

4-1-1976

Attacking the Forfeiture as Liquidated Damages Clause in North Carolina Installment Land Sales Contracts as an Equitable Mortgage, Penalty, and Unfair and Deceptive Trade Practice

R. James Lore

Follow this and additional works at: <https://archives.law.nccu.edu/ncclr>



Part of the [Law Commons](#)

Recommended Citation

Lore, R. James (1976) "Attacking the Forfeiture as Liquidated Damages Clause in North Carolina Installment Land Sales Contracts as an Equitable Mortgage, Penalty, and Unfair and Deceptive Trade Practice," *North Carolina Central Law Review*: Vol. 7 : No. 2 , Article 11.

Available at: <https://archives.law.nccu.edu/ncclr/vol7/iss2/11>

This Comment is brought to you for free and open access by History and Scholarship Digital Archives. It has been accepted for inclusion in North Carolina Central Law Review by an authorized editor of History and Scholarship Digital Archives. For more information, please contact jbeeker@nccu.edu.

Attacking The "Forfeiture As Liquidated Damages" Clause In North Carolina Installment Land Sales Contracts As An Equitable Mortgage, Penalty, And Unfair And Deceptive Trade Practice

I. INTRODUCTION

There has been a recent revival in North Carolina of the use of a low equity financing device. This device is the installment land sales contract. It seems to have especially captivated the market in the past several years in developing resort projects.¹ These resort projects typically sell undeveloped lots to lower middle class families who plan to pay for their lot during their working years and ultimately build the retirement home of their dreams. Unfortunately, the present bad economic times have introduced many of these purchasers (vendees) to a seemingly fatal pitfall accompanying the use of the installment land sales contract. This pitfall is the "forfeiture as liquidated damages clause". It is a vendor's ax that strikes without prior notice in abruptly cutting off all of the existing equity that vendees have sunk into their property. *A fortiori* old methods of defense must be resurrected and novel methods of attack must be advanced to protect especially the relatively low income North Carolinians from the "forfeiture as liquidated damages clause." This paper is devoted to illuminating some old defenses hiding in the stacks and to proposing a novel attack based on these defenses.

II. THE NATURE OF THE FINANCING DEVICE

Although most realty transactions in America today are still financed by the traditional mortgages and deeds of trust, another method of financing is becoming more prevalent.² The device is the so-called "installment land sales contract," alternatively called "land sales contract", "agreement for deed" or "contract for deed".³

Under this method of financing, the seller (vendor) retains his deed as security for the purchaser's (vendee's) payment of the purchase

1. A conversation on November 26, 1975 with Mr. Donald A. Davis, former Assistant North Carolina Attorney General (Consumer Protection Division, 1971-1975) revealed that on numerous occasions he handled complaints concerning resort developments. When the complaint indicated the method of financing, it generally was the installment land sales contract.

2. Hines, *Forfeiture of Installment Land Contracts*, 12 KANSAS L. REV. 475, 476 (1964). ("The contract form of land sale finance was first utilized extensively by the railroad companies during the latter half of the nineteenth century in selling the large acreages acquired in the course of railroad building.")

3. Note, *Installment Land Contract—Mortgage or Contract?*, 26 U. MIAMI L. REV. 855 (1972).

ATTACKING FORFEITURE

price.⁴ The purchase price is paid in regular periodic installments over a term of years. These payments are analogous to payments of principal and interest in amortized mortgage payments which, depending on the type of transaction, may approximate the rental value of the land. The vendee is usually allowed to immediately go into possession under an expressed covenant and has the right to remain in possession during the payment period so long as he complies with certain other conditions to which he covenants.⁵ Also, as required by covenant, the deed to the land is delivered to the vendee when all of the payments are completed.⁶

This financing device presents several qualities which make it appealing to both the vendor and the vendee. The low income vendee is especially attracted to the use of the installment land sales contract because he oftentimes will not qualify for FHA or VA mortgage insurance.⁷ Neither would such a low equity purchaser be able to meet the down payment requirement for uninsured mortgages in today's tight-money private financial sector. For example, an uninsured prospective purchaser can expect to make at least a 33% down payment (40-60% if farmland is being purchased).⁸ However, with the installment land sales contract, the down payment will generally be less than 20% of the total purchase price.⁹ The closing costs (other than the down payment) will also be much less because there are fewer fees or none at all necessary for title searches, title insurance, third party lenders, recording, etc.¹⁰ Thus, the initial expense of moving in (closing costs including down payment) will be a much lower cash figure than the traditional mortgage (and deed of trust) financing device would be for the same transaction.

The aforementioned advantages to the purchaser (vendee) are greatly outweighed by the advantages that the installment land sales contract gives to the vendor. At the outset the low initial moving in expense enlarges his potential class of purchasers, thereby, arguably enabling the vendor to receive a higher price.¹¹ The vendor also avoids the paying of

4. Frequently the deed will be placed in escrow.

5. Typically, the vendee is responsible for all taxes, insurance and repairs, if developed during the payment period. More critical covenants and conditions will be discussed *infra* PENNY & BROUDE, CASES AND MATERIALS ON LAND FINANCING, at 80 (1970) [hereinafter cited as PENNY and BROUDE].

6. In general the material in this paragraph comes from PENNY & BROUDE, *supra* note 5, at 80.

7. Mixon, *Installment Land Contracts: A Study of Low Income Transactions*, 7 HOUSTON L. REV. 523-525 (1970).

8. Power, *Land Contracts as Security Devices*, 12 WAYNE L. REV. 391, 399 (1966).

9. *Id.* at 406.

