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A Mortgage By Any Other Name: A Plea For The Uniform Treatment Of Installment Land Contracts And Mortgages Under The Bankruptcy Code

Juliet M. Moringiello*

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I. Introduction

In October 1994, Congress enacted the most recent amendments to the Bankruptcy Code of 1978 (the "Code").[1] The amendments include provisions raising the debt limits for Chapter 13 eligibility, increasing exemption amounts and adding to the existing categories of priorities and non-dischargeable debts.[2] However, one question often litigated under the Code remains unresolved: that of the status of installment contracts for the purchase of real estate when the buyer files for bankruptcy. This article seeks to show that such contracts, commonly known as installment land contracts, should be treated in bankruptcy like their functional equivalents—purchase-money mortgages.

A. The Hypothetical Debtor

Buyer wants to purchase a piece of real estate. Buyer, however, is having trouble finding conventional financing in the form of a mortgage loan from a bank, perhaps because Buyer does not have a sufficient downpayment. As a result, Buyer asks a potential seller if Seller would be willing to finance the purchase price of the property.

At this point, the Seller willing to finance the purchase has two options. Seller can either take back a promissory note secured by a purchase-money mortgage, or Seller can offer an installment land contract. Either device will likely carry a higher interest rate than the institutional mortgage loan, because Buyer is something of a credit risk. If Seller elects to use a purchase-money mortgage, Seller conveys title to the property to Buyer and retains only a security interest in the land. Buyer takes possession and becomes the owner of the land, subject to the lien of seller. If, however, Seller enters into an installment land contract, Seller keeps title to the property until the Buyer pays the entire purchase price.[3]

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1. 11 U.S.C. §§ 101-1330 (1994).

2. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, 4111-12 (1994).

3. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 3.26 (3d ed. 1994)[hereinafter NELSON & WHITMAN TREATISE]. Such an arrangement is sometimes known as a contract for deed, a long term land contract or a land sale contract. It is important to distinguish these types of contracts from the ordinary executory contract for the sale of land, which is used primarily to establish the rights and liabilities of the buyer and seller between the date of their bargain and the date of closing, which is usually only a

Normally, during the contract period, the Buyer will be required to pay property taxes, maintain casualty insurance, and keep the property in good repair. Buyer also takes possession of the land, but is not considered the owner since Seller retains title.

The installment land contract solution has benefits for both Buyer and Seller. Buyer gets to take possession of the land without a large downpayment, and without the large closing costs customarily associated with institutional financing. Seller, on the other hand, sells land that may have been difficult to sell, receives a relatively high interest rate, and receives more favorable tax treatment than if the transaction were a cash sale.[4] In addition, the Seller, in some states, has the remedy of forfeiture.[5] It is the remedy of forfeiture which makes the installment land contract more favorable, from Seller's perspective, than the seller-financed purchase-money mortgage. Traditionally, buyers under installment land contracts have not received the protections afforded to mortgagors of real property upon default.[6] In many states, a seller, upon default by the buyer, can exercise the right of forfeiture. If the land is located in such a state, the Seller can remove Buyer from the land without following mortgage foreclosure rules. If the Seller exercises this right, Buyer loses all interest in the land and all payments made on the contract.[7]

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month or two later. *Id.* § 3.26, at 68-69. See also 7 POWELL, LAW OF REAL PROPERTY, ¶ 938.20 (Rohan ed. 1995), for a general discussion of the installment land contract. It is not considered a lease arrangement. *Id.*

4. *See* 26 U.S.C. § 453 (1994). *See also* NELSON & WHITMAN TREATISE, *supra* note 3, § 3.34, at 106-11.

5. The forfeiture remedy is a major disadvantage to the buyer. On the part of the buyer, the choice to enter into an installment land contract often is not a choice at all. If the buyer is a good credit risk for an institutional lender, it would be preferable for the buyer to get a mortgage loan from such a lender. One court termed the installment land contract the "poor man's mortgage." Ellis v. Butterfield, 570 P.2d 1334, 1336 (Idaho 1977). Advocates of the approach that treats installment land contracts according to state-law characterizations believe the option between a mortgage and a installment land contract is a true choice. *See, e.g.*, Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts in Bankruptcy*, 74 MINN. L. REV. 227, 321 (1989).

6. *See infra* text accompanying notes 24-33.

7. Many states have taken legislative steps to mitigate the harshness of forfeiture for the buyer. *See, e.g.*, CAL. CIV. CODE §§ 3275, 3369 (West 1970); IOWA CODE ANN. §§ 656.1-656.6 (West 1987 & Supp. 1995); MD. CODE. ANN., REAL PROP. §§ 10-101 to 10-108 (1988 & Supp. 1994); MINN. STAT. ANN. § 559.21 (West 1988 & Supp. 1995); MONT. CODE ANN. § 28-1-104 (1993); N.D. CENT. CODE §§ 32-18-01 to 32-18-06 (1976); OKLA. STAT. ANN. tit. 16, § 11(A) (West 1986). For related discussion of statutory limitations on forfeiture, see NELSON & WHITMAN TREATISE, *supra* note 3, § 3.28, at 70-74; Donna R. Roper, Comment, *Forfeiture Clauses in Land Installment Contracts: Time for Equitable Foreclosure*, 8 U. PUGET

B. The Problem

Although the installment land contract is widely considered to be the functional equivalent of a purchase-money mortgage,[8] its treatment as such is not clear when the buyer files for bankruptcy. The Code is silent as to whether installment land contracts should be treated as the functional equivalent of purchase-money mortgages in the event of the buyer's bankruptcy. The Code, however, does provide for special treatment of installment land contracts when the seller is a debtor in bankruptcy. In such a case, if the trustee in bankruptcy rejects the contract, the Code provides the buyer with an option. The Buyer can either declare the contract terminated, or the buyer may remain in possession, make all payments, and receive the deed to the property from the trustee.[9]

The question of whether the installment land contract is an executory contract or a mortgage is crucial in the buyer's bankruptcy because the two are treated very differently under the Code.[10] For the reasons explained below, sellers usually prefer that an installment land contract be treated as an executory contract. As

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SOUND L. REV. 85 (1984).

8. NELSON & WHITMAN TREATISE, *supra* note 3, § 1.7.

9. 11 U.S.C. § 365(i) provides:

> (1) If the trustee rejects an executory contract of the debtor for the sale of real property or for the sale of a timeshare interest under a timeshare plan, under which the purchaser is in possession, such purchaser may treat such contract as terminated, or, in the alternative, may remain in possession of such real property or timeshare interest.
>
> (2) If such purchaser remains in possession—
>
> > (A) such purchaser shall continue to make all payments due under such contract, but may, offset against such payments any damages occurring after the date of the rejection of such contract caused by the nonperformance of any obligation of the debtor after such date, but such purchaser does not have any rights against the estate on account of any damages arising after such date from such rejection, other than such offset; and
> >
> > (B) the trustee shall deliver title to such purchaser in accordance with the provisions of such contract, but is relieved of all other obligations to perform under such contract.

11 U.S.C. § 365(i) (1994). Section 365(i) was included in the Bankruptcy Reform Act of 1978 as one of the "several safeguards for the protection of nonbankrupt parties to leases and sales contracts involving real estate." BENJAMIN WEINTRAUB & ALAN N. RESNICK, BANKRUPTCY LAW MANUAL § 7.10[10] (3d ed. 1993). As the legislative history suggests, 365(i) was designed to protect the non-debtor purchaser of real property under a land installment sales contract. S. REP. NO. 989, 95th Cong., 2d Sess. 60, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5846 and H.R. REP. NO. 595, 95th Cong., 2d Sess. 349, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6306.

10. 11 U.S.C. §§ 365, 502, 1129(b), 1325(a)(5) (1994).

a result, when the buyer files for bankruptcy, the seller will often move to compel the buyer to assume or reject the contract.[11]

If the buyer is considered a mortgagor, the buyer, when a bankruptcy petition is filed under Chapters 11, 12 or 13, can deal with the mortgage in his plan of reorganization.[12] Under the Code a debtor may modify the rights of secured creditors.[13] As a result, the debtor is permitted to pay, over the period of the plan, the value of the mortgagee's secured claim.[14] On the other hand, if the buyer is in possession under an installment land contract deemed to be an executory contract, the debtor must assume the contract in full in order to retain the land.[15] As a result, he must perform the contract according to its original terms, without any modification of amount owing or interest rate.[16] In addition, if the buyer/debtor has defaulted on the contract, he must either cure the defaults or provide adequate assurance of cure in order to assume the contract. If the debtor rejects the contract, the seller gets the land back.[17]

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11. *See* 11 U.S.C. § 365(d). *See, e.g.*, *In re* Redpath Computer Services, Inc., 181 B.R. 975 (Bankr. D. Ariz. 1995); *In re* Steffen, 181 B.R. 981 (Bankr. W.D. Wash. 1995); Firearms Import and Export Corp. v. United Capitol Ins. Co. (*In re* Firearms Import and Export Corp.), 131 B.R. 1009 (Bankr. S.D. Fla. 1991); *In re* Seabrook Island Ocean Club, Inc., 118 B.R. 410 (Bankr. D.S.C. 1990). See also NELSON & WHITMAN TREATISE, *supra* note 3, § 8.19, at 692-94, for a discussion of vendor and vendee remedies within the context of installment land contracts.

12. 11 U.S.C. §§ 1123(b)(5), 1222(b)(2), 1322(b)(2), (1994).

13. *Id.*

14. 11 U.S.C. §§ 1123 (b)(5), 1129(b)(2)(A)(i)(II), 1222(b)(2), 1225(a)(5), 1322(b)(2), 1325(a)(5) (1994). In Chapter 13, a plan only lasts three years (five with court approval). If the mortgage is for a longer term than three years, the debtor may provide for a longer payment period. 11 U.S.C. § 1322(b)(5).

Should the loan be secured solely by a lien on the debtor's personal residence, the debtor would not be allowed to modify the mortgagee's rights under the mortgage documents. 11 U.S.C. §§ 1123(b)(5), 1322(b)(2) provide that a debtor's plan of reorganization cannot modify the rights of a holder of a claim secured only by a lien on the debtor's personal residence. Since a home mortgage cannot be modified, this article does not discuss home mortgages.

15. 11 U.S.C. § 365 (1994).

16. 11 U.S.C. § 365. *In re* Patch Graphics, 32 B.R. 373, 375 (Bankr. W.D. Wis 1983), *In re* Cox, 28 B.R. 588, 589 (Bankr. D. Idaho 1983), *In re* Booth, 19 B.R. 53, 60 (Bankr. D. Utah 1982).

17. *In re* Rancho Chamberino, 77 B.R. 555, 560 (Bankr. W.D. Tex. 1987). The court in Fox v. Hill (*In re* Fox), relying on Pennsylvania law, stated in dicta that a purchaser could remain in possession of the land during the pendency of the bankruptcy case because upon termination of the contract, the buyer would become a tenant and the seller would only be entitled to relief from stay if the buyer/tenant ceased making fair rental payments. However, rejection of the contract would effect a breach, and the debtor would lose all of his equity

Courts have encountered difficulty in determining how to decide the issue of whether an installment land contract should be treated as a mortgage or a contract subject to the provisions of § 365 of the Code. Some courts have looked to state law to resolve the issue.[18] Others have looked to the definition of executory contract,[19] while still others have imposed some standard of fairness upon either the buyer or the seller.[20] Lacking uniformity, these varying approaches inexorably lead to inconsistency from state to state[21] and sometimes even within a state.[22] As a result, it is difficult for parties to predict, at the outset of their transaction, how an installment land contract will be treated for bankruptcy purposes.

This article will examine the treatment of installment land contracts in bankruptcy cases and propose that such contracts be treated as mortgages. In proposing solutions to the problem of installment land contracts in bankruptcy, it is necessary to examine the position of sellers under installment land contracts and purchase-money mortgagees outside of bankruptcy in order to determine whether there is any compelling reason to treat them differently in bankruptcy.[23]

II. Remedies and Rights Under Installment Land Contracts and Mortgages

The two most important differences between installment land contracts and purchase-money mortgages outside of bankruptcy are the location of title and the seller's available remedies. To appreciate the anomalous nature of installment land contracts it is necessary to examine the remedies available under both installment land contracts and mortgages, as well as the history of mortgage remedies.

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in the property. 83 B.R. 290, 300 (Bankr. E.D. Pa. 1988).

18. *See infra* text accompanying notes 134-55.

19. *See infra* text accompanying notes 156-77.

20. *See infra* text accompanying notes 178-204.

21. *See infra* notes 195-99 and accompanying text.

22. *See infra* note 183 and accompanying text.

23. One of the frequently stated goals of the Bankruptcy Code is the equal treatment of similarly situated creditors. *See* THERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 276-77 (1989).

A. *The Forfeiture Remedy-The Installment Land Contract's Defining Feature*

The buyer's incentive for entering into an installment contract is clear—it gives the buyer the opportunity to occupy the property without paying the large downpayment commonly associated with institutional financing.[24] The seller also has a clear incentive—the availability of forfeiture. The forfeiture clause, common in installment land contracts, allows the seller to declare the contract terminated, retain all payments as liquidated damages, and retake possession of the premises without legal process upon the buyer's default.[25] Consequently, the buyer forfeits any equity in the property which may have been built during possession. This clause renders the installment land contract, from the seller's point of view, more favorable than a mortgage or deed of trust, since under both of those instruments, a mortgagee must foreclose the mortgagor's equity of redemption in order to retake possession of the real property.[26] While the seller under an installment land contract also has the right to sue for the overdue installments, specific performance of the contract, damages from the breach or foreclosure of the buyer's rights, sellers most frequently elect use of the forfeiture remedy.[27]

It is important to note that default rates under installment land contracts are higher than default rates for mortgages, because the installment financing device tends to be used by lower income buyers who cannot qualify for conventional financing.[28] As a

24. Often a seller, extending credit by taking back a purchase money mortgage, will accept a lower downpayment than an institutional lender. Therefore, the choice between using an installment land contract and using a purchase-money mortgage rests primarily with the seller.

25. NELSON AND WHITMAN TREATISE, *supra* note 3, § 3.26, at 68-69. The availability of forfeiture has been diminished in several states. See notes 34-46 *infra* and accompanying text.

26. The procedure which the mortgagee must follow differs from state to state. In a small minority of states, strict foreclosure is permitted. In others, foreclosure is by judicial sale or by a power of sale contained in the mortgage instrument. See *infra* text accompanying notes 51-60.

27. Grant S. Nelson & Dale A. Whitman, *The Installment Land Contract—A National Viewpoint*, 1977 B.Y.U. L. REV. 541, 542.

28. BAXTER F. DUNAWAY, THE LAW OF DISTRESSED REAL ESTATE § 10.02[1] (Clark Boardman Callaghan, 1995).

result, the very people who would not be able to afford a home,[29] small business premises, or a farm without the installment land contract are the ones who stand to lose not only their real property, but also all equity in that real property.[30]

Many have argued that abolition of the forfeiture remedy would end the use of the installment land contract as a financing device.[31] By extension, some have argued that treating an installment land contract as a mortgage for bankruptcy purposes would have the same effect.[32] However, the treatment of installment land contracts as mortgages for bankruptcy purposes would not, in itself, eliminate the remedy of forfeiture. Rather, it would delay the remedy, just as creditor remedies under mortgages and deeds of trusts are delayed by the automatic stay.[33]

B. *Chipping Away at the Forfeiture Remedy*

Various states have, by statute, attempted to make the remedy of forfeiture less severe. State law varies greatly as to how a seller can regain the land after a buyer default. Iowa[34] and Minnesota,[35] for example, provide grace periods before allowing use of the forfeiture remedy. Under these statutes, the seller

29. This article does not address residential installment land contracts, because under §§ 1123(b)(5) and 1322(b)(2), a debtor must pay a home mortgage debt in full under a plan of reorganization. This applies only to claims secured by a lien on real property that is the debtor's residence. *See supra* note 14.

30. In reality, mortgagors rarely recover any equity in a foreclosure sale, because foreclosure sales rarely bring the fair market value of the realty. However, the foreclosure mechanism, at least in theory, allows the value of the property to be tested at a sale.

31. *See, e.g.*, Thomas Leo McKeiman, *Preserving Real Estate Contract Financing in Washington: Resisting the Pressure to Eliminate Forfeiture*, 70 WASH. L. REV. 227, 246 (1995); Eric T. Freyfogle, *Vagueness and The Rule of Law: Reconsidering Installment Land Contract Forfeitures*, 1988 DUKE L.J. 609; James Geoffrey Durham, *Forfeiture of Residential Land Contracts in Ohio: The Need for Further Reform of a Reform Statute*, 16 AKRON L. REV. 397 (1983). This article will not address the question of whether installment land contracts should be universally abolished.

32. This argument is implicit in *In re Speck*, in which the court, in holding that an installment land contract is an executory contract subject to § 365, stressed that "[t]he contract for deed is one of the few alternatives to commercial financing available, and it is especially well suited to the realities of agricultural land sales." 50 B.R. 307, 308 (Bankr. D.S.D. 1985).

33. The automatic stay provided in 11 U.S.C. § 362 prohibits any action to obtain property of the estate or property of the debtor. 11 U.S.C. § 362(a). As a result, a mortgagee cannot foreclose the mortgagor's interest in the property unless the mortgagee obtains relief from the stay. 11 U.S.C. § 362(d) (1994).

