In the United States Bankruptcy Court

for the Northern District of Iowa

WILLIAM D. BEIER *Debtor(s).*	Bankruptcy No. 95-60437KW Chapter 13
GERALD L. HORKHEIMER *Plaintiff(s)* vs. WILLIAM D. BEIER *Defendant(s)*	Adversary No. 95-6188KW

ORDER

On February 22, 1996, the above-captioned matter came on for trial pursuant to assignment. Plaintiff Gerald Horkheimer appeared in person with Attorney Gary McClintock. Debtor William Beier appeared in person with Attorney Don Gottschalk. Evidence was presented after which the Court took the matter under advisement with briefs to be submitted by March 8, 1996. All briefs have now been submitted and the matter is ready for ruling. This is a core proceeding pursuant to 28 U.S.C. § 157 (b)(2)(G), (K), and (O).

STATEMENT OF THE CASE

Debtor filed his Chapter 13 petition on March 15, 1995. He is in possession of real property, ownership of which is in dispute. Debtor wishes to retain it as a business asset to generate income to fund the plan. Plaintiff filed this adversary (i) to obtain a determination that Debtor is a tenant, and (ii) to obtain relief from the automatic stay to terminate Debtor's rights as a tenant and to regain possession of the real property.

FINDINGS OF FACT

Plaintiff Gerald Horkheimer is a business owner and manufacturer of housing in Hazelton, Iowa. In November 1991, he leased business property on North Main Street in Hazelton to Debtor William Beier. Debtor leased this property as a building within which to hold auctions.

The lease was for a term of three years and contained an option to purchase. The option existed until termination of the lease or until expiration of the lease on January 1, 1995. This lease was received into evidence as Exhibit "C".

In January 1993, Debtor exercised the option and purchased the real property on contract for $49,500. This real estate contract was prepared by Attorney Gary McClintock and is a standard Iowa Bar form real estate contract. It was never recorded. The contract was received into evidence as Exhibit "A". In addition to normal payment terms, the contract states:

> The down payment of $5000 [is] evidenced by a promissory note executed simultaneously with this contract due and payable on July 1, 1993. In the event note and interest is [sic] not paid, Buyer shall be [in] default and will voluntarily forfeit contract back to seller.

Simultaneously with the execution of the contract, Debtor executed the $5000 promissory note to Plaintiff, which was received into evidence as Exhibit "D".

Debtor made installment payments until June or July 1994, but failed to make the $5000 promissory note payment that was due July 1993. Plaintiff testified that Debtor told him he could not pay the $5000. Plaintiff further stated that he told Debtor he "would work with him" on the $5000 note if Debtor continued to make installment payments.

After this point, the parties differ as to their interpretation of events. Plaintiff testified that he intended to strictly enforce the forfeiture clause in the contract. After the $5000 note was not paid in July 1993, he considered the real estate contract forfeited, and assumed Debtor understood this.

Plaintiff asserts that the parties agreed that Debtor was to pay rent and insurance, and Plaintiff was to pay the taxes. As Debtor remained on the property, Plaintiff characterized the continuing relationship as one of landlord/tenant. Plaintiff testified he considered Debtor's monthly payments to be lease payments, while Debtor testified he considered them to be installment contract payments. Although Debtor failed to make all monthly payments from January through July 1994, he remained in continuous possession of the property.

In September 1994, a building on the property burned and the property sustained $34,500 in damages. Although Debtor held the insurance policy on the property, he had the insurance check made out to both himself and Plaintiff in accordance with the insurance clause in the real estate contract. Debtor turned over the insurance check in the amount of $34,500 to Plaintiff in November 1994.

In a separate transaction, Plaintiff made an unrelated and independent $7000 loan to Debtor in March 1994. That loan was for purchase of personal property, i.e. hutches and tools for inventory. Debtor signed a promissory note for this loan, evidenced in Exhibit E.

Plaintiff testified that in January 1995, he contacted Debtor about renting the property during 1995 as he now considered the contract forfeited. He stated they agreed on a rental of $250 per month, and that Debtor paid the January rent. Plaintiff stated they again agreed upon a three year lease.

On January 16, 1995, Debtor allegedly told Plaintiff he wished to buy the real property. Plaintiff arrived at a sale price of $26,500, which included the $7000 loan for personal property, by subtracting from the balance due on the real estate contract (i) all credits Debtor paid previously and (ii) the insurance proceeds. Plaintiff testified that, because of Debtor's past failure to make monthly payments, they agreed that the entire amount was to be paid on the closing date of February 8, 1995. This agreement was documented and received into evidence as Exhibit "B". On February 8, 1995, Plaintiff learned that Debtor did not intend to complete the transaction. On March 15, 1995, Debtor filed his Chapter 13 petition.