10. Mixon found that in the Houston area closing costs for a house which sold for \$10,300.00 were \$735.00 with a regular mortgage, and \$86.16 with an installment land sales contract. Mixon, *supra* note 7, at 535.

11. Hines, *supra* note 2, at 478.

372 NORTH CAROLINA CENTRAL LAW JOURNAL

any discount points to any third-party lenders.¹² Moreover, there is a significant income tax advantage to the vendor if he receives less than 30% of the property's value in the first year of transfer.¹³ Upon meeting this condition and making the proper election for the Internal Revenue Service, the seller will be taxed only on the installments that actually are paid in each year and then, only to the extent that the portion of the installment represents gain over the seller's cost basis.¹⁴ Unlike the mortgage transaction the seller will not be taxed on all the gain in the year of transfer.

Probably the biggest advantage to the vendor is the benefit of the notorious "forfeiture as liquidated damages clause." Through this clause a vendor upon default by the vendee gives himself the right (or depending on your viewpoint the vendee has given him the right) to summarily (without notice) accelerate the contract, retake possession of the property, and keep all installments paid and improvements made as liquidated damages.¹⁵ A typical clause used by a vendor corporation in North Carolina reads:

That upon our default or breach of any term of this contract you (or assigns) may, without any notice to us, notice being expressly waived, either (1) elect to accelerate this contract and declare same void and forfeited, together with a forfeiture of all payments and improvements, to be retained by you as liquidated damages and or for rent for the detention of said Lots, and forthwith take immediate possession of the Lots and remove us and anyone holding under us in the manner provided by law for tenants unlawfully holding over, or (2) elect to affirm and enforce this contract, accelerate the unpaid balance, making same due and payable, at once, and enforce payment of same.¹⁶

Because almost every such contract declares time to be of the essence, default means falling behind on one payment, from the first to the last.¹⁷ Unlike the traditional mortgage approach, most courts have generally not allowed a defaulting vendee to have a right to an equity of redemption.¹⁸ As if the above windfall to the vendor were not in practice

12. *Id.*

13. INT. REV. CODE OF 1954, § 453 (This condition would typically be met).

14. *Id.* See also, Hines, *supra* note 2, at 477 and Power, *supra* note 8, at 400.

15. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 20, at 29 (2nd ed. 1970) [hereinafter cited as OSBORNE].

16. This clause was taken from an "Agreement for Deed" used to finance the selling of real property in the Colington Harbor Development, Dare County, North Carolina.

17. Note, *Forfeiture and the Installment Land Contract*, 35 BROOKLYN L. REV. 83, n.2 (1968).

18. For an excellent article see Lewis & Reeves, *How the Doctrine of Equitable Conversion Affects Land Sales Contract Forfeitures*, 3 REAL ESTATE L.J. 245, 253 (1974) citing OSBORNE, *supra* note 15, § 20 at 29 and Lee, *Remedies for Breach of the Installment Land Contract*, 19 MIAMI L. REV. 552 (1965).

enough, one commentator asserts that the very motive for the use of the installment land sales contracts is that vendors know that the people who use this method of financing are financially incapable of asserting their legal rights.¹⁹ In such cases the defaulting vendee can be easily persuaded to leave, thereby making it easy to clear the title before resale.²⁰

The vendor's advantage through the use of the "forfeiture as liquidated damages clause" discussed *supra* sets the stage for the crux of this paper—how to attack this onerous provision under North Carolina law. In order to understand the first method of attack, one must first observe the analogy between a vendee in possession under an installment land sales contract and a mortgagor under a purchase money mortgage.²¹ The main basis for this analogy is the doctrine of equitable conversion. Under the doctrine of equitable conversion, a court of equity looks upon a vendee in a land sales contract as the owner of the land even though no title has passed.²² In turn the vendor is looked upon as the owner of the purchase money.²³ Another basis of analogy is that both instruments serve to accomplish the same goal—a financing device.²⁴ In substance, the vendor is an equitable mortgagee and the vendee an equitable mortgagor. Therefore, their concomitant rights and duties should not differ because of a mere variation in form.²⁵ Indeed, as recently as 1967, the North Carolina Supreme Court, speaking through Justice Sharp (now Chief Justice), stated:

The relation between vendor and vendee in an executory agreement for the sale and purchase of land is substantially that subsisting between mortgagee and mortgagor, *and is governed by the same general rules.*²⁶ (emphasis added)

If the above statement could be taken at its face value, this may be a solution for the protection of our defaulting vendee from the "forfeiture as liquidated damages clause". If the same general rules govern the vendor-vendee relationship as govern the mortgagor-mortgagee relationship, why cannot the vendee invoke the same inviolable protection that the courts of equity created long ago for a defaulting mortgagor? This, of course, is the equity of redemption upon which a mortgagee (vendor) must foreclose to extinguish. After all, the general rule is that

19. Warren, *California Land Sales Contracts: A Time for Reform*, 9 U.C.L.A. L. REV. 608, 633 (1962).

20. *Id.*

21. 5 WILLISTON, CONTRACTS § 792 at 744 (Rev. ed. 1961) [hereinafter cited as WILLISTON].

