

Forfeiture Clauses in Land Installment Contracts: Time for Equitable Foreclosure

I. INTRODUCTION

Washington courts often quote the maxim "equity abhors a forfeiture."¹ Yet the courts' treatment of a defaulting buyer under a land installment contract contradicts these words. When a land installment contract includes a forfeiture provision,² Washington courts generally limit the defaulting buyer's equitable remedy to a "grace period."³ During the grace period,⁴ a defaulting buyer may be able to reinstate the contract by bringing the payments up to date, but the contract is forfeited if the grace period expires before the buyer performs.⁵ Upon forfeiture,

1. See, e.g., *Radach v. Prior*, 48 Wash. 2d 901, 904, 297 P.2d 605, 607 (1956) (court granted a thirty-day grace period when the equities arose in the contract vendee's favor: he had paid 68% of the contract price, had made improvements beyond those for which he had been compensated, had tendered the balance due upon notice of forfeiture, and seller had accepted a tax payment from buyer after expiration of the forfeiture notice); *Batchelor v. Madison Park Corp.*, 25 Wash. 2d 907, 917, 172 P.2d 268, 274 (1946) (forfeiture avoided because only the state can maintain a suit to forfeit rights granted by the state to a city).

2. Forfeiture clauses allow a seller, upon a buyer's default, to declare the contract forfeited, to repossess the property, and to retain all previous payments from the buyer as liquidated damages. Forfeiture clauses are used extensively in land installment contracts. G. OSBORNE, G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* § 3.25, at 80 (1979) [hereinafter cited as G. OSBORNE].

3. By granting a grace period, the court defers the forfeiture and allows the defaulting buyer a period of time during which the buyer can comply with the contract terms and avoid forfeiture. Courts weigh certain factors in deciding to offer grace periods. These factors include substantial payments, improvements, attempts to pay delinquencies, and the size of the delinquency compared to the buyer's equity. *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 784, 215 P.2d 425, 429 (1950) (because the equities of the case warranted the remedy, purchaser was granted a sixty-day grace period to avoid the hardship that would result from strict enforcement of a forfeiture provision). See *Radach v. Prior*, 48 Wash. 2d 901, 905, 297 P.2d 605, 608 (1956). Courts will not grant a grace period, however, when there is little hope of future payments. See, e.g., *Foley v. Superior Court*, 57 Wash. 2d 571, 574-75, 358 P.2d 550, 552 (1961) (the court distinguished other cases in which it was not clear that the purchaser could make future payments, and granted a grace period because the purchaser offered to pay the full contract price plus all costs).

4. See, e.g., *Knoblauch v. Sanstrom*, 37 Wash. 2d 266, 268, 223 P.2d 462, 463 (1950) (five-day grace period); *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 784, 215 P.2d 425, 429 (1950) (thirty-day grace period, the customary time allotted); *Barrett v. Bartlett*, 189 Wash. 482, 484, 65 P.2d 1279, 1280 (1937) (ten-day grace period).

5. See, e.g., *Radach v. Prior*, 48 Wash. 2d 901, 904-05, 297 P.2d 605, 608 (1956);

the seller retains all prior installment payments and repossesses the property regardless of the seller's actual loss.⁶ The buyer loses the entire investment.⁷

The Washington courts' reliance on grace periods stems from their refusal to order foreclosure by judicial sale⁸ if the land installment contract includes a forfeiture clause.⁹ This was not always the case. Early Washington courts declined to enforce forfeiture provisions that constituted penalties rather than provisions for liquidated damages.¹⁰ Nonetheless, this treatment of forfeiture clauses in land installment contracts subsequently lost favor with the Washington courts.¹¹ As a result, grace periods remain the sole equitable remedy in Washington for defaulting buyers under land installment contracts containing forfeiture clauses.

Washington courts should reinstate foreclosure by judicial sale as an equitable remedy for a defaulting buyer because grace periods often fail to relieve the harsh results of forfeiture when the buyer has a large equity in the contracted property.¹² A two-

Moeller v. Good Hope Farms, Inc., 35 Wash. 2d 777, 783, 215 P.2d 425, 429 (1950).

6. 3 AMERICAN LAW OF PROPERTY § 11.75, at 188 (A.J. Casner ed. 1952).

7. *Id.*

8. Foreclosure by judicial sale allows the court to foreclose the contract as though it were a mortgage, according to statutory requirements. This means that the property is sold to satisfy the debt and the costs of the proceedings. Any excess from the sale is paid to the buyer. *Id.* § 11.74, at 186-87. WASH. REV. CODE ch. 61.12 (1983) controls forfeiture procedures. See *infra* notes 82-93 and accompanying text.

9. See *Rains v. Lewis*, 20 Wash. App. 117, 122, 579 P.2d 980, 983 (1978) (when purchaser failed to tender payment in full by the end of the grace period, the forfeiture provision was enforced). See also *First Nat'l Bank of Everett v. Tiffany*, 40 Wash. 2d 193, 200, 242 P.2d 169, 173 (1952) (court ordered foreclosure because the contract was subject to an existing mortgage, but also noted that it would not foreclose a contract with a forfeiture clause as a mortgage).

10. See, e.g., *McDaniels v. Gowey*, 30 Wash. 412, 426, 71 P. 12, 17 (1902) (stipulated damages are penalties, not liquidated damages, if the stipulated sum is punitive rather than compensation for damages actually sustained). See also *Everett Land Co. v. Maney*, 16 Wash. 552, 557-58, 48 P. 243, 244 (1897) (court granted the relief as liquidated damages, but explained that it would not enforce any provision for liquidated damages, even if some of the required performance could not be measured by a pecuniary standard, as long as the damages could be ascertained by a jury); *Krutz v. Robbins*, 12 Wash. 7, 10-14, 40 P. 415, 416-17 (1895) (court refused to enforce any provision for liquidated damages if enforcement would create a penalty, or when the damages were ascertainable).

However, many early Washington cases did not distinguish between earnest money contracts and land installment contracts. See, e.g., *Taylor v. Interstate Inv. Co.*, 75 Wash. 490, 135 P. 240 (1913); *Johnson v. Cook*, 24 Wash. 474, 64 P. 729 (1901); *St. Paul and Tacoma Lumber Co. v. Bolton*, 5 Wash. 763, 32 P. 787 (1893); *Shelton v. Jones*, 4 Wash. 692, 30 P. 1061 (1892).