34. IOWA CODE ANN. §§ 656.1-656.6 (West 1987).

35. MINN. STAT. ANN. § 559.21 (West 1988 & Supp. 1995).

cannot evict the buyer from the property until the seller gives the buyer notice and an opportunity to cure.[36] Maryland has prohibited forfeiture in all cases in which the buyer is a consumer.[37] Oklahoma has, by statute, effectively rendered the installment land contract obsolete by requiring installment land contracts to be foreclosed in the same manner as mortgages.[38]

In other states, the courts, rather than the legislatures, have lessened the impact of the remedy of forfeiture.[39] In these decisions, the courts have applied a confusing mixture of contract law and mortgage law principles.[40] Florida courts, applying mortgage law principles, have given installment land contract buyers an equity of redemption.[41] Kansas courts have also applied mortgage principles in giving buyers a post-foreclosure right of redemption.[42] Indiana courts generally prohibit forfeiture,[43] but will allow it when the buyer has paid only a small portion of the contract price.[44] In Utah, courts applying the contract principle of unjust enrichment have held that buyers are entitled to a return of a portion of the purchase price that they have already paid, usually

36. IOWA CODE ANN. §§ 656.2, 656.4; MINN. STAT. ANN. § 559.21.

37. In Maryland there is no forfeiture in contracts for the sale of real property where the buyer is an individual. MD. CODE ANN., REAL PROP. §§ 10-101 to 10-108 (1988 & Supp. 1994). Ohio and Illinois also make a distinction between residential and commercial property in their installment land contract statutes. OHIO REV. CODE ANN. §§ 5313.05, 5313.06, 5313.08 (1989); ILL. ANN. STAT. ch 735, para. 5/15-1106 (Smith-Hurd 1994).

38. OKLA STAT. ANN. tit. 16, § 11(A) (West 1986). For a general discussion of statutory limitations on forfeiture, *see* Grant S. Nelson and Dale A. Whitman, *Installment Land Contracts—The National Scene Revisited*, 1985 B.Y.U. L. REV. 1, 6-11.

39. Kentucky, for example, relies on the doctrine of equitable conversion. *See, e.g.*, Sebastian v. Floyd, 585 S.W.2d 381, 383 (Ky. 1979).

40. *Compare* H.L. Land Co. v. Warner, 258 So. 2d 293 (Fla. App. 1972) *with* Soffe v. Ridd, 659 P.2d 1082 (Utah 1983).

41. H.L. Land Co. v. Warner, 258 So. 2d 293, 296 (Fla. App. 1972)(holding that "an installment land sale contract is in essence a mortgage, and . . . the safeguards for the debtor and the remedies for the creditor are the same as those between a mortgagor and mortgagee"). The court in *H.L. Land* limited its holding to contracts under which the buyer has possession or other "burdens and benefits of ownership." *Id.* For a discussion of the equity if redemption and its importance in mortgage law, *see infra* notes 54-65 and accompanying text.

42. Nelson v. Robinson, 336 P.2d 415 (Kan. 1959)(court deemed installment land contract to be an equitable mortgage and granted the buyers a six month redemption period).

43. Skendzel v. Marshall, 301 N.E.2d 641 (Ind. 1973), *cert. denied*, 415 U.S. 921 (1974).

44. Phillips v. Nay, 456 N.E.2d 745 (Ind. Ct. App. 1983).

to the extent that such portion exceeds the fair rental value of the land.[45]

As a result of the above legislative and judicial responses to forfeiture, the differences between installment land contracts and purchase-money mortgages are disappearing.[46]

C. The Right of Redemption—The Mortgage's Defining Feature

Under early English common law, a mortgage was essentially a conveyance of fee simple ownership from the debtor to the creditor.[47] The conveyance, however, was on condition subsequent, that is, if the debtor paid the creditor in full on the payment date, or "law day," then the debtor could reenter the land and terminate the creditor's estate.[48]

Over the years, however, the debtor's equity of redemption developed. When a mortgagor defaults on his mortgage, the mortgagor has the right to pay the entire amount of the outstanding debt and receive the legal interest in the property.[49] This is called the mortgagor's "equity of redemption." Although a mortgagor and mortgagee can agree that the mortgagor will relinquish the right of redemption by, for instance, the mortgagor giving a deed in lieu of foreclosure, the agreement cannot be made in the mortgage instrument itself.[50]

In order to obtain title to the real property, a mortgagee must act to foreclose this "equity of redemption." There are three main types of foreclosure in the United States, although only two are generally viable.[51] The rarest type of foreclosure is strict foreclosure.[52] In states that permit strict foreclosure, the mortgagee must

45. *See, e.g.*, Soffe v. Ridd, 659 P.2d 1082 (Utah 1983)(awarding buyers on counterclaim a return of that portion of the total payments they had made in excess of the fair rental value of the premises during their occupancy); Young v. Hansen 218 P.2d 666 (Utah 1950)(recovering excess payments under theory of unjust enrichment). *But see* Bellon v. Malnar 808 P.2d 1089 (Utah 1991)(allowing interest on contract as an alternative to fair rental value).

46. For a general discussion of judicial limitations on the forfeiture remedy, *see*, Nelson and Whitman, *supra* note 38, at 11-31.

47. NELSON AND WHITMAN TREATISE, *supra* note 3, § 1.2.

48. *Id.*

49. For a related discussion of mortgagors' rights among selected jurisdictions, see NELSON AND WHITMAN TREATISE, *supra* note 3, § 3.29, at 74-91.

50. Dorman v. Fisher, 155 A.2d 11, 13 (N.J. 1959).

51. ROBERT KRATOVIL & RAYMOND J. WERNER, MODERN MORTGAGE LAW AND PRACTICE § 41.08, 41.09, 41.11 (2d ed. 1981).

52. At the current time, strict foreclosure is utilized in only three states. *See* CONN. GEN. STAT. ANN. § 49-15 (West 1995); 735 ILL. REV. STAT. ANN.. § 5/15-1403 (West 1995);

bring a judicial action for foreclosure.[53] When the judgment of foreclosure is granted, the mortgagee can take title to the property without a sale.[54]

The two generally viable types of foreclosure are judicial foreclosure[55] and foreclosure by power of sale.[56] In both types the property is sold at a public sale under the theory that a public sale is the best place to test the value of the property.[57]

In judicial foreclosure, the mortgagee must first obtain a judgment of foreclosure, and then the ensuing sale is supervised by the court.[58] Power of sale foreclosure exists only where state law permits it, and the power of sale is contained in the mortgage instrument.[59] No court action is involved, but the property must be sold at a public sale.[60]

Throughout history, parties who have financed the purchase of land have tried to defeat, or "clog," the mortgagor's equity of redemption. One way in which parties have tried to do this is by having the buyer give the financier an absolute deed for the property, which the financier would transfer to the buyer when all sums owing were paid.[61] Courts routinely view such attempts, however, as disguised mortgages and give the buyer the equity of redemption.[62]

VT. STAT. ANN. tit. 12, § 4528, (1994). *See generally* NELSON & WHITMAN TREATISE, *supra* note 3, § 7.10.

53. *See* NELSON & WHITMAN TREATISE, *supra* note 3, § 7.10.

54. *See, e.g.,* Crane v. Loomis, 25 A.2d 650, 651 (Conn. 1942); *see also* VT. STAT. ANN. tit. 12, § 4528.

55. Judicial foreclosure is exclusively or generally followed in 21 states. NELSON & WHITMAN TREATISE, *supra* note 3, § 7.11, n. 1, at 490-91.

56. Power of sale foreclosure is permitted in over thirty jurisdictions. *Id.* § 7.19, n. 1, at 512.

57. Robert K. Lifton, *Real Estate in Trouble: Lender's Remedies Need an Overhaul,* 31 BUS. LAW 1927,1936 (1976); William C. Prather, *Foreclosure of the Security Interest,* 1957 U. ILL. L. F. 420, 429.

58. KRATOVIL & WERNER, *supra* note 51, § 7.11, n. 1, at 490-91.

59. *Id.* § 7.19, n. 1, at 512.

60. Power of sale foreclosure is permitted in over thirty jurisdictions. NELSON & WHITMAN TREATISE, *supra* note 3, § 7.19, n. 1, at 512.

61. For a discussion of the deed absolute, see generally, *Id.* § 3.5; Roger A. Cunningham & Saul Tischler, *Disguised Real Estate Security Transactions as Mortgages in Substance,* 26 RUTGERS L. REV. 1 (1972). Some commentators have concluded that the installment land contract is "virtually identical in form to the common law mortgage, the deed absolute." Linda S. Hume, *Real Estate Contracts and the Doctrine of Equitable Conversion in Washington: Dispelling the Ashford Cloud,* 7 U. PUGET SOUND L. REV. 233, 245 (1984).

62. Hume, *supra* note 61, at 247.

It is now well settled throughout the country that any absolute conveyance of land which the parties intend as security for a debt will be considered a mortgage and that mortgage law will be applied.[63] However, the maxim "once a mortgage, always a mortgage"[64] has not traditionally applied to installment land contracts.[65]

In spite of policies favoring redemption, the installment land contract has remained a viable device. In *Miller v. Anderson*,[66] the court distinguished installment land contracts from deeds absolute by stating that "[t]itle to the property involved in an equitable mortgage starts with the borrower and passes to the lender as security for money borrowed. [In an installment land contract], title originated with . . . the lender."[67] In distinguishing installment land contracts from equitable mortgages, the court in *Miller* stated it would consider a transaction to be an equitable mortgage only when the parties intend to enter into a mortgage relationship.[68] The important inquiry, however, should not be whether the parties intended a mortgage, because parties entering into an installment land contract do not intend a mortgagor-mortgagee relationship. Instead, the crucial inquiry should be whether the parties intended that the deed to the realty stand as security for a debt.[69]

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63. Cunningham and Tischler, *supra* note 61, at 4. In determining whether an absolute deed should be considered a mortgage, courts must consider extrinsic evidence. When there is a writing obligating the grantee to reconvey the land, the party seeking to establish an equitable mortgage must establish that the two writings constitute part of the same transaction. *Id.* at 11-12. When there is no additional writing, courts tend to be lenient in admitting parol evidence, because "[a]n allegation that the deed was given for security is necessarily an allegation that the deed was not intended to embody the entire agreement of the parties." *Id.* at 9.

64. Gavin v. Johnson, 41 A.2d 113, 117 (Conn. 1945).

65. Cunningham and Tischler, *supra* note 61, at 7. Called "[o]ne of the most important aspects of the mortgage relationship . . . [t]his maxim primarily applies to an agreement embodied in or contemporaneous with the execution of the mortgage, and its purpose is to protect the debtor who, under circumstances of hardship or necessity, might be an easy prey to those who sought to exact inequitable conditions." *Gavin*, 41 A.2d at 117.

66. 394 N.W. 2d 279 (Minn. Ct. App. 1986).

67. *Id.* at 283.

68. *Id.*

69. Cunningham and Tischler, *supra* note 61, at 6.

III. General Bankruptcy Principles

Since installment land contracts are essentially security devices, the disparate treatment of purchase-money mortgages and installment land contracts conflicts with two of the primary objectives of bankruptcy: providing the debtor with a "fresh start"[70] and treating similarly situated creditors equally.[71] Treating the installment land contract as a mortgage would better encourage the debtor's reorganization efforts, because the debtor could then deal with the contract under a plan of reorganization. Therefore, in the absence of any compelling reason for treating installment sellers differently from purchase-money mortgagees, it seems that they should be treated alike, since both installment land contracts and purchase-money mortgages constitute methods for financing the purchase of real property.

Installment sellers and purchase-money mortgagees are similarly situated. Both are entitled to full payment of their debt outside of bankruptcy. If there is no default, both get paid the purchase price of the land, plus interest. Outside of bankruptcy, both would be entitled to the land upon the buyer's default; although the purchase-money mortgagee would be required to follow foreclosure procedures. Both could sell the land to satisfy the debt. Absent a compelling reason for allowing an installment seller to be repaid in full in bankruptcy, regardless of the value of the land, while an undersecured purchase-money mortgagee is entitled only to the present value of the real property plus an unsecured claim,[72] the two devices should be treated alike for bankruptcy purposes.

A debtor's fresh start is embodied in the discharge that a debtor receives upon the successful completion of a bankruptcy

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70. The fresh start for debtors lies "at the heart of all bankruptcy law." SULLIVAN ET AL. *supra* note 23, at 20.

71. THOMAS D. CRANDALL ET AL., THE LAW OF DEBTORS AND CREDITORS ¶ 10.02 (Warren, Gorham & Lamont 1991).

72. Section 506(a) states:

> an allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a) (1994).

case.[73] When a debtor files under Chapter 7, the debtor's property is liquidated and applied to the debtor's prepetition debts.[74] To the extent that the estate is not sufficient to pay the debts, the debts are discharged.[75] When a debtor files for bankruptcy under one of the reorganization chapters, the debtor will pay a portion of his prepetition debts according to his plan, and will emerge from bankruptcy free from his remaining prepetition debts.[76]

As the following section will explain, treatment of an installment land contract as a security device is essential to the debtor's fresh start. This result is best illustrated when the land subject to the contract is worth less than the contract price. If the contract were held subject to §365, the seller would be paid the full purchase price.[77] If the contract were considered a security device, the seller would have two claims, an allowed secured claim equal to the value of the property and an allowed unsecured claim in the amount of the difference between the value of the property and the contract price.[78] The debtor then would be able to discharge the portion of the purchase price that exceeded the value of the collateral, and the debtor would be in the same position as a purchase-money mortgagor and any other debtor whose property is subject to a security interest.

A. *Treatment of Executory Contracts Under the Bankruptcy Code*

Regardless of the similarities between mortgages and installment land contracts, it is not clear that they will be treated in the same manner under the Bankruptcy Code. Under the Code, the trustee or debtor in possession can assume or reject executory contracts.[79] As a result, the cases dealing with installment land

73. 11 U.S.C. §§ 524, 727, 1141, 1228, 1328 (1994). In Chapter 7, a discharge is granted after the estate property is liquidated and the creditors are paid. 11 U.S.C. § 727. A Chapter 7 discharge is only available to a debtor who is an individual. 11 U.S.C. § 727. In Chapters 12 and 13, the court grants the discharge after all plan payments are completed. 11 U.S.C. § 1228, 1328. In Chapter 11, the confirmation of the debtor's plan constitutes the discharge. 11 U.S.C. § 1141.

74. 11 U.S.C. §§ 704(1)(a), 726.

75. 11 U.S.C. § 727.

76. *See* 11 U.S.C. §§ 1141(d)(1), 1228, 1328(a).

77. 11 U.S.C. § 365 (1994). *See infra* notes 89-94 and accompanying text.

78. 11 U.S.C. § 506 (a) (1994).

79. 11 U.S.C. § 365(a). For the remainder of this article, I will use the word "trustee" to refer to both the trustee and the debtor in possession.

contracts often start by addressing the question of whether or not the contract at issue is "executory."

1. The Search for a Definition of "Executory." —The term "executory contract" is not defined in the Code. Many courts, however, point to the legislative history of the Code, which states that the term "generally includes contracts on which performance remains due to some extent on both sides."[80] Since "executory contract" is not defined anywhere in the Code, courts have interpreted the term, and thus the section, in a variety of ways.

One common definition of the term "executory contract" is the "Countryman test." Professor Countryman defined an executory contract as "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance by the other."[81]

Professor Countryman contrasted executory contracts with those fully performed by the non-bankrupt party. If a contract is fully performed by the non-bankrupt party, the contract will give that party a claim in the debtor's bankruptcy.[82] Such contracts do not fall within the assume or reject provisions of the Code because

> [t]he estate has whatever benefit it can obtain from the other party's performance and the trustee's rejection would neither add to nor detract from the creditor's claim or the estate's liability. . . . [The trustee's] assumption, on the other hand, would in no way benefit the estate and would only have the effect of converting the claim into a first priority expense of administration and thus of preferring it over all claims not assumed . . .[83]

Several commentators have found fault with "executoriness" as a threshold requirement for the application of § 365. Professor Westbrook advocates abolishing the requirement of "executoriness" altogether,[84] proposing instead a functional approach to contracts in bankruptcy.[85] Michael T. Andrew also criticizes executoriness

80. S. REP. NO. 989, 95th Cong., 2d Sess. 58, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5844.

81. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973).

82. *Id.* at 451.

83. *Id.* at 451-52 (footnotes omitted).

84. Westbrook, *supra* note 5, at 230.

85. *See infra* notes 331-35 and accompanying text.

as a threshold, stating that the definition of executory contract serves no meaningful purpose in the rejection context, but is necessary in the assumption context to distinguish between those contracts which should be entitled to administrative priority and those which should not.[86]

With all of the confusion surrounding the definition of executory, it is necessary to examine the purposes and effects of § 365 to determine whether installment land contracts are among the types of contracts to which § 365 should apply.