22. THOMPSON ON REAL PROPERTY § 4447 (1963 repl.).

23. *Id.*

24. Lewis and Reeves, *supra* note 18, at 254.

25. *Id.*

26. *Brannock v. Fletcher*, 271 N.C. 65, 70, 155 S.E.2d 532, 539 (1967). (This case will be discussed more fully *infra*).

the courts will not honor an agreement to limit the right of a mortgagor to exercise his right of redemption.²⁷ For example, the longtime acceptance of this position by the North Carolina Supreme Court is shown by the following statement:

If a transaction be a mortgage in substance, the most solemn engagement to the contrary, made at the time, cannot deprive the debtor of his right to redeem; such a case being, on ground of equity, an exception to the maxim '*modus et conventio vincunt legem*'. Nor can a mortgagor, by any agreement at the time of the execution of a mortgage, that the right to redeem shall be lost if the money be not paid by a certain day, debar himself of such right; for in such a contract, time will not be regarded as of its essence.²⁸

By the general rule, foreclosure is the only method by which the mortgagee may terminate the mortgagor's equity of redemption.²⁹ Logically, it would seem that the court's traditional protection against waiver by agreement of a mortgagor's equity of redemption combined with the recognition that the parties in any installment land sales contract have an equitable mortgagor-mortgagee relationship would snuff the life out of the typical "forfeiture as liquidated damages provision." For it is patently obvious that such a clause is an attempt (generally successful) to summarily cut off a defaulting vendee's (equitable mortgagor's) equity of redemption. Surprisingly, the general rule in America is that the defaulting vendee has no right to an equity of redemption.³⁰ Why the inconsistency? One author suggests the reason is that most courts, when initially confronted with the problem, simply failed to recognize the analogy.³¹ By the time it was in fact recognized, the doctrine of *stare decisis* had made the error difficult to correct. Why did not the courts initially recognize this analogy and strike down the "forfeiture as liquidated damages clause" as an attempt to circumvent the right of redemption? The answer lies in the historical confusion by the courts of the installment land sales contract with the "buy-sell agreement"—also called "deposit receipt agreement", "purchase and sale agreement", or "earnest-money agreement".³²

The fact that these two types of agreements are fundamentally different has been recognized by two of America's greatest scholars in the

27. OSBORNE, *supra* note 15 § 97 (1970).

28. *Robinson v. Willoughby*, 65 N.C. 520, 523 (1871).

29. WEBSTER, *REAL ESTATE LAW IN NORTH CAROLINA* § 248 (1971) (note, the right to exercise one's right of redemption may be barred in certain cases of estoppel or passage of time); OSBORNE, *supra* note 15, § 306.

30. Lewis & Reeves, *supra* note 18, at 253 *citing* OSBORNE, *supra* note 15, § 20, at 29. 5 WILLISTON § 792 at 776 (rev. ed. 1961).

31. Hines, *supra* note 2, at 480.

32. *Id.*

field of contracts, Samuel Williston³³ and Arthur L. Corbin.³⁴ Corbin states that unlike the installment land sales contract, money deposited under a "buy-sell agreement" would be genuinely forfeited as liquidated damages upon default, ". . . the actual injury being uncertain and difficult to estimate and the amount not being unreasonable or disproportionate to the total value involved."³⁵

What then are the distinguishing features between the "buy-sell agreement" and the installment land sales contract that have confused so many courts and attorneys? At this point some of the distinguishing features, as written by one previously cited pair of authors, are worth quoting. In a "buy-sell agreement" a prospective ". . . purchaser makes the deposit of the earnest money on the signing of the contract, with the promise that in a relatively short time (weeks or months) the transaction will be consummated, the balance of the purchase price paid, and the deed delivered."³⁶

Under such agreements it is generally the expectations of the parties that, upon the vendee's breach, the vendor should retain the earnest money deposited as liquidated damages. It is also understood by the parties that the earnest money is paid to evidence the purchaser's sincerity and, in part, to compensate the vendor for removing the property from the market for the period until closing, if the vendee should breach the agreement. The earnest money deposited usually does not exceed 10 percent of the purchase price. Such an amount is sufficient, under most circumstances, to suggest a serious intent on the part of the purchaser and to cover any brokerage commission that may be involved should the sale not proceed to closing.³⁷

However, Williston suggests what is probably the most critical test for distinguishing the installment land sales contract from the wholly executory "buy-sell agreement" for purposes of triggering equitable mortgage treatment. That test is whether the purchaser is given immediate possession and beneficial enjoyment of the land.³⁸

III. THE POSITION OF THE NORTH CAROLINA SUPREME COURT FROM THE PAST TO THE PRESENT

Now that the incongruity and confusion in this area of law has been brought into focus, it is only fitting that the approach of the North Carolina Supreme Court be fully analyzed. The analysis will be pre-

33. 5 WILLISTON, *supra* note 21, § 792.

34. Corbin, *The Right of a Defaulting Vendee to Restitution of Installments Paid*, 40 YALE L.J. 1013, 1030 (1931).

35. *Id.* at 1031.

36. Lewis and Reeves, *supra* note 18, at 253.

37. *Id.*

38. 5 WILLISTON, *supra* note 21, § 792 at 774.

376 *NORTH CAROLINA CENTRAL LAW JOURNAL*

sented chronologically in order to show not only where the North Carolina Supreme Court stands on this issue, but also how it got there.