11. See *infra* notes 19-23 and accompanying text.

12. See *infra* notes 56-59 and accompanying text.

step approach is needed when dealing with defaulting buyers under a land installment contract that contains a forfeiture provision. First, the court should apply a liquidated damages analysis to the forfeiture clause and refuse to enforce the provision if a forfeiture would result in a disproportionate loss to the defaulting buyer.¹³ Second, the court should order foreclosure by judicial sale as an equitable remedy if the forfeiture acts as a penalty, rather than as compensation for the seller's actual loss.¹⁴

This Comment will trace the history of the Washington courts' decision to deny foreclosure by judicial sale in land installment contracts with forfeiture clauses and will demonstrate the viability and preferability of foreclosure by judicial sale as an equitable remedy for a defaulting buyer. The Comment will also describe how other states, either legislatively or judicially, have resolved the inequity of forfeitures.

II. THE HISTORICAL REJECTION OF FORECLOSURE UNDER FORFEITURE CLAUSES

Early Washington courts allowed equitable foreclosure of installment contracts by judicial sale on the theory that the seller's retained legal title acted as security for the debt and, thus, created an equitable mortgage.¹⁵ Courts often treated a forfeiture clause in a land installment contract as a provision for liquidated damages.¹⁶ If the buyer's loss considerably exceeded the seller's loss, the courts held that forfeiture acted as a penalty

13. G. OSBORNE, *supra* note 2, § 3.26. See, e.g., *Skendzel v. Marshall*, 261 Ind. 226, 233-34, 301 N.E.2d 641, 644-46 (1973), *cert. denied*, 415 U.S. 921 (1974) (forfeiture provision acted as a penalty and was unenforceable).

14. See, e.g., *Skendzel v. Marshall*, 261 Ind. 226, 234-41, 301 N.E.2d 641, 646-50 (1973), *cert. denied*, 415 U.S. 921 (1974).

15. See *St. Paul & Tacoma Lumber Co. v. Bolton*, 5 Wash. 763, 766, 32 P. 787, 788 (1893) (the parties' equitable rights under the bond contract were the same as those under a mortgage); *Shelton v. Jones*, 4 Wash. 692, 697, 30 P. 1061, 1062 (1892) (although the court found no vendor's lien in favor of the seller, the court determined that the seller retained a security interest, upon which the seller could foreclose).

16. For detailed discussions of the analysis applied when determining whether a forfeiture constitutes liquidated damages, see *McDaniels v. Gowey*, 30 Wash. 412, 424-29, 71 P. 12, 17 (1902) (contract damages are simple mathematical computations; thus, stipulated sums are usually penalties under these circumstances); *Johnson v. Cook*, 24 Wash. 474, 478-80, 64 P. 729, 731 (1901) (forfeiture of a stipulated sum for failure to erect a house on mortgaged property was not enforced because the forfeiture acted as a penalty, not as liquidated damages; the stipulated sum was a penalty because the actual damages were capable of accurate determination).

and refused to enforce the forfeiture.¹⁷ Instead, the courts ordered the property foreclosed by judicial sale and limited the seller's recovery to the amount of the debt owed, plus any damages resulting from the default.¹⁸

In *Pease v. Baxter*,¹⁹ decided in 1895, the Washington Supreme Court held that forfeiture provisions destroyed any possible application of the equitable mortgage theory, which allowed for foreclosure by judicial sale.²⁰ The rationale was that, by construing the contract as an equitable mortgage and by ordering foreclosure through judicial sale, the courts were "flatly contradicting the express terms of the contract itself."²¹ The court held that a forfeiture clause created a contract of conditional sale, rather than an equitable mortgage.²² Thus, the *Pease* court, without a clear explanation, dropped any reference to the liquidated damages analysis²³ and set the stage for removing equitable foreclosure as a remedy when a buyer defaults on a land installment contract containing a forfeiture clause.

In *Pease*, Justice Dunbar relied upon his opinion in *Reddish v. Smith*²⁴ as the basis for the court's decision that a land installment contract with a forfeiture clause could not be foreclosed as an equitable mortgage, but must be forfeited as a contract of conditional sale.²⁵ Justice Dunbar dismissed objections to his reliance on *Reddish* by stating merely that "the equitable interests of the vendee [buyer] were contended for in that [*Reddish*] case, and the principle discussed was the same."²⁶ *Reddish*,

17. See, e.g., *McDaniels v. Govey*, 30 Wash. 412, 424-29, 71 P. 12, 16-18 (1902); *Johnson v. Cook*, 24 Wash. 474, 478-80, 64 P. 729, 731 (1901).

18. The courts explained that equity would step in when a forfeiture acted as a penalty. *McDaniels v. Govey*, 30 Wash. 412, 427, 71 P. 12, 16-18 (1902). The equitable remedy for breach of contract is foreclosure by judicial sale. *Taylor v. Interstate Inv. Co.*, 75 Wash. 490, 495, 135 P. 240, 242 (1913).

19. 12 Wash. 567, 41 P. 899 (1895).

20. *Id.* at 570-76, 41 P. at 899-901. See *infra* notes 21-28 and accompanying text.

21. *Pease*, 12 Wash. at 573, 41 P. at 900.

22. *Id.* at 576, 41 P. at 901.

23. The court explained its decision to enforce the forfeiture provision by stating that it had to enforce the terms of the contract, no matter how harsh, because "in the absence of fraud [the contract] is conclusively presumed to speak the minds of the contracting parties." *Id.* at 574-75, 41 P. at 901.

Later cases evince the confusion created by *Pease* and discuss the belief that a forfeiture clause should not be enforced when the provision acts as a penalty, rather than as a provision for liquidated damages. See *supra* note 16.

24. 10 Wash. 178, 38 P. 1003 (1894).

25. *Pease*, 12 Wash. at 570, 41 P. at 899-900.

26. *Id.* at 573, 41 P. at 900.

however, was an action of ejectment, and the question before the court was whether the seller could retain the payments received prior to the forfeiture.²⁷ The buyer was arguing that the forfeiture referred only to the contract and not to the payments already received.²⁸ The *Reddish* court did not discuss title, the buyer's equitable interest, or foreclosure as an equitable remedy. Justice Dunbar, therefore, erroneously relied on *Reddish* to determine how a forfeiture clause affected the interest of a buyer under a land installment contract.