Based on the foregoing, Plaintiff claims he is the owner of this real property. Plaintiff asserts it was the parties' understanding that the real estate contract would not become a completed sale until the $5000 was paid. When the $5000 was not paid, the contract became a nullity. Plaintiff maintains that he is the owner of the property, even if the contract was not a nullity, despite failing to formally forfeit the contract upon nonpayment of the $5000.

Debtor asserts that he purchased the property in January 1993. Although he did not make a down payment, he acknowledges giving Plaintiff a $5000 note. Debtor testified that he did not understand that the validity of the contract was dependent on payment of the $5000 note. He testified that even though he failed to make the $5000 payment due on July 1993, Plaintiff never asked for it, nor did Plaintiff inform him that the contract was forfeited.

Debtor testified that he endorsed the insurance check over to Plaintiff in November 1994 pursuant to a conversation in which they agreed that they would apply the proceeds to the contract balance. Debtor testified that he understood the $34,500 would be applied to the real estate contract with a portion of those proceeds satisfying the $5000 promissory note. Debtor testified that he was not aware that the original contract was not recorded.

Debtor's explanation of the January 1995 purchase agreement is that he took a third party to Plaintiff's office for the purpose of selling his interest to this third party. He testified that he understood the transaction that followed was an

attempt to sell to this third party and not a repurchase of the real property he claims he already owned.

Plaintiff argues that the original real estate contract was nullified by Debtor's failure to pay the $5000 down payment. Plaintiff asserts further that this nullification placed ownership of the real property in him and made Debtor a lessee.

Debtor argues that the original real estate contract is valid and was never forfeited. He states that his past payments and the $34,500 insurance payment were applied to the original real estate contract price and the $5000 promissory note, leaving him with substantial equity in the property.

LAND CONTRACT

Iowa law applies in determining real property rights. Chiu v. Wong, 16 F.3d 306, 309 (8th Cir. 1994); In re N.S. Garrott & Sons, 772 F.2d 462, 466 (8th Cir. 1985). In Iowa, the installment land contract is a commonly used method to buy land through credit. Iowa follows the English rule that execution of a real estate contract gives the vendee equitable title in the estate from the date of sale. O'Brien v. Paulson, 186 N.W. 440, 441 (Iowa 1922). The vendee sustains any losses that occur between the date of sale and actual conveyance of legal title. Id. Similarly, the vendee reaps any appreciation in the value of the land. The vendor retains legal title to the land as security for payment of the debt. Rector v. Alcorn, 241 N.W.2d 196, 200 (Iowa 1976); In re Bolton, No. L-90-02191D, slip op. at 10 (Bankr. N.D. Iowa May 30, 1991). The original contract between Plaintiff and Debtor is a real estate contract.

The contract was not recorded by either party. Iowa Code section 558.41 provides that "[a]n instrument affecting real estate is of no validity against subsequent purchasers for a valuable consideration, without notice ... unless the instrument is filed and recorded in the county in which the real estate is located, as provided in this chapter." Iowa Code § 558.41 (1995). The fact that a contract is unrecorded, however, does not affect its validity between the parties to the contract. Knapp v. Baldwin, 238 N.W. 542, 544 (Iowa 1931); In re Mason, 189 B.R. 932, 937 (Bankr. N.D. Iowa 1995).

This Court concludes that the recording status of this original real estate contract conveying Plaintiff's real property to Debtor is irrelevant. No subsequent purchaser is involved in this dispute. Under existing law, the contract is valid as between the parties to the contract.

CONDITION PRECEDENT

Plaintiff asserts that payment of the $5000 promissory note was a condition precedent to formation of the original real estate contract.

Conditions precedent ... are those facts and events, occurring subsequent to the making of a valid contract, that must exist or occur before there is a right to immediate performance, before there is a breach of contract duty, before the usual judicial remedies are available.

In re Allen, 135 B.R. 856, 864-65 (Bankr. N.D. Iowa 1992) (quoting Mosebach v. Blythe, 282 N.W.2d 755, 759 (Iowa App.1979) (quoting 3A Corbin on Contracts, § 628 at 16 (1960))).

Whether a condition precedent exists depends upon the intent of the parties as evidenced by the contract document. Allen, 135 B.R. at 865. This intent is gleaned from the entire instrument, rather than from specific words in the instrument, and it should be construed as comprising promises rather than conditions. Allen, 135 B.R. at 865 (citing Restatement 2d of Contracts § 227(2) and cmt.d).

It is the conclusion of this Court that Debtor's payment of the $5000 note did not constitute a condition precedent to formation of the contract. When the Court applies the inference construing the terms of the contract as promises, rather than conditions, the language of the entire contract points unmistakably to the parties' intention of making the $5000 note a promise. Paragraph one of the contract, for example, lists the purchase price of the real estate as $49,500, "of which Five thousand dollars has been paid" as a down payment. Even though the $5000 down payment was rendered in the form of a promissory note, there is no language making the contract contingent upon actual payment of the note.