2. *The Effect of Classifying a Contract as Executory.* –If the installment land contract is considered to be an executory contract, and the debtor files under Chapters 11, 12 or 13, the trustee may assume or reject the contract at any time before confirmation of the plan.[87] The court, however, on the request of any party to the contract, may order the trustee to determine within a "specified period of time" whether to assume or reject the contract.[88] Generally, in determining this time period, courts impose a reasonable time based on the facts of each case.[89] If the trustee assumes the contract, then the trustee must promptly cure any defaults, compensate the seller for any loss resulting from the defaults and provide adequate assurance of future performance.[90] The Code does not state when the defaults must be cured,[91] nor does it define what constitutes adequate assurance of future performance.[92] In addition, the debtor must fully perform the

86. Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845, 894 (1988) (hereinafter "Andrew I"). *See infra* note 365.

87. 11 U.S.C. § 365(d).

88. *See, e.g.,* Theatre Holding Corp. v. Mauro, 681 F.2d 102, 104 (2d Cir. 1982).

89. Bank of Honolulu v. Anderson (*In re* Anderson), 36 B.R. 120, 125 (Bankr. D. Hawaii 1983). In *In re* Anderson, the court held that 18 months was too long of a time period to be reasonable, and fixed the time for the debtor's assumption or rejection of the contract at 120 days. Within the 120 day period, the debtor was required to cure her arrearage under the land contract in full. *Id.* at 126.

90. Assumption is subject to court approval. 11 U.S.C. § 365(a).

91. The definition of prompt cure depends on the facts of each case. *Compare In re* Coors of North Mississippi, Inc., 27 B.R. 918 (Bankr. N.D. Miss. 1983) (allowing a three year cure period for defaults in a beer distributorship agreement) *with* General Motors Acceptance Corp. v. Lawrence, 11 B.R. 44 (Bankr. N. D. Ga. 1981) (a cure period in excess of a year is not a prompt cure).

92. Adequate assurance is also defined on a case by case basis. However, such adequate assurance should not improve the position of the non-debtor contract party to the detriment of the debtor. *In re* Grayhall Resources, Inc., 63 B.R. 382, 389 (Bankr. D. Colo. 1986).

contract by paying the original amount due under the contract according to its terms.

If the trustee cannot comply with the assumption requirements, then the trustee will be forced to reject the contract and the buyer will lose the land.[93] The rejection of the contract is then treated as a breach,[94] and such breach gives the non-debtor party (here, the seller) a claim that is treated as if it arose prior to the bankruptcy petition.[95] If the debtor so breaches, the non-debtor party has the remedies provided for in the contract; therefore, the seller in this case is entitled to re-enter the land.

If the estate assumes the contract, all payments on the contract including payments on account of prepetition defaults are treated as administrative claims, because they are expenses of the estate.[96] A plan of reorganization requires that priority claims be paid in full,[97] therefore, the installment land seller will be preferred over almost all other creditors.

The theory behind giving administrative expense priority to these payments is that the non-debtor party to the contract should get the full benefit of his bargain because the contract is providing a benefit to the estate.[98] As a result, the "cost" of accepting a contract is an assumption of the contract's liabilities on the part of the estate.[99] This rule allows the estate to realize on the value of a contract asset in circumstances where it seems desirable to do

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93. Note that even if the installment land contract is viewed as a mortgage, there is a chance that the debtor will lose the land. The mortgagee retains the right to foreclose after the bankruptcy case is closed if the buyer cannot maintain payments.

94. 11 U.S.C. § 365(g).

95. 11 U.S.C. § 502(g) (1994). The claim will be treated as a general unsecured claim. *In re* Walnut Associates, 145 B.R. 489, 493 (Bankr. E.D. Pa. 1992). *See generally* DAVID G. EPSTEIN ET AL., BANKRUPTCY § 5-7, 237-43 (1993).

96. Under 11 U.S.C. § 507(a)(1), administrative expenses receive first priority in payment. Administrative expenses include "the actual, necessary costs and expenses of preserving the estate, including wages, salaries or commissions for services rendered after commencement of the case," 11 U.S.C. § 503(b)(1)(A), and any tax incurred by the estate, 11 U.S.C. § 503(b)(1)(B)(i). *See In re* Mushroom Transportation, 90 B.R. 718 (Bankr. E.D. Pa. 1988); *In re* Norwegian Health Spa, In., 79 B.R. 507 (Bankr. N.D. Ga. 1987).

97. 11 U.S.C. § 1129(a)(9)(A) forbids a court from confirming a debtor's plan of reorganization unless administrative claims are paid in full (unless the holder of the claim has agreed to a different treatment). 11 U.S.C. §§ 1222(a)(2) and 1322(a)(2) both state that a plan must provide for the full payment of all priority claims, unless the holder of the claim agrees otherwise.

98. Andrew I, *supra* note 86, at 883.

99. *Id.*

so.[100] As a result, a debtor might assume a contract to purchase fungible goods when the price of those fungible goods has increased between the contract date and the delivery date, but reject such a contract when the price has decreased.[101] In the installment land contract context, however, assumption can only benefit the seller, not the buyer, for reasons advanced below.

The grant of administrative expense priority results in unfairness to the debtor/buyer and to the debtor's unsecured creditors. The debtor will be required, under a plan of reorganization, to pay the full contract price for the property.[102] That result is not unfair if the fair market value of the land on the date of the bankruptcy filing equals or exceeds the contract price. In that scenario, both the installment seller and the mortgagee would be entitled to full payment of their claims. However, if the contract price exceeds the fair market value, then the treatment of the two creditors is different. Suppose the creditor is M, mortgagee. The outstanding amount due on the mortgage is $100,000, and, on the date of the bankruptcy filing, the land is worth $90,000. M would be entitled to $90,000, the amount of his secured claim, plus an unsecured claim for $10,000, priority for which would be pro-rata with all of the other unsecured creditors.[103]

On the other hand, if the creditor is C, executory contract party, and the trustee assumed the contract, the creditor would be entitled to the full $100,000, pursuant to the contract. In addition, if the buyer is in default prior to the bankruptcy filing, or if the

100. *Id.* at 882.

101. Professor Westbrook illustrates that a trustee will assume a contract only when there is a "Net Value" in assumption. Westbrook, *supra* note 5, at 263-70. Westbrook's analysis is based on a contract to purchase fungible goods. Land, however, is unique.

102. In order for a plan of reorganization to be confirmed, all administrative claims must be paid in full. 11 U.S.C. §§ 1129(a)(9)(A), 1322(a)(2) (1994).

103. There is an exception to this rule in Chapter 11 if the mortgagee with an undersecured claim makes the § 1111(b) election. Under § 1111(b), an undersecured creditor can give up any right to vote on the plan of reorganization as an unsecured creditor. In return, the undersecured creditor's claim is treated as fully secured and the creditor (the mortgagee in my hypothetical) must be paid, over the course of the plan, the amount of that claim ($100,000 in the hypothetical) and those payments must have a present value of at least the amount of the secured portion ($90,000). 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1994). A mortgagee makes this election in the belief that the value of the land will increase during the course of the plan. Even if the mortgagee makes the § 1111(b) election, however, the mortgagee is not paid according to the original terms of the mortgage, because, in the hypothetical, the electing mortgagee would be entitled to $90,000 plus interest, not $100,000 plus interest. *See*, EPSTEIN ET AL., *supra* note 95, at § 10-27; ELIZABETH WARREN AND JAY WESTBROOK, THE LAW OF DEBTORS AND CREDITORS, 728-30 (3d ed. 1996).

buyer defaults after the plan is confirmed, all of the overdue payments, pre-petition and post-petition, are also given administrative expense priority.

This administrative expense priority does not make sense for installment land contracts. The original rule regarding executory contracts was designed to protect the estate from incurring administrative liabilities and assure that parties to pending contracts and leases "would not be elevated fortuitously to administrative priority."[104] According to one commentator:

> Assumption is proper when the estate, as successor to the debtor, can obtain the benefit of some contract or lease asset (if it properly chooses to do so) only at the cost of taking on the debtor's performance obligations. Any other use of "assumption" confers priority for priority's sake, for the purpose of elevating a claim to administrative status rather than as a means of obtaining some contractual benefit.[105]

However, if the seller's claim is viewed as a secured one, this problem does not arise.

This result is well illustrated in *In re Frontier Properties*.[106] Under the contract at issue in that case, after a buyer default the seller was entitled to treat the contract as a note and mortgage and immediately foreclose and seek a deficiency judgment.[107] The trustee assumed the installment land contract and subsequently rejected it.[108] After rejection, the property was sold at a trustee's sale, resulting in a deficiency claim.[109] The court ordered that the deficiency claim, as well as interest on the deficiency, be treated as administrative expenses under the debtor's plan.[110] The court justified depriving unsecured creditors by stating that the assumption of the installment land contract benefitted the unsecured creditors.[111]

104. Andrew I, *supra* note 86, at 881.

105. *Id.* at 890.

106. 979 F.2d 1358 (9th Cir. 1992).

107. *Id.*

108. *Id.* at 1362.

109. *Id.* at 1361.

110. *Id.* at 1368.

111. *Frontier Properties*, 979 F.2d at 1367. The grant of administrative priority to post-petition interest on the deficiency claim results in a particular benefit to the installment seller over the mortgagee. As a general rule, post-petition interest has the lowest priority in distribution. 11 U.S.C. § 726. A mortgagee may only receive post-petition interest when it is oversecured. As a result, a mortgagee would never receive post-petition interest on a

While the court's reasoning may be persuasive when applied to some contracts of the debtor, such as supply contracts where the assumption would allow the debtor to stay in business, it does not seem persuasive for land contracts. If it were persuasive, all secured creditors should be paid in full, because the debtor's use of encumbered collateral benefits the estate, and thus benefits unsecured creditors. Giving installment land contract payments administrative priority, therefore, interferes with the debtor's fresh start and results in unequal treatment of similarly situated creditors.

B. Treatment of Mortgages Under the Bankruptcy Code

On the other hand, if the installment land contract is viewed as a security device, the seller will stand in the position of a mortgagee in the bankruptcy case. If the value of the land is less than the amount owing on the contract, the debtor purchaser will be able to bifurcate the vendor's claim under § 506(a) of the Code into a secured claim and an unsecured claim.[112] A reorganization plan must then provide to the creditor the present value of the secured claim.[113] On the other hand, if the value of the property exceeds the amount owing on the contract, the remaining equity would be available to the bankruptcy estate. In a Chapter 7 case, this would benefit unsecured creditors by its availability for distribution.[114] In a reorganization under Chapters 11, 12 or 13, this extra equity would also benefit general unsecured creditors since under a reorganization plan an unsecured creditor must receive at least what would have been received in a Chapter 7 case.[115]

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deficiency claim. 11 U.S.C. § 506(b).

112. 11 U.S.C. § 506(a) (1994). A debtor cannot modify the claim of a home mortgagee in a Chapter 11 or 13 plan. 11 U.S.C. §§ 1123(b)(5), 1322(b)(2).

A debtor's ability to bifurcate claims in Chapter 7 cases was addressed by the Supreme Court in *Dewsnup v. Timm*, which held that a debtor could not "strip down" an undersecured mortgagee's lien. 502 U.S. 410, 417 (1992). The effect of that prohibition is to allow the creditor to reap the benefit of any increase in the property's value between the date of the bankruptcy petition and the sale of the property. *Id.* The application of *Dewsnup* is limited to Chapter 7 cases.

113. 11 U.S.C. §§ 1129(b)(2)(A), 1325(a)(5) (1994).

114. 11 U.S.C. §§ 724, 726. The land would be sold as part of the liquidation, and any excess in the sales price over the allowed liens on the property would be distributed to general unsecured creditors.

115. 11 U.S.C. §§ 1129(a)(7), 1225(a)(4), 1325(a)(4). There are other benefits, particularly in a Chapter 11, arising out of the increased equity. The debtor could use the extra equity as collateral for a post-petition loan, possibly allowing the debtor to remain in

If the installment land contract is viewed as a mortgage the seller is forbidden, by the automatic stay, from commencing or continuing foreclosure or forfeiture proceedings.[116] When the debtor has stopped making payments prior to filing a bankruptcy petition, the classification issue is crucial. Since § 362 prohibits creditors from attempting to acquire property of the debtor or the estate, the debtor keeps the land while the case is pending when the contract is considered a mortgage.[117] If the contract is considered an executory contract, however, then upon rejection, the buyer must surrender the land to the seller.[118]

Moreover, treating an installment land contract as a mortgage does not offend the plain language of the Bankruptcy Code. Under the Code, a "lien" is a "charge against or interest in property to secure payment of a debt or performance of an obligation."[119] Thus, the Code recognizes the possibility of alternative mortgage devices.

IV. The Tangled Judicial Treatment of Installment Land Contracts In Bankruptcy

In bankruptcy cases, installment land contracts have received inconsistent treatment. Courts have held both that the installment

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business.

116. Section 362 of the Bankruptcy Code provides for an automatic stay upon the filing of a petition under Chapters 7, 9, 11, 12, or 13. 11 U.S.C. § 362(a) (1994). Section 362(d) sets forth grounds for relief from the stay. 11 U.S.C. § 362(d) (1994).

117. *See* 11 U.S.C. § 362.

118. In *Shaw v. Dawson*, the court affirmed an order of the bankruptcy court holding that a real estate contract, in which the debtors were the purchasers of the land, was an executory contract under New Mexico law. 48 B.R. 857, 861-62 (Bankr. D.N.M. 1985). Under § 365 of the Bankruptcy Code, the debtor is required to either assume or reject executory contracts. If the debtor chooses to assume the contract, any existing defaults must be cured, and adequate assurance of future performance must be provided to the vendor. *Id.* at 859. Because the debtors in this case were not financially able to cure, affirming the bankruptcy court's order "had the practical effect of forcing [the debtors] to reject the contract and lose the land." *Id.*

119. 11 U.S.C. § 101(31) (1994).

land contract is in substance a mortgage[120] and an executory contract.[121]

Courts holding that installment land contracts are security devices for purposes of bankruptcy do so for a number of reasons. Cited reasons include: state law determines a debtor's property rights in bankruptcy;[122] courts recognize alternative mortgage devices;[123] and general purposes of the Code require that installment land contracts be treated as financing devices.[124]

Meanwhile, courts holding that an installment land contract is an executory contract for purposes of bankruptcy also look to state law.[125] Other courts have applied the Countryman definition of executory contract and have found it to fit installment land contracts.[126] One court, pointing to the express mention of installment land contracts in § 365(i) of the Code, concluded that, even when the vendee is in bankruptcy, the contract should be considered executory.[127]

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120. *See, e.g., In re* MCorp Financial, Inc., 137 B.R. 219 (Bankr. S.D. Tex. 1992); Thorpe v. Jones (*In re* Jones), 54 B.R. 697 (Bankr. E.D. Ark. 1985); Reich v. Burke (*In re* Reich), 54 B.R. 995 (Bankr. E.D. Mich 1985); *In re* Leazier, 55 B.R. 870 (Bankr. N.D. Ind. 1985); Love v. Kradel (*In re* Love), 38 B.R. 771 (Bankr. D. Mass. 1983); *In re* Cox, 28 B.R. 588 (Bankr. D. Idaho 1983); *In re* Adolphsen, 38 B.R. 776 (Bankr. D. Minn. 1983); *In re* Booth, 19 B.R. 53 (Bankr. D. Utah 1982)(rejecting the Countryman definition of executory contract).

121. *See, e.g.*, Shaw v. Dawson, 48 B.R. 857 (Bankr. D.N.M. 1985); *In re* Speck, 50 B.R. 307 (Bankr. D.S.D. 1985). *In re Frontier Properties*, 979 F.2d 1358 (10th Cir. 1992); *In re Anderson*, 36 B.R. 120 (Bankr. D. Haw. 1983).

122. This reasoning follows at least two lines. One is that if the state follows equitable conversion, then the buyer is the owner of the land and the contract is merely a financing device. *In re McDaniel*, 89 B.R. 861 (Bankr. E.D. Wash. 1988); *In re Leazier*, 55 B.R. 870. The other is if the state has, by statute or case law, declared the land contract to be a financing device, then it is. Mitchell v. Streets (*In re* Streets and Beard Farm Partnership), 882 F.2d 233 (7th Cir. 1989)(relying on Butner v. U.S., 440 U.S. 48 (1979)).

123. *See, e.g., In re* Love, 38 B.R. 771 (Bankr. D. Mass. 1983); *In re* Himberger, 9 B.R. 278 (Bankr. D. Neb. 1981); *In re* Carr, 18 B.R. 794 (Bankr. E.D. Pa. 1982); *In re* Climer, 10 B.R. 872 (W.D. Tenn. 1977). The Code recognizes the existence of liens other than by mortgage. Under the Code, a lien is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101 (1994).

124. *In re* Adolphsen, 38 B.R. 776 (Bankr. D. Minn 1983).

125. In some states which do not recognize equitable conversion, the installment land contract is considered to be an executory contract. *See, e.g., Shaw*, 48 B.R. 857 (applying New Mexico law).

126. *In re* Speck, 50 B.R. 307, 308 (Bankr. D.S.D. 1985).

127. *Shaw*, 48 B.R. at 860.