After the *Pease* court determined that a forfeiture clause created a contract of conditional sale, Washington courts held repeatedly that executory contracts with forfeiture clauses conveyed no title to buyers.²⁹ In 1925 *Ashford v. Reese*³⁰ extended the *Pease* holding to include all executory contracts. Thereafter, executory contracts conveyed no title or real estate interest to purchasers.³¹

In 1977 the Washington Supreme Court overruled *Ashford* in *Cascade Security Bank v. Butler*³² and held that a buyer's interest under a land installment contract is "real estate."³³ The court made no distinction between contracts with or without forfeiture clauses.³⁴ Although *Cascade* reinstated the buyer's interest as "real estate" and did not differentiate between contracts with or without forfeiture clauses, the court failed to overrule *Pease* and has continued to enforce forfeiture provisions.³⁵

27. *Reddish*, 10 Wash. at 182, 38 P. at 1005.

28. *Id.*

29. See, e.g., *First Nat'l Bank of Everett v. Tiffany*, 40 Wash. 2d 193, 200, 242 P.2d 169, 173 (1952) (because purchase was under a mortgage, purchasers had a homestead right; however, if purchase had been under a contract with a forfeiture clause, no title would have passed under an equitable mortgage theory); *Churchill v. Ackerman*, 22 Wash. 227, 231, 60 P. 406, 408 (1900) (no title passes under an executory land installment contract).

30. 132 Wash. 649, 233 P. 29 (1925), overruled, *Cascade Sec. Bank v. Butler*, 88 Wash. 2d 777, 780, 567 P.2d 631, 633 (1977).

31. See *Ashford*, 132 Wash. at 650, 233 P. at 30.

32. 88 Wash. 2d 777, 780, 567 P.2d 631, 633 (1977).

33. *Id.* at 782, 567 P.2d at 634.

34. The court's failure to differentiate between contracts with or without forfeiture clauses probably results from the fact that most land installment contracts are written on a standard form A-1964, or a similar form, which includes a forfeiture clause. Falconer, *Real Estate Contracts*, 2 WASHINGTON REAL PROPERTY DESKBOOK § 37.46, standard form A-1964, at SU-37-25 (1979) [hereinafter cited as 2 WASH. REAL PROP. DESKBOOK].

35. *Rains v. Lewis*, 20 Wash. App. 117, 122, 579 P.2d 980, 983 (1978) (court enforced forfeiture provision even though purchaser had the funds available three days after the end of the grace period). See also *Terry v. Born*, 24 Wash. App. 652, 655-56, 604 P.2d

Continued enforcement of forfeiture clauses may be a result of the *Cascade* court's specific refusal to recognize the doctrine of equitable conversion.³⁶ Equitable conversion treats the seller's retained legal title as security for the unpaid purchase price, while treating the lien as a mortgage.³⁷ Consequently, the buyer's interest becomes real property, and the seller's interest becomes personal property.³⁸ The seller's retained legal title then acts as security for future payments by creating a vendor's lien,³⁹ an equitable right that permits the seller to enforce payment of the purchase price.⁴⁰ Under a vendor's lien, the standard remedy for a buyer's default is foreclosure by judicial sale.⁴¹

Despite the *Cascade* court's rejection of the doctrine of equitable conversion, Washington courts have applied the doctrine's principles.⁴² In *Freeborn v. Seattle Trust and Savings Bank*,⁴³ the Washington Supreme Court characterized the seller's interest under a real estate contract as personal property and the buyer's interest as real property when the seller retained legal title to the property. The court's characterization of the parties' respective property rights coincides with the parties'

504, 506 (1979) (when contract called for forfeiture if buyer sold the property without seller's consent, and buyer contracted to sell the property, court indicated that it would enforce forfeiture, if on remand, the lower court found that the alienation restriction was reasonable).

36. *Cascade*, 88 Wash. 2d at 783-84, 567 P.2d at 634. The court explained that it did not want to adopt the doctrine because it did not wish to "buttress the rationale" of the cases with a fiction; the court would then be forced to make case-by-case determinations of the boundaries of the doctrine. *Id.* at 784, 567 P.2d at 634.

37. For a complete discussion of the doctrine, see *Skendzel v. Marshall*, 261 Ind. 226, 234-39, 301 N.E.2d 641, 646-49 (1973), *cert. denied*, 415 U.S. 921 (1974).

38. *Cascade*, 88 Wash. 2d at 783, 567 P.2d at 634.

39. *Id.*

40. 3 AMERICAN LAW OF PROPERTY, *supra* note 6, § 11.73. By retaining legal title to the property, the seller has retained an equitable right to the property. The seller holds the legal title as security for future payments, even though the buyer has possession. Thus, the seller not only has a lien against the buyer's equitable interest in the property, but also has security for compelling future payments.

41. 77 AM. JUR. 2D *Vendor and Purchaser* § 415 (1975).

42. See, e.g., *Terry v. Born*, 24 Wash. App. 652, 655, 604 P.2d 504, 506 (1979) (comparing seller's retained title under the contract to a "security device" similar to a real estate mortgage or a deed of trust).

Adherence to the principles of the doctrine of equitable conversion was forecast by others after the *Cascade* decision, even though the Washington courts do not use the term "doctrine of equitable conversion." Nock, Strait & Weaver, *Equitable Conversion in Washington: The Doctrine That Dares Not Speak Its Name*, 1 U. PUGET SOUND L. REV. 121, 138 (1977).

43. 94 Wash. 2d 336, 340, 617 P.2d 424, 426-27 (1980).

rights under the doctrine of equitable conversion. Yet, despite the application of some of the doctrine's principles, Washington courts continue to refuse to apply the principles of foreclosure by judicial sale to land installment contracts that contain forfeiture clauses.⁴⁴

Equally confusing is the attitude of the Washington courts regarding vendors' liens. For years, Washington courts refused to recognize a vendor's lien.⁴⁵ Recently, however, the Washington Supreme Court based its decision in *In re Washburn*⁴⁶ on a vendor's lien. In *Washburn*, the court created a fiction in order to find that the purchasers had a vendor's lien.⁴⁷ After the purchasers had taken possession of a house under an earnest money agreement, they returned possession of the house to the sellers before title passed. When the sellers failed to return the earnest money according to a rescission agreement, the court held that the purchasers had a vendor's lien on the property.⁴⁸

The recognition of a vendor's lien in *Washburn* may reflect another step by the Washington Supreme Court towards accepting foreclosure by judicial sale as an equitable remedy for defaulting buyers. If the court accepts foreclosure as an equitable remedy for defaulting buyers, the court should take the next step and treat forfeiture clauses in land installment contracts as provisions for liquidated damages. If that step is taken in cases when forfeiture will act as a penalty and not as liquidated damages, the court can refuse to enforce the provision and can order foreclosure of the property by judicial sale.

