Winther (Buyers) signed a contract for deed on Sellers' farm.[21] The contract stated a purchase price of $294,400, including an $85,376 down payment which the Buyers paid.[22] The $209,024 remaining balance was amortized at $10,451 principal plus interest annually, with a final balloon payment of $123,585 due November 1, 1987.[23]

Buyers paid all nine annual installments as agreed.[24] However, they failed to secure alternative financing and could not fund their 1987 balloon payment.[25] The land contract was thus in default, with Buyers having made

17. *See* Note, 28 S.D.L. REV. at 467 (cited in note 1). This casenote involved a memorandum opinion from the First Circuit Court of South Dakota, where the court refused to quiet the vendor's title until he refunded to the vendee the excess of the payments made over the damages caused by the vendee's breach. The court predicated this ruling on two grounds: first, the default provision was held to constitute a penalty rather than a clause providing for liquidated damages, and second, the ruling was justified on equitable grounds. *Id.* at 469 (citing Case v. Mayer, No. 80-207, mem. op. (1st Cir. Ct. S.D. Mar. 18, 1981)).

18. Note, 28 S.D.L. REV. at 467 (cited in note 1).

19. 380 N.W.2d 359 (S.D. 1986).

20. 447 N.W.2d 347 (S.D. 1989).

21. *Id.* at 349. The farm included 433 acres of pasture, 177 acres of cropland, and a 16 acre building site. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.* The Buyers were married to each other at the time they entered the contract for deed. Antoinette Winther sought a divorce in the circuit court for Brown County, and was granted a judg-

total principal and interest payments of $293,516.[26]

On January 5, 1988, Sellers initiated an action to foreclose the Buyers' rights under the contract for deed.[27] After a bench trial, judgment was entered foreclosing the Buyers' rights, subject to Sellers' payment of $35,126[28] in restitution to the Buyers.[29] This sum represented the trial court's adjustment of the parties' equities under S.D.C.L. § 21-50-2[30] and per the South Dakota Supreme Court's unanimous opinion in *Dow*.[31] Sellers appealed on various grounds,[32] and Buyers sought review of four aspects of the equitable

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ment and decree of divorce dated February 2, 1988. The divorce decree directed Antoinette to deed her interest in the real property, subject to the contract for deed, to Elden, who was to assume all indebtedness related to the property. *Id.* at 349-50.

26. *Id.* at 350.

27. *Id.* Although Antoinette had signed the contract for deed, she was directed by the divorce decree, *see supra* note 25, to transfer her interest, via quit claim deed, to Elden. Antoinette was not served with a certificate of readiness for trial, which "must be served" under S.D.C.L. § 15-6-40(b) (1986). Antoinette did not appear at the trial, and a default judgment was entered against her. Six days after she was served with notice of the default judgment, Antoinette filed a motion, with supporting affidavit, for relief from judgment under S.D.C.L. § 15-6-60(b) (1986). Her motion was granted by the trial court. *Id.*

28. *Id.* at 349. The trial court's equitable adjustment, rounded to the nearest dollar for simplicity, was computed as follows:

Sellers' Detriment		
1.	Rent	$ 99,162
2.	Easement Payment to Buyers	300
3.	Loss of Land Value	147,044
4.	Expense of Original Sale	5,838
5.	Miscellaneous Expenses in Land Recovery	21,293
	TOTAL DETRIMENT	$273,637
Sellers' Benefits		
1.	Principal Paid	$179,336
2.	Interest Paid	114,179
3.	Buyers' Improvements	15,248
	TOTAL BENEFITS	$308,763
	Less: TOTAL DETRIMENT	273,637
	EQUITABLE ADJUSTMENT	$ 35,126

Id.

29. *Id.* *See supra* note 25.

30. *See infra* note 48.

31. For a full discussion of *Dow*, *see infra* notes 60-68 and accompanying text.

32. *Beitelspacher*, 447 N.W.2d at 349. On Notice of Appeal No. 16388, Sellers asserted trial court error on four main issues and six sub-issues. The main issues included: (1) the equitable adjustment formula of *Dow* is inconsistent with S.D.C.L. Chapter 21-50; (2) *Dow* should not be given retrospective application; (3) if the *Dow* formula applies, the trial court did not properly implement it (see the six sub-issues listed below); and (4) a default judgment initially entered against Antoinette Winther should not have been set aside under S.D.C.L. § 15-6-60(b). The six sub-issues to the court's adjustment in *Beitelspacher* included:

> (1) the trial court's determination that $20 per acre fair rental value for cropland was incorrect; (2) improvements made by Buyers were counted twice; (3) all costs of original sale were not allowed as detriments to Sellers; (4) Sellers' increased income tax liability from reposses-

adjustment.[33]

The supreme court affirmed most of the trial court's findings, but reduced the equitable adjustment figure to $19,879.[34] The *Beitelspacher* decision was extremely significant, especially to vendors holding seasoned real estate contracts, because the court held that the equitable adjustment rule of *Dow* would be applied retroactively from 1986.[35] The court further held that a trial court's power to adjust the rights of the contracting parties was not limited by S.D.C.L. § 21-50-3, which merely authorizes the court to establish a time within which a defaulting party must comply with the terms of the contract.[36] Finally, the court held that in adjusting the competing equities, a trial court need not consider the Sellers' increased income tax liability upon repossession, income tax paid by Sellers on interest payments received from Buyers, or Buyers' income tax savings throughout the life of the contract.[37]

In a dissenting opinion, Justices Sabers and Miller took issue with what they considered the majority's bold change of a contract for deed into a mere lease agreement.[38] The dissenting justices felt that this change deprived the Sellers of the benefit of their original bargain and was contrary to the letter and spirit of the governing statute and caselaw.[39] Further, they asserted that if the courts are to assume responsibility for adjusting the equities of the parties, they must be prepared to do the whole job.[40] In this regard, the dissent felt the majority erred in not considering the costs of the original sale and the income tax aspects which affect the relative equities of both parties.[41] Finally, the dissent proposed an alternative formula for balancing the parties' rights in a real estate contract foreclosure action.[42]

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sion should have been considered; (5) income tax paid by Sellers on interest payments received from Buyers should have been considered; and, (6) income tax savings of the Buyers should have been considered.

Id.

33. *Id.* Buyers asserted, by Notice of Review, No. 16389, that the trial court erred in four aspects concerning adjustment of the equities between the parties: (1) a WEB penalty was improperly assessed as a detriment to the property; (2) excessive attorney's fees were awarded to Sellers, as the trial court failed to determine what portion of Sellers' claimed fees were reasonable; (3) interest on the value of the payments made to Sellers should have been considered in balancing the equities; and, (4) increases in "ASCS crop bases" should have been included in the equitable balancing process as they were a benefit to the property. Buyers' assertions of error will not be reviewed individually, but will be considered in assessing whether the *Dow* formula was properly implemented by the trial court. *Id.*

34. *Id.* at 353-54. The court noted trial court error and reversed a double counting of farm improvements totalling $15,248. *Id.* at 353.

35. *Id.* at 352-53. The *Beitelspacher* court cited three criteria which are used to determine whether a rule is to be given retrospective application: (1) the purpose to be served by the particular new rule; (2) the extent of reliance which has been placed upon the old rule; and (3) the effect on the administration of justice of a retroactive application of the new rule. *Id.*

36. *Id.* at 351-52.

37. *Id.* at 353-54.

38. *Id.* at 355.

39. *Id.* The dissent cited S.D.C.L. § 21-50-2, Prentice v. Classen, 355 N.W.2d 352 (S.D. 1984) and Heikkila v. Carver, 378 N.W.2d 214 (S.D. 1985). The statute and both cases are discussed *infra* at notes 48, 49, and 54, respectively.