A. In re Booth

In re Booth[128] is the most often cited case supporting the position that an installment land contract should be treated as a security device. The *Booth* court stated that the question of what is and is not an executory contract should be decided by federal, not state law.[129] While recognizing the Countryman definition of executory contract, the court in *Booth* noted further that the Countryman test serves as a guide in determining when assumption or rejection of a contract under § 365 will benefit the estate.[130] Accordingly, what is or is not executory should be tied to the ultimate goals of reorganization.[131]

Using this reasoning the *Booth* court stated that the installment land contract benefits the bankruptcy estate more when viewed as a mortgage than as an executory contract because such treatment enlarges the value of the estate and furthers the debtor's rehabilitation.[132] This reasoning, however, may lead to inconsistent results, as there may be some instances in which viewing the installment land contract as an executory contract may result in a greater benefit to the estate.[133]

The *Booth* reasoning, therefore, does not provide firm guidance on the issue of whether installment land contracts are subject to § 365. If contracting parties were to rely solely on *Booth*, they might not know, at the outset of their relationship, how their agreement would be viewed in bankruptcy.

B. The State Law Approaches

1. State Law as Determinative of Property Rights. —Many courts adhere to the principle that, since a debtor's property rights are governed by state law, the buyer's interest in the land subject to an installment land contract likewise should be determined by state law. As a result, state law characterization of installment land contracts looms large in the reasoning of many courts considering the issue. In states in which installment land contracts are

128. 19 B.R. 53 (Bankr. D. Utah 1982).
129. *Id.* at 62 n.20.
130. *Id.* at 55.
131. *Id.* at 56.
132. *Id.* at 58.
133. *See infra* text accompanying notes 186-94.

considered under state law to be mortgages, courts in bankruptcy cases also treat them as mortgages.[134] In *In re Leazier*,[135] the court first found that the contract was not executory,[136] and then held that because in Indiana, a land contract is treated the same as a mortgage when the purchaser has "made any substantial payment and has not abandoned the property," the contract could be treated as a financing device in the debtor's Chapter 13 plan.[137] The court in *In re Kratz*[138] relied upon an Ohio statute which was substantially similar to the Indiana statute considered by the *Leazier* court.[139] Although the court in *In re Fox*[140] noted that a Pennsylvania statute deemed installment land contracts to be executory, the court found that the state could not define what contracts were executory for purposes of federal law.[141] Further, the court found that, particularly for residential installment land contracts, the Pennsylvania courts and legislature had granted installment buyers some of the same protections as mortgagors.[142]

Some courts have held installment land contracts to be executory contracts in states where forfeiture is still acceptable.[143]

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134. Heartline Farms v. Daly, 128 B.R. 246 (D. Neb. 1990). The court answered the question of whether federal law should control the characterization of installment land contracts in the negative, basing its decision primarily on the fact that Nebraska law considers installment land contracts to be security devices. *Id.* The Nebraska statute says that "an executory contract for the sale of land under which the vendee is entitled to or does take possession thereof shall be deemed a mortgage of the land for the unpaid balance of the purchase price." NEB REV. STAT. § 77-1401 (Reissue of 1990).

135. 55 B.R. 870 (Bankr. N.D. Ind. 1985).

136. *Id.* at 872.

137. *Id.* The Indiana position is set forth in Skendzel v. Marshall, 301 N.E.2d 641 (Ind. 1973), *cert. denied,* 415 U.S. 921 (1974). In Indiana, the buyer's interest in any land contract under which the buyer has made a substantial downpayment must be foreclosed. *Id.* at 240-41.

138. 96 B.R. 127 (Bankr. S.D. Ohio 1988).

139. *Id.* Under the Ohio statute, if the buyer has paid a sum equal to or exceeding twenty percent of the purchase price, or has paid in accordance with the terms of the contract for a period of five years, then the seller may only recover possession of the land by foreclosure. *Id.* at 129.

140. 83 B.R. 290 (Bankr. E.D. Pa. 1988).

141. *Id.* at 296-97.

142. *Id.* at 297. The real property in *Fox* consisted of mixed residential and commercial property.

143. *See* Shaw v. Dawson, 48 B.R. 857 (Bankr. D.N.M. 1985). *Shaw* also stands for the proposition that § 365(i) means that installment land contracts are executory. *Id.*; *see also In re* Heartline Farms, Inc., 116 B.R. 694 (Bankr. D. Neb. 1990)(holding that in Nebraska, if strict foreclosure is allowed, the contract is executory, if the contract must be foreclosed, then it is a mortgage). An installment land contract in Nebraska is treated as a mortgage when the buyer has a substantial equity in the property. *Id.* at 698. This seems to take the

However, the court in *Bank of Honolulu v. Anderson (In re Anderson)*[144] still treated the land contract as an executory contract rather than a security device while conceding that in Hawaii, forfeiture is not permitted when a certain percentage of the contract price has been paid.[145] Reaching the opposite conclusion, the court in *In re McDaniel*,[146] applying a Washington statute which allowed forfeiture, ruled that an installment land contract is a mortgage because the forfeiture statute was similar to the statute regulating the foreclosure of deeds of trust.[147]

2. Adherence to Equitable Conversion as Determinative of the Issue. —Other courts, relying on state law characterizations, point to the state's adherence to the equitable conversion theory to treat the installment land contract as a mortgage. Under the equitable conversion theory, at the moment a buyer and seller sign a contract for the sale of real estate, equitable ownership passes to the buyer.[148] The court in *In re Bertelsen*[149] used this reasoning to hold that an Illinois land contract is in the nature of a secured transaction, since, upon the execution of a contract to sell real estate, the seller becomes the trustee of the legal title for the buyer with a lien on the land as security for the purchase price.[150]

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question of "executoriness" out of the equation altogether.

144. Bank of Honolulu v. Anderson (*In re* Anderson), 36 B.R. 120 (Bankr. D. Haw. 1983).

145. *Id.* at 124-25. In Hawaii, if a debtor/buyer has a certain amount of equity in the property, the seller must foreclose. The Bankruptcy Court sitting in Hawaii will not treat the contract as a mortgage, however, and in *Anderson*, the court stated that a debtor cannot "rush to the Bankruptcy Court and request the Court to change an ugly duckling (agreement of sale) into a beautiful swan (mortgage)." *Id.* at 124. It is interesting to note that Hawaii is one of the growing number of states that considers the seller's interest in the land subject to an installment land contract to be personal property for purposes of the state judgment lien laws. Bank of Hawaii v. Horwoth, 787 P.2d 674 (Haw. 1990).

146. 89 B.R. 861 (Bankr. E.D. Wash. 1988).

147. *Id.* at 869. In *McDaniel*, the court concluded that the installment land contract gives the buyer a property right in the real estate and the seller a "lien/mortgage type security interest." *Id.*

148. Vogel v. Northern Assurance Co., 219 F.2d 409 (3rd Cir. 1955).

149. 65 B.R. 654 (Bankr. C.D. Ill. 1986). Another case applying Illinois law reached the same conclusion. *See* In re Streets & Beard Farm Partnership, 882 F.2d 233 (7th Cir. 1989) (concluding that "the vendor holds legal title in trust solely as security for the payment of the purchase price").

150. *In re* Bertelsen, 65 B.R. 654, 657 (Bankr. C.D. Ill. 1986). This case has a little for everyone. The court relies heavily on the *In re Booth* discussion of policy reasons for holding that an installment land contract should be treated as a mortgage. The court also addresses the application of the Countryman definition and the argument that since installment land contracts are considered to be executory contracts when the seller is in

Bankruptcy courts applying the laws of several other states have reached the same result.[151] Pennsylvania adheres to the equitable conversion theory,[152] but in a case in which the debtor was a seller under an earnest money contract for the sale of land, the court held that the debtor could reject the contract pursuant to § 365.[153] Thus, it seems that equitable conversion alone does not transform an executory contract into a security device.[154] Conversely, bankruptcy courts in states that do not adhere to equitable conversion rely on that fact in order to characterize installment land contracts as executory contracts.[155]

C. *"Executoriness" as a Threshold Issue*

Some courts have found that installment land contracts simply do not constitute contracts on which substantial performance is due from both contracting parties. The court in *In re Adolphsen*[156] took note of the apparent adoption of the Countryman test in the legislative history to the Code, but found that, "the fact that [the seller] holds legal title and must at some point convey it to the debtors does not render the contract executory any more than the duty of the holder of a promissory note to return the note when the debt is satisfied makes it executory."[157] The court in *In re Cox*,[158] while apparently basing its holding on the reasoning of *In re Booth*, also cited the lack of substantial performance on the part of the seller, especially when the seller deposits the deed into

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bankruptcy, they should be considered so when the buyer is in bankruptcy. *Id.* at 658.

151. Thorpe v. Jones (*In re* Jones), 54 B.R. 697 (Bankr. E.D. Ark. 1985) (applying the Arkansas view that execution of a contract for deed effects an equitable conversion); *In re* Cox, 28 B.R. 588 (Bankr. D. Idaho 1983)(applying Idaho law adopting equitable conversion); Love v. Kradel (*In re* Love), 38 B.R. 771 (Bankr. D. Mass. 1983)(applying Pennsylvania law, which adopts equitable conversion, and recognizing the fact that the Bankruptcy Code does recognize alternative mortgage devices).

152. Pivirotto v. City of Pittsburgh, 528 A.2d 125, 127-28 (Pa. 1987).

153. *In re* W & L Associates, Inc., 71 B.R. 962 (Bankr. E.D. Pa. 1987).

154. *See also In re* Carver, 61 B.R. 824 (Bankr. D.S.D. 1986), *rev'd on other grounds* 71 B.R. 20 (D.S.D. 1986)(recognizing that South Dakota adopts equitable conversion but holding that an installment land contract is not a mortgage under South Dakota law).

155. *See, e.g.*, *In re* Finley, 138 B.R. 181 (Bankr. E.D. Tex. 1992); *In re* Waldron, 65 B.R. 169 (Bankr. N.D. Tex. 1986).

156. 38 B.R. 776 (Bankr. D. Minn. 1983).

157. *Id.* at 778. The legislative history to the Code uses a promissory note as an example of a contract which is not executory. *See* H. REP. NO. 595, 95th Cong., 1st Sess. 374 (1977) & S. REP. NO. 989, 95th Cong, 2d Sess. 58 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5936, 5787.

158. 28 B.R. 588 (Bankr. D. Idaho 1983).

escrow upon execution of the contract.[159] Likewise, the Seventh Circuit, in *In re Streets & Beard Farm Partnership*,[160] based its holding on the equitable conversion doctrine, but added that, "the delivery of a legal title is a mere formality and does not represent the kind of significant legal obligation that would render the contract executory."[161]

Many courts start their analysis of the issue by inquiring about whether the installment land contract fits within the "Countryman definition" of executory contract. The court in *Bank of Honolulu v. Anderson (In re Anderson)* made a distinction between land contracts under which the deed was placed in escrow and land contracts under which the deed was not placed in escrow. The court held that the seller's failure to place the deed in escrow constituted a lack of substantial performance, and thus, the contract was still executory.[162] The court in *In re Frontier Properties*[163] also used this argument in holding that installment land contracts are executory.[164]

However, the escrow argument does not persuade all courts. In *Shaw v. Dawson*,[165] the court considered the fact that the deed was placed in escrow to be irrelevant and held that because the buyer was required to make payments and the seller was to deliver the deed, the contract was executory.[166]

Courts have pointed to various other contractual duties of the seller in finding that installment land contracts are within the Countryman definition. In *Frontier Properties*, the court considered material the fact that the seller was required to pay underlying debts, taxes and insurance premiums on the property and concluded that the seller retained substantial obligations under the contract.[167] Likewise, in *Anderson*, the seller was required to pay

159. *Id.* at 590.

160. 882 F.2d 233 (7th Cir. 1989).

161. *Id.* at 235.

162. *In re* Anderson, 36 B.R. 120, 125 (Bankr. D. Haw. 1983). The court in *In re* Speck also relied on the fact that the seller was required to deliver title upon the buyer's full payment of the purchase price in ruling that performance was due on both sides and, therefore, the installment land contract was executory. 50 B.R. 307, 308 (Bankr. D.S.D. 1985).

163. 979 F.2d 1358 (9th Cir. 1992).

164. *Id.*

165. Shaw v. Dawson, 48 B.R. 857 (Bankr. D.N.M. 1985).

166. *Id.* at 861. The court in *In re* Buchert reached the same conclusion. 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987).

167. 979 F.2d at 1365.

for utilities under the contract, another fact which the court considered in ruling the contract executory.[168] However, purchase-money mortgagees will often pay the taxes and insurance on the subject property out of escrow in order to make sure that their interest in the property is protected.

Under section 2-401 of the Uniform Commercial Code (the "U.C.C."),[169] any attempted reservation of title by a seller of goods who delivers the goods to the buyer is limited to the reservation of a security interest in the goods.[170] The court in *In re Fitch*[171] relied heavily on this section in ruling that a contract for the sale of a business, which involved the transfer of land, personal property, and the goodwill of the business, constituted a security device rather than an executory contract.[172] The court pointed out that a contract under which no performance is due other than the payment of money, as was the case with the contract in *Fitch*, is not executory under § 365 of the Bankruptcy Code.[173]

The argument that if the seller has outstanding duties, such as delivery of the deed upon full payment, then the contract is executory must fail because under that analysis even a mortgage could be considered executory. Upon full payment of the mortgage indebtedness, the lender/mortgagee must cancel the note evidencing the indebtedness and release the mortgage lien.[174] One court held that an installment land contract was executory because the seller was required to give his consent before any assignment of the contract by the buyer could be effective.[175] Again, commonly, a mortgagee must consent to any proposed assignment or assumption of the mortgage. The court in *In re Bellamah Community Development*[176] pointed to the following unperformed obligations of the seller in ruling that a subdivision trust was an installment

168. *In re* Anderson, 36 B.R. 120, 125 (Bank. D. Haw. 1983).

169. U.C.C. § 2-401 (1995).

170. *Id.*

171. *In re* Fitch, 174 B.R. 96 (Bankr. S.D. Ill. 1994).

172. *Id.* at 103 (holding that an installment contract for purchase of business, which included real property, goods and intangibles such as good will, was a security device, relying on equitable conversion for the real estate, and U.C.C. for the goods).

173. *Id.* at 104.

174. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-707 (West 1990 & Supp. 1994); DEL. CODE ANN. tit. 25, § 2111 (1989 & Supp. 1994); 21 PA. CONS. STAT. ANN. § 681 (1983 & Supp. 1995).

175. *In re* Henke, 84 B.R. 693, 698 (Bankr. D. Mont. 1988).

176. *In re* Bellamah Community Development, 107 B.R. 337 (Bankr. D.N.M. 1989).

land contract and thus executory: the seller had the right to pay the taxes if the buyer failed to do so; the seller could only declare the buyer in default of the agreement by delivering notice of same to the buyer; and the seller could only accelerate the indebtedness by written notice.[177] Again, in mortgage agreements, one finds the same rights and duties on the part of the mortgagee. As a result, it seems that defining a contract as executory or not is not an appropriate starting point for determining whether § 365 applies.

D. Bankruptcy Policy as the Determinative Factor

Courts on both sides of the issue have pointed to general bankruptcy policies in order to determine whether an installment land contract is a security device or an executory contract. In answering this question, some courts have held that the proper interpretation depends on which characterization would be more beneficial to the estate.[178] Several cases dealing with installment land contracts have arisen in Chapter 13 proceedings,[179] and particularly in these cases, courts have found that characterizing the installment land contract as a security device is more beneficial to the debtor than characterizing the contract as executory.[180] According to the court in *In re Fox*, the interest of the debtor was so strong that the debtor was given a choice as to how to characterize the contract.[181] That court, like the court in *In re Booth*, applied the "functional nature" of Countryman's definition, and characterized an installment land contract conveying mixed residential and commercial realty as a secured sale because doing so would benefit the estate.[182] This result seems undesirable

177. *Id.* at 341 (involving an agreement known as a subdivision trust, in which the title to the land is delivered to a trustee).

178. *See, e.g., In re* McCallen, 49 B.R. 948 (Bankr. D. Or. 1985); *In re* Thurmond, 46 B.R. 723 (Bankr. D. Or. 1985).

179. *See, e.g.,* Fox v. Hill (*In re* Fox), 83 B.R. 290 (Bankr. E.D. Pa. 1988); *In re* Flores, 32 B.R. 455 (Bankr. S.D. Tex. 1983).

180. *See, e.g.,* Thorpe v. Jones (*In re* Jones), 54 B.R. 697, 699 (Bankr. E.D. Ark. 1985)("treatment of this contract for deed as a security instrument will diminish the likelihood of a forfeiture of the debtor's equity in her homestead which should be preserved where possible"). Under § 1322 of the Code and Nobelman v. American Savings Bank, 508 U.S. 324 (1993), it is unclear whether the characterization would make much of a difference when a home is involved.

181. *In re* Fox, 83 B.R. at 291.

182. *Id.* at 301. The opinion states that, "[section] 365 should be conceptualized as a tool of the Debtor, to benefit the estate at the debtor's option wherever possible, and should rarely, if ever, be used to deprive a consumer-debtor of a residence." *Id.* at 294. In *Fox*, the

since, if it were widely adopted, sellers would have no way of anticipating how their agreements would be viewed in bankruptcy.