III. THE CASE FOR JUDICIAL SALE INSTEAD OF FORFEITURE

A. *The Case Against Forfeitures*

When a defaulting buyer has a large equity in the property, the loss under forfeiture is frequently disproportionate to the

44. See *supra* note 36.

45. See, e.g., *Jacobson v. Chee Lumber Co.*, 128 Wash. 436, 442, 223 P. 12, 14 (1924); *Smith v. Allen*, 18 Wash. 1, 6-7, 50 P. 783, 785 (1897).

46. 98 Wash. 2d 311, 654 P.2d 700 (1982).

47. *Id.* at 315, 654 P.2d at 702.

48. *Id.* The *Washburn* court distinguished the lien from the disallowed vendor's lien in *Smith v. Allen*, 18 Wash. 1, 50 P. 783 (1897). Whereas the lien in *Smith* was a silent lien based only on equitable principles, the lien in *Washburn* was a recorded judgment. Thus, the lien did not offend the Washington recording statutes. *Washburn*, 98 Wash. at 313-15, 654 P.2d at 701-02.

seller's damages.⁴⁹ Although a forfeiture provision may seem fair to the parties at the outset, the provision can become unfair as time progresses⁵⁰ because the buyer's potential losses from default increase as the equity increases and as the buyer improves the property.⁵¹

Regardless of the possible inequities, forfeiture provisions are viewed as quick remedies for sellers with defaulting buyers because of the traditional "time is of the essence" clause.⁵² This clause allows the seller to declare the contract terminated upon the buyer's default, to retake possession of the property without legal process, and to retain all prior payments as liquidated damages.⁵³ Nevertheless, forfeiture clauses are not necessarily speedy remedies today. Courts may delay enforcement by allowing a grace period,⁵⁴ and sellers usually must litigate to quiet title or to eject the buyer.⁵⁵

The situation is complicated further because the grace periods often vary in length. Neither party can predict when the grace period will begin, or how long it will last.⁵⁶ Furthermore, courts may allow the defaulting buyer to bring the contract up to date during the grace period rather than requiring the buyer to satisfy the entire contract;⁵⁷ yet today's uncertain real estate

49. *Skendzel v. Marshall*, 261 Ind. 226, 232-33, 301 N.E.2d 641, 645 (1973), cert. denied, 415 U.S. 921 (1974). See *infra* notes 104-10 and accompanying text.

50. Note, *Forfeiture Under Installment Land Contracts in Utah*, 1981 UTAH L. REV. 803, 816.

51. *Radach v. Prior*, 48 Wash. 2d 901, 906-07, 297 P.2d 605, 609 (1956). The court cited *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 215 P.2d 425 (1950) to explain why additional improvements to the property required equity to step in to alleviate the inequity created when the buyer had paid on a contract for six years and had only three payments remaining at the time of default. The court explained that the more the buyer paid toward the purchase price, the greater the buyer's loss would be under the forfeiture. As the buyer's loss increased, so did the inequity of a forfeiture.

52. *G. OSBORNE*, *supra* note 2, § 3.25, at 80.

53. *Id.*

54. See *supra* note 3 and accompanying text.

55. *Id.* See also *Tyler v. Casey*, 115 Wash. 2d 1042, 1043 (1921).

56. 2 WASH. REAL PROP. DESKBOOK, *supra* note 34, § 37.38. Although thirty days is the usual length of time, courts will sometimes allow less time if appropriate under the circumstances. See *supra* note 4.

57. See, e.g., *Dunbabin v. Allen Realty Co.*, 26 Wash. App. 660, 613 P.2d 570 (1980). In *Dunbabin*, purchasers paid taxes due and raised the amount of the insurance in accordance with the contract agreement during the grace period, and the court dismissed the forfeiture proceedings. The court indicated that upon notice of intent to declare forfeiture, the purchaser automatically has a grace period, and that if the purchaser conforms to the contract during that period, there can be no grounds for forfeiture. *Id.* at 667, 613 P.2d at 575. This complicates the seller's position, but does nothing to upset the law that, if the purchaser fails to conform during the period, forfeiture results. Litigation

market may prevent the buyer from marketing the property before the end of the grace period. As a result, a buyer loses the total investment through forfeiture.⁵⁸ The seller, on the other hand, usually has greater leverage because a larger equity in the property allows the seller to market the property at a lower price and still protect the equity. Forfeiture may disproportionately burden the defaulting buyer and effectively defeat any incentive for the seller to buy back the property at a fair price.⁵⁹ Similarly, the threat of forfeiture may discourage the buyer from maintaining the property. Clearly, forfeiture fails to encourage an equitable out-of-court settlement by the parties.

Current legal and recording practices also defeat the argument that forfeiture provides a speedy and inexpensive remedy for a seller against a defaulting buyer.⁶⁰ Nonetheless, sellers may feel more protected by forfeiture clauses, particularly when the buyer has a large equity in the property or when the property has increased in value. In either situation, however, the buyer may resell the property to a third party on another contract or allow a third party to assume the original contract.⁶¹ The seller, now usually dealing with an unknown buyer, can only hope that the new buyer will maintain the property. Thus, the forfeiture provision can defeat the seller's own reasons for including the forfeiture clause while also disproportionately burdening the defaulting buyer.

Washington courts have excused their failure to invalidate forfeiture clauses, regardless of the inequities and inconsistencies, on the theory that courts should not interfere with the parties' right to contract.⁶² Washington courts have long accepted

seems to be the only way the seller may solidify his position.

58. See *supra* note 5 and accompanying text.

59. This may not be true if the seller owes on underlying contracts. However, if the buyer has a large equity in the property, the seller may view forfeiture as a windfall.