40. *Beitelspacher*, 447 N.W.2d at 355.

41. *See supra* note 32.

42. *Beitelspacher*, 447 N.W.2d at 355-56. The dissent's proposed formula is based upon enforce-

III. BACKGROUND

A. *Development of South Dakota Caselaw*

South Dakota courts have for many years recognized default clauses as legitimate means to foreclose a defaulting buyer's rights under a contract for deed.[43] Further, the courts have routinely enforced liquidated damages provisions where accurate damages were incapable of estimation at the inception of the contract.[44] South Dakota is also one of the few states which still recognize strict foreclosure[45] as an acceptable means of foreclosing a defaulting vendee's contract rights.[46] As such, South Dakota has been criticized for being particularly reluctant to aid the contract vendee.[47] Moreover, past South Dakota courts have merely paid lip service to S.D.C.L. § 21-50-2, which empowers the courts to equitably adjust the rights of all parties in a real estate contract foreclosure.[48]

As recently as 1984, the South Dakota Supreme Court in *Prentice v. Classen*,[49] affirmed a strict foreclosure judgment, holding that a default clause was valid and not a penalty where the defaulting vendees had paid 31% of a $45,000 contract price and were given only 30 days to cure their breach.[50] In so holding, the court did acknowledge the safeguards provided by section 21-50-2.[51] The court, however, did not find a substantial disparity between the relative positions of the parties and enforced the forfeiture clause as written.[52]

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ment of the original contract terms. A detailed discussion of the differences between the majority and dissenting formulas is addressed *infra* at notes 102-11.

43. *See generally* Clark and Richards, 7 S.D.L. REV. at 44-45 (cited in note 1).

44. Ordinarily a provision for payment of a stipulated sum for liquidated damages will be sustained if: (1) at the time the contract was made the damages in the event of breach were incapable or very difficult of accurate estimation; (2) there was a reasonable endeavor by the parties to fix fair compensation; and (3) the amount stipulated bears a reasonable relation to probable damages and is not disproportionate to any damages reasonably to be anticipated. *Prentice*, 355 N.W.2d at 355 (citing Anderson v. Cactus Heights Country Club, 125 N.W.2d 491 (S.D. 1963)).

45. A decree of strict foreclosure of a mortgage finds the amount due under the mortgage, orders its payment within a certain limited time, and provides that, in default of such payment, the debtor's right and equity of redemption shall be forever barred and foreclosed; its effect is to vest the title of the property absolutely in the mortgagee, on default in payment, without any sale of the property. BLACK'S LAW DICTIONARY 582 (5th ed. 1979).

46. Clark and Richards, 7 S.D.L. REV. at 45 (cited in note 1).

47. *Id.* (Legal scholars have written that in South Dakota "just about every card in the deck" is stacked "in favor of the vendor" and that "it seems that the South Dakota court is particularly reluctant to aid the vendee.") (citing Howe, *Forfeitures in Land Contracts*, CURRENT TRENDS IN STATE LEGISLATION 415, 417 (1953-54); Vanneman, *Strict Foreclosure on Land Contracts*, 14 MINN.L. REV. 342, 366 (1930)).

48. S.D.C.L. § 21-50-2 (1987) originated from S.L. 1913, ch. 138; R.C. 1919, § 2915; S.D.C. 1939 & Supp. 1960, § 37.3102. With reference to foreclosure of real estate contracts, the statute, unchanged since its 1913 inception, reads in pertinent part. "The court in such actions shall have the power to equitably adjust the rights of all parties thereto . . . ." *Id.*

49. 355 N.W.2d 352 (S.D. 1984).

50. *Id.* at 354-55. *Prentice* involved a $45,000 contract for deed on the purchase of 56 acres of pasture land, a garage, house and outbuilding. Two years into the contract the purchasers experienced marital difficulties and subsequently defaulted on their 1982 annual contract payment. Though the contract purchasers had paid $13,995 (principal) of the contract price and made improvements to the property, the *Prentice* court affirmed a trial court finding that a liquidated damages clause was valid and not a penalty under S.D.C.L. § 53-9-5. *Id.*

51. *Id.* at 355.

52. *Id.*

Unfortunately, the court did not define how substantial a disparity must be before judicial intervention would be appropriate. However, a close reading of *Prentice* reveals several important factors which the court considered in assessing the parties' positions. The factors included payments made on the contract, improvements made to the property, and loss of rents and other detriments suffered by the vendors.[53] This signalled the court's first articulation of factors it was contemplating in a formal balancing process, and foreshadowed impending changes in the court's philosophy towards awarding restitution to a defaulting vendee.

Nevertheless, in the following year the court again affirmed a strict foreclosure judgment in *Heikkila v. Carver*,[54] where the defaulting vendees had paid 33% of a $592,000 contract price, (in addition to making $80,000 of improvements),[55] and were given ninety days from the judgment date to pay the contract balance or forfeit all payments previously made.[56] In affirming the trial court's ruling that the contract's default clause was valid, the supreme court made its predictable cite to the safeguards of section 21-50-2.[57] The court then cited the balancing factors established in *Prentice*, and once again found no substantial disparity between the contracting parties.[58] However, the court again signified forthcoming changes in contract forfeiture law by recognizing that a trial court may order restitution to a defaulting vendee by virtue of its equitable adjustment powers under section 21-50-2.[59]

Apparently not yet satisfied with its previous decisions, or possibly as an attempt to articulate more clearly its developing position on the subject, the supreme court, two months later, decided another contract adjustment case.[60]

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53. *Id.*

54. 378 N.W.2d 214 (S.D. 1985). *Heikkila* involved the foreclosure of a 1979 contract for deed on the sale of a Harding County ranch. The contract fixed the purchase price at $592,000 which included real estate, a dwelling on the property, and a portion of the vendors' mineral rights. Under the terms of the contract, payment was to be made by the assumption of a $12,908.70 debt on a state land contract, a down payment of $159,091.31 and $41,202 annual installments of principal and interest from January 3, 1980, and thereafter for nineteen years. The stated interest rate was 7.5%; however, upon default in payment, interest would accrue at 11% until the default was cured. *Id.* at 215.

Purchasers (Carvers) were delinquent in making their 1982 and 1983 payments. However, on each occasion they tendered payment within the sixty-day grace period provided for in the contract. In 1984, purchasers again failed to make their January 3 installment payment. On January 18, 1984, vendors (Heikkilas) gave purchasers proper notification of their intention to foreclose if payment was not made within the sixty-day grace period. Purchasers did not tender payment, and on March 23, 1984, vendors brought suit for strict foreclosure of the contract. *Id.* at 216.

55. *Id.* at 220.

56. *Id.* at 215-16.

57. *Id.* at 217-18.

58. *Id.*

59. *Id.* at 219-20. The purchasers in *Heikkila* maintained that even if foreclosure was warranted, the trial court erred in not allowing restitution to the extent that improvements made exceeded the damages suffered by the vendors. However, purchasers did not present this claim to the trial court. The supreme court refused to hold that the trial court erred in not awarding restitution inasmuch as restitution was not requested at trial, nor was there sufficient evidence presented to the court from which it could, upon its own accord, award restitution. *Id.*

60. *Dow*, 380 N.W.2d 359. *Dow* involved a 1981 contract for deed on 960 acres of land in Edmunds County, South Dakota. The contract stated a $432,000 purchase price, payable at $125,000 down, and $10,000 annually from March 1, 1982, through March 1, 1986, with a balloon payment on March 1, 1987. The interest rate was 9.5% per annum. *Id.* at 360.