Moreover, courts applying Oregon law have reached conflicting results applying this "benefit to the estate" analysis.[183] The dispute in *In re McCallen*[184] was whether § 108(b)[185] or § 362 of the Code applied in order to toll a statutory redemption period after a judgment of strict foreclosure entered upon the debtor's default under an installment land contract.[186] The court found that after such a judgment, the debtor retained the right to possess the land.[187] Looking to the policy of benefitting the estate and encouraging the debtor's rehabilitation, the court found that the automatic stay should apply.[188] In bolstering its conclusion that § 362 controlled, the court pointed to the fact that § 108(b) does not apply to curing defaults "under executory contracts" because such a cure would be governed by § 365.[189] Had the court ruled that the contract was a mortgage, the right of redemption would

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real property consisted of a storefront and a three-bedroom apartment above it. *Id.* at 293. Section 1322(b)(2) prohibits the modification of rights of holders of secured claims "secured only by a security interest in real estate that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). Courts have interpreted § 1322(b)(2) only to loans secured solely by a single-family residence. *In re* Leazier, 55 B.R. 870 (Bankr. N.D. Ind. 1985); Grubbs v. Houston First American Savings Assoc., 730 F.2d 236 (5th Cir. 1984).

In any event, courts in the Third Circuit (which includes Pennsylvania, the state in which *Fox* arose) seem extremely reluctant to prohibit residential debtors from bifurcating their mortgage liens, and it appears that any additional collateral taken by the mortgage lender will remove a mortgage from the purview of 11 U.S.C. § 1322(b)(2) in the Third Circuit. Hammond v. Commonwealth Mortgage Corp. of America (*In re* Hammond), 27 F.3d 52 (3d Cir. 1994) (mortgage also covered appliances, machinery, furniture and equipment); Third National Bank Trust Co. v. Tallo (*In re* Tallo), 168 B.R. 573 (M.D. Pa. 1994) (security interest in rents, issues and profits "removed mortgagee's protection against modification of claims secured only by the debtor's residence").

183. *Compare In re* McCallen, 49 B.R. 948 (Bank. D. Or. 1985) *with In re* Thurmond, 46 B.R. 723 (D. Or. 1985).

184. 49 B.R. 948.

185. Section 108(b) states that if applicable non-bankruptcy law or an agreement fixes the period within which the debtor may file any pleading, cure any default or perform any other similar act, and

> such period has not expired before the date of the filing the petition, the trustee may only file, cure or perform, as the case may be, before the later of—
>
> (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
>
> (2) 60 days after the order for relief.

11 U.S.C. § 108(b) (1994).

186. *In re* McCallen, 49 B.R. 948.

187. *Id.* at 951.

188. *Id.* at 952.

189. *Id.*

have expired upon the later of 60 days after the bankruptcy filing or the end of the state created redemption period.[190]

In another case decided by the bankruptcy court sitting in Oregon, the benefit to the estate approach led to the opposite result. In *In re Thurmond*[191] the bankruptcy court followed *Booth* and ruled that an installment land contract was a mortgage and stated that contracts must be reviewed in light of the policies of benefitting the estate, encouraging the debtor's rehabilitation, and providing adequate protection for the estate's creditors.[192] Leading to tremendous uncertainty, this approach would leave the contracting parties in the position of not knowing how their agreement will be treated in the event of the buyer's bankruptcy.

Chapter 12 of the Bankruptcy Code[193] was designed to provide relief to family farmers because relief was previously unavailable under Chapters 7 and 11 of the Code.[194] In *Heartline Farms v. Daly*,[195] the court held that the installment land contract at issue was a mortgage because Nebraska law considers them to be mortgages.[196] The court added that the policy behind Chapter 12 would be frustrated by characterizing an installment land contract as an executory contract.[197] However, in *Brown v. First National Bank in Lenox,*[198] an Eighth Circuit case applying Iowa law, the court rejected the debtors' argument that the special policies behind Chapter 12 warranted a finding that an installment land contract is a security device.[199] *In re Rancho Chamberino*[200] is another case under Chapter 12 in which the court considered whether an installment land contract is an

190. *See* 11 U.S.C. § 108(b). *See also* Johnson v. First National Bank of Montevideo (*In re* Oak Farms, Inc.), 37 B.R. 178 (Bankr. D. Minn. 1984).

191. 46 B.R. 723 (D. Or. 1985).

192. *Id.* at 724.

193. 11 U.S.C. §§ 1201-1231 (1994).

194. Melanie Fisher, *Disposable Income Determination: Challenges in the Chapter 12 Family Farmer Context*, 18 J. CORP. L. 713, 716 (1993). The legislative history of Chapter 12 also sheds light upon the impetus behind its enactment. According to House Conference Notes, the family farmer provision was "designed to give family farmers facing bankruptcy a fighting chance to reorganize their debts and keep their land." H.R. CONF. REP. NO. 958, 99th Cong., 2d Sess. 48, *reprinted in* 1986 U.S.C.C.A.N. 5246, 5249.

195. 128 B.R. 246 (D. Neb. 1990).

196. *Id.* at 248-49.

197. *Id.* at 252.

198. 844 F.2d 580 (8th Cir. 1988).

199. *Id.* at 581.

200. 77 B.R. 555 (Bankr. W.D. Tex. 1987).

executory contract and, declining to follow *Booth*, found that it was.[201] The court in *In re Coffman*[202] applied a three-pronged test in resolving the issue of whether a land sale contract is an executory contract. The court looked to: (1) the nature of the parties' relationship under state law; (2) the definition of executory contract under bankruptcy law; and (3) the policies behind the bankruptcy laws.[203] The *Coffman* court ultimately concluded that the installment land contract is an executory contract, not a security device.[204]

E. *The Argument that § 365(i) Renders all Installment Land Contracts Executory*

Congress specifically recognized installment land contracts in § 365(i) and § 365(j) of the Code.[205] Those sections address installment land contracts under which the debtor is the seller of the land. Section 365(i) protects the non-debtor buyer of land when the buyer is in possession by allowing the buyer, in the event the trustee rejects the contract, to either treat the contract as terminated, or remain in possession, make all payments, and receive title to the property in accordance with the contract.[206] Section 365(j) protects the buyer who elects to treat the contract as terminated by giving the buyer a lien on the real property to the extent of the purchase price paid before termination.[207]

The specific inclusion of certain installment land contracts within the scope of § 365 was central to the court's reasoning in *Shaw v. Dawson*.[208] The *Shaw* court, in holding that an installment land contract, under which the buyer was the debtor, fell within § 365, reasoned that the express recognition of installment land contracts in § 365(i) evidenced Congress' intention that all installment land contracts be treated as executory under § 365.[209] The court also reasoned that, since the Code provides for special treatment under § 365 when the seller is the debtor, but is silent as

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201. *Id.* at 558-61.
202. 104 B.R. 958 (Bankr. S.D. Ind. 1988).
203. *Id.* at 961.
204. *Id.* at 963.
205. 11 U.S.C. § 365(i), (j) (1994).
206. *See supra* note 9 and accompanying text.
207. 11 U.S.C. § 365(j).
208. 48 B.R. 857 (Bankr. D.N.M. 1985).
209. *Id.* at 860.

to special treatment when the buyer is the debtor, Congress did not intend any special treatment for a buyer/debtor.[210]

The effect of § 365(i) is to give the non-debtor purchaser under an installment land contract the same protections which would be provided for a mortgagor upon its mortgagee's bankruptcy.[211] The Code incorporated § 365(i) to ameliorate the evil caused by cases such as *In re New York Investors Mutual Group*,[212] which allowed an installment land seller, in bankruptcy, to reject the contract and deprive the non-debtor buyer-in-possession of the land.[213] Under § 365(i), a buyer is entitled to remain in possession, even if the seller/debtor rejects the contract so long as the buyer continues making payments on the contract.[214] Prior to the enactment of § 365(i), courts were split as to whether a debtor/seller could deprive a buyer in possession of its possession by rejecting the contract of sale.[215]

The argument that § 365(i) should be construed to include all installment land contracts within the definition of executory contract was rejected in *In re Fox*.[216] The *Fox* court interpreted the purpose behind § 365(i) to be one of preserving the rights of persons in possession of realty.[217] Congress enacted § 365(i) to provide fairness for purchasers in possession and did not consider the executoriness of the installment land contract device.[218] Likewise, the *Booth* court noted that §§ 365(i) and (j) do not

210. *Id.*

211. If the debtor/seller were a mortgagee, that seller would have two property interests which could go into the bankruptcy estate: its right to payment under the mortgage note, and its lien on the land. *See* NELSON & WHITMAN TREATISE, *supra* note 3, § 5.27. There is nothing in the Bankruptcy Code which would allow the mortgagee's trustee to recover the legal interest in the land for the estate. *See* Frank R. Lacy, *Land Sale Contracts in Bankruptcy*, 21 UCLA L. REV. 477, 480 (1973)("[c]learly, nothing in the Bankruptcy Act empowers the trustee to retrieve . . . property already sold by the bankrupt.").

212. 143 F. Supp. 51 (S.D.N.Y. 1956).

213. *Id.*

214. 11 U.S.C. § 365(i).

215. *See, e.g., In re* New York Investors Mutual Group, 143 F. Supp. at 54 (allowing the trustee in bankruptcy to reject the contract with a resulting return of possession to the debtor/seller).

216. 83 B.R. 290 (Bankr. E.D. Pa. 1988).

217. *Id.* at 301.

218. *See* S. REP. NO. 989, 95th Cong., 2d Sess. 60, *reprinted in* 1978 U.S.C.C.A.N. 5846 (stating that subsections (h) and (i) of § 365 were enacted to protect non-debtors in possession of real property).

represent the Countryman test, but "are a tonic for the consequence of its application."[219]

The foregoing survey of case law shows the great inconsistency among the courts in addressing installment land contracts in bankruptcy. The discussion which follows will show that since installment land contracts are enhanced remedy mortgages, they should be treated as such in bankruptcy and that bankruptcy policy mandates uniformity in the treatment of installment land contracts in bankruptcy.

V. The Need for Uniformity

Congress has the power to establish uniform bankruptcy laws for the United States under Article I section 8 of the United States Constitution.[220] Courts have long interpreted this mandate as meaning that state laws are suspended only to the extent of actual conflict with the federal bankruptcy system.[221] Courts have not interpreted the Constitution to require that results in bankruptcy cases be uniform from state to state.[222] In solving the problem of whether an installment land contract is an executory contract or a mortgage, courts must apply two principles of bankruptcy law: the principle that property rights are determined by state law[223] and the principle that federal law determines whether or not a contract is executory within the meaning of the Bankruptcy Code.[224]

A. The Installment Land Contract as an Enhanced-Remedy Mortgage

The principle that state law determines property rights in bankruptcy raises the following question: what exactly are those

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219. *In re* Booth, 19 B.R. 53, 56 (Bankr. D. Utah 1982).

220. U.S. CONST. art. I, § 8, cl. 4.

221. *See* Stellwagen v. Clum, 245 U.S. 605, 613 (1918). *See also* Ogden v. Sanders, 12 Wheat. 213 (1827); Sturges v. Crowninshiel, 4 Wheat. 122 (1819).

222. *Stellwagen*, 245 U.S. at 613.

223. Butner v. U.S., 440 U.S. 48 (1979). *Butner* is repeatedly cited by courts as leading authority for this issue. *See, e.g.*, *In re* D'Anna, 177 B.R. 819, 823 (Bankr. E.D. Pa 1995)(emphasizing that the holding of *Butner* remains valid under the Bankruptcy Code of 1978); Coan v. Bernier (*In re* Bernier), 176 B.R. 976 (Bankr. D. Conn. 1995)(quoting *Butner* for proposition that property interests are created by state law unless some federal interest requires otherwise); *In re* White, 88 B.R. 498, 510 (Bankr. D. Mass. 1988)(recognizing that, under *Butner*, a bankruptcy court shall not give a creditor rights that state law withholds).

224. *See, e.g.*, Benevides v. Alexander (*In re* Alexander), 670 F.2d 885, 888 (9th Cir. 1982); Murphy v. Griffel (*In re* Wegner), 61 B.R. 414, 418 (Bankr. D. Mont. 1986).

rights which must be respected?[225] The seller under an installment land contract has, in some states, the right to reenter the land upon default without legal process and cause the buyer to forfeit all equity in the land.[226] Is it that remedy which must be respected, or is it the seller's right to the value of that land which must be respected? There are two primary differences between the land contract and the purchase-money mortgage: the location of legal title;[227] and the seller's remedies upon default.[228]

The fact that, under an installment land contract, the seller holds the deed to the real property until the full contract price is paid does not justify the disparate treatment of installment land contracts and mortgages in bankruptcy. When a seller of goods under an installment contract attempts to keep title to those goods after delivery to the seller, the law is settled. The retention of title is in effect the retention of a security interest.[229] Even in real estate law, the location of title is irrelevant in certain circumstances. In states which use the deed of trust instead of the mortgage, title is actually transferred from the mortgagor (known in such states as a "trustor") to a trustee for the benefit of the mortgagee, known in such states as the "beneficiary." The mortgagee/beneficiary, however, is treated in bankruptcy as a secured creditor. The court in *In re Cox*[230] pointed to the fact that deeds of trust are considered security devices to strengthen its holding that an installment land contract is a security device.[231]

Even in the context of purchase-money mortgages, however, the rights of the seller/mortgagee differ. It is useful, therefore, to compare the various foreclosure laws.

A comparison of the title theory,[232] the lien theory[233] and

225. *See generally* James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983).

226. *See supra* text accompanying notes 24-33.

227. *See supra* text accompanying note 3.

228. *See supra* text accompanying notes 24-33, 47-69.

229. U.C.C. § 2-401 (1995). *See infra* note 328 and accompanying text.

230. 28 B.R. 588 (Bankr. D. Idaho 1983).

231. *Id.* at 590.

232. The title theory of mortgages has its roots in the English Common Law. Today, only about twelve American states follow the title theory. For a discussion of the history and application of the title theory of mortgages, see NELSON AND WHITMAN TREATISE, *supra* note 3, §§ 4.1, 4.24; Wesley A. Sturges & Samuel O. Clark, *Legal Theory and Real Property Mortgages*, 37 YALE L.J. 691, 702 (1928).

the intermediate theory of mortgages[234] illustrates some of the differences in remedies under purchase-money mortgages. In title theory states, the mortgagee is considered to hold legal title to the land for security purposes.[235] Since the right to possession is a fundamental incident of the mortgagee's legal title, the mortgagee in a title theory state has, in theory, the right to take possession of the land both before and after default.[236] The mortgagee will agree not to exercise that right while the mortgagor is current in his payments.[237] In lien theory states, the mortgagor holds full title to the land, and thus, until foreclosure, the mortgagee does not have the right to take possession of the land absent a clause in the mortgage allowing the mortgagee to do so.[238] In intermediate theory states, the mortgagor holds legal title to the land until default, after which time the legal title is in the mortgagee.[239] Thus, the mortgagee has the right to possession of the land upon default.[240] However, mortgagees in all three types of states are treated equally for purposes of bankruptcy, as secured creditors, and as a result, all three types of mortgagees are prevented by the automatic stay from exercising their rights under the mortgages.[241] Therefore, in the mortgage arena, the bankruptcy laws disregard state created distinctions in remedies, in the sense that all remedies are put on hold during the bankruptcy case.

While the differences in title, lien and intermediate jurisdictions have the most impact on the relationship between the mortgagor and the mortgagee, as between the mortgagor and third parties, the mortgagor is the legal owner of the land.[242] As a

233. About two thirds of the states follow the lien theory. Note that in such states, even if title is actually transferred, the mortgagor has the right of possession until foreclosure. Thus, under a deed of trust, the trustee, who holds the legal title for the benefit of the mortgagee (called the beneficiary in such states), has no right to enter upon the land until there has been a foreclosure sale. For a general discussion of the lien theory, see NELSON AND WHITMAN TREATISE, *supra* note 3, § 4.2; Sturges and Clark, *supra* note 232.

234. Four states follow the intermediate theory of mortgages. For a general discussion, see NELSON AND WHITMAN TREATISE, *supra* note 3, § 4.3; Sturges & Clark, *supra* note 232.

235. *See* NELSON AND WHITMAN TREATISE, *supra* note 3, §§ 4.1, 4.24.

236. *Id.*

237. *Id.*

238. *Id.* at § 4.2.

239. *Id.* at § 4.3.

240. *See* NELSON AND WHITMAN TREATISE, *supra* note 3, § 4.3.

241. 11 U.S.C § 362 (1994).

242. Sturges & Clark, *supra* note 232, at 704. Sturges & Clark explain several hypothetical situations illustrating the point that there is no real difference among the theories save for the mortgagee's right to enter upon the land.

result, the mortgagor can possess, lease, or further encumber the land.[243] Likewise, the buyer under an installment land contract, while not the legal owner, does have a mortgageable interest in the land, even in states which recognize the forfeiture remedy. In addition, the buyer's interest in the land can be reached by docketing a judgment lien against the buyer-debtor's real property.[244]

In the real property mortgage context, therefore, the Code modifies state law rights which are arguably property rights, such as the right of possession. For instance, in states that follow the title and intermediate theories of mortgages, the mortgagee has the right to enter the property after default and before foreclosure. Once the mortgagor has filed for bankruptcy, however, the mortgagee cannot exercise those property rights, due to the automatic stay.[245] Therefore, while the mortgagee's right under state law is that of title holder, it is indisputable that under bankruptcy law the mortgagee is a secured creditor.[246]

Likewise, foreclosure procedures vary greatly from state to state. In some states, strict foreclosure is permitted. In others,

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243. The mortgagor's actions would of course be subject to any restrictions in the mortgage documents.

