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## TREATMENT OF THE VENDEE'S LAND CONTRACT IN A CHAPTER 13 BANKRUPTCY

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A CLE Presentation

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## 1. Introduction.

The land contract presents a challenge in the Chapter 13-bankruptcy context—is it more like a mortgage or an executory contract? Depending on how a bankruptcy court treats the land contract, the vendee/debtor's options are affected—he may or may not be able to cure, assume, modify or reject the land contract. Bankruptcy Court treatment of the land contract will itself depend on that Court's reading of the applicable state's law on law contracts.

If the vendee/debtor's land sale contract is treated as an executory contract, then he can only assume or reject it, and if he assumes it, the default must be cured "promptly". If, on the other hand, the land sale contract is treated as a secured financing device, then the vendee/debtor may assume the contract and cure the default (if there is one) within a "reasonable time" and maintain payments. Lastly, if the contract is treated as a secured financing device, and it is subject to modification (and only some are), the vendee/debtor may modify it and make payments over the life of the plan.

## 2. The Statutory Framework.

How a land contract is treated will determine which code section controls. If the land contract is treated as an executory contract, then 11 U.S.C. § 365 controls:

### **11 U.S.C. § 365. Executory contracts and unexpired leases**

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee -

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

If the land contract is treated as a financing device, then 11 U.S.C. §§ 1322(b)(2) & (5), and 1325(a)(5) controls:

### **11 U.S.C. § 1322. Contents of plan**

...

(b) Subject to subsection (a) and (c) of this section, the plan may -

...

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

...

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(c) 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; and

(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.

### **11 U.S.C. § 1325. Confirmation of plan**

(a) Except as provided in subsection (b), the court shall confirm a plan if -

...  
(5) with respect to each allowed secured claim provided for by the plan -

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder;

### **3. Indiana Law on Land Contracts—The Skendzel Case**

The first determination that must be made is whether the land sale contract is an executory contract or a financing device. In Indiana, a land sale contract is treated the same as a mortgage if the purchaser has made a substantial payment and has not abandoned the property.

Skendzel v. Marshal, 261 IN 226 (1973), was the landmark Indiana case in which the Indiana Supreme Court decided that almost every land contract should be considered as a mortgage thus making foreclosure the proper action to seek relief on the default of a land sale contract and possession as opposed to forfeiture. In Skendzel the plaintiff brought suit for possession through enforcement of a forfeiture clause of a land sale contract. Had the plaintiff prevailed, the defendant would have forfeited \$21,000 outright—well over ½ the original contract price. The court held that the \$21,000 forfeiture as a liquidated damming would be inconsistent with generally accepted principals of equity and fairness and sided with the trial court which refused to allow operation of the forfeiture clause in a land sale contract. The Supreme Court's opinion in Skendzel focuses on the similarity between a land sale contract and a mortgage stating that although they are different in form (which party holds the deed) they are very similar in substance. Therefore when it comes to default, a land contract should be treated as a mortgage wherein foreclosure, and not forfeiture, is the correct remedy.

In a more recent case, the Indiana Court of Appeals in Parker v. Camp, 656 N.E.2d 822 (Ind. App. 1995) affirmed Skendzel. In Parker, the plaintiff sought to enforce a land sale contract which allowed for forfeiture as a remedy where the vendee had paid to the vendor less than 75% of the contract purchase price. The Court in Parker held "the conduct before us permits the vendor to seek forfeiture until the vendee attains substantial equity in the property defined as 75% of the purchase price. We hold that such a provision is void as being against public policy of this state as set forth in Skendzel. Thus foreclosure rather than forfeiture is the proper remedy."

The court however recognized, as did the Skendzel Court that there are limited circumstances in which forfeiture would be the proper remedy for a default on a land contract. These include the abandoning or absconding vendee or where the vendee has paid only a minimal amount of the vendor's

security interest in the property or the vendor's security interest in the property has been endangered by the acts or omissions of the vendee.

#### **4. Indiana Bankruptcy Courts and the Land Contract—*In re Leazier***

In *In re Leazier*, 55 B.R. 870 (Bankr. N.D. Ind. 1985), a Northern District Court held that a land sale contract--accompanied by a substantial down payment by the vendee—is a financing device and not an executory contract. The Court looked to Indiana case law on the issue:

[t]he contract in the case at bar is not executory in nature. It is merely a financing device. A land contract is treated the same as a mortgage in Indiana when the purchaser has made any substantial payment and has not abandoned the property. 55 B.R. 872

#### **5. In Bankruptcy Court . . . the Particulars**

The ramification in the bankruptcy context of Indiana Courts holding land sale contracts to be security devices is that the vendee/debtor is able to treat the land sale contract as if it were a mortgage. Specifically, the vendee/debtor would be entitled to cure defaults and maintain payments pursuant to § 1322(b)(5). Most importantly, if the vendee/debtor assumes the land sale contract on which the last payment is due after the date on which the final payment under the plan is due, he has a "reasonable time to cure" the default on the contract according to § 1322(b)(5). This is in stark contrast to the "prompt" cure which must be made pursuant to § 365 if the land contract is deemed an executory contract.

Another ramification from land contracts being deemed mortgages in Indiana is that there exists a possibility of modification of the land sale contract pursuant to § 1322(b)(2). However, if the land sale contract is secured by only the real property that is vendee/debtor's principal residence the contract will be protected from modification by § 1322(b)(2) which states in relevant part that "the plan may modify the rights of holders of secured claims, *other than the claim secured only by a security interest in real property that is the debtors principal residence.*" In that case the vendee/debtor must perform consistent with that contract if he assumes it and the classic example here is found in *In re Sennhenn*, 80 B.R. 89 (Bankr. N.D. OH 1983).

In *Sennhenn*, the court held that the vendee/debtor who decided to keep the residential real property bought pursuant to a land sale contract with a balloon payment requirement, must pay that balloon payment according to the original terms of the contract.

It should be asked whether, even if the vendee/debtor is allowed pursuant to § 1322(b)(5) to modify the land sale contract, such modification is even useful to the vendee/debtor. Since the full amount of the secured claim must be paid by the vendee/debtor during the life of the plan, this may not be economically possible for a vendee/debtor.

#### **6. Land Contract as Executory Contract**

It should be understood that it is possible for the bankruptcy court in Indiana to determine that a land sale contract is an executory contract. For example, if the vendee/debtor fits within the exceptions outlined in the *Skendzel* case (the vendee/debtor has only paid a minimal amount of payments to the vendor or has abandoned or in some way harmed the rights of the vendor in the property) the vendee/debtor is left under § 365 with only the two options: assuming the land sale contract or rejecting it.

As it was discussed above, if the vendee/debtor assumes the land sale contract then the default of payments must be "promptly" cured--something that might be very difficult for a vendee/debtor to do in that position. The other option would be for the vendee/debtor to reject the land sale contract. If the vendee/debtor does reject it, it seems possible that forfeiture might be the applicable remedy for the vendor in state Court.