Much like *Prentice* and *Heikkila*, *Dow v. Noble* involved a strict foreclosure action on a $432,000 contract for deed, where the defaulting purchasers had paid 31% of the contract's principal before default.[61] As in the previous cases, the trial court entered a default decree foreclosing the purchasers' contract rights, subject to a short redemption period.[62] However, the trial court further concluded that the purchasers had some equity in the real property and alternatively proposed that sellers pay the purchasers $10,600 to finalize the judgment.[63]

In a unanimous decision, the supreme court affirmed the trial court's judgment, subject to a revised adjustment figure of $36,535.[64] In arriving at this conclusion the court adopted a formula which purported to balance the parties' equities by subtracting the benefits bestowed upon the vendors from the detriments they had incurred during the life of the contract.[65] This formula incorporated all the balancing factors identified in *Prentice*, including pre-default contract payments,[66] property improvements, loss of rents and other detriments[67] suffered by the vendor.[68] Further, the court apparently determined that virtually any disparity of funds between the parties would neces-

61. *Id.* Purchasers had made a $125,000 down payment and one annual principal payment of $10,000 before defaulting on the $432,000 contract. *Id.*

62. *Id.* The trial court set the redemption period at thirteen days. S.D.C.L. § 21-50-3 allows the court to set the time for compliance with the terms of a contract, however, the time cannot be less than ten days from the rendition of the judgment. *Id.*

63. *Id.* On appeal the purchasers questioned (1) whether the trial court's award of costs and attorney's fees was excessive and improper, and (2) whether the trial court equitably adjusted the parties' rights under S.D.C.L. § 21-50-2. Vendor filed a notice of review and asserted that the trial court erred as a matter of law when it concluded that Nobles had any equitable interest in the real property. *Id.*

64. *Id.* at 361. The revised adjustment figure included purchasers' interest payments of $25,935, which the supreme court added to the trial court's judgment. *Id.*

65. *Id.* The court adopted the following trial court computations in its balancing of equities:

Rent equivalent, 3 years, each	
$30.00 per acre	$ 86,400
Less taxes, etc.	6,000
	$ 80,400
12.5% loss in land value	54,000
Expenses to recover land, including attorney's fees	13,900
	$148,300
Principal paid by defendants	135,000
Improvements - expenses to prepare and seed land to winter wheat	23,900
Total benefit to plaintiff	$158,900
Less adjustment	148,300
	$ 10,600
Supreme Court's interest adjustment	25,935
	$ 36,535

Id.

66. *Id.* The supreme court revised the trial court's $10,600 equitable adjustment computation, adding purchasers' interest payments of $25,935 to the benefits side of the formula to offset three years of rent credited to the vendor. *Id.*

67. *Id.* The *Dow* court included as other detriments: property taxes, real estate devaluation, and expenses to recover land, including attorney's fees. *Id.*

68. *Id.*

sitate an adjustment, as the revised $36,535 restitution figure represented 8.5% of the original contract price.

Thus, for the first time since section 21-50-2 was enacted in 1913, the supreme court had applied definitive factors to the adjustment process and awarded restitution to a defaulting vendee in a contract for deed foreclosure. Before deciding *Beitelspacher*, however, the court relied on its decree in *Heikkila*, and affirmed another trial court judgment awarding restitution to vendees who had defaulted on real estate sales contracts.

Safari, Inc. v. Verdoorn,[69] involved a $175,000 real estate sales contract for the purchase of a bar/lounge.[70] Three months into the contract the purchasers voluntarily relinquished possession of the business after having paid 30% of the contract price.[71] The vendors, Safari, Inc., brought an action for specific performance or, in the alternative, an order restoring all interest in the property to them.[72] The trial court entered the latter order.[73] The court did not, however, permit Safari to retain $52,000 in payments as specified in a liquidated damages provision, holding the provision void as a penalty.[74] Instead, the trial court found that Safari suffered actual damages of $30,168, subtracted that amount from the $52,000, and entered a judgment against Safari for $21,832.[75] On appeal the supreme court affirmed the trial court's judgment, citing its declaration in *Heikkila* that a trial court may order restitution to a defaulting vendee by virtue of its equitable adjustment powers under section 21-50-2.[76]

As noted above, the supreme court in *Beitelspacher* established its commitment to the equitable adjustment process by ruling that the balancing formula it adopted in *Dow* will be retroactively applied to pre-1986 real estate contracts. Thus, in the span of five years the court has taken measures to

69. 446 N.W.2d 44 (S.D. 1989).

70. *Id.* at 45. The parties originally agreed to a price of $275,000 (this price included the business and real estate) with $75,000 down. After buyers (Verdoorns) could only raise $50,000, the parties agreed to split the transaction by selling the real estate and the business separately. They agreed to a purchase price of $175,000 for the business, including a $50,000 down payment and monthly payments of $2,000 commencing May 1, 1986. Interest was 10% per annum. Buyers leased the real estate separately for $1,000 per month, with an option to purchase. Sale and lease agreements consistent with these terms were prepared and executed. Both parties were represented by legal counsel with whom they reviewed and discussed the terms of the agreements. *Id.*

The purchasers took possession of the enterprise and made immediate changes to attract a different, younger clientele. Gross sales fell substantially. The trial court found this was partially due to purchasers' management. As a result, purchasers were only able to make the May payment under the sales agreement and the April, May, and June payments under the lease agreement. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at 45-46. The court rejected as speculative Safari's claimed damages for loss of fair market value of the business in the amount of $90,000. In addition, there was no evidence of the expenses of the first sale or those expenses expected upon resale after foreclosure. Such evidence was absent despite the fact that the use of a realtor on both occasions could have resulted in additional total expenses of approximately fifteen percent of value or $40,000. *Id.*

76. *Id.* at 47. The court additionally noted that allowing purchasers to retain payments made under the contract would unjustly enrich them. *Id.*

silence critical commentators[77] by endorsing a position that affords equitable treatment to a defaulting vendee in a real estate contract foreclosure action.

B. *Conflicting Theories of Forfeiture*

South Dakota law provides a procedure for addressing a default on a real estate sales contract.[78] Under S.D.C.L. § 21-50-3 a trial court has the power to establish the time within which the defaulting party must cure the default.[79] If the defaulting party does not cure the default within the time specified by the court, the party's contract rights are foreclosed.[80] In a case where the purchaser cannot or will not redeem, traditional analysis would suggest that forfeiture should follow.[81] When forfeiture is unavoidable and state courts have no statutory guidance, the courts, now including those in South Dakota, are holding that forfeiture may not be "free."[82] Increasingly, the vendor must return the payments he has received insofar as they exceed the actual damages caused by the purchaser's default.[83]

An award of restitution to a defaulting vendee involves two conflicting theories of forfeiture law: contract rescission and contract termination.[84] Each theory offers a method of evaluating the fairness of a forfeiture by calculating the defaulting purchaser's restitutionary rights and weighing these rights against any offsetting vendor damage claims.[85] In practice, these two methods of damage computation can yield widely divergent results.[86] Therefore, the court's view of the fairness of the forfeiture can significantly affect the forfeiture theory it selects.[87]

1. *Contract Rescission*

The forfeiture-as-rescission theory of restitution is based on an undoing of the contract, and its elements of recovery return the vendor to her pre-con-

77. *See supra* note 47.

78. S.D.C.L. ch. 21-50 (1986).

79. Under South Dakota law, a contract for the purchase of real estate works an equitable conversion. The contract vendor holds title in trust for the purchaser and the vendee holds equitable title and has use and possession of the property. South Dakota's land installment foreclosure process is essentially a three step process: (1) a vendor brings a foreclosure suit under S.D.C.L. § 21-50-1; (2) a trial is held and the state court sets a certain time period in which the vendee must comply with the contract terms (this may include payment of an accelerated amount), S.D.C.L. § 21-50-3; and (3) if the vendee does not comply, the clerk of court must certify that the time has expired and the vendee has not complied with the terms of the contract, under S.D.C.L. § 21-50-6. When the foreclosure process is complete, the parties are placed in the same legal position as if the contract had not been made. *In re* Carver, 61 B.R. 824, 828 (Bankr. D.S.D. 1986).