244. NELSON AND WHITMAN TREATISE, *supra* note 3, §§ 3.35, 3.36. These propositions hold true both in states that have kept forfeiture and states that have not, as well as states which recognize equitable conversion and those that do not.

245. The filing of a bankruptcy petition

> operates as a stay, applicable to all entities, of —
>
> . . . .
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate.

11 U.S.C. § 362(a)(3), (4).

246. In Heartland Federal Savings & Loan Assoc. v. Briscoe Enterprises, Ltd. (*In re* Briscoe Enterprises, Ltd.), 994 F.2d 1160, 1165 (5th Cir. 1993), the court explained this "alteration of . . . mortgagees' rights," noting that "[b]ankruptcy frequently rewrites the secured creditor's state law rights. *Id.* An example of this is the automatic stay of § 362, as a result of which the creditor has lost the right of foreclosure." *Id.* The prohibition on foreclosure, however, is not absolute. In effect, "the automatic stay provision . . . prohibits a mortgagee from obtaining either possession of the mortgaged property or the appointment of a receiver to collect the rents therefrom without first requesting the bankruptcy court to grant relief from the stay . . . ." First Federal Savings & Loan Assoc. of Toledo v. Hunter (*In re* Sam A. Tisci, Inc.), 133 B.R. 857, 859 (N.D. Ohio 1991). "All that the automatic stay does is to force creditors and other interested parties to seek the bankruptcy court's approval before taking certain types of action against a debtor or against property of the estate." Delta Savings and Loan Assoc. Inc. v. I.R.S., 847 F.2d 248, 250 (5th Cir. 1988).

foreclosure is by a power of sale contained in the mortgage and no court action is necessary.[247] In still others, a mortgagee can only foreclose by judicial action. Bankruptcy stays all of these rights.[248] Since an installment seller is, in substance, a mortgagee with the enhanced remedy of strict foreclosure, the installment seller should be treated as such. The court in *In re Speck*,[249] while holding that an installment land contract is executory, recognized the status of an installment land contract as a financing device with enhanced remedies, stating,

> The contract for deed is one of the few alternatives to commercial financing available, and it is especially well suited to the realities of agricultural land sales. To those who have always relied upon the intrinsic value of the land, holding the deed is more than a ministerial act, it is the ultimate protection.[250]

An enhanced remedy does not qualify as a property right.[251] In *The Gold Clause Cases*,[252] the Court addressed contractually created "property" rights in the following manner:

> Contracts, however express, cannot fetter the constitutional authority of Congress. Contracts may create rights of property, but when contracts deal with a subject matter which lies within the control of Congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of

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247. This is commonly used in "deed of trust" states.

248. Because of the automatic stay provided in 11 U.S.C. § 362, a bankruptcy filing stays any foreclosure proceeding brought by a mortgagee prior to the filing. Also, if a mortgagee has not yet started foreclosure proceedings prior to the bankruptcy filing, it may not do so after the filing without the permission of the bankruptcy court. DUNAWAY, *supra* note 28, § 24.02[1].

249. 50 B.R. 307 (Bankr. D.S.D. 1985).

250. *Id.* at 308.

251. For a good discussion of property rights which must be respected in bankruptcy, in the context of a takings argument, see Rogers, *supra* note 225.

There is substantial disagreement as to whether specific performance rights qualify as property rights and whether, as such, they should be respected in bankruptcy. *See infra* notes 255-57 and accompanying text.

252. Norman v. Baltimore & Ohio R.R. Co., Nortz v. Unites States, 294 U.S. 317 (1935), and Perry v. United States, 294 U.S. 330 (1935), are commonly known as the Gold Clause Cases. The plaintiffs in the Gold Clause Cases challenged a Resolution of Congress which invalidated clauses in contracts which gave the payee the right to demand payment in gold or an amount of money measured by gold. The Court held that the Resolution, which required that every obligation be discharged in any currency which at the time is legal tender, was a valid exercise of Congress' power over the monetary system. *Norman*, 294 U.S. at 316.

> dominant constitutional power by making contracts about them.[253]

Professor Rogers, in arguing that the modification of a secured creditor's claim in a bankruptcy case does not constitute an unconstitutional taking, points out that a debtor and an unsecured creditor cannot enter into a contract which provides that, in the event of insolvency, the contracting creditor would be paid ahead of all other creditors, since one cannot contract out of the bankruptcy power.[254] Clearly, a mortgage cannot provide that mortgagee can obtain the subject property by strict foreclosure upon the mortgagor's bankruptcy. However, that is exactly what the seller under an installment land contract is doing: contracting out of the bankruptcy power.

Some of the literature regarding treating the remedy of specific performance as property is worth noting. One could analogize the seller's rights under an installment land contract to the right of specific performance. If the right of specific performance were considered a state created property right, as some have urged, then bankruptcy law would respect that right.[255] If, in bankruptcy, a non-debtor party to a contract could enforce a right of specific performance, then that creditor would be paid 100 percent on its claim while the debtor's other creditors would be entitled to only their pro-rata share in the distribution. Some critics of that position claim that such a recognition would violate the equality principle,[256] while others advocate focusing on the state law attributes of the specific performance right and urge that if the effect of the specific performance clause would be to give the creditor priority over the debtor's other creditors outside of bankruptcy, then the right should be honored in the debtor's bankruptcy. If outside of bankruptcy, the specific performance right would not elevate the creditor over all others, then it should not be honored.[257] The seller's remedies under an installment

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253. *Norman*, 294 U.S. at 307-08.

254. Rogers, *supra* note 225, at 994-95. It is well settled that in bankruptcy a secured creditor is entitled only to the value of the collateral securing its debt. Wright v. Union Central Life Ins. Co., 311 U.S. 273, 278 (1940).

255. For a detailed discussion of treating remedies, particularly the remedy of specific performance, as property, *see* David Frisch, *Remedies as Property: A Different Perspective on Specific Performance Clauses*, 35 WM. & MARY L. REV. 1691 (1994).

256. *See, e.g.*, Westbrook, *supra* note 5, at 245.

257. *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 65-66, 110-11 (1986).

land contract do not elevate the seller over the buyer's other creditors any more than a mortgagee holds on elevated position over other creditors. If the buyer mortgages its interest in the land[258] subject to an installment land contract, the rights of its mortgagee are the same as those of a second mortgagee. Even in states that permit forfeiture, the seller cannot take the land without giving the buyer's mortgagee notice and an opportunity to protect itself.[259] As a result, since outside of bankruptcy the enhanced remedy of the installment land seller places it in the same position as a purchase-money mortgagee *vis a vis* later mortgagees, there is no reason to give the enhanced remedy an exalted status inside of bankruptcy.

B. The Conflict Between State Laws Allowing Forfeiture and Bankruptcy Policy

Several courts holding that an installment land contract is an executory contract justify their holdings by requiring that state laws be respected in bankruptcy.[260] When state laws violate the general scheme of the federal bankruptcy laws, however, the bankruptcy laws will override state law.[261] It is important to note that many of the courts reaching the conclusion that an installment land contract is a mortgage do not address the issue of the possible supremacy of the Bankruptcy Code, reaching their conclusions solely on state law characterizations.[262]

A good example of a conflict between state-created rights and bankruptcy policy exists in § 522(f) of the Code,[263] which allows a debtor to avoid the fixing of a lien that is a nonpossessory, nonpurchase-money security interest in certain consumer goods and

258. *See supra* note 244 and accompanying text.

259. NELSON & WHITMAN TREATISE, *supra* note 3, § 3.35.

260. *See* Shaw v. Dawson, 48 B.R. 857, 861 (Bankr. D.N.M. 1985); Bank of Honolulu v. Anderson (*In re* Anderson), 36 B.R. 120 (Bankr. D. Haw. 1983).

261. Perez v. Campbell, 402 U.S. 637 (1971) (decided under the Bankruptcy Act); Penn Terra, Ltd. v. Dep't of Envtl. Resources, 733 F.2d 267 (3d Cir. 1984).

262. This result is explicitly stated in *In re* McDaniel, 89 B.R. 861, 872, n.7 (Bankr. E.D. Wash. 1988). The McDaniel court did, however, state that there was no overriding bankruptcy policy reason to treat the installment land contract as an executory contract contrary to Washington law. *Id.* at 875. The court in *In re* Buchert noted that Congress recognized an overriding federal policy in the case of collective bargaining agreements and installment land contracts under which the debtor is the seller, and found that when the debtor is the buyer, there is no reason to override state law. 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987).

263. 11 U.S.C. § 522(f) (1994).

tools of the debtor's trade if that security interest impairs an exemption to which the debtor is otherwise entitled.[264] Under that section, the debtor can avoid a consensual lien otherwise valid under state law.[265] This disregard of a state-created property right is valid because to rule otherwise would harm the debtor's right to a fresh start.

Another example of the Bankruptcy Code displacing state-created rights is § 552 of the Code,[266] which terminates the effect of after-acquired property clauses in valid security agreements.[267] The Uniform Commercial Code provides that a security agreement may "provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."[268] Once the debtor files for bankruptcy, however, this floating lien ceases to float, for § 552 provides that "property acquired by the estate or the debtor after the commencement of the [bankruptcy] case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."[269] Again, any contrary rule in the Bankruptcy Code would hinder the debtor's fresh start.

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264. 11 U.S.C. § 522(f)(1)(B). Under subsection (f):

> [T]he debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—
>
> . . . .
>
> (B) a nonpossessory, nonpurchase-money security interest in any [named consumer goods].

11 U.S.C. § 522 (f)(1)(B).

265. The Uniform Commercial Code allows nonpossessory, nonpurchase-money security interests in consumer goods. *See* U.C.C. § 9-107 (1994). The U.C.C. does not, however, allow liens to attach to consumer goods under after-acquired property clauses. An after-acquired property clause will not be valid when the collateral is consumer goods unless the debtor receives such goods within ten days after the secured party gives value. U.C.C. § 9-204(2) (1994). In 1984, through the passage of the FTC Credit Practices Rule, Congress prospectively banned nonpurchase-money security interests in consumer goods when a bank is the lender. 12 C.F.R. § 227.13 (1995). "Thereafter, security interests became, by definition, property interests that could not encumber certain consumer goods, at least so far as bankruptcy courts were concerned." David Gray Carlson, *Postpetition Interest under the Bankruptcy Code*, 43 U. MIAMI L. REV. 577, 585-86 (1989).

266. 11 U.S.C. § 552 (1994).

267. *Id.*

268. U.C.C. § 9-204.

269. 11 U.S.C. § 552(a). This termination of the floating lien does not apply to after-acquired proceeds, product, offspring, rents or profits of the original collateral, if the security agreement extends to such proceeds, product, offspring, or profits. 11 U.S.C. § 552(b).

Many of the cases addressing the uniformity question deal with the differences among state exemption laws, differences which are permitted under the Code.[270] In *In re Sullivan*,[271] the Seventh Circuit upheld Illinois' decision to opt out of the federal scheme of exemptions.[272] In doing so, the court ruled that the Bankruptcy Code requires only "geographical uniformity," not true uniformity.[273] Therefore, as long as debtors in the same state are treated equally, the requirement of uniformity is met.

In holding that only geographical uniformity is required in bankruptcy, *Sullivan* relied on *Hanover National Bank v. Moyses*.[274] The *Moyses* court addressed the constitutionality of the Bankruptcy Act of 1898 (the "Act"), because the Act provided no federal exemptions and thus allowed all debtors to take advantage of state exemptions.[275] The Court in *Moyses* ruled that the bankruptcy system is uniform within its constitutional mandate "when the trustee takes in each [s]tate whatever would have been available to the creditors if the bankrupt law had not been passed."[276]

As applied to installment land contracts therefore, in order to have geographical uniformity, the contract must be treated like a mortgage. In most states, prior to the time of forfeiture, the buyer's interest in the contract is considered to be real property for purposes of judgment lien attachment.[277] This rule applies whether or not the state allows forfeiture. Therefore, if, outside of bankruptcy, creditors would be able to reach the debtor's equity in the real property subject to an installment land contract, then inside of bankruptcy, the debtor's equity in the land should be considered the debtor's property, and thus property of the estate. Conversely, if the debtor has no equity at all in the property, there is nothing to which a creditor's lien can attach. However, the contract should

270. *See* 11 U.S.C. § 522(b), which "permits states to 'opt out' of the federal exemptions delineated in the Bankruptcy Code, in favor of their own state created exemptions." Douglas E. Deutsch, *"Exemption Reform: Examining the Proposals,"* 3 AM. BANKR. INST. L. REV. 207, 209 (1995).

271. 680 F.2d 1131 (7th Cir. 1982).

272. *Id.*

273. *Id.* at 1133.

274. 186 U.S. 181 (1902).

275. *Id.* at 188-89.

276. *Id.* at 190.

277. POWELL, *supra* note 3, ¶ 938.26[3]; DUNAWAY, *supra* note 28, § 10.08[5].

still be treated as a mortgage, in the interest of certainty at the time of contract signing.

The Bankruptcy Code will yield to state laws when some important public interest is at stake. States' rights are respected in one well-recognized exception to the automatic stay: "The enforcement of a judgment, other than a money judgment, obtained in an action . . . to enforce [a state's] police or regulatory power" is not stayed by the automatic stay.[278] Applying this exception, the court in *Penn Terra Ltd. v. Department of Environmental Resources*[279] held that the automatic stay did not prevent Pennsylvania from seeking an injunction against a mining company in bankruptcy to correct violations of state environmental laws.[280]

In analyzing the conflict between state laws and the Bankruptcy Code, the court in *Penn Terra* recognized that, while Congress has the constitutional prerogative to preempt the states, preemption "must either be explicit, or compelled due to an unavoidable conflict between the state law and the federal law."[281] As a result, the Bankruptcy Code preempts state law only where it is clear that Congress intended that it should do so.

The treatment of installment land contracts in bankruptcy does not raise a question of federal preemption any more than the treatment of secured transactions or mortgages does. The *Penn Terra* court stated that "[w]here important state law or general equitable principles protect some public interest, they should not be overridden by federal legislation unless they are inconsistent with explicit congressional intent such that the supremacy clause mandates their supersession."[282] It is difficult to argue that the enhanced remedies given to installment sellers advance a public interest so important that the remedies should be respected even when the buyer is in bankruptcy.

The Supreme Court has struck down attempts by states to frustrate the debtor's right to a fresh start. For instance, in *Perez v. Campbell*,[283] a state law had the effect of forcing the debtor to pay a discharged tort judgment after bankruptcy.[284] The Supreme

278. 11 U.S.C. § 362(b)(5).
279. 733 F.2d 267 (3d Cir. 1984).
280. *Id.*
281. *Id.* at 272.
282. *Id.* at 273.
283. 402 U.S. 637 (1971).
284. *Id.* at 643.

Court addressed the crucial question of what kind of conflict between state and federal law is permissible under the Supremacy Clause.[285] In *Perez*, the debtor had been involved in an automobile accident.[286] The Arizona statute at issue in the case provided for suspension of a driver's license and registration when the driver had an unpaid judgment against him arising out of an automobile accident.[287] The suspension could continue until the judgment was paid, and the statute provided that a "discharge in bankruptcy . . . shall not relieve the judgment debtor from any of the requirements of [the statute]."[288]

The debtors in *Perez* claimed that the Arizona statute was in direct conflict with the Bankruptcy Act and as such violated the Supremacy Clause of the Constitution.[289] The state argued that the law was not one with the primary purpose of debt collection in contravention of the bankruptcy laws, but rather was one with the principal purpose of protecting the public from "the use of automobiles by financially irresponsible persons."[290] The Court, in ruling for the debtors, stressed that the sole emphasis of the Arizona law was "one of providing leverage for the collection of damages from drivers who either admit that they are at fault or are adjudged negligent,"[291] and as such was in conflict with the debtor's fresh start.[292]

The Court held the statute in *Perez* to be unconstitutional because it stood as an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[293] Although the prevention of unsafe driving is an admirable goal, the Court left to Congress the job of determining which debts survive bankruptcy.[294] Indeed, Congress has done exactly that in § 523 of the Code, excepting from discharge 16 categories of debts, including those for alimony and child support, student loans, and

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285. *Id.* at 644-54.
286. *Id.* at 638.
287. *Id.* at 641-42.
288. *Perez*, 402 U.S. at 641-42.
289. *Id.* at 643.
290. *Id.* at 644 (quoting Schecter v. Killingsworth, 380 P.2d 136, 140 (Ariz. 1963)).
291. *Id.* at 646-47.
292. *Id.* at 652.
293. *Perez*, 402 U.S. at 649 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941), for the proper test of a state statute's Constitutionality).
294. *Id.* at 651-52, 656.

debts arising from drunk driving accidents.[295] The court, in *In re Fox*, applied this argument to installment land contracts stating, "we believe that the significance of state law pales in comparison with the overriding Bankruptcy Code policy of protecting the property of debtors' estates."[296] The overriding federal interest in that case was stated to be the interest in allowing debtors to keep their homes.[297]

Treating installment land contracts as anything other than mortgages violates the debtor's fresh start. Like the statute in *Perez*, any state classification of installment land contracts that would allow them to be treated as executory contracts and require them to be paid in full are nothing other than attempts to collect a debt from the debtor in full. Although some forms of enhanced remedies are permissible in bankruptcy, the treatment of a secured loan as an executory contract is not. None of the permissible enhanced remedies allow collection of a higher amount from the debtor. A security interest allows payment from the collateral;[298] guarantees[299] and letters of credit[300] allow payment from third parties.