60. See *supra* text accompanying notes 54-58. According to WASH. REV. CODE § 65.08.070 (1983), any conveyance of land that is not recorded is void against a subsequent purchaser or mortgagee.

61. The standard land installment contract form A-1964 does not include a "due on sale" clause, which would require the contract to be paid in full if the purchaser sold to a third party. 2 WASH. REAL PROP. DESKBOOK, *supra* note 34, § 37.

62. See, e.g., *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 782, 215 P.2d 425, 428 (1950); *Pease v. Baxter*, 12 Wash. 567, 572, 41 P. 899, 900 (1895); *CHG Int'l, Inc. v. Robin Lee, Inc.*, 35 Wash. App. 512, 514-15, 667 P.2d 1127, 1129 (court refused to set aside a condition precedent agreed to by the parties because the condition had not been excused by action of the promisor, and because there had been no detrimental reliance by the promisee), *petition for review denied*, 100 Wash. 2d 1029 (1983).

that a seller, under a contract with a forfeiture provision, may seek other remedies, including damages, when a buyer defaults.⁶³ However, the courts have failed to recognize that courts, too, have options other than mere postponement of forfeiture through the use of grace periods. Only with earnest money contracts⁶⁴ have the courts used a liquidated damages-penalty analysis in deciding whether they will allow forfeiture of earnest money as provided in the contract.⁶⁵

Under earnest money contracts, the courts analyze forfeiture provisions on a liquidated damages theory. This enables the courts to choose among three different remedies when the forfeiture provision would act as a penalty: rescission,⁶⁶ damages,⁶⁷ or specific performance.⁶⁸ If a court awards damages to the seller, the court limits the recovery to the seller's actual damages, plus any costs associated with the default.⁶⁹

Courts have not explained the disparity in treatment between earnest money contracts and land installment contracts. The disparity may result from several factors that distin-

63. Hume, *Real Estate Contracts and the Doctrine of Equitable Conversion in Washington*, 7 U. PUGET SOUND L. REV. 233, 246 (1984). Even though a contract includes a forfeiture clause, a seller's remedies include damages, specific performance, or collection of past due installments. *Id.* n.54.

64. An earnest money contract establishes the rights and liabilities of the contracting parties prior to closing the sale. The earnest money contract ends at the closing, when the parties either pay the purchase price in full or enter into a separate agreement, which is often an installment land contract. The seller usually retains legal title until the buyer pays the full purchase price or enters into an executory land installment contract for the balance. G. OSBORNE, *supra* note 2, § 3.25, at 79.

65. See, e.g., *Jenson v. Richens*, 74 Wash. 2d 41, 47, 442 P.2d 636, 640 (1968) (forfeiture provision in earnest money contract that does not act as a penalty sets limit for damages under a breach); *Artz v. O'Bannon*, 17 Wash. App. 421, 427-28, 562 P.2d 674, 677 (1977) (court enforced a forfeiture provision as liquidated damages when the amount was reasonable and the purchaser failed to provide the required down payment under an earnest money contract).

66. See, e.g., *Miller v. Moulton*, 77 Wash. 325, 328, 137 P. 491, 492 (1914) (when parties rescind the contract, they relinquish any rights due under the contract, and both parties are returned to their original positions).

67. See, e.g., *Jenson v. Richens*, 74 Wash. 2d 41, 47, 442 P.2d 636, 640 (1968) (when contract includes a forfeiture provision, the court usually accepts this as a provision for liquidated damages, thus limiting the amount of damages available to the seller upon the buyer's default).

68. See, e.g., *Russell v. Stephens*, 191 Wash. 314, 71 P.2d 30 (1937) (seller can choose to enforce a forfeiture provision or sue for the purchase price when buyer defaults); *Asia Inv. Co. v. Levin*, 118 Wash. 620, 204 P. 808 (1922) (even though contract included a forfeiture provision, that provision did not destroy seller's right to specific performance).

69. See *Artz v. O'Bannon*, 17 Wash. App. 421, 427-28, 562 P.2d 674, 677 (1977).

guish earnest money contracts and land installment contracts. In an earnest money contract, the seller usually retains possession of the property and does not convey title until the sale closes.⁷⁰ Because the sale has not closed, the earnest money agreement is viewed as a promise to contract, and the seller has not been injured beyond costs and possible lost profits.⁷¹ The distinctions appear to be matters of form over substance. Buyers and sellers are capable of establishing their own terms under both land installment and earnest money contracts. However, the Washington courts have continually refused to invalidate the forfeiture provision under land installment contracts. In short, courts do not limit the seller's recovery to the actual loss, but do limit the buyer's equitable remedy to a grace period.⁷²

B. Removing Inequitable Forfeiture Clauses

The Washington courts' failure to analyze the forfeiture provision of a land installment contract under a liquidated damages theory contradicts established contract law, which enforces liquidated damages provisions only when the parties could not have easily or precisely ascertained possible future losses at the time the parties contracted.⁷³ By enforcing the forfeiture clause in a land installment contract, a court effectively establishes the previous payments and the property improvements as liquidated damages.⁷⁴ However, land installment contracts do not require liquidated damages provisions because the fixed payments under the contract terms enable both the courts and the parties to ascertain easily and precisely the seller's loss at any time during

70. G. OSBORNE, *supra* note 2, § 3.25, at 79.

71. *Id.*

72. The court's stance often results in an enforcement of forfeiture clauses that ignores inequities. *See, e.g.,* Radach v. Prior, 48 Wash. 2d 901, 297 P.2d 605 (1956) (purchasers had paid 68% of the purchase price and had made substantial improvements to the property, but the court would have enforced forfeiture if purchasers had been unable to tender the balance of the contract price by the end of the thirty-day grace period); Moeller v. Good Hope Farms, Inc., 35 Wash. 2d 777, 215 P.2d 425 (1950) (purchasers had paid nearly one-half of the contract price and had made improvements in the property; thus, unless purchasers could pay the contract in full by the end of the grace period, their losses would far outweigh sellers' losses).