80. S.D.C.L. § 21-50-3 (1987).

81. G. NELSON & D. WHITMAN § 3.29, at 100 (cited in note 6). *See also Beitelspacher*, 447 N.W.2d at 351.

82. G. NELSON & D. WHITMAN § 3.29, at 100 (cited in note 6).

83. *Id.*

84. Freyfogle, 1988 DUKE L.J. at 637 (cited in note 1). Professors Nelson and Whitman refer to the two competing forfeiture theories as "rental value" (rescission) and "difference value" (termination). *See* G. NELSON & D. WHITMAN § 3.29, at 103 (cited in note 6).

85. Freyfogle, 1988 DUKE L.J. at 638 (cited in note 1).

86. *Id.* at 630.

87. 7 POWELL ¶ 938.22[2], at 84D-38 (cited in note 1).

tract position.[88] As such, a vendor who elects rescission, or where the rescission remedy is judicially imposed, should not also have the right to enforce a contract in an action for damages to obtain a deficiency judgment.[89]

Under the rescission theory the vendor suffers two elements of loss when the purchaser breaches the contract and the vendor reacquires the property: (1) the rental value of the property while in the hands of the purchaser, and (2) any decline in value of the property caused by the purchaser, excepting ordinary wear and tear.[90] Rescission also requires, however, that the vendor return to the purchaser any previously received installment payments, both principal and interest, as well as the value of any improvements that the purchaser has made to the property.[91] Under this forfeiture-as-rescission approach, the contract price is irrelevant, as is the purchaser's equity in the property.[92]

2. *Contract Termination*

Under the competing forfeiture theory of contract termination, the vendor recovers the property not because the contract is being undone, but because the contract has been terminated and the purchaser's equitable interest has come to an end.[93] Under this theory the vendor is entitled to recover the contract price, less the sum of any payments received and the value of the property when recovered by the vendor.[94] If the combination of payments and the property value exceed the contract price the purchaser can claim restitution.[95] Alternatively, if the contract price exceeds the property's value the vendor should receive a deficiency judgment.[96]

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88. Freyfogle, 1988 DUKE L.J. at 629 (cited in note 1).

89. *Id.* at 623 (citing Herrington v. McCoy, 434 N.E.2d 67, 69-70 (Ill. 1982); Gray v. Bowers, 332 N.W.2d 323, 325 (Iowa 1983); Nygaard v. Anderson, 366 P.2d 899, 903 (Or. 1961)). *See also* 7 POWELL ¶ 938.22[2], at 84D-37 (cited in note 1) ("as many courts have explained, it makes little sense to award a vendor damages based on breach of contract if the contract is being rescinded").

90. Freyfogle, 1988 DUKE L.J. at 629 (cited in note 1) (citing 1 G. PALMER § 5.6 (cited in note 14)).

91. *Id.* (citing 1 G. PALMER § 5.9 (cited in note 14)).

92. *Id.* As explained later, the court has applied the rescission theory of forfeiture in both *Dow* and *Beitelspacher*. Thus, references to the defaulting parties having real estate *equity*, appear to be an anomaly, since under the rescission theory of forfeiture a purchaser's equity is irrelevant. *See, e.g., Dow*, 380 N.W.2d at 360.

93. Freyfogle, 1988 DUKE L.J. at 638 (cited in note 1).

94. *Id.* at 629-30.

95. *Id.* at 630.

96. *Id.* at 638. The matter of a deficiency judgment upon default of an executory real estate contract was recently addressed in *Wolken v. Bunn*, 422 N.W.2d 417 (S.D. 1985). *Wolken* involved a purchaser's willful breach of a $200,000 contract which he personally guaranteed. *Id.* at 418-19. Upon a trial court's order of foreclosure and a deficiency judgment, the purchaser appealed, arguing that deficiency judgments in conjunction with strict foreclosure of a land contract are not allowed by South Dakota law. *Id.* at 419. The purchaser based his argument on the aged authority of *Terpin v. Daugherty*, 220 N.W. 852 (S.D. 1928). In *Terpin*, the supreme court held that a plaintiff cannot have a contract terminated or canceled to enable him to get back the land, and at the same time have the contract kept alive to enable him to get the purchase price, or any part of it. *Id.* at 854. While not expressly overruling *Terpin*, the supreme court easily distinguished the controlling facts of the cases and held that a deficiency judgment was allowable under the facts in *Wolken*. *Wolken*, 422 N.W.2d at 420. In so holding, the court stated that S.D.C.L. § 44-8-23 (detailed below) exempts executory real estate sales contracts from the statutory prohibition on deficiency judgments after mortgage fore-

Absent statutory guidance, the question that courts regularly face is how to make the vendor whole in the easiest and fairest manner, given the positions of the parties at the time of default.[97] One way courts have approached this problem is to allow the vendor to choose between contract rescission or contract termination.[98] Commentators have stated that this may well be the best approach, since the vendor suing for breach of contract generally has the choice between contract rescission and a suit for contract damages.[99] According to a California court, the choice is the vendor's because permitting the vendee to make the choice may encourage breach by allowing him to convert the contract sale into a lease with an option to purchase.[100] This would allow the defaulting party the benefit of any increase in the property's value, with the vendor bearing the entire risk of any decrease in the property's value.[101]

IV. ANALYSIS

In *Beitelspacher*, a divided supreme court applied both theories of contract forfeiture and arrived at very different adjustment figures.[102] The *Beitelspacher* majority applied the rescission theory of forfeiture as originally adopted in *Dow*. Conversely, the dissent supported the contract termination theory of forfeiture, which entitled the vendors to enforce the original contract. As explained below, the *Beitelspacher* case is an excellent illustration of how a court's application of either theory can significantly affect the parties in a contract forfeiture.

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closures. *Id.* at 419. The court further stated that deficiency judgments are written in reference to mortgages and are intended to prevent unjust enrichment. *Id.* at 420.

S.D.C.L. § 44-8-23 provides:

> Nothing contained in § 44-8-20 or § 44-8-21 shall affect the liabilities of the parties to a contract for sale of real estate prior to the time such contract is merged into a mortgage note and mortgage, and judgment for foreclosure or for the amount due under said contract or any other customary judgment, may be rendered under such contract.

S.D.C.L. § 44-8-20 provides:

> No claim for any deficiency in the amount secured by any real estate mortgage given after June 30, 1933, to secure all or any part of the purchase price of such real estate shall exist after the foreclosure of such mortgage by action or advertisement, but such foreclosure shall be a full satisfaction of such mortgage and no deficiency judgment shall thereafter exist or be rendered.

97. Freyfogle, 1988 DUKE L.J. at 638 (cited in note 1).

98. 7 POWELL ¶ 938.22[2], at 84D-41, (cited in note 1) (citing Honey v. Henry's Franchise Leasing Corp. of America, 415 P.2d 833 (Cal. 1966)). In the often cited *Honey* case, written by Chief Justice Traynor, the Supreme Court of California held that where a purchaser had materially breached a land contract the vendor had an election to rescind or to enforce the contract. The defaulting vendee, however, had no such election. *Honey*, 415 P.2d at 835.

99. 7 POWELL ¶ 938.22[2], at 84D-41 (cited in note 1). *See also* G. NELSON & D. WHITMAN § 3.29, at 102 (cited in note 6).