In the context of § 365 of the Code, Congress has expressed an overriding federal interest in two types of executory contracts,

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295. 11 U.S.C. § 523(a) (1994). Although debtors in Chapter 13 receive, overall, a broader discharge than the debtors in Chapter 7, debts arising out of alimony, child support, student loans, drunk driving accidents and criminal fines are also non-dischargeable in Chapter 13. 11 U.S.C. § 1328(a) (1994).

296. 83 B.R. 290, 298 (Bankr. E.D. Pa. 1988).

297. *Id.* In *Fox*, had the court ruled the contract subject to § 365, the debtor would have been required to pay $20,000 for property worth $7,000 in order to keep her home (a building which consisted of a store and an apartment). The debtor in that case was a single mother of five who was "desperate for a home for her large family when she entered into this transaction." *Id.* at 293. The *Fox* case illustrates what can happen when two completely unsophisticated business people attempt to design a real estate transaction.

298. 11 U.S.C. § 506(a) (1994).

299. The automatic stay does not enjoin actions against guarantors. An exception is made in Chapter 13. Under § 1301(a), actions against codebtors are stayed if the debt is a consumer debt and the codebtor is not in the business of guaranteeing debt. 11 U.S.C. § 1301(a) (1994).

300. Some courts have enjoined payments on letters of credit in bankruptcy. Wysko Inv. Co. v. Great Am. Bank, 131 B.R. 146 (Bankr. D. Ariz. 1991); Prime Motor Inns, Inc. v. First Fidelity Bank N.A. N.J., 130 B.R. 610 (Bankr. S.D. Fla. 1991); In re Delaware River Stevedores, Inc., 129 B.R. 38 (Bankr. E.D. Pa. 1991). However, if the independence principle is respected, a creditor may draw under a letter of credit and the issuing bank would then have an action against the debtor under the reimbursement agreement. Juliet M. Moringiello, *Silencing the Loose Cannon: The Need for the Bankruptcy Code to Recognize Letters of Credit*, 27 LOY. L.A. L. REV. 619 (1994).

collective bargaining agreements[301] and installment land contracts when the debtor is the seller.[302] The Supreme Court in *NLRB v. Bildisco & Bildisco*,[303] recognized that labor contracts, although executory, have a special status, and thus, a stricter standard than the business judgment rule would be required for rejection.[304] Afterwards, in the 1984 amendments to the Code, Congress adopted a stricter standard for rejection of such contracts, one which takes into account the best interests of the employees.[305] In the case of collective bargaining agreements, there is no question that the contract is an executory one and that § 365 applies. However, the interest in protecting employees is so strong that Congress enacted a heightened standard for rejection.

It is somewhat misleading, in addition, to characterize installment land contracts when the debtor is the vendor as executory contracts, as § 365(i) does. Congress enacted § 365(i) to combat what was seen as unfair treatment of the buyers under installment land contracts when the seller filed for bankruptcy.[306] When the seller files for bankruptcy, the Code allows the buyer to remain on the land, continue payments and receive title.[307] This result is the same as would be reached if the installment land contract were a purchase-money mortgage and the seller were a mortgagee.[308]

If installment land contracts were considered mortgages for bankruptcy purposes, § 365(i) would be unnecessary. Under § 541 of the Code,[309] all of the debtor's rights in property become property of the estate.[310] When the debtor is a mortgagee, the

301. 11 U.S.C. § 1113 (1994). Section 1113 prohibits a court from approving the rejection of a collective bargaining agreement unless: the trustee (including the debtor in possession) has made a proposal to the representative of the employees that provides for the necessary modifications in the employees' benefits and protections in order to permit the reorganization of the debtor and assures that all creditors, the debtors and all affected parties are treated fairly; the authorized representative of the employees has refused to accept the proposal without good cause; and the balance of the equities clearly favors rejection of the agreement. *Id.*

302. 11 U.S.C. § 365(i).

303. 465 U.S. 513 (1984).

304. *Id.* at 526.

305. *See* 11 U.S.C. § 1113.

306. *See supra* note 9 and accompanying text.

307. 11 U.S.C. § 365(i).

308. *See In re* Booth, 19 B.R. 53, 62-63 (Bankr. D. Utah 1982).

309. 11 U.S.C. § 541 (1994).

310. *Id.*

lien on the property becomes property of the estate, but the mortgagor's property interest does not.[311] As a result, when a mortgagee files for bankruptcy, the mortgagor remains on the land.[312] Therefore, Congress could have protected nondebtor buyers under installment land contracts even without making special provisions for them in § 365(i), by simply treating the contracts as mortgages.

With the most recent Code amendments, Congress recently settled one question of state law remedies. Until the Code amendments of 1994, courts battled with determining the extent of state-created real property rights in the context of the treatment of a home mortgage in a Chapter 13 plan.[313]

A debtor in Chapter 13 is permitted to cure and maintain payments on long-term debts, such as mortgages, but is not permitted to impair a mortgagee's rights if the mortgage is secured by real property which is the debtor's residence.[314] This provision protects home mortgagees to a greater extent than other secured lenders under the Code.[315] For years, there was substantial debate regarding the termination point for the debtor's right of cure. Should debtors be permitted to cure their mortgages after mortgagees have exercised the right of acceleration?[316] Should debtors be permitted to cure mortgages after mortgagees have commenced foreclosure proceedings?[317] Should debtors be permitted to cure after judgment for foreclosure[318] or even during postsale statutory redemption periods?[319]

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311. *See id.*

312. The same analysis applies when the contract is a lease of real property. 11 U.S.C. § 365(h). Andrew I, *supra* note 86, at 904-05.

313. *See, e.g., In re* Roach, 824 F.2d 1370 (3d Cir. 1987); DiPierro v. Taddeo (*In re* Taddeo), 685 F.2d 24 (2d Cir. 1982); *In re* Callahan, 158 B.R. 898 (Bankr. W.D.N.Y. 1993); Thompson v. Great Lakes Fed. Sav. & Loan Ass. (*In re* Thompson), 17 B.R. 748 (Bankr. W.D. Mich. 1982); *In re* Soderlund, 7 B.R. 44 (Bankr. S.D. Ohio 1980), *rev'd*, 18 B.R. 12 (Bankr. S.D. Ohio 1981).

314. 11 U.S.C. § 1322(b)(2) (1994).

315. For background, *see* Veryl Victoria Miles, *The Bifurcation of Undersecured Residential Mortgages Under § 1322(b)(2) of the Bankruptcy Code: The Final Resolution*, 67 AM. BANKR. L.J. 207, 255-68 (1993).

316. *See DiPierro*, 24 F.2d 685.

317. *See* Midlantic v. DeSeno (*In re* DeSeno), 17 F.3d 642 (3d Cir. 1994); Green Tree Acceptance, Inc. v. Hoggle (*In re* Hoggle), 12 F.3d 1008 (11th Cir. 1994).

318. *See In re* Roach, 824 F.2d 1370 (3d Cir. 1987); *In re* Brown, 75 B.R. 1009 (Bankr. E.D. Pa. 1987).

319. *See In re* Roach, 824 F.2d at 1371.

In *In re Roach*, the Third Circuit, disagreeing with the Sixth and Seventh Circuits, ruled that the debtor's right to cure expired upon the entry of the foreclosure judgment.[320] The reasoning of the *Roach* court is instructive for its illustration of the relative reluctance to override the state law creation of property interests.[321] After a judgment of foreclosure in New Jersey, no mortgage remains to be cured.[322] The mortgage merges into the final judgment of foreclosure and the mortgage contract is extinguished.[323] The court in *Roach* found that after the point of judgment, there were no substantial federal interests that would justify ignoring the state-created property interests.[324]

The 1994 Code amendments silenced this debate by providing that if the mortgagor files for bankruptcy before the property is sold at a properly conducted foreclosure sale, the mortgagor may cure the default and maintain payments as part of the reorganization plan.[325] According to the legislative history of the Code amendments, any contrary result would hinder the debtor's fresh start.[326] Congress thus felt it necessary to make uniform this question of mortgage law, so that debtors in all states would be provided with the same opportunity to cure their mortgages. Here again, the remedies of creditors differed from state to state, in some, the creditor could take the land notwithstanding the debtor's bankruptcy so long as a foreclosure judgment had been entered; in others, if the bankruptcy intervened between judgment and sale, the creditor could be paid according to the debtor's plan.

The policy of encouraging reorganizations is explicit in the Code's legislative history. Under the Act, the treatment of secured claims was ambiguous. The Code made it clear that undersecured

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320. *Id.* at 1379.

321. *Id.* at 1374.

322. *Id.* at 1377.

323. *Id.*

324. *In re* Roach, 824 F.2d at 1377-78.

325. 11 U.S.C. § 1322(c)(1). Section 1322(c) states:

> Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—
>
> (1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law.

Id.

326. Bankruptcy Reform Act of 1994 Section by Section Description, 140 CONG. REC. H10, 764-71 (daily ed. Oct. 4, 1994) (inserted by Rep. Brooks); 140 CONG. REC. E 2204 (daily ed. Oct. 8, 1994) (statement by Rep. Brooks).

claims were to be bifurcated into secured and unsecured claims.[327] In the words of one commentator, the change "was to give the secured creditor the *value* of its property rights, and to prevent that creditor from exercising the rights themselves."[328] Under an installment land contract, it is the enhanced remedy which gives the seller a more valuable right (full payment of its entire claim) than the property right of the mortgagee (full payment of the secured portion of the claim). Therefore, if the enhanced remedy is not protected in bankruptcy, the installment seller should receive the same value as the mortgagee would since the value of the underlying real property is the same. Treating an installment land contract as a mortgage would thus encourage the debtor/buyer's reorganization, by preventing the creditor/seller's exercise of its enhanced remedy.

VI. The Search for the Right Analogy

Under Article 2 of the Uniform Commercial Code,[329] which governs the sale of goods, if a seller of goods retains title to the goods after delivery to the buyer, such retention of title is limited in effect to the reservation of a security interest.[330] As a result, the treatment of installment sales of goods in bankruptcy is settled and uniform, while of course looking to state law.

Professor Westbrook proposes a "functional approach" to contracts in bankruptcy which abandons executoriness as a threshold matter in determining whether § 365 applies.[331] Instead, Westbrook urges courts, in determining whether § 365 applies, to search for the "economic function of the agreement."[332] Westbrook's functional analysis of contracts is tied to the concept of the other party's "[i]interest in the [t]hing itself."[333] The interest in the thing itself is the interest which allows the other party, the installment seller in the instant analysis, to dominion over a specific asset *or* to have priority in the proceeds of the sale

327. H.R. REP. NO. 595, 95th Cong., 2d Sess. at 180 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6141.

328. Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAP. U. L. REV. 313, 315 (1994).

329. U.C.C. §§ 2-101 to 2-725 (1995).

330. U.C.C. § 2-401 (1995). This rule is echoed in § 1-201(37), which defines the term "security interest."

331. Westbrook, *supra* note 5.

332. *Id.* at 319.

333. *Id.* at 258.

of that asset.[334] In the sale of goods context, an undelivered seller has a right to the thing itself, while the delivered seller has only the right to the value of the thing.[335]

In proposing a functional approach to installment land contracts in bankruptcy, Westbrook compares the seller in an installment land contract to a secured seller of onions.[336] If the secured seller has delivered the onions to the buyer, then state law, upon the buyer's default, and bankruptcy law allow the seller to recover only the value of the onions.[337] On the other hand, if the seller has not delivered the onions before the bankruptcy filing, then the seller has the right to the onions themselves.[338] As a result, in order to receive the onions according to the contract of sale, the debtor should be required to assume the contract and pay the full contract price under § 365.[339] Under Professor Westbrook's analysis, in determining how to treat an installment land contract in bankruptcy, courts should look to whether state law treats the seller as a delivered[340] or an undelivered[341] seller.

The problem with this analysis, however, is that under the usual installment land contract, the property is physically delivered, the buyer has the right to possess the land and the only right that the seller has is the right to hold the title until the entire purchase price is paid. To address the undelivered/delivered distinction under Article 2 of the U.C.C. is to ignore the fact that the buyer has the land, and to shift the analysis to remedies, which are changed in bankruptcy.

The closer analogy would be to "true" leases and leases intended as security under Article 9 of the U.C.C.[342] Although bankruptcy courts apply state law in determining whether such

334. *Id.*

335. *Id.* at 319.

336. Westbrook, *supra* note 5, at 263-268.

337. *Id.* U.C.C. § 9-504 (1994). Outside of bankruptcy, the delivered seller is entitled to recover the full purchase price of the onions. However, if the onions bring more than the purchase price upon resale, the seller must give the surplus to the buyer. Westbrook, *supra* note 5, at 319.

338. Westbrook, *supra* note 5, at 267.

339. *Id.* at 266.

340. Which would be the case in states that treat an installment land contract like a mortgage, the seller is entitled to only the value of the land at foreclosure.

341. Which would be the case in states which allow forfeiture in all situations, the seller is entitled to the land itself.

342. U.C.C. § 1-201 (1995)(setting out the standard by which leases are to be considered either true leases or security interests).

leases are in fact security interests, courts have long adhered to the principle that substance of the transaction should take precedence over the form.[343] Where personal property is involved, if a lease is found under the U.C.C. to be an installment sale, it is a secured sale, and the seller must comply with Article 9 of the U.C.C. to retain an interest in the property.[344] Interestingly, while Westbrook praises the cases addressing the lease/sale distinction as helpful because of their functional analysis of the economic purposes of the agreement, he advocates, in the absence of Congressional action, a delivered/undelivered analysis under state law for installment land contracts.[345]

The court in *In re Pacific Express*[346] applied the delivered/undelivered analysis to a "lease" of personal property.[347] Applying the Countryman definition of executory contract, the court held that, when the seller has delivered the thing sold, the contract is no longer executory, because, even if the seller has some remaining obligations, the failure to fulfill them would not excuse full payment for the goods.[348] It is important to note, however, that the delivery on which the court focused was the physical delivery of the thing sold, not the delivery of the title.[349]

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343. Pacific Express, Inc. v. Teknekron Infoswitch Corp. (*In re* Pacific Express), 780 F.2d 1482, 1485 (9th Cir. 1986) (addressing the conflict between § 544 and § 365 of the Code).

344. Courts sitting in bankruptcy cases also recognize certain leases of personal property as disguised secured sales. In answering the question of whether a lease is a true lease or a lease intended as security, the courts look to state law, reflected in §1-201(37) of the Uniform Commercial Code. *See, e.g.*, NYNEX BISC v. Beker Industries Corp. (*In re* Beker Industries Corp.), 69 B.R. 937 (Bankr. S.D.N.Y. 1987). In many cases involving the sale of realty, courts have applied principles from the U.C.C., *see, e.g.*, Kuhn v. Spatial Design, Inc., 585 A.2d 967 (N.J. Super. Ct. App. Div. 1991), even though the U.C.C. does not apply to the sale or transfer of an interest in real property. U.C.C. §§ 2-102, 2-105, 2-107, 9-104. The U.C.C. is state, not federal law, and courts applying the U.C.C. in bankruptcy cases are of course deferring to state law in determining the rights of an installment seller of goods. However, Article 2 of the U.C.C. has been adopted in every state (except Louisiana); therefore, the law is uniform. It is also a policy of the U.C.C. drafters to make uniform the laws of the states. It is therefore relatively easy to look at installment sales of personal property in bankruptcy cases and say that the court respects state law with regard to property rights.

345. Westbrook, *supra* note 5, at 318-19, 321. Professor Westbrook notes that, [p]erhaps there should be a special bankruptcy policy about land-sale contracts, especially in rehabilitation proceedings." *Id.* at 321.

346. 780 F.2d 1482

347. *Id.* at 1487-88.

348. *Id.* at 1487-88.

349. *Id.* at 1487.

Some commentators have suggested that even true leases (for purposes of Article 9 of the U.C.C.) of certain types of personal property (specifically equipment) should be treated as security interests for purposes of the Bankruptcy Code.[350] The theory behind such a proposal is that the economic expectations of most equipment lessors and parties with security interests in equipment are the same.[351] On the other hand, other commentators have argued forcefully that "rent-to-own" contracts for consumer goods should be treated as "true" leases for bankruptcy purposes using a similar argument.[352] Lessors in the rent-to-own business are in the business of leasing used property. Therefore, the economic expectation of the lessor is that the property will be returned and leased again.[353]

Applying the argument to real estate leases, it is clear that a true lease of real estate is not analogous to a mortgage because, in a real estate lease, the lessor expects to regain possession of the property at the end of the lease term. Since land has a practically unlimited useful life there is a significant residual interest in the land at the end of the lease term.[354] The argument does work, however, when mortgages and installment land contracts are compared. When land is sold by the installment land contract device, the seller never expects to get the land back; rather, the seller expects a stream of payment, much like a purchase-money mortgagee, who also expects a stream of payment.

In 1985, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") attempted to eliminate some of the differences in treatment between security interests in real property and security interests in personal property by approving the Uniform Land Security Interest Act ("ULSIA").[355] The ULSIA, which has not been adopted in any state, provides that

350. *See generally*, Margaret Howard, *Equipment Lessors and Secured Parties in Bankruptcy: An Argument for Coherence*, 48 WASH. & LEE L. REV. 253 (1991).