As early as the case of *Poindexter v. McCannon*,³⁹ decided in 1830, the North Carolina Supreme Court showed its preference for a construction of any equivocal relationship between parties to a transaction for the future conveyance of realty as that of mortgagor-mortgagee. Although this case dealt with an alleged conditional sale rather than an installment land sales contract, the language used by the court in construing the agreement expressed the following rule of construction:

It is equivocal in itself. But it is *sufficient to induce the Court to decree a redemption*, if nothing else appeared, because the Court *inclines to that side, to prevent oppression and hard dealing*.⁴⁰ (emphasis added)

In 1856 the North Carolina Supreme Court in *Scarlett v. Hunter*⁴¹ confronted a case that involved a suit brought by a vendee for the specific performance of a contract to convey title to land upon one payment on a specified date by the vendee of a sum certain with interest. The vendee was allowed to go into immediate possession, but did not make the payment on the specified date. Neither party took any action for almost three years until the vendee tendered principal and interest. Upon the vendor's refusal to accept the tendered principal, the vendee brought the action for specific performance. Because this action was for specific performance, this case is important for two reasons collateral to its value as precedent. First, the court implicitly applies the doctrine of equitable conversion by stating that:

Where there is a contract for the sale of land, the vendee is considered, in equity, as the owner, and the vendor retains the title as security for the purchase-money.⁴²

Secondly, and more importantly, the court clearly applied mortgagor-mortgagee law to the facts of the case in stating:

The right of redemption is not affected by failure to make payment; for the mortgagee may rest satisfied with his security as long as he chooses, and when he wants his money he may compel payment within a reasonable time, *or foreclose the equity of redemption*.⁴³ (dictum) (emphasis added)

The court through dictum seemed to recognize a defaulting vendee's right to an equity of redemption in a land sales contract which must be

39. *Poindexter v. McCannon*, 16 N.C. 373 (1830).

40. *Id.* at 376.

41. *Scarlett v. Hunter*, 56 N.C. 84 (1856).

42. *Id.* at 85.

43. *Id.*

foreclosed upon to be cut off if full payment was not made in a reasonable time.

By 1864, the interest of a purchaser (vendee) in the land sale contract had been further crystalized into an equity of redemption.⁴⁴ Subsequently, in 1879 the court in *Jones v. Boyd*⁴⁵ again spoke, in dictum, to the nature of the vendor-vendee relationship and to the need to foreclose a vendee's equity of redemption. This case involved an installment land sales contract payable in five annual installments. Although the five-year period had not run, the vendor filed an action for, *inter alia*, specific performance because the vendee had missed some annual payments. The court disallowed the suit as being premature under a construction of the plaintiff-vendor's title bond. (Evidently the absence of a "time of the essence clause" prevented specific performance until final default and the end of the five-year term). However, the court spoke of the relationship upon final default as follows:

The relation between vendor and vendee in an executory agreement for the sale and purchase of land is substantially that subsisting between mortgagee and mortgagor, and governed by the same general rules. In both cases the legal title to the land is held as a security for the debt, to be conveyed or reconveyed to the owner of the equitable title when the debt is paid. 'A vendor,' says Rodman, J., in *Ellis v. Hussey*, 66 N.C. 501, 'who contracts to convey on payment of the purchase-money, may be considered as between the parties a mortgagee.' *Keeping the analogy in mind, it would seem that the right of the legal owner to have possession and a foreclosure by sale after final default must be the same in both cases.*⁴⁶ (emphasis added)

The now established dictum that a vendor would be entitled to have possession and a foreclosure by sale upon default was reaffirmed in the 1908 case of *Jones v. Jones*,⁴⁷ but again the court spoke through dictum. In addition, the same dictum made it clear that the vendee would be entitled to the surplus, if any, after payment of the balance of the purchase money.⁴⁸

However, in all of the cases heretofore examined, the notorious "forfeiture as liquidated damages clause" was conspicuously absent from the contract. Neither was there any "time of the essence" clause reflected in any of these opinions. It remained to be seen what effect, if any, their inclusion would have made in the dictum of the above cases which seemingly established the vendee's entitlement to foreclosure on his equity of redemption and to any surplus above that needed to satisfy

44. *Schoffner v. Fogleman*, 60 N.C. 564, 568 (1864).

45. *Jones v. Boyd*, 80 N.C. 258 (1879).

46. *Id.* at 261.

47. *Jones v. Jones*, 148 N.C. 358, 62 S.E. 417 (1908).

48. *Id.* at 360-61, 62 S.E. at 417-18.

378 *NORTH CAROLINA CENTRAL LAW JOURNAL*

the balance of the purchase price. In the very next term after *Jones, supra*, the North Carolina Supreme Court squarely faced and decided this question in *Hicks v. King*.⁴⁹ In that case the plaintiff (vendor) leased his farm to the defendant (vendee) for a term of ten years at an annual rental of a certain amount of cotton with the additional provisions:

. . . [T]hat if said rent was promptly paid, together with the taxes on the land, then the defendant could become purchaser of the land upon payment of fifty bales more, *with provision for forfeiture if any installment of rent is not promptly paid by lessee, and right of re-entrance thereon*.⁵⁰ (emphasis added)

During the first five years the defendant (vendee) fell behind in his payments and the vendor at the end of the fifth year brought an action for recovery of the land and the balance due on the rent. The lower court rendered judgment for the plaintiff (vendor) for the value of the additional fifty bales of cotton and for rent due to date. Furthermore, the court ordered that upon nonpayment the property be sold for payment thereof and costs. From this order the plaintiff (vendor) appealed. The North Carolina Supreme Court affirmed the lower court while rejecting the plaintiff's (vendor's) argument ". . .that the court should have held that punctual payment of rent was of the essence of the contract, and that upon default the plaintiff was entitled to re-enter and take possession."⁵¹ The reason for the rejection of the vendor's contention was that the above quoted provision, for forfeiture upon default of rent installments paid in, made the agreement in substance an equitable mortgage, with all the accompanying protections. Concluding, the court stated the guidelines for the case of a vendee's default as:

When, as here, the full period for installments has passed at the date of the judgment, it is necessary only to deduct the payments made and direct a sale of the property to pay the balance due. When there are installments which have not fallen due, the present value only of such should be charged against the purchaser. *Contracts for sale on installments are similar to mortgages. If neither is the equity destroyed by the stipulation for prompt payment, but the debtor is ENTITLED to have the balance ascertained and a sale ordered, and to receive surplus, if any*.⁵² (emphasis added)

The *Hicks* case was a culmination of the evolutionary process of the law of installment land sales contracts in North Carolina. From it we can extract the following principles:

49. *Hicks v. King*, 150 N.C. 370, 64 S.E. 125 (1909) [discussed briefly in 115 A.L.R. 380 (1938)].

50. *Id.* at 370, 64 S.E. at 126.

51. *Id.* at 371, 64 S.E. at 126.

52. *Id.* at 371-72, 64 S.E. at 126.

ATTACKING FORFEITURE

- (1) The vendor-vendee relationship is treated in equity as a mortgagor-mortgagee relationship;
- (2) Parties cannot destroy a vendee's right to an equity of redemption by a stipulation for time to be of the essence and default to result in forfeiture of installments paid in as liquidated damages;
- (3) A vendor is entitled to the balance owed under the contract computed as follows:
 - (a) If the full term for payment of installments is passed at the date of judgment by deducting the amount actually paid from the total term price; or
 - (b) If the full term has not passed at time of judgment, by deducting the then existing value of the payments which should have been made from the total term price; (*dictum*)
- (4) The defaulting vendee is *entitled* to have a judicial foreclosure and sale of the property;⁵³
- (5) The defaulting vendee is *entitled* to receive any surplus, if any, from that sale, above the balance owed, based on the computation in (3) above (and presumably costs of sale).

From the date of this decision, 1909 until 1967, the North Carolina Supreme Court seems not to have again considered directly or indirectly the issue. Indeed, from 1925 until 1967, the court seems not to have again addressed a case involving an installment land sales contract. This may have been caused by many factors, but I suggest that the *Hicks* decision stunted the growing use of the installment land sales contract as a financing device. After all, if the court was going to treat it as a purchase money mortgage, why should people not use the more traditional purchase money mortgage itself? But, with the passing of time the holding of the *Hicks* case and the cases from which it evolved were probably lost in the stacks and forgotten. Possibly this factor, combined with a change in economic times, led to its return to use—the result being the 1967 case of *Brannock v. Fletcher*.⁵⁴ This was an action by a vendee to recover payments made under an installment land sales contract.⁵⁵ The contract contained an acceleration clause in case of default, but did not contain a “forfeiture as liquidated damaged clause”.⁵⁶ The case arose over disagreements between the vendor and vendee over collateral financial matters and alleged defaults in some payments. As a result the vendor demanded that the vendee vacate. The vendee reluctantly acquiesced and brought the suit to recover

53. For judicial foreclosure in North Carolina generally, see WEBSTER, *supra* note 29; see also N.C. GEN. STAT. 1-339.1 (Supp. 1975).

54. *Brannock v. Fletcher*, 271 N.C. 65, 155 S.E.2d 532 (1967).

55. *Id.* at 66, 155 S.E.2d at 536.

56. An examination of the Record on appeal shows this to be true.

payments made. At trial the evidence concerning whether the vendee-plaintiff was actually behind in payments was ambiguous. Nevertheless, the defendant-vendor was granted a motion for nonsuit at the close of the plaintiff-vendee's evidence.⁵⁷ Justice Sharp (now Chief Justice) initially stated that the plaintiff's theory of recovery was implicitly rescission, as evidenced by the defendant-vendor's allegedly wrongful demand for possession, in which the plaintiff-vendee had acquiesced.⁵⁸ The result, if proven, the court reasoned, would be to put the parties back in their original positions.⁵⁹ The plaintiff would be thereby entitled to recover installments paid in, minus any set-off, for the rental value of the defendant-vendor's property during the plaintiff-vendee's period of occupancy.⁶⁰ The court held that the lower court erred in withdrawing the case from the jury because the ambiguity in the evidence could enable the jury to find validity in the vendee's rescission hypothesis.⁶¹

Apart from its value as a *caveat* to a vendee in pleading his theory of recovery, the real purpose in the discussion of this case is to confront dictum pronounced by Justice Sharp concerning the hypothetical situation of the vendee being in default without the vendor having rescinded the contract. At one point in the opinion Justice Sharp makes the following statements with supporting authority:

If, however, plaintiffs were behind in their payments (as defendants allege), and continued in default after reasonable notice, defendants would have been entitled to take possession of the premises without resorting to an action of ejectment—provided possession could be obtained peaceably. In such event, plaintiffs would not be entitled to recover back what they had paid.