100. *Honey*, 415 P.2d at 835.

101. *Id.* *See also* 7 POWELL ¶ 938.23[6], at 84D-93-94 (cited in note 1):

> "[I]f [restitution] was the only damage calculation available to the vendor, the potential for purchaser abuse would be considerable. This damage calculation approach would allow the purchaser to walk away from a contract at any time and treat the contract as a lease, recovering his payments to the extent that they exceed fair rental value (assuming no waste). A purchaser might be particularly inclined to pursue this approach if the property has declined in value or if he decides that his contract bargain was disadvantageous.

102. It is unknown whether the court knowingly applied the competing theories as no mention of contract rescission or termination was made in the case.

Following the classic rescission-based theory of forfeiture, the vendors in *Beitelspacher* should be allowed to collect $261,454, including $99,162 for the fair rental value of the property while in the purchasers' possession, and $162,292 as compensation for a decline in property value.[103] The court similarly must order the vendor to return the purchasers' payments ($293,516) plus the value of improvements to the property ($15,248) for a total offset of $308,764.[104] Thus, applying the rescission formula would the vendors return to their pre-contract position, subject to a payment of $47,310, to the defaulting purchasers.[105] The *Beitelspacher* majority also allowed the sellers to offset $27,431 of "other detriments" against the $47,310 judgment, including a $300 easement payment, $5,838 of expenses incurred in the original sale, and $21,293 in miscellaneous expenses related to land recovery, including attorney's fees.[106] Thus, in the final analysis the sellers reacquired the land, including compensation for its depreciated value and the fair rental value for its use, and were ordered to pay $19,879 to the purchasers.[107]

Had the *Beitelspacher* majority instead chosen to apply the contract termination theory, as advanced by the dissent, the defaulting purchasers would also have been obligated to return the property to the sellers subject, however, to a $15,897 payment *to the sellers.*[108] This result is reached by subtracting the $123,585 unpaid contract balance,[109] plus $18,375 of accrued interest, and $21,293 in foreclosure expense, from the $147,356 value of the property when returned to the sellers.[110] Interestingly, application of the termination approach yields the same result as would a foreclosure by sale, the major differ-

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103. The loss in land value in *Beitelspacher* is understated by $15,248, because of a double counting of land improvements by the trial court. *Beitelspacher,* 447 N.W.2d at 353. Property improvements are properly credited to the purchasers under the rescission-based theory of forfeiture.

104. *Id.* at 350.

105. Purchasers' Payments & Improvements: $308,764
Less: Rent & Land Depreciation Owed to Sellers: 261,454
$ 47,310

106. *Id.*

107. *Id.* As previously mentioned, the *Beitelspacher* court reduced the trial court's $35,126.84 equitable adjustment figure to $19,878.84, to correct a double counting of improvements. *Id.* at 353.

108. *Id.* at 356. It should be noted that the dissenting justices included neither the $300 easement payment nor the $5,838 cost of the original sale as "other detriments" to the sellers. *Id.*

109. The contract balloon balance of $123,585.44 would include $114,963.20 of principal and $8,622.24 of interest.

110. *Beitelspacher*, 447 N.W.2d at 356. Stated another way, the vendor is entitled to the contract price, less the payments received and the value of the property when recovered by the vendor. As explained in G. Nelson & D. Whitman, if this method of formulation is taken literally, it would be subject to serious criticism:

	$294,400	- Contract price.
Less:	293,516	- Payments received.
Less:	147,356	- Value of property when recovered.
	($146,472)	
Less:	18,375	- Two years accrued interest.
Less:	21,293	- Foreclosure expense.
	$106,804	Reimbursement to the purchaser.

However, a literal application ignores the "time value" of money. Thus, a proper computation would account for the future value of the asset and the associated income stream. Here, the *Beitelspacher* contract spanned ten years, with interest stated at 7.5%, resulting in the following figures:

ence being the property's value measured by the court upon the testimony of witnesses, rather than by an actual sale.[111]

So given the obvious difference in the competing forfeiture calculations, which theory yielded the more equitable result in *Beitelspacher*? As explained below, both theories have their respective places in foreclosure proceedings. At least one treatise, however, explains that in a strict foreclosure action the proper theory is that of contract termination rather than rescission.[112] This is because strict foreclosure is merely a judicial proceeding to determine when the defaulting purchaser's equitable interest is terminated.[113] Therefore, it appears that the *Beitelspacher* dissent applied the correct remedy calculation and the vendors should have been allowed to enforce the contract and recover their expectation interests.

In a related issue, the vendors in *Beitelspacher* argued that S.D.C.L. § 21-50-3 should be interpreted to limit the trial court's equitable adjustment authority under section 21-50-2 to fixing the time within which a defaulting party may comply with the terms of the contract.[114] The supreme court disagreed, reasoning that section 21-50-2 referred to "rights" which may be adjusted and section 21-50-3 deals with only one aspect of those rights—the time within which to cure a default.[115] It is undisputed that the court may set the time for compliance with the terms of the contract. Again, however, a strict foreclosure action is simply a judicial proceeding to determine when the defaulting purchaser's equitable interest in the contract will be terminated.[116] Further, it requires only the termination theory of forfeiture to determine whether a disparity exists between the parties.[117] If, after applying the termination theory, the court determines that a disparity exists, it may then decide

	$430,805	- November 1, 1987, (future) value of the original contract price minus an $85,376 down payment made at inception. ($209,024.00).
Less:	307,220	- November 1, 1987, (future) value of the income stream. (Annual payments of $10,451.20 principal plus 7.5% interest).
Less:	147,356	- Value of property when recovered.
	($ 23,771)	
Less:	18,375	- Two years accrued interest.
Less:	21,293	- Foreclosure expense.
	($ 15,897)	Reimbursement to the purchaser.

See G. NELSON & D. WHITMAN § 3.29, at 103-04 (cited in note 6).

111. When properly computed the termination approach yields the same result as would a judicial sale.

	$147,356	- Value of property upon default.
Less:	123,585	- Balance of contract upon default.
	23,771	
Less:	18,375	- Two years accrued interest.
Less:	21,293	- Foreclosure expense.
	($ 15,897)	Reimbursement to the purchaser.

See G. NELSON & D. WHITMAN § 3.29, at 103-04 (cited in note 6).

112. 7 POWELL ¶ 938.22[3][b], at 84D-44 (cited in note 1).

113. *Id.*

114. *Beitelspacher*, 447 N.W.2d at 351.

115. *Id.*

116. 7 POWELL ¶ 938.22[3][b], at 84D-44 (cited in note 1).

117. *See supra* note 113.

whether the disparity is substantial. If so, the court may "equitably adjust" the rights of the parties and award restitution to the defaulting vendee.

This naturally raises the question of how great a disparity must exist before the court will construe it as substantial. Many courts have concluded that restitution is appropriate if, and only if, the payments exceed the vendor's losses by a *material* amount.[118] These same courts, however, are reluctant to explain how wide the gap must be before restitution will be awarded.[119] If the amount considered to be material is too high, a forfeiture provision may be construed as a penalty. This would seriously frustrate the positive steps taken to protect the interests of the defaulting contract purchasers. Alternatively, if the amount was set too low, vendees may be encouraged to breach their contracts and installment land contracts would essentially become lease agreements. This would deprive the vendor of a prompt, economical remedy, while lessening the pecuniary risk to the purchaser. Further, if a substantial disparity exists, should the court award the full amount of the excess, or just an amount sufficient to reduce the vendor's gain to an acceptable level?[120]

In *Dow*, the court's final adjustment figure was $36,535, or 8.5% of the original contract price.[121] In *Beitelspacher*, the final figure was $19,879, or 6.8% of the original price.[122] Both of these cases involved installment real estate contracts on agricultural real estate. Given the risk, and the often volatile nature of real estate investments, fairness would suggest that courts should allow vendors to retain some portion of the contract price as compensation for purchaser breach.