Further support that neither party considered the $5000 note necessary to complete this contract is derived from Debtor's continuing possession of the land and Plaintiff's oral promise to "work with" Debtor on repayment of the note even though the validity of such an oral promise is questionable.

It is the conclusion of this Court that Plaintiff's claim that payment of the $5000 down payment constituted a condition precedent to formation of the contract is without merit both factually and legally. The contract was valid from the date of its execution.

FORFEITURE

Plaintiff contends that the real estate contract was forfeited when Debtor breached the contract by failing to pay the $5000 note and failing to make continuous payments on the installment contract. While the note and contract were materially breached when payments were not timely made, this renders the contract voidable rather than void. Lakeland Tool & Engineering v. Thermo-Serv, 916 F.2d 476, 480 (8th Cir. 1990); Audubon County v. Am. Emigrant Co., 40 Iowa 460, 465 (Iowa 1875). Voidable contracts remain in existence, are valid, and are binding until avoided by the party entitled to do so.

When a vendee breaches a real estate contract by defaulting on payments, the vendor can: (1) retain the real estate and sue for damages; (2) rescind the entire contract; (3) forfeit the contract; or (4) seek specific performance. Abodeely v. Cavras, 221 N.W.2d 494, 497-98 (Iowa 1974). These four remedies essentially provide two alternatives: (i) proceeding under the contract or (ii) terminating it. Abodeely, 221 N.W.2d at 498.

The real estate contract between Plaintiff and Debtor was breached by (i) Debtor's failure to pay the $5000 promissory note for the down payment and (ii) his failure to make continuous installment payments on the contract. These failures rendered the real estate contract voidable. At that point, the seller had the option to proceed under the contract or terminate it. Mr. Horkheimer testified that he chose to terminate the contract.

To terminate a voidable contract, it is necessary to take affirmative steps pursuant to Iowa forfeiture law. Forfeitures in Iowa are regarded with disfavor, and courts favor contract interpretations that do not involve forfeiture. Gottschalk v. Simpson, 422 N.W.2d 181, 185 (Iowa 1988). Forfeiture of a real estate contract can only be accomplished pursuant to Iowa Code Chapter 656. Iowa Code § 656.1 (1995). Iowa Code section 656.2 states that the vendor initiates forfeiture by serving the vendee with written notice that:

> a) reasonably identifies the contract and accurately describes the covered real estate;
>
> b) specifies the contract terms with which the vendee did not comply;
>
> c) states that the contract will be forfeited, unless within 30 days after service of the notice is complete the vendee performs the terms in default and pays the reasonable costs of service.
>
> d) specifies the vendor's attorney costs pursuant to § 656.7 and states that payment of the attorney fees is not required to comply with the notice and prevent forfeiture.

Iowa Code § 656.2 (1995).

Plaintiff did not comply with the forfeiture process required by Chapter 656. Debtor defaulted on the note and the real estate contract. The contract contained a forfeiture clause. Plaintiff, however, did not give written notice of forfeiture to Debtor as required by section 656.2. Therefore, the real estate contract was not legally forfeited and remains in effect.

EXECUTORY CONTRACTS IN IOWA

Through his amended chapter 13 plan filed October 25, 1995, Debtor is attempting to assume this valid, non-forfeited real estate contract as an executory contract under 11 U.S.C. § 365. Under the amended plan section entitled "Secured Creditors * Real Estate," there is no monetary value listed for the debt owed to Plaintiff as Plaintiff has yet to submit a

claim.

Executory contracts are not defined in the Bankruptcy Code. In re Scanlon, 80 B.R. 131, 132 (Bankr. S.D. Iowa 1987). Case law, however, has developed a test to determine whether a contract is executory under § 365. This test, derived from Professor Vern Countryman's definition of executory contracts and the equivalent standard adopted by the Supreme Court in NLRB v. Bildisco & Bildisco, 465 U.S. 513, 522 (1984), provides that an executory contract is "a contract under which the obligations of both the [debtor] and the other party to the contract are so unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." In re Bockes Brothers, Inc., Adv. No. 93-60881KW, slip op. at 1-2 (Bankr. N.D. Iowa Apr. 4, 1994).