'It is settled law that where a party agrees to purchase real estate and pays a part of the consideration therefor and then refuses or becomes unable to comply with the terms of his contract, he is not entitled to recover the amount theretofore paid pursuant to its terms. *Rochlin v. P.S. West Construction Co.*, 234 N.C. 443, 67 S.E.2d 464; *Improvement Co. v. Guthrie*, 116 N.C. 381, 21 S.E. 952; 31 A.L.R.2d 118, Annotation, Vendee's Recovery of Purchase Money; 55 Am. Jur., Vendor and Purchaser, Section 535, page 927; 92 C.J.S., Vendor & Purchaser §554a page 566.' *Scott v. Foppe* 247 N.C. 67, 70, 100 S.E. 2d 238, 240.⁶²

An examination of the *Scott* case, from which Justice Sharp quoted, immediately shows the mistake in analysis to which so many courts

57. *Brannock v. Fletcher*, 271 N.C. 65, 70, 155 S.E.2d 532, 537 (1967).

58. *Id.* at 69, 75, 155 S.E.2d at 538, 542.

59. *Id.* at 75, 155 S.E.2d at 542.

60. *Id.*

61. *Id.*

62. *Id.* at 72-3, 155 S.E.2d at 540.

ATTACKING FORFEITURE

381

(North Carolina being an exception until this point), in other jurisdictions, have fallen victim. The *Scott* case involved a wholly executory "buy-sell agreement" (as distinguished from an installment land sales contract with the vendee in possession) under which the plaintiff had never taken possession. As has been previously discussed, forfeiture of small sums in "buy-sell agreements" has always been allowed to be validly forfeited as liquidated damages.⁶³ Similarly, all of the cases cited within the *Scott* case do not support the Justice's dictum.⁶⁴ Finally, all of the other citations relied on by Justice Sharp were to secondary authority whose position understandably recites the misguided and illogical general rule to which most jurisdictions (e.g., North Carolina and Florida⁶⁵ being exceptions) have historically adhered.⁶⁶

Later in the opinion Justice Sharp, again in dictum, makes statements concerning a vendor's remedies upon a vendee's default.

[H]e may bring an action for damages for the breach, or may sue in equity for specific performance, or bring an action for the purchase price remaining unpaid, or proceed to enforce his vendor's lien for unpaid purchase money, or, if he has parted with possession of the land, he may sue to recover its possession, or retake possession if the premises are vacant; he may retake possession and recover damages for the breach, or he may bring a suit for foreclosure of the vendee's interest or to quiet title, or he may rescind the contract *in toto* with the usual rights and duties attendant on such action, or *he may accept the noncompliance as a forfeiture of the contract*, or he may bring an action to rescind the contract or declare it at an end. Further, he may remain inactive and retain for his own use the moneys paid by the purchaser, and he may retain or recover a deposit made by the purchaser on the purchase price. 92 C.J.S., Vendor & Purchaser §375 (1955).

See *Credel v. Ayers*, 126 N.C. 11, 35 S.E. 128, 48 L.R.A. 751; *Allen v. Taylor*, *supra*; *Mitchell v. Wood*, *supra*

If the purchaser makes default in the stipulated payments, the vendor may refuse to perform further on his part, or he may take proceedings to foreclose the vendee's rights under the contract, 'without incurring liability at law to refund to the purchaser any part of the purchase money theretofore paid where the vendor does not act indicating rescission of the contract.' (emphasis added) 55 Am. Jur.,

63. Corbin, *supra* note 34.

64. *Rochlin v. P.S. West Const. Co.*, 234 N.C. 443, 67 S.E.2d 464 (1951) (as *Scott* involves a deposit under a buy-sell agreement); *Improvement Co. v. Guthrie*, 116 N.C. 381, 21 S.E. 952 (1895) (Vendee brought the action on the rescission theory without asking for foreclosure and would not have been entitled anyway because the vendor was also a vendee who did not himself have title).

65. *H & L Land Co. v. Warner*, 258 So.2d 293 (Fla. 2nd Dist., 1972) discussed in Note, *supra* note 3.

66. *Lewis & Reeves*, *supra* note 18, and *Williston*, *supra* note 21.

382 NORTH CAROLINA CENTRAL LAW JOURNAL

Vendor & Purchaser §§535, 536 (1946). *The mere fact that the vendor resumes possession of the property does not entitle the purchaser to recover payments made on the contract where it is not rescinded.* 92 C.J.S., Vendor & Purchaser §554 (1965).⁶⁷ (emphasis added)

For the latter statement the dictum can again be disposed of by noting that it is supported again by secondary authority repeating the admitted general rule which North Carolina historically has not followed. With respect to the former statement, once again, the court cites three North Carolina cases which would not support a claim of forfeiture of the vendee's payments as liquidated damages in an installment sales contract.⁶⁸ In fact, the case of *Mitchell v. Wood*⁶⁹ actually is in accord with the *Hicks* rationale. In *Mitchell* the court stated that a vendor who sued a vendee in default for rescission of the contract, writ of possession, and for damages for withholding possession had asked for the wrong remedy.⁷⁰ The court went on to say that the proper remedy was foreclosure and proceeded accordingly by substituting this theory *ex mero motu*.⁷¹ It ordered that the vendee either pay the balance immediately or the property would be sold by the sheriff with the excess, if any, being paid over to the vendee.⁷²

How could the court be sidetracked into pronouncing *dictum* which was not in accordance with the *Hicks* decision? This question is probably best answered by noting the conspicuous absence of any reference in *Fletcher* to the *Hicks* case or the line of cases from which (with the exception of *Jones v. Boyd*⁷³—which was used for collateral purposes) it evolved. The parties simply must not have brought these cases to the court's attention. Neither party cited *Hicks* or any of its predecessors in their briefs (this is probably because the basis of the plaintiff's action was rescission). Thereupon, the court lapsed into dictum supported by secondary authority and North Carolina cases which were neither on point nor in harmony with the *Hicks* line of cases.