Professor Palmer's treatise on restitution suggests that courts should recognize a vendor's right to retain a reasonable percentage of the agreed price without proof of damages.[123] This idea parallels the notion of earnest money, which in its original conception was something paid "to bind the bargain," and could justifiably be retained upon a purchaser's breach.[124] Today earnest money is recognized as little more than a down payment which is a relatively small part of the purchase price.[125] Professor Palmer cites ten percent as a common down payment, and urges that courts should allow this portion of a purchaser's payments to be retained by the vendor, at least where the purchaser's breach is willful and deliberate.[126] Allowing vendors to retain pay-

118. Freyfogle, 1988 DUKE L.J. at 629 (cited in note 1) (citing *Heikkila*, 378 N.W.2d at 217 (substantial disparity between payments plus improvements and vendor's detriment necessary); Clampitt v. A.M.R. Corp., 706 P.2d 34, 40 (Idaho 1985) (no recovery when purchaser's lost $747,100 and vendor's lost $752,874); Warner v. Rasmussen, 704 P.2d 559, 563 (Utah 1985) (no recovery when purchaser's lost $14,000 and vendor's lost $10,500)).

119. *Id.*

120. *Id.* (citing Sidney Fed. Sav. & Loan Ass'n. v. Jones, 337 N.W.2d 779, 782 (Neb. 1983); Huckins v. Ritter, 661 P.2d 52, 54 (N.M. 1983); Johnson v. Carman, 572 P.2d 371, 373 (Utah 1977)).

121. *Dow*, 380 N.W.2d at 361.

122. *Beitelspacher*, 447 N.W.2d at 350. It should be noted that the adjustment figures in both *Dow* and *Beitelspacher* were computed using the contract rescission theory of forfeiture.

123. 1 G. PALMER § 5.5, at 598 (cited in note 14).

124. *Id.* at 599.

125. *Id.* (citing RESTATEMENT OF CONTRACTS § 357 under which restitution would be denied to a defaulting purchaser of a payment of "earnest money").

126. *Id.* at 599-600.

ments under ten percent of the purchase price would simplify the administration of restitution, without imposing an undue hardship upon the defaulting purchaser.[127] Further, when confronted with an amount exceeding ten percent, consistency would require the court to award restitution only to the extent of the excess.

Because of the supreme court's current position, virtually any disparity between the equitable interests of the respective parties will compel an adjustment and support an award of restitution. This theory echoes that of conventional mortgage foreclosure and dispels many of the traditional notions of the installment land contract. Consequently, there remains little reason for an aggrieved contract vendor to choose a forfeiture remedy. Thus, alternative remedies may be a vendor's only haven from judicially imposed "equitable adjustments."

A. *Alternatives to Forfeiture*

Following the court's decision in *Beitelspacher*, the equitable adjustment process adopted in *Dow* will be applied retroactively.[128] Disregarding the equity of this decision, land contract vendors, and attorneys who may have counseled parties to land contract sales in reliance on prior South Dakota caselaw, may wish to review alternative means of handling contract forfeitures.

1. *Contract Rescission*

One alternative remedy is formal contract rescission. This remedy is applied in the manner described above for a rescission-based forfeiture.[129] The vendor gets the property back with an award for any decline in value, and recovers the reasonable rental value of the land while in the purchaser's possession.[130] The purchaser recovers his payments and any increase in property value from the date of contract execution.[131] In a rescission-based forfeiture, as contrasted with the formal remedy of rescission, many courts will require restitution to the purchaser only if the restitutionary amount owed the purchaser is so high as to shock the conscience or to render the loss a penalty.[132]

From the vendor's perspective the rescission remedy can be attractive, particularly if the fair rental value of the property exceeds the amount that the purchaser has paid, since the vendor could easily recover a deficiency judgment.[133] On the other hand, the vendor cannot recover consequential damages since rescission is based implicitly on the notion that neither side is at fault.[134] Rescission will also be attractive to the vendor if the property has

127. *Id.* at 600.
128. *Beitelspacher*, 447 N.W.2d at 352-53.
129. *See supra* notes 88-92 and accompanying text.
130. 7 POWELL ¶ 938.22[3][a], at 84D-43 (cited in note 1).
131. *Id.*
132. *Id.*
133. *Id.* ¶ 938.24[4], at 84D-105.
134. *Id.*

appreciated in value, or if the original sale was at a below market price, since the vendor can recapture any increase by recovering the property.[135] Through rescission, the vendor can undo the contract and start the entire process again.[136]

2. *Foreclosure*

Despite its costs in terms of time and money, the foreclosure remedy may also be appealing in certain circumstances. In South Dakota, a vendor may pursue two methods of foreclosure: strict foreclosure and foreclosure by sale.

a. *Strict Foreclosure*

Under strict foreclosure the court sets the date by which the defaulting purchaser must redeem his rights by paying in full the unpaid, contract price.[137] If the contract remains unpaid, the purchaser's equitable rights in the property are eliminated and the vendor once again becomes the sole owner of the property.[138]

Strict foreclosure is based on contract termination rather than contract rescission.[139] Therefore, a vendor after strict foreclosure has a right to damages in an amount equal to his expectation interest under the contract.[140] Some courts analogize strict foreclosure with forfeiture, a theory that would not allow the vendor to recover damages.[141] Strict foreclosure, however, is not a judicial remedy for breach.[142] It is simply a judicial proceeding in which a court decides when the defaulting purchaser's equitable interest in the property comes to an end.[143] As such, it is a remedy entirely consistent with the recovery of money by either party.[144] Traditionally, courts did not require restitution in strict foreclosure.[145] Modern courts, however, regularly condition strict foreclosure on some form of restitution by the vendor where the property value exceeds the unpaid contract balance.[146] Moreover, some states require foreclosure by sale if the loss to the purchaser would be too great under strict foreclosure without restitution.[147]

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135. *Id.*

136. *Id.* It seems likely, however, that a purchaser could refuse to pay rent to the extent that the vendor's claim for lost rental income is covered by the increased property value enjoyed by the vendor. *Id.* (citing Askari v. R&R Land Co., 179 Cal. App. 3d 1101 (Cal. 1986); Gomex v. Pagaduan, 613 P.2d 658 (Hawaii 1980) (comparing California, Utah, and Hawaii methods of calculating vendor damages)).

137. *Id.* at ¶ 938.22[3][b], at 84D-44-45 (citing G. NELSON & D. WHITMAN § 7.9 (cited in note 6)).

138. *Id.* at 84D-44 (cited in note 1).

139. *Id.* Note this statement is directly opposite the majority's rescission calculation in *Dow* and *Beitelspacher*, both cases in which plaintiff/vendors sued on strict foreclosure theories.

140. *Id.*

141. *Id.* (citing Ryan v. Kolterman, 338 N.W.2d 747 (Neb. 1983); Lancaster v. Carelli, 571 P.2d 899 (Or. 1977)).

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.* at 84D-44-45.