To determine the federal question of whether a real estate contract is executory or nonexecutory, this Court and others utilize the Countryman/Bildisco standard. In re Hill, No. C 86-0115, slip op. at 3 (N.D. Iowa Jan. 14, 1987); Scanlon, 80 B.R. at 133. Using the following rationale, they conclude that Iowa real estate contracts are executory:

> Applying Professor Countryman's definition to Iowa real estate contracts, it is clear that the obligation of the real estate vendor to deliver legal title to the vendee upon final payment would be excused by the vendee's failure to complete the contract payments (citation omitted). Although in Iowa a real estate contract of this type enables the vendor to be secured until final payment is made, it is still an executory contract under Countryman's definition since ... the failure of either to complete performance would constitute a material breach excusing performance of the other.

Hill, slip op. at 3; Bockes Brothers, Adv. No. 93-60881KW, slip op. at 1.

Section 365 of the Bankruptcy Code provides the conditions under which a trustee or a debtor in possession may assume or reject an executory contract or an unexpired lease. 11 U.S.C. § 365 (1996). As this petition is brought under Chapter 13, § 365(d)(2) applies and provides that:

> [i]n a case under chapter 9, 11, 12, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of residential real property ... of the debtor at any time before the confirmation of a plan but the court, on the request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

11 U.S.C. § 365(d)(2) (1996).

The original January 1993 real estate contract between Plaintiff and Debtor is executory. Debtor is permitted under § 365(d)(2) to elect to assume the contract. Debtor has elected to assume the contract in his Chapter 13 Plan. Therefore, the real estate contract remains valid and in effect.

JANUARY 1995 PURCHASE AGREEMENT

Plaintiff and Debtor executed a "Purchase Agreement" in January 1995 concerning the same real estate covered by the original real estate contract executed in January 1993. The consideration for this Purchase Agreement included the remaining balance Debtor owed on the original real estate contract plus the balance due on the unrelated $7000 promissory note given in March 1994.

Debtor asserts that the purpose of this Purchase Agreement was to sell his interest in the real estate to a third party. Plaintiff, however, maintains that the purpose of the Purchase Agreement was to allow Debtor to purchase the same real estate he failed to purchase under the original real estate contract. The Court, however, has now concluded that the original real estate contract is still valid. Therefore, the impact of this January 1995 Purchase Agreement is now in question.

It is possible, based on this record, to surmise alternatively that the parties intended 1) to enter into a novation of the existing contract to purchase the property, 2) to sell the property to a third party, 3) to modify the original contract, or 4) to rescind the original land contract. Such an exploration, however, would ultimately prove to be useless as the parties

testified to their intent. Absent evidence of some other meeting of the minds, this Court cannot conclude that their intent was different than that revealed in their testimony.

The agreement was executed in January of 1995 and contained a "time is of the essence" clause. The parties did not complete performance under the agreement. Debtor failed to pay the balance of the original real estate contract and the $7,000 promissory note by February 8, 1995. This failure on the part of Debtor was followed by Plaintiff's resulting failure to convey legal title to the real estate when he did not receive payment. As a result, both parties failed to perform under this agreement and the contract, by its own terms, has terminated. It is ultimately the conclusion of this Court that the only valid contract between Plaintiff and Defendant is the real estate contract executed between Plaintiff and Defendant in January of 1993.

SUMMARY

In summary, it is the conclusion of this Court that the parties entered into a valid real estate contract in January of 1993 in which Mr. Beier purchased business property described in these proceedings from Mr. Horkheimer. This Court concludes that there were no conditions precedent to the formation of the land contract. The contract was properly executed and effective as of the date of execution.

Mr. Beier materially breached the contract by failing to pay the $5000 promissory note and failing to make all payments under the installment contract. At that point, Mr. Horkheimer had the legal authority to forfeit the contract. However, forfeiture of a land contract requires compliance with provisions of Chapter 656 of the Iowa Code. Mr. Horkheimer did not comply with these provisions. The contract signed in January of 1995 is of no legal significance to the ultimate conclusions of this Court.

It is the conclusion of this Court that the original real estate contract remains in effect. The real estate in question constitutes an asset of the estate and, on the basis of this record, appears to have substantial equity. This is an executory contract and is subject to the provisions of 11 U.S.C. § 365. As the property potentially has substantial equity, the motion to modify the stay, under this record must be denied.

WHEREFORE, for all of the reasons set forth herein, it is the determination of this Court that the real estate contract entered into between Plaintiff and Defendant in January of 1993 remains in effect.

FURTHER, based on the existence of this valid real estate contract, Debtor, William D. Beier, is the owner of this property subject to the rights of Seller, Gerald L. Horkheimer, under that contract.

FURTHER, the Motion to Modify Stay filed by Mr. Horkheimer is denied for the reasons set forth in this ruling.

FURTHER, the real estate in question, as an asset of Debtor's estate, shall be administered in this Chapter 13 Petition according to the Bankruptcy Code.

SO ORDERED this 11th day of April, 1996.

Paul J. Kilburg
U.S. Bankruptcy Judge