67. *Brannock v. Fletcher*, 271 N.C. 65, 73-4, 155 S.E.2d 532, 541 (1967).

68. *Credle v. Ayers*, 126 N.C. 11, 35 S.E. 128 (1900) (there, the vendee could not get foreclosure and application of the proceeds to the judgment for the fair rental value of the property in which he was in wrongful possession because the vendor himself was a mortgagor whose own equity had been foreclosed and extinguished at time of judgment.); *Allen v. Taylor*, 96 N.C. 37, 1 S.E. 462 (1887). (That case held only that in the absence of an agreement to the contrary can a vendor regain possession of land from a vendee until the full purchase price is paid. There is some supporting dicta, but it would seemingly be overruled by the *Hicks* case 22 years later.)

69. *Mitchell v. Wood*, 70 N.C. 297 (1874).

70. *Id.* at 299.

71. *Id.*

72. *Id.* at 300.

73. *Jones v. Boyd*, 80 N.C. 258 (1879).

ATTACKING FORFEITURE

383

Because the statements were by way of dictum, the North Carolina consumer who is in the status of a defaulting vendee gets a reprieve. As a result, the *Hicks* case is the only viable precedent in North Carolina defining the rights of a defaulting vendee under an installment land sales contract containing a "forfeiture as liquidated damages clause", because it is the only case where the North Carolina Supreme Court has spoken to the issue other than through dictum. The *Hicks* case is therefore the guiding star to any lower court (and hopefully any subsequent North Carolina Supreme Court) action taken to attack the onerous "forfeiture as liquidated damages clause" in installment land sales contracts.

IV. POTENTIAL SANCTIONS FOR USE OF THE "FORFEITURE AS LIQUIDATED DAMAGES CLAUSE" IN INSTALLMENT LAND SALES CONTRACTS

Now that the North Carolina position has been established, we can turn to the potential sanctions for noncompliance with the precedent of *Hicks* and for the use of the "forfeiture as liquidated damages clause" in general. From the *Hicks*⁷⁴ rationale springs alternative remedies. First, there would be the right of the vendee for the protection of his equity of redemption to institute judicial foreclosure. This would entitle the foreclosing vendee to the surplus, if any, after the satisfaction of the balance of the selling price plus costs. If the vendor had already summarily conveyed the property to another, there would seemingly be a cause of action for wrongful alienation of the vendee's equity of redemption.⁷⁵ In the usual case the vendee also would be able to foreclose on the property, even though it had been conveyed to the vendor's grantee. The reason being is that in the usual case the installment land sales contract would be for a term greater than three years. Presumably, the contract would therefore have been registered for the vendee's protection pursuant to North Carolina General Statute §47-18. This would give constructive notice of the former vendee's interest so as to prevent the vendor's subsequent grantee from attaining the status of a bona fide purchaser.

A concomitant line of attack on the "forfeiture as liquidated damages clause" would flow from the decision of *Hicks v. King*.⁷⁶ This attack would be that the clause would be void as a penalty. In *Knutton v. Cofield*⁷⁷ the supreme court stated its test for a liquidated damages clause being void as a penalty. The test as stated is:

74. *Hicks v. King*, 150 N.C. 370, 64 S.E. 125 (1909).

75. *Freeman v. Bell*, 150 N.C. 146, 63 S.E. 682 (1907).

76. *Hicks v. King*, 150 N.C. 370, 64 S.E. 125 (1909).

77. *Knutton v. Cofield*, 273 N.C. 355, 160 S.E.2d 29 (1968).

384. *NORTH CAROLINA CENTRAL LAW JOURNAL*

[A] stipulated sum is for liquidated damages only (1) where the damages which the parties might reasonably anticipate are difficult to ascertain because of their indefiniteness or uncertainty and (2) where the amount stipulated is either a reasonable estimate of the damages which would probably be caused by a breach or is reasonably proportionate to the damages which have actually been caused by the breach.⁷⁸ (quotations omitted)

Certainly, the liquidated damages clause in an installment land sales contract cannot meet this test because the court itself has specified the method for computation of damages.⁷⁹ By using the court's own method of computation the amount of damages is always certain to be capable of measure in any case of the vendee's default; hence, the first part of the court's test for a valid liquidated damages provision can never be satisfied. It is also doubtful that the second part of the test could ever be satisfied once a vendee had paid a substantial sum of money to a vendor.

The vendee's entitlement to foreclosure, wrongful alienation, and penalty actions, however, are traditional remedies which do not provide the necessary deterrent against today's highly commercialized vendor using the "forfeiture as liquidated damages clause". A much better vehicle for use by the defaulting vendee, who has been summarily deprived of his payments through a "forfeiture as liquidated damages clause", is to bring an action for treble damages under North Carolina General Statute §75-16, prohibiting "unfair or deceptive acts or practices" under North Carolina General Statute §75-1.1.

This statutory language was modeled after the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (1973 ed.).⁸⁰ Consequently, a recent North Carolina Supreme Court decision has stated that, while it is for the judge to decide whether an act or practice falls within the language of N.C.G.S. §75-1.1, guidance for the interpretation of the statute may be obtained from references to the decisions on appeal from the Federal Trade Commission.⁸¹ This statement by the court makes a brief examination of the federal decisions in order.

Congress, in enacting the Federal Trade Commission Act, left undefined the exact prohibition of the statute in order to achieve flexibility:

What shall constitute unfair methods of competition denounced by the act, is left without specific definition. Congress deemed it better to leave the subject without precise definition, and to have each

78. *Id.* at 361, 160 S.E.2d at 34.