73. J. POMEROY, EQUITY JURISPRUDENCE § 433 (5th ed. 1941). *See infra* note 75.

74. Gooden v. Hunter, 56 Wash. 2d 617, 620, 355 P.2d 20, 23 (1960) (when there was no forfeiture provision in a contract involving personal property, sellers were bound to return any purchase money paid that was not necessary to compensate sellers for actual damages).

the life of the contract.⁷⁵ In fact, because forfeitures can result in recoveries that are disproportionate to the seller's loss, forfeitures often defeat the purpose of liquidated damages by acting as penalties rather than as compensation for sellers' actual losses.⁷⁶

A forfeiture clause generally does not act as a penalty when the defaulting buyer has little equity in the property or when the buyer has absconded without attempting to cure the default.⁷⁷ However, the forfeiture will act as a penalty when a buyer has made a large down payment at closing, when a buyer has paid on the contract for several years, or when a buyer has improved the property.⁷⁸ Under forfeiture, such defaults usually penalize the buyer. The severity of the penalty increases as the seriousness of the breach decreases.⁷⁹

When the Washington courts step in to alleviate the inequity of a stipulated penalty in a land installment contract, the remedy does not remove the penalty; the grace period merely postpones the penalty in most cases.⁸⁰ Thus, the liquidated damages provision, which may have seemed fair at the outset, has evolved into a harsh penalty.⁸¹

C. *The Preference for Foreclosure by Judicial Sale*

Under foreclosure, the court orders the property sold, according to statutory requirements, to satisfy the debt and the costs of the foreclosure proceedings.⁸² Any excess from the sale is paid to the buyer to protect the investment.⁸³ Unless the mortgage or a separate instrument includes an express agree-

75. Even as early as 1902, the Washington Supreme Court stated that a court can easily compute the amount of the seller's injury when a buyer defaults under a land installment contract. *McDaniels v. Gowey*, 30 Wash. 412, 425, 71 P. 12, 16 (1902).

76. See *supra* note 72.

77. *Skendzel v. Marshall*, 261 Ind. 226, 240-41, 301 N.E.2d 641, 650 (1973), *cert. denied*, 415 U.S. 921 (1974).

78. *Moeller v. Good Hope Farms, Inc.*, 35 Wash. 2d 777, 784, 215 P.2d 425, 429 (1950).

79. *Freedman v. Rector, Wardens & Vestrymen of St. Mathias Parish*, 37 Cal. 2d 16, 20-23, 230 P.2d 629, 632-33 (1951) (buyer should receive restitution for amount of down payment that exceeds seller's damages).

80. See, e.g., *Radach v. Prior*, 48 Wash. 2d 901, 905, 297 P.2d 605, 608 (1956). Finding the cash to pay off a contract, however, or even to bring the payments up to date, may be difficult for a cash-poor buyer. Note, *supra* note 50, at 815.

81. Note, *supra* note 50, at 816.

82. 3 AMERICAN LAW OF PROPERTY, *supra* note 6, § 11.74, at 186-87. See WASH. REV. CODE ch. 61.12 (1983) (controlling foreclosure procedures).

83. WASH. REV. CODE § 61.12.50 (1983).

ment for payment of a particular sum of money upon default, the mortgagee's (seller's) recovery is limited to the mortgaged property.⁸⁴ Prior to the judicial sale, a buyer may satisfy the mortgage debt or the judgment.⁸⁵ The buyer may also remain in possession during the time prior to the sale.⁸⁶

The court may set a minimum or upset price for the property,⁸⁷ or it may conduct a hearing to establish the fair market value of the property to be credited to the foreclosure judgment upon application for the confirmation of a sale.⁸⁸ The seller may not receive a deficiency judgment if the fair market value would discharge the mortgage debt.⁸⁹

If the contract contains an express agreement for the payment of a specific sum of money, the court can decree a deficiency judgment, to be satisfied by any other property of the mortgagor debtor.⁹⁰ If the contract does not contain an express agreement, the seller may first receive a personal judgment for the overdue payments that the debtor's other property can satisfy.⁹¹ Consequently, the seller has some protection against property that has lost value, even without a deficiency judgment. Although a judicial sale may result in a lower selling price, the foreclosure process offers equitable protection to the seller and does not enforce a harsh penalty against the defaulting buyer.

Under foreclosure by judicial sale, the buyer's right to excess proceeds allows compensation for increased property value, for property improvements, and for a buyer's large equity.⁹² Foreclosure also protects the buyer by allowing reinstatement of the contract during the notice period or redemption of the property during the redemption period.⁹³ Furthermore, because foreclosure by judicial sale tends to equalize the positions of buyer and seller, foreclosure encourages both parties

84. *Id.*

85. *Id.* § 61.12.060.

86. *Id.* § 6.04.130.

87. *Id.* § 61.12.060.

88. *Id.*

89. *Id.*

90. *Id.* § 61.12.070.

91. *Stevens v. Irwin*, 132 Wash. 289, 294, 231 P. 783, 785 (1925).

92. Because contract law acknowledges that the buyer assumes the risk of loss once he has taken possession of the property, the buyer should be liable for any decrease in value or should receive the benefit of an increase in value. Lichty, *Rights and Estates of Vendor and Vendee Under an Executory Contract for the Sale of Real Property*, 1 WASH. L. REV. 9, 12 (1925).

93. Note, *supra* note 50, at 829.

to resolve the default outside of the courtroom.

Foreclosure has many benefits. Not only does foreclosure promote equitable remedies for both parties under a buyer's default, but it also encourages defaulting buyers to maintain the property during the default period and acts as an incentive for out-of-court settlements. Above all, foreclosure prevents the forfeitures that equity abhors.

IV. MITIGATION OF FORFEITURES IN OTHER STATES

By adopting foreclosure as an equitable remedy, Washington would join the modern trend.⁹⁴ Some state legislatures have dealt with forfeiture.⁹⁵ Maryland, for instance, prohibits forfeitures of installment land contracts involving the sale of residential property to a noncorporate buyer and requires foreclosure by judicial sale upon a purchaser's default.⁹⁶ A few legislatures have set a threshold percentage.⁹⁷ For example, Ohio requires foreclosure when the buyer has paid at least twenty percent of the contract price or when the buyer has paid on the contract for five years or more.⁹⁸ Maryland sets forty percent as the