351. *Id.* at 253, 305.

352. Barkley Clark et al., *"Rent-to-Own" Agreements in Bankruptcy: Sales or Leases?*, 2 AM. BANKR. INST. L. REV. 115 (1994). One proposed version of the bankruptcy code amendments, which passed the Senate, proposed that rent-to-own contracts be treated as security devices in bankruptcy. S. 540, 103d Congress, 1st Sess. (1993). The version of the bill which ultimately passed did not contain that provision.

353. Clark et al., *supra* note 352, at 124.

354. For a discussion of the difference between a lease and a mortgage, see *In re* Booth, 19 B.R. 53 (Bankr. D. Utah 1982).

355. UNIF. LAND SECURITY INTEREST ACT, 7A U.L.A. 225 (Supp. 1995).

"[i]f a seller's retention of legal title to real estate after the buyer enters into possession is intended as security, the seller's interest is a security interest."[356] Under ULSIA, as under the U.C.C., the location of the title to the real property is immaterial.[357] One of the purposes behind ULSIA is the simplification and modernization of the law of secured real estate transactions, for NCCUSL recognized that real estate law clings to its ancient, historical roots and that courts are reluctant to change the rules.[358]

VII. Section 365 and Installment Land Contracts: A Bad Fit

The current reliance on the distinction between contracts which are executory and those which are not is misplaced. This is a point stressed under Professor Westbrook's functional analysis, under which it is important to look at the other party's (seller's) rights in the property subject to the contract.[359] Bankruptcy policy, in many areas, exalts substance over form.[360] Therefore, the Code already adequately addresses installment land contracts in its treatment of secured claims.

The scheme of requiring assumption or rejection of executory contracts rests on the theory that certain contracts are beneficial to the bankrupt's estate. The power to assume or reject dates from the earliest days of American bankruptcy law.[361] The idea was that the trustee had the power to assume contracts which would result in a profit to the estate.[362] The evil that § 365 is designed to combat is the situation in which both the debtor and the other party to the contract have unperformed obligations under the contract when the debtor files for bankruptcy. If the other party were merely deemed a creditor, he could be forced to deliver his performance of the contract and receive in consideration a mere

356. UNIF. LAND SECURITY INTEREST ACT § 111(25), 7A U.L.A. at 231.

357. UNIF. LAND SECURITY INTEREST ACT § 202, 7A U.L.A. at 237. Section 202 states, "[e]ach provision of this [Act] with regard to rights, obligations, and remedies applies whether title to the collateral is in the debtor, the secured creditor, or a third party." *Id.*

358. Prefatory note to UNIF. LAND SECURITY INTEREST ACT, 7A U.L.A. at 222.

359. Westbrook, *supra* note 5, at 286-87.

360. For instance, payments for alimony and support of a spouse or child of a debtor are not dischargeable, but not to the extent that "such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support." 11 U.S.C. § 523(a)(5)(B). It is clear that bankruptcy courts can apply a federal standard in determining whether payments are, in fact, in the nature of alimony, maintenance, or support.

361. 2 COLLIER ON BANKRUPTCY ¶ 365.01 (15th ed. 1995).

362. *Id.*

fraction of what he was entitled to under the original contract. The payment scheme under § 365 allows the other party, if he is required to perform, to receive in bankruptcy exactly what he would receive outside of bankruptcy.[363] The theory is that it is better to proceed with the debtor's commercial plans than to freeze them as of the filing date. This way, the debtor would be entitled to full contract performance, just as if bankruptcy had not intervened.

It is questionable whether characterizing installment land contracts as executory is consistent with the purposes underlying § 365. Treating an installment land contract as an executory contract would give the installment seller a clear advantage over a similarly situated, purchase-money mortgagee. A debtor can, under a plan of reorganization, cure mortgage defaults and make payments under the plan.[364]

The reason for the assumption/rejection provisions in § 365 is based on keeping contracts that are beneficial to the estate and rejecting those that are not. Courts which apply the Countryman definition in ruling that an installment land contract is executory under § 365 appear to have lost sight of the explanation for that definition.[365] In the words of Professor Williston, "all contracts to a greater of lesser extent are executory. When they cease to be so, they cease to be contracts at all."[366] Collier gives a good example of how all contracts which are not fully performed are to some extent executory.[367] Countryman framed his definition in light of the reason for the trustee's option to assume or reject.[368] A trustee should only assume a contract when the assumption will

363. *Id.*

364. *See, e.g.*, 11 U.S.C. §§ 1123, 1129, 1222, 1225, 1322, 1325, 1328. *See generally* NELSON & WHITMAN TREATISE, *supra* note 3, §§ 8.14-8.55 (outlining reorganization plans under Chapters 11, 12, and 13).

365. Michael T. Andrew makes a distinction between executory and nonexecutory contracts and posits that a definition of executory is necessary to distinguish between those contracts that the trustee may properly elevate to administrative priority and those that the trustee may not. If a contract is fully performed, there are no remaining benefits to the estate, and thus, there is no reason to elevate the payments to administrative priority. *See generally* Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1, 28-29 (1991).

366. 1 RICHARD A. LORD, WILLISTON ON CONTRACTS § 1.19 (4th ed. Lawyers Cooperative Publishing Co. 1990).

367. 2 COLLIER, *supra* note 361, § 365.01[2].

368. Countryman, *supra* note 81, at 450.

benefit the estate.[369] If the only effect of assumption would be to prejudice other creditors, then § 365 should not apply.[370] As this article has shown, treating installment land contracts as executory contracts serves primarily to elevate the seller to a higher position than a similarly situated, purchase-money mortgagee.

Countryman addressed the comparison between purchase-money mortgages and installment land contracts and saw the seller's obligation to deliver the deed as material.[371] He contrasted this with the position of the purchase-money mortgagee, who, in Countryman's opinion, has fully performed "when he has executed the deed and surrendered possession of the property."[372] According to Countryman, once the debtor has received all possible benefits from the contract, the nondebtor party has only a claim in the bankruptcy case, and the trustee has no reason to assume the contract.[373]

Countryman thus based his conclusion regarding installment land contracts in bankruptcy on the assumption that the transfer of the deed from the seller to the buyer constitutes full benefit. However, under an installment land contract, once the buyer takes possession of the land, the buyer is usually required to pay for taxes, utilities, insurance and maintenance of the property. The delivery of title should not be considered the moment of full performance, because in real estate law, as in the law of the sale of goods, sometimes the location of title is disregarded in determining the rights of parties with interests in the real estate.[374]

It is also curious to say, as some courts do, that if a contract is executory, then it is not a security device. A revolving loan agreement is certainly an agreement carrying obligations on the

369. *Id.*

370. *See Id.*

371. *Id.*

372. *Id.*

373. The commentators agree that, when a nondebtor contracting party has fully rendered the performance to which the debtor is entitled, then the contract is not one which the trustee can assume or reject under § 365. Countryman, *supra* note 81, at 451; Westbrook, *supra* note 5, at 264; Andrew I, *supra* note 86, at 890. Such contracts are not covered by § 365, because the nondebtor's full performance will give the nondebtor a provable claim in bankruptcy and the estate would not gain anything by assuming the contract.

374. If a court finds a deed absolute to be a financing device, it will be considered a mortgage. *See supra* footnotes 61-65 and accompanying text. When the deed of trust is used instead of a mortgage, the deed is transferred to a trustee. It would seem then, that possession is, in some instances, more important than title.

part of both the lender and the borrower.[375] The court in *Booth* recognized this problem and characterized the Countryman definition as a mere guideline.[376]

In some ways, the Code already treats executory contracts and leases, on the one hand, and security interests, on the other, identically. Professor John D. Ayer makes this comparison in the context of leases in bankruptcy.[377] If, when the buyer/debtor files for bankruptcy, the value of the land is greater than the amount owing on the contract, the buyer gets the benefit of the increase. This result is the same whether the buyer is a purchaser under an installment land contract or a mortgagor. If the seller is a secured creditor, the seller is entitled to the amount owed on the loan.[378] Likewise, if the seller is a seller under an installment land contract, the seller is guaranteed only the amount due under the original contract.[379]

However, when the property is worth less than the original contract price, the mortgagee is entitled to merely the value of the collateral, while the installment seller is still entitled to the full contract price. This result is anomalous, because if payment had been for cash at the outset, the seller of course would not have been entitled to any benefit of the increase in value of the property. As compensation for waiting for payment, the seller under both devices charges an interest rate to the borrower and reserves to himself the right to take possession of the land upon default. There seems to be no reason why the two should be treated differently. Professor Ayer, in his article on leases, elucidates the anomaly in the distinction between leases and secured credit.[380] While he argues that the two devices serve

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375. *See* 11 U.S.C. § 365(c)(2). Section 365(c)(2) prohibits the trustee from assuming or assigning any executory contract if "such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor." *Id.* This subsection was incorporated into the Code to prevent trustees from requiring new advances of money or other property, While permitting the trustee to continue to use and pay for property already advanced, it does not allow the demanding of new loans or additional transfers of property under lease commitments. H.R. REP. NO. 595, 95th Cong., 2d Sess. 348 (1977), *reprinted* in 1978 U.S.C.C.A.N. 97-100.

376. *See supra* text accompanying notes 128-33.

377. John D. Ayer, *On the Vacuity of the Sale/Lease Distinction*, 68 IOWA L. REV. 667, 694 (1983).

378. 11 U.S.C. § 506 (1994).

379. *See* 11 U.S.C. § 365(i)(2)(A). This will be the result if the trustee accepts the contract. If the trustee rejects, all of the debtor's equity in the land will be forfeited.

380. Ayer, *supra* note 377, at 695.

substantially the same purpose, he reaches no conclusion as to whether leases should be treated as secured transactions presently are or vice versa.[381]

In addition, legislative history to the Code indicates that it was the intention of Congress to treat installment land contracts as mortgages. This intent can be found in the legislative history of § 502(b)(6) of the Code, which deals with the claim of a lessee against the debtor-lessor for breach of a lease.[382] In distinguishing between "true" leases and leases which constitute disguised security interests, the legislative history states, "[f]inancing 'leases' are in substance installment sales or loans. The 'lessors' are essentially sellers or lenders and should be treated as such for purposes of the bankruptcy law."[383] It is interesting to note that the history makes no distinction between installment sales and loans. The legislative history continues by stating that one must focus on the economic substance of the transaction and not "on the locus of title" in order to distinguish between a true lease and a security interest.[384]

Proponents of the treatment of installment land contracts as executory contracts fear the installment land contract's demise as a purchasing device if installment land contracts are treated as mortgages in bankruptcy.[385] However, those who foresee the demise of installment land contracts fail to recognize the fact that not every troubled debtor files for bankruptcy, rather studies have shown that most people wait entirely too long before seeking the protection of the bankruptcy laws.[386]

At least one commentator criticizes the impulse on the part of courts, legislators, and writers to balance the substantive goals of bankruptcy with other areas of law, such as environmental law and labor law.[387] Jackson, in setting forth the limits to what bankruptcy law can do, posits that in its role as a collective debt-collection

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381. *Id.* at 697, 698.

382. 11 U.S.C. § 502(b)(6).

383. S. REP. NO. 989, 95th Cong., 2d Sess. 63-64 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5849-5850.

384. *Id.* at 5850. The report, in distinguishing between true leases and financing transactions, stated "the fact that the lessee assumes and discharges substantially all of the risks and obligations ordinarily attributed to outright ownership of the property is more indicative of a financing transaction than a true lease." *Id.*

385. *See* text accompanying notes 31-32.

386. SULLIVAN et al., *supra* note 23, at 21.

387. JACKSON, *supra* note 257, at 1-3.

device, bankruptcy law should not create rights . . . [but] should act to ensure that the rights that exist are vindicated to the extent possible.[388] In his discussion of *Booth*, Jackson focuses on the differences between mortgages and installment land contracts, and criticizes the *Booth* court for "substantively recharacterizing the underlying property right from a contract for deed to a secured sale."[389] The question of whether § 365 applies to installment land contracts is better answered, however, by looking at the similarities between installment land contracts and mortgages.

Jackson's complaint about *Booth* is tied to the fact that the *Booth* court balanced installment land contract law against bankruptcy policy. However, the *Booth* result can be achieved in a way consistent with Jackson's view of the proper role of bankruptcy law by focusing on the attributes of an installment land contract rather than the state law label.[390] A court need not find that installment land contracts conflict with bankruptcy policy to conclude that such contracts are in fact security devices and should be so treated in bankruptcy. Rather, by viewing the installment land contract as an enhanced remedy mortgage, a court can reach the same result.[391]

All creditors have their remedies changed somewhat in bankruptcy. A good example is that of a creditor with an Article 9 security interest. A secured creditor, with a security interest in personal property, has the right of self-help repossession upon default, provided that the repossession can be effected without a breach of the peace.[392] Failing that, the secured creditor can bring an action for the amount due.[393] If the debtor desires to redeem the property before it is sold, the debtor must tender the

388. *Id.* at 22.

389. *Id.* at 120-21.

390. *Id.* at 65-66. Jackson applies the same attributes analysis in determining the extent of estate property. *Id.* at 94.

391. Professor Margaret Howard makes a similar argument in proposing that equipment lessors and secured creditors be treated alike in bankruptcy. While she does not claim that bankruptcy law should "cavalierly disregard state law entitlements," she does question whether "bankruptcy should follow state law distinctions that may themselves be irrational because they are not supported by relevant differences." Margaret Howard, *Equipment Lessors and Secured Parties in Bankruptcy: An Argument for Coherence*, 48 WASH & LEE L. REV. 253, 255 (1991).

392. U.C.C. § 9-503 (1995).

393. *Id.*

entire amount outstanding on the loan.[394] The creditor has the option to retain the property in lieu of selling it, in which case, the creditor could reap the benefit of any increased value of the property.[395]

In bankruptcy, however, the position of that creditor changes. After a bankruptcy petition has been filed, the secured creditor can neither attempt self-help repossession nor commence litigation to collect the debt. Both actions are subject to the automatic stay.[396] If, in a Chapter 7 case, the debtor desires to redeem the property, under the Bankruptcy Code, the debtor must tender only the fair market value of the property.[397] It seems, thus, that remedies are not the type of state-created property rights that bankruptcy courts must respect under *Butner.*

Finally, it makes sense to examine the history behind § 365 of the Code in order to conclude that the executory analysis should not apply to installment sales of real property. Under the Bankruptcy Act of 1898, title to the debtor's executory contracts and leases did not immediately vest in the trustee, but vested only after adoption by the trustee. The reason for this treatment was that executory contracts and leases involved future liabilities as well as rights, and the estate should not be charged with these except when they were clearly assumed.[398] Therefore, the estate would not automatically become liable on burdensome contracts.

The purpose of the election to assume or reject is to protect the estate from assuming administrative liabilities when it would not be advisable to do so.[399] Assumption elevates the nondebtor party to a special priority, an administrative one.[400] Under an installment land contract, the buyer receives, at the time it signs the contract, possession and use of the property, just as if it holds title.

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394. U.C.C. § 9-506. Under U.C.C. § 9-506, prior to the time that the secured party disposes of the collateral, the debtor may "redeem the collateral by tendering fulfillment of all obligations secured by the collateral, as well as expenses [of sale]," and, if provided for in the security agreement, attorney's fees. *Id.*

395. U.C.C. § 9-505. This option does not apply when the collateral is consumer goods and the debtor has paid sixty percent of the price (in the case of purchase money security interests) or the loan (in the case of all other security interests). *Id.* For all other secured loans, the creditor cannot keep the collateral if the debtor objects.

396. 11 U.S.C. § 362.

397. 11 U.S.C. § 722. This section applies only to tangible personal property intended primarily for personal, family, or household use.

398. 2 COLLIER ON BANKRUPTCY, *supra* note 361, ¶ 365.01[1].

399. Andrew I, *supra* note 86, at 866.

400. *Id.* at 890.

Therefore, assumption, with the accompanying necessity of full payment and administrative priority, seems to "confer[] priority for priority's sake, for the purpose of elevating a claim to administrative status rather than as a means of obtaining some contractual benefit."[401]

VIII. Conclusion

The application of § 365 to installment land contracts serves to prefer one type of creditor holding land as security for a debt, the installment seller, over another, the purchase-money mortgagee, when the two are in fact similarly situated. Such an application violates one of the basic principles of bankruptcy law, the equal treatment of creditors. Although bankruptcy law does, and should, respect state-created property rights, the distinction that states make between installment land contracts and mortgages is a distinction of form rather than substance.

In addition, the debtor's fresh start is an overriding principle of bankruptcy law. Treating installment land contracts as anything other than mortgages violates the debtor's right to a fresh start. Such treatment allows a seller, who often has much greater bargaining power than the buyer, to contract out of the bankruptcy power and render the buyer liable for the full purchase price of the land, regardless of any decrease in value of the land between the date of signing of the contract and the bankruptcy filing.

Congress enacted § 365(i) of the Code to recognize the fact that an installment land contract is, functionally, a purchase-money mortgage. It is time for Congress and the courts to recognize that, whether the buyer or the seller is in bankruptcy, the installment land contract is, in reality, a financing device.

401. *Id.*