147. *Id.* at 84D-45 (citing *Ryan*, 338 N.W.2d at 747; Thomas v. Klein, 577 P.2d 1153 (Idaho

b. *Foreclosure by Sale*

As in strict foreclosure, foreclosure by sale is based on contract termination rather than rescission. Again, the court establishes a deadline for the purchaser's redemption period.[148] The only difference between the two foreclosure methods is that foreclosure by sale is followed by an actual sale of the property, either public or private.[149] The net sale proceeds go to the vendor as payment on the unpaid contract balance.[150] The excess, if any, goes to the purchaser or other claimants.[151] Thus foreclosure by sale, unlike strict foreclosure, has a built-in mechanism by which the purchaser recovers restitution if the property value exceeds the contract balance.[152] As in strict foreclosure, the vendor should be entitled to a deficiency judgment.[153]

3. *Breach of Contract*

Consistent with basic contract law, the vendor should be able to cancel or terminate the contract upon an uncured material breach by the purchaser.[154] Once the contract is terminated, the purchaser's equitable right to possess and use the property should end, and full title to the property should return to the vendor.[155] Vendors frequently bring an action for breach of contract when purchasers fail to close an earnest money contract.[156] The only apparent drawback of the contract breach remedy is that a vendor might not have a right to retain the property if its value exceeds the unpaid contract price.[157] But, as courts increasingly require restitution and foreclosure, vendors in forfeiture actions are rapidly losing their former ability to retain windfalls; the inability to retain the property after a contract breach remedy will thus usually prove insignificant.[158]

4. *Specific Performance*

In the unusual case in which a purchaser has the resources to complete his contractual obligations, two nearly identical remedies provide additional options for the vendor faced with a default.[159] A vendor can sue for specific performance, an equitable remedy, or bring a common law action for the

1978); Ellis v. Butterfield, 570 P.2d 1334 (Idaho 1977); Chaffin v. Ramsey, 555 P.2d 459 (Or. 1976); Vista Management, Ltd. v. Cooper, 726 P.2d 974 (Or. 1986)).

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.* The deficiency judgment would of course be barred if a state has imposed an anti-deficiency statute. *See supra* note 96.

154. Freyfogle, 1988 DUKE L.J. at 641 (cited in note 1) (citing E. FARNSWORTH, CONTRACTS § 8.18).

155. *Id.* at 641.

156. *Id.*

157. *Id. Cf.* E. FARNSWORTH, CONTRACTS § 8.14 (courts now willing to grant restitution to breaching party).

158. Freyfogle, 1988 DUKE L.J. at 641-42 (cited in note 1).

159. *Id.* at 642.

purchase price.[160] Both actions require the purchaser to pay the full purchase price and obligate the vendor, once payment occurs, to deliver a deed.[161]

5. *Summary of Alternatives*

For the vendor, then, actions for rescission, foreclosure, breach of contract, and specific performance can all prove useful in various settings.[162] In selecting among these available remedies, the vendor must first decide whether or not he wants to recover the property.[163] In South Dakota, a vendor who wants to reacquire property has four remedies from which to choose: forfeiture, rescission, strict foreclosure, and contract termination followed by a suit for contract damages.[164] Alternatively, a vendor who does not want to reacquire the property can either seek a foreclosure by sale or bring an action for specific performance of the balance due on the purchase price.[165]

For the vendor who is willing to recover the property, the best remedy will often be contract termination followed by a suit for contract damages.[166] This remedy enables the vendor to recover the property and obtain a deficiency judgment for all consequential damages.[167]

There are some cases, however, in which rescission will be a more attractive remedy for the vendor who seeks to recover the property.[168] In rescission, the vendor can recover the property and retain payments made by the purchaser to the full extent of the fair rental value of the property while the purchaser possessed it.[169] In some cases, particularly when the property has appreciated in value or the original contract price was low, this remedy may increase the vendor's damage award.[170]

When the vendor does not want to recover the property, the best remedy may be to sue for specific performance and ask the court to order the sale of the property if the price is not paid within a reasonable time.[171] If the purchaser performs, the vendor receives the full amount he is due.[172] If the purchaser does not perform, the property is sold at a forced sale and the money goes first to the vendor.[173]

These alternative remedies offer the vendor opportunities to frustrate newly created purchaser protections and avoid much of the uncertainty associ-

160. *Id.* (citing Trachtenburg v. Sibarco Stations, Inc., 384 A.2d 1209, 1212 (Pa. 1978) ("[A]n assumpsit action at law for the purchase price of the land . . . is a third remedy which has always been available to the seller in our common law courts.")).
161. *Id.*
162. *Id.*
163. 7 POWELL ¶ 938.24[6], at 84D-113 (cited in note 1).
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.* at 84D-114.
169. *Id.*
170. *Id.*
171. *Id.* (citing Renard v. Allen, 391 P.2d 777 (Or. 1964)).
172. *Id.*
173. *Id.*

ated with judicially imposed "equitable adjustments" in forfeiture cases. What then has the contract purchaser gained? Some states have addressed this problem by judicially or statutorily eliminating forfeiture; this requires vendors to foreclose and extends the applicable redemption periods.[174] Other states pursue a similar approach, sometimes referred to as "convertability."[175]

B. *Diminishing the Role of Forfeiture*

The trend in most jurisdictions is clearly toward application of mortgage concepts to aid defaulting purchasers.[176] The logical conclusion of this trend would be an absolute equivalency of installment contracts and mortgages, with foreclosure becoming the exclusive means by which an aggrieved vendor could execute upon his security interest in the property.[177] Oklahoma has taken this stance by completely abolishing the distinction between contracts for deed and mortgages, subjecting both to the same rules of foreclosure.[178]

Other states have imposed more moderate statutory restrictions on installment contract forfeitures. Illinois, for instance, requires foreclosure on any installment contract for residential real estate if the purchase price is to be paid over a period exceeding five years, and if the unpaid principal and interest upon foreclosure is less than 80% of the total purchase price.[179] Similarly, a vendor in Ohio must foreclose by judicial sale if the purchaser has paid as agreed for at least five years or has paid at least 20% of the contract price.[180] Maryland takes a somewhat different approach by permitting a purchaser to demand a grant of the subject property, after at least 40% of the contract price has been paid.[181] In return the purchaser must execute a purchase money mortgage to the vendor or another mortgagee procured by the purchaser.[182]

In other states the judiciary has intervened to prevent forfeiture and force judicial sale. In 1979, the Kentucky Supreme Court stated "[t]he modern trend is for courts to treat land sale contracts as analogous to conventional mortgages, thus requiring a seller to seek a judicial sale of the property upon the buyer's default."[183] Thus, from a remedial perspective, Kentucky has achieved the same result by way of judicial decision that Oklahoma reached by

174. Freyfogle, 1988 DUKE L.J. at 631 (cited in note 1).

175. *Id.* at 631-32. "Under the convertability approach, the installment contract is treated as a contract until some specified point in time . . . usually defined in terms of the percentage of the purchase price paid . . . or in terms of the length of time that the contract has been in effect. Once the conversion point is reached, the contract is converted into a mortgage, and the purchaser enjoys all the rights of mortgagors." *Id.* (citing 7 POWELL ¶ 938.22[6], at 84D-62 (cited in note 1)).

176. G. NELSON & D. WHITMAN § 3.29, at 104 (cited in note 6).

177. *Id.* States that require foreclosure sometimes permit strict foreclosure, while others require foreclosure by sale. South Dakota of course allows both methods of foreclosure.

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

179. ILL. ANN. STAT. ch. 110, para. 15-1106(2) (Smith-Hurd Supp. 1989).

180. OHIO REV. CODE ANN. § 5313.07 (Anderson 1989).

181. MD. REAL PROP. CODE ANN. § 10-105(a) (the deed and mortgage executed shall supersede entirely the land installment contract). *Id.* § 10-105(d).

182. *Id.* § 10-105(a).