94. G. OSBORNE, *supra* note 2, § 3.28, at 95.

95. See, e.g., ARIZ. REV. STAT. ANN. §§ 33-741 to -749 (1974 & Supp. 1983) (statutory grace periods of thirty days to nine months determined by percentage of purchase price paid at time of default); CONN. GEN. STAT. ANN. § 49-24 (West 1978 & Supp. 1983) (court may foreclose liens and mortgages by judicial sale rather than by strict foreclosure); FLA. STAT. ANN. § 697.01 (West 1969 & Supp. 1983) (all conveyances of real property are deemed mortgages subject to rules of foreclosure); IOWA CODE ANN. §§ 656.1-.6 (West 1950 & Supp. 1983) (thirty-day statutory notice [grace] period required before forfeiture); MICH. COMP. LAWS ANN. §§ 600.3101, .3155, .5741 (1968 & Supp. 1984-1985) (court has jurisdiction to foreclose mortgage of real estate and land contracts; court can set minimum sale price at forfeiture or foreclosure sale; court can set amount of restitution [redemption price] owed to seller); MINN. STAT. ANN. § 559.21 (West 1947 & Supp. 1984) (length of statutory notice [grace] period dependent upon percentage of purchase price paid); MONT. CODE ANN. § 28-1-104 (1983) (defaulting buyer may be relieved of forfeiture upon making full compensation unless buyer was grossly negligent, willful, or fraudulent); N.D. CENT. CODE §§ 32-18-01 to -06 (1976 & Supp. 1983) (six-month notice period required upon default if more than two-thirds of outstanding balance owed; in all other cases one-year notice period required); OKLA. STAT. ANN. tit. 12, § 686 (West 1960 & Supp. 1983-1984) (all mortgages must be judicially foreclosed); OKLA. STAT. ANN. tit. 16, § 11A (West Supp. 1983-1984) (all contracts for real property treated as mortgages); S.D. CODIFIED LAWS ANN. § 21-50-1 (1979 & Supp. 1983) (judicial foreclosure available upon default of executory contract for sale of real property).

96. MD. REAL PROP. CODE ANN. §§ 10-101 to -108 (1981 & Supp. 1983).

97. If the statutory percentage of the contract has been paid by the buyer, the court will not enforce the forfeiture clause and will foreclose the contract by judicial sale as a mortgage. The threshold percentage is often different than the break-even point, the point where the seller will suffer no damage. Note, *supra* note 50, at 817 n.105.

98. OHIO REV. CODE ANN. §§ 5313.01-.10 (Page 1981). See also Note, *Installment*

threshold percentage.⁹⁹ California allows either party to request a foreclosure after the buyer has paid three percent.¹⁰⁰ Oklahoma simply treats all installment land contracts as mortgages.¹⁰¹

Numerous states, however, leave forfeiture clauses to the courts,¹⁰² and some of these courts order foreclosure by judicial

Land Contract—Forfeiture Clause Held Invalid—Seller's Remedy for Breach of the Contract Is to Obtain a Judicial Sale of the Property—Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979), 7 N. Ky. L. Rev. 303, 309 (1980).

99. MD. REAL PROP. CODE ANN. § 10-105 (1981).

100. CAL. CIV. CODE § 1675 (West Supp. 1984). See also Note, *supra* note 50, at 817 n.103.

101. G. OSBORNE, *supra* note 2, § 3.27, at 84. See also OKLA. STAT. ANN. tit. 16 § 11A (West Supp. 1983-1984).

102. G. OSBORNE, *supra* note 2, § 3.28, at 95. Some courts have refused to enforce inequitable forfeitures. See, e.g., Strack v. Miller, 645 P.2d 184, 187 (Alaska 1982) (when equity and justice so require, court may refuse to enforce an express forfeiture provision in a land installment contract); Woods v. Monticello Dev. Co., 656 P.2d 1324, 1326 (Colo. Ct. App. 1982) (defaulting buyer may be entitled to redeem if trial court determines equities so warrant); Vines v. Orchard Hills, Inc., 181 Conn. 501, 505-06, 435 A.2d 1022, 1025-26 (1980) (purchaser has equitable claim for restitution to prevent unjust enrichment and to avoid forfeiture); Clements v. Castle Mortgage Serv. Co., 382 A.2d 1367, 1370-71 (Del. Ch. 1977) (court may prevent a forfeiture when equity requires); Kaiman Realty v. Carmichael, — Hawaii —, —, 659 P.2d 63, 64 (1983) (inequitable forfeiture of purchaser's equitable ownership prohibited); Nichols v. Knowles, 87 Idaho 550, 555-56, 394 P.2d 630, 633 (1964) (if contract damages bear no reasonable relation to actual damages, provision is an unenforceable penalty); Mustard v. Sugar Valley Lakes, 7 Kan. App. 2d 340, 342, 642 P.2d 111, 112 (1981) (equitable foreclosure permitted when forfeiture inequitable); Maxey v. Glindmeyer, 379 So. 2d 297, 301 (Miss. 1980) (court referred to Uniform Commercial Code and equated forfeiture provision in land sales contract to a liquidated damages provision, limiting seller's recovery to actual damages); Ryan v. Kolterman, 215 Neb. 355, —, 338 N.W.2d 747, 749 (1983) (forfeiture treated as strict foreclosure and permitted only when property value is less than the amount owed on contract); Long v. Towne, 98 Nev. 11, 13-14, 639 P.2d 528, 530 (1982) (court decisions imply that a lien foreclosure sale is an equitable alternative to forfeiture); Newcomb v. Ray, 99 N.H. 463, 467-68, 114 A.2d 882, 884-85 (1955) (defaulting purchaser entitled to excess of payments beyond seller's actual harm); Albuquerque Nat'l Bank v. Albuquerque Ranch Estates, Inc., 99 N.M. 95, 102, 654 P.2d 548, 555 (1982) (court may refuse to enforce a forfeiture provision when results would be harsh and inequitable); Bean v. Walker, 95 A.D.2d 70, 74-75, 464 N.Y.S.2d 895, 898 (1983) (purchaser holds equitable title, and seller has a vendor's lien; equity should intervene if forfeiture would result in inequitable disposition of property and exorbitant monetary loss); Brannock v. Fletcher, 271 N.C. 65, 70, 155 S.E.2d 532, 539 (1967) (relation between vendor and vendee in executory agreement for sale of land is substantially that subsisting between mortgagee and mortgagor and is governed by same general rules); Economy Sav. & Loan Co. v. Hollington, 105 Ohio App. 243, 248-50, 152 N.E.2d 125, 130-31 (1957) (court will not enforce a forfeiture provision in land contracts if forfeiture would act as a penalty); Braunstein v. Trotter, 54 Or. App. 687, 691-94, 635 P.2d 1379, 1381-83 (1981) (court reviewed tangled history of enforcement of forfeiture provisions in land sale contracts), *petition for review denied*, 292 Or. 568, 644 P.2d 1129 (1982); Anderson Contracting Co. v. Daugherty, 274 Pa. Super. 13, 22, 417 A.2d 1227, 1232 (1979) (purchaser's rights under land installment