79. *Hicks v. King*, 150 N.C. 370, 64 S.E. 125 (1909).

80. *Hardy v. Toler*, 288 N.C. 303, 218 S.E.2d 342 (1975).

81. *Id.* at 308, 218 S.E.2d at 345.

ATTACKING FORFEITURE

385

case determined upon its own facts, owing to multifarious means by which it is sought to effectuate such schemes.⁸²

Nevertheless, in the last 54 years since this decision, certain broad principles have emerged. It can now be asserted that any device, manner of operation, mode of doing business, or method of advertisement, carried on in business or commerce which has the capacity or likelihood to deceive the public constitutes an unfair and deceptive trade practice. It is not essential that actual deception take place, it being sufficient that there exists a capacity to deceive.⁸³ Neither is it necessary in order for an act to be held unfair and deceptive that it constitute fraud.⁸⁴ Whether good or bad faith exists, or whether the intent to deceive exists, is not material to the question of whether the act is being violated, since it is sufficient that the device, advertisement, trade name, representation, or manner of doing business is likely to deceive. Most importantly, in determining whether a statement or representation is deceptive within the meaning of the act, the courts are concerned with the impression it is likely to create upon prospective purchasers.⁸⁵

Applying these principles, announced in these federal cases, to the use of a "forfeiture as liquidated damages clause" in North Carolina, immediately leaves one with the feeling that North Carolina General Statutes §75-1.1 has been violated. What could have more capacity to deceive or be more unfair to a low equity vendee? As typically written this clause is an attempt to contract away a defaulting vendee's right to foreclosure, judicial sale, and surplus, if any—in short, his equity of redemption. This is an attempt to deprive a citizen of North Carolina of a *right* clearly given to him under the decision of *Hicks v. King*⁸⁶ which is incapable of being impaired through contract.⁸⁷ It would be interesting to know how many citizens believe in their minds that if they signed an installment land sales contract the "forfeiture as liquidated damages clause" would be conclusive. This not only has the capacity to deceive, but it is *actually* deceptive and unfair.

The view of the Federal Trade Commission (FTC) is in accord. The FTC believes that such clauses are unfair and deceptive even though there has been no concomitant deprivation of a state right to foreclosure based on principles of equitable mortgage. Recently, the Commission has filed no less than three complaints charging *inter alia*, that the use of

82. *FTC v. Beachnut Packing Co.*, 257 U.S. 441, 453 (1922).

83. *Montgomery Ward v. FTC*, 285 F.2d 879 (9th Cir. 1960).

84. *D.D.D. Corp. v. FTC*, 125 F.2d 679 (7th Cir. 1942) cited in *Hardy v. Toler*, 288 N.C. 303, 218 S.E.2d 342 (1975).

85. *Kulwajtys v. FTC*, 239 F.2d 654 (7th Cir. 1956).

86. *Hicks v. King*, 150 N.C. 370, 64 S.E. 125 (1909).

87. *Robinson v. Willoughby*, 65 N.C. 520 (1871).

386 *NORTH CAROLINA CENTRAL LAW JOURNAL*

the "forfeiture as liquidated damages clause" is an "unfair act or practice".⁸⁸ One such complaint reads in part:

The aforesaid contracts also provide that upon failure of the purchaser to pay any installment due under the contract, the seller shall be entitled to retain all sums previously paid thereunder by the purchaser.

The use by respondents of the aforesaid provision is an unfair act or practice because the sums retained by the respondents are not calculated to bear any relation to the actual damages, if any, sustained by respondents by reason of the purchaser's default.⁸⁹

The result of one of these complaints has been an agreement to a cease and desist order.⁹⁰

These FTC complaints and order and the foregoing established federal court principles should be, in and of themselves, sufficient persuasive authority to support a court finding that a "forfeiture as liquidated damages clause" violates North Carolina General Statutes §75-1.1. How could any other result be reached if one of the avowed purposes of the statute is to be carried out by the courts? That purpose is ". . . to provide civil legal means to maintain ethical standards of dealings . . . between persons engaged in business and the consuming public within this State."⁹¹

V. CONCLUSION

By now it should be obvious that approval of the "forfeiture as liquidated damages clause" in installment land sales contracts is an illogical anomaly in the law. Its use has been perpetuated over time by confused courts failing to see the purchase money mortgage analogy until *stare decisis* had already set in. Historically, the North Carolina Supreme Court is one of the few that has not been deceived and has seen the installment land sales contract for what it really is—an equitable mortgage. Accordingly, the court has heretofore preserved a defaulting vendee's sacred equity of redemption. Once again, it is time for the courts of this State, armed with the holding in the *Hicks* case, to come to the rescue because many of our citizens are being deprived of an historic right that they do not even realize they have. If *Hicks* no longer is adequate, an unfair and deceptive trade practice under G.S. 75-1.1 and G.S. 75-16 would be a most welcome and badly needed substitute.

R. JAMES LORE

88. In re GAC Corp., FTC Docket No. C-2523 (1974); In re Horizon Corp., FTC Docket No. 9017 (1975); In re Amrep. Corp., FTC Docket No. 9018 (1975).

89. In re GAC Corp., FTC Docket No. C-2523 at 19 (1974).

90. In re GAC Corp., FTC Docket No. C-2523 (1974).

91. N.C. GEN. STAT. § 75-1.1(b) (1975).