183. Sebastian v. Floyd, 585 S.W.2d 381, 383 (Ky. 1979).

statute—installment land contracts will be treated as the functional equivalent of mortgages.[184] In states requiring foreclosure, forfeiture is not an alternative in any situation.[185]

Other states take a somewhat different approach. In *Skendzel v. Marshall*,[186] a prominent Indiana opinion, the Indiana Supreme Court held that foreclosure is required unless the purchaser has paid only a minimal amount on the contract or has abandoned the property and absconded.[187] The Indiana court analogized the vendor's lien to a mortgage and concluded that it was logical that such a lien should be enforced through foreclosure proceedings.[188] Since the original decision in *Skendzel*, Indiana courts have read the minimal payment and abandonment exceptions to foreclosure narrowly, and now require foreclosure in nearly all cases.[189] This approach taken by the Indiana courts is sometimes described as the convertability approach.[190] New York courts, citing *Skendzel*, have taken an approach essentially identical to that employed in Indiana.[191]

Proponents of the convertability approach argue that it seems to balance the conflicting interests of vendors and purchasers.[192] In the early stages of an installment land contract's performance, the contract form is respected and the vendor can enforce the forfeiture clause.[193] It is during this initial period that the vendor most needs a speedy recovery method, because the outstanding purchase price might only slightly exceed the property's value, and the vendor will suffer if recovery is delayed.[194] As the contract matures, concern shifts toward the purchaser, and the remedial aspects of mortgage law apply to protect his growing equity.[195] Given the accumulation of contract payments, the vendor's concerns are reduced, and the property's value is likely to exceed the unpaid purchase price.[196]

However, the convertability approach has been criticized for its vagueness.[197] It may be unclear to aggrieved vendors when foreclosure is required and when forfeiture is permitted.[198] If the vendor does resell without foreclos-

184. 7 POWELL ¶ 938.22[6], at 84D-60-61 (cited in note 1).
185. *Id.* at 61.
186. 301 N.E.2d 641 (Ind. 1973), *cert. denied*, 415 U.S. 921 (1974).
187. *Id.* at 650.
188. *Id.* at 648.
189. 7 POWELL ¶ 938.22[6], at 84D-61 (cited in note 1).
190. *Id. See supra* note 175.
191. POWELL ¶ 938.22[6], at 84D-62 (citing Duke v. Werbalowsky, 497 N.Y.S.2d 524 (1985); Bean v. Walker, 464 N.Y.S.2d 895 (1983); Gerder Services, Inc. v. Johnson, 439 N.Y.S.2d 794 (Sup. Ct. 1981)).
192. Freyfogle, 1988 DUKE L.J. at 633 (cited in note 1) (citing Power, *Land Contracts as Security Devices*, 12 WAYNE L. REV. 391, 408-34 (1966); Note, *Installment Land Contracts: The Illinois Experience and the Difficulties of Incremental Judicial Reform*, 1986 U. ILL. L. REV. 91, 92 (1986); Note, *Reforming the Vendor's Remedies for Breach of Installment Land Sale Contracts*, 47 S. CAL. L. REV. 191, 216-32 (1973)).
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.*
198. *Id.* (citing Note, 1986 U. ILL. L. REV. at 114 (cited in note 192)).

ing, the purchaser could claim that the vendor breached the contract by reselling prematurely and could recover substantial damages for breach.[199]

In summary, there is every reason to expect that this movement to classify installment land contracts as mortgages, at least for remedy purposes, will continue.[200] Courts in states like South Dakota, where there is no current statutory guidance on the subject, will increasingly be called upon to determine the relative rights of the contracting parties. As such, all parties would benefit from solid statutory or judicial guidelines.

C. *Proposed Guidelines To Equitable Adjustment*

While the mechanical approach of statutes in Ohio, Illinois, and Maryland offer the benefit of a fixed conversion point for foreclosure, these states have been criticized for failing to consider factors like growth of a purchaser's equity.[201] Conversely, while judicial interpretations have been attacked as vague and potentially hazardous to unsuspecting vendors, their flexibility allows courts to exercise discretion and provide for such factors as equity growth.[202]

The first step towards a workable compromise between the statutory and judicial approaches would be to allow the vendor to choose between the rescission and termination theories of forfeiture.[203] As explained above, a vendor suing for an uncured material breach of contract generally has the choice between these theories. Allowing the vendee (or a sympathetic court) to make this decision may encourage breach by allowing the vendee to transform the contract into a lease agreement or permitting the vendee to avoid an unfavorable bargain, thus placing all contract risks on the innocent vendor.

Next, the court should articulate guidelines which define how substantial the disparity between the parties must be before it will order an award of restitution to the defaulting vendee. As a policy matter, this limit might be lower for residential real estate contracts, as opposed to agricultural and commercial financing. In this regard, Professor Palmer's suggested minimum of ten percent of the purchase price would seem fair.[204] Where the amount of disparity exceeds ten percent, consistency would suggest that restitution only be awarded in an amount of the excess.

Finally, by favoring the termination theory of restitution in a contract foreclosure proceeding, courts will essentially be conducting a foreclosure by sale; the difference being the use of expert testimony to establish the property's fair market value, rather than an actual public or private sale.[205] This method

199. *Id.* at 633-34.
200. G. NELSON & D. WHITMAN § 3.29, at 107 (cited in note 6).
201. Freyfogle, 1988 DUKE L.J. at 635 (cited in note 1) (Professor Freyfogle notes that two factors affecting purchaser equity are an increase in market values and improvements made by the purchaser).
202. *Id.*
203. *See generally* Freyfogle, 1988 DUKE L.J. at 650 (cited in note 1).
204. *See supra* text accompanying note 126.
205. *See supra* note 111 and accompanying text.

eliminates the ambiguities of the convertability approach, while providing for the growth of purchaser equity through improvements and market appreciation. This approach, when combined with the suggested minimum disparity figure, protects both parties to the contract by affording the aggrieved vendor a prompt, economically feasible remedy in the early stages of the contract, while protecting the purchaser's equity in its latter stages.

V. CONCLUSION

Modern courts, now including those in South Dakota, have demonstrated an increased willingness to protect defaulting purchasers from harsh and inequitable forfeiture provisions in real estate sales contracts. These courts justify restitution as a protection for the breaching purchaser who has established some degree of contract equity. However, a significant risk attendant with this new attitude is that assistance may be given at the expense of the innocent vendor. Further, some courts have shown confusion over the availability of competing forfeiture remedies and how to calculate restitutionary relief. Still other courts have established vague guidelines that endorse flexibility over solid instructional guidance.

The South Dakota Supreme Court has undeniably taken significant measures to provide equity in real estate contract forfeitures. The state's developing case law, however, exhibits many of the aforementioned deficiencies. In *Beitelspacher*, the court was split as to which forfeiture remedy was appropriate and how it should calculate remedial relief after forfeiture. Further, the court has been remiss in establishing rules which provide guidance to contracting parties. Though South Dakota's case law is still in its infancy, continued ambiguities will adversely affect both current and potential parties to a contract sale.

The astute vendor holding a seasoned real estate sales contract presently has every reason to avoid contract forfeiture and may do so by choosing from a variety of forfeiture alternatives. Moreover, potential sellers who would previously have relied on quick, inexpensive foreclosure procedures may now justify increased financing terms, since previous distinctions between conventional mortgage and contract remedies are no longer present. Ironically, given the present status of the law, the contract purchaser suffers a dual injustice. First, the current protections are merely illusory; and second, the same purchaser for whom these protections were adopted loses a very important source of low-equity financing.

The judiciary or the legislature can save this important source of financing by resolving current ambiguities and re-establishing specific guidelines for the administration of contract default procedures. These procedures should govern forfeiture remedies and establish a definitive level where the parties can be certain that restitution will be awarded to a defaulting purchaser. Absent

judicial or statutory guidance, current uncertainties decisively favor alternative financing and signal the death of contract for deed sales in South Dakota.

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