sale under a mortgage theory.¹⁰³ In 1973 the Indiana Supreme Court decided the leading case of *Skendzel v. Marshall*.¹⁰⁴ Since then, Indiana courts have applied mortgage law to installment land contracts when a buyer defaults under a forfeiture provision if the forfeiture would act as a penalty rather than as liquidated damages. In *Skendzel*, the seller retained title under a land installment contract that included a forfeiture clause, and the defaulting buyer paid \$21,000 of the \$36,000 contract price.¹⁰⁵ The court decided three basic issues: the forfeiture clause was a provision for liquidated damages; a forfeiture would cause the buyer to suffer a loss totally disproportionate to the seller's actual loss; and the liquidated damages provision acted as a penalty because the exact compensation could be computed easily at the time of the default.¹⁰⁶ The court held that the forfeiture clause was therefore unenforceable as a penalty.¹⁰⁷

The *Skendzel* court applied mortgage law to the contract and treated the retained title as security for the debt.¹⁰⁸ The seller's interest created a vendor's lien that the court could enforce either through forfeiture or through foreclosure.¹⁰⁹ Because the defaulting buyer had a large equity in the property, the court ordered foreclosure by judicial sale as the preferable and equitable remedy, even though the contract included a forfeiture clause.¹¹⁰

Other jurisdictions have applied the equitable mortgage theory to land installment contracts with forfeiture clauses. In 1979 the Kentucky Supreme Court applied the *Skendzel* reasoning in a similar situation.¹¹¹ The Kentucky court held that there is no

contract are those of mortgagor, requiring foreclosure instead of forfeiture), *appeal dismissed*, 492 Pa. 630, 425 A.2d 329 (1980); *De Leon v. Aldrete*, 398 S.W.2d 160, 163 (Tex. Civ. App. 1965) (restitution permitted when purchaser's payments exceed seller's actual losses); *Stonebraker v. Zinn*, 286 S.E.2d 911, 914-15 (W. Va. 1982) (court refused to equate land installment contracts to equitable mortgages, but liquidated damages clauses unenforceable as penalties if contract damages far exceed actual damages); *Schwartz v. Syver*, 264 Wis. 526, 532-33, 59 N.W.2d 489, 492-93 (1953) (seller must repay payments that exceed seller's loss), *overruled on other grounds*, *Stuesser v. Ebel*, 19 Wis. 2d 591, 597, 120 N.W.2d 679, 682-83 (1963).

103. G. OSBORNE, *supra* note 2, § 3.28, at 95.

104. 261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974).

105. *Id.* at 228-30, 301 N.E.2d at 643.

106. *Id.* at 231-34, 301 N.E.2d at 644-46.

107. *Id.*

108. *Id.* at 234-41, 301 N.E.2d at 646-50.

109. *Id.*

110. *Id.* at 240-41, 301 N.E.2d at 650.

111. *Sebastian v. Floyd*, 585 S.W.2d 381 (Ky. 1979) (the court refused to enforce a

practical difference between a mortgage and an installment land contract, and reversed an appellate court's ruling in favor of forfeiture. In California the cases clearly reflect the recognition that installment land contracts should be treated as security under mortgage law.¹¹² Florida courts have compared the seller's position to a mortgagee's position and have foreclosed installment land contracts.¹¹³

Although statutory threshold percentages may provide guidance for courts, the *Skendzel* approach gives courts more flexibility by allowing them to determine when foreclosure by judicial sale is the more equitable remedy for both parties. In situations where the parties are unable to resolve the default by an out-of-court agreement, Washington courts could follow *Skendzel* and order foreclosure by judicial sale. This would prevent liquidated damages from creating a penalty for the defaulting buyer under a land installment contract.

V. CONCLUSION

The time has come for Washington courts to recognize that they have a choice of equitable remedies: grace periods and foreclosure by judicial sale. Washington courts have lived with *Pease v. Baxter*¹¹⁴ and its progeny far too long; a forfeiture clause should not remove the right to foreclosure. *Cascade Security Bank v. Butler*¹¹⁵ reestablished the buyer's interest as real property and removed the obstacle preventing foreclosure as an equitable remedy. *In re Washburn*¹¹⁶ recognized the vendor's lien as a part of Washington law. The next step is for the courts to realize that foreclosure by judicial sale constitutes a viable, equitable remedy.

forfeiture provision and ordered a foreclosure by judicial sale, analogizing land installment contracts to mortgages). See *supra* notes 104-10 and accompanying text for discussion of the *Skendzel* case.

112. See, e.g., *Honey v. Henry's Franchise Leasing Corp.*, 64 Cal. 2d 801, 803-04, 415 P.2d 833, 835, 52 Cal. Rptr. 18, 20 (1966) (penalties and forfeitures are denied in California when a buyer defaults; instead, the seller receives actual damages and the buyer receives any excess); *Williams Plumbing Co. v. Sinsley*, 53 Cal. App. 1027, 1033, 126 Cal. Rptr. 345, 349 (1976) (court viewed land installment contracts with security devices as similar to mortgages and did not enforce a forfeiture for late payment).

113. See *H & L Land Co. v. Warner*, 258 So. 2d 293 (Fla. App. 1972) (when buyer defaulted, court ordered foreclosure of the property by judicial sale, equating the parties' rights to those under a mortgage). See also Note, *supra* note 98, at 309-10.

114. 12 Wash. 567, 41 P. 899 (1895).

115. 88 Wash. 2d 777, 567 P.2d 631 (1977).

116. 98 Wash. 2d 311, 654 P.2d 700 (1982).

Washington courts can treat defaulting buyers under land installment contracts with forfeiture clauses far more equitably. If enforcement of the forfeiture provision would create a disproportionate loss to the buyer, the court should view the forfeiture clause as a provision for liquidated damages that is a penalty. The court should refuse to enforce the forfeiture provision and should order foreclosure by judicial sale.

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