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The Bankruptcy Code's Missing Link: How the Undefined "Executory Contract" Quandary is Leaving Land Sales and Bankruptcy Courts in Limbo

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The Bankruptcy Code’s Missing Link: How the Undefined “Executory Contract” Quandary is Leaving Land Sales and Bankruptcy Courts in Limbo

ABBY PONDER*

Arguably the most convoluted concept lurking within bankruptcy law is that of the “executory contract” which may be found within section 365 of the bankruptcy code. Since its inception in 1978, this section has been dubbed one of the most “psychedelic” areas of American jurisprudence. The phantasmagoric nature of this section largely derives from Congress declining to provide a definition within the Code for executory contracts. Already rife with confusion and contradiction, the missing definition of executory contract, which comes under section 365, represents a significant “missing link” of understanding for bankruptcy courts in ruling on land sale contracts. Bankruptcy judges nationwide have struggled to make sense of this area of law with scant jurisprudential support. Sale of land contracts within bankruptcy courts thus creates a particularly unique issue wherein circuits and bankruptcy courts alternate between concluding that such sales represent executory contracts, or that they constitute land security devices immune from the reach of section 365. While benefits exist to adopting either interpretation, on balance, treating land sale contracts as security devices presents the more equitable solution. The two camps of logic that courts rely upon, however, pose a more interesting issue. Bankruptcy is under federal jurisdiction and within our Constitution, is a power granted to Congress to create, “uniform Laws on the subject of Bankruptcies throughout the United States.” Treating sale of land contracts differently depending on the state in which the bankruptcy court sits is an unsatisfactory and unsustainable strategy. It also flies in the face of what our Framers of the United States Constitution intended for bankruptcies. At the same time, though preferable to the alternative, treating land sale contracts as security devices would not wholly

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fix the problem but would at least take the issue out of the hands of section 365. Anything less than Congress taking back the reins on section 365 and carving out a niche within the bankruptcy code for sale of land contracts would be akin to placing a Band-Aid over a bullet hole.

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I. INTRODUCTION

Imagine yourself to be in dire need of securing a home for you and your family, and perhaps, aspiring to have your own taste of the American dream by owning your own home. But unfortunately, you have no experience in purchasing property. You have neither the income nor the credit necessary to secure a traditional preapproval for a mortgage. You exhaust all of your options and eventually find yourself having to utilize other forms of financing, that of the installment sale of land contract. As this is your only chance to buy a home, you take this route as a last resort. But though you are able to secure the property through this avenue, you run into substantial obstacles with the property. The roof is in abysmal condition, the plumbing system is in severe disrepair, and to top it off, the heating system does not work. You have strained your already modest finances by taking on these repairs. Paying for the repairs alongside the monthly payments for the property finally overcome you, and you find yourself filing for bankruptcy.

That is the situation the debtor faced in *In re Fox*.¹ The debtor, a single parent of five children, was desperate to find a home for her large family.² She executed an agreement for a sale of land large enough to accommodate her family, but also that seemed, at least on the surface, reasonably affordable.³ Unbeknownst to the debtor, a novice in real estate, the property presented significant habitability issues: it lacked an operable heating system; the roof was in very poor condition; and serious malfunctions plagued its plumbing.⁴ Unsurprisingly, the debtor had to resort to filing for bankruptcy.⁵ The crux of the bankruptcy case centered around whether the debtor could treat the installment land sale contract she entered into as akin to a purchase-money mortgage, or if the debtor's transaction had to be treated as an executory contract under section 365 of the bankruptcy code.⁶ If the latter were to occur, the sale of land installment contract would be treated as an executory contract under section 365 of the bankruptcy code and the debtor in *In re Fox* would lose her residence and all the money she had paid into the sale agreement.⁷ The bankruptcy court, to its credit in this case, mainly focused on equity.⁸ The principal equitable equation involved not depriving this single working mother of several children, of her residence.⁹ The court acknowledged 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 as a basis to deprive a consumer-debtor of a residence."¹⁰ Still the court was faced with the difficulty of deciding whether the debtor's sale of land contract should be treated as a security device, which would spare her property, or if it should be treated as an executory contract, which would deprive her of her residence.¹¹ In the end, the court looked to Pennsylvania statutory law, common law, and case law, eventually arriving to the conclusion that the debtor's installment land sale contract was a security device, and not an executory contract.¹² This decision removed the residence from the reach of the bankruptcy provision and is what allowed the debtor to be able to keep her home.¹³

Most would agree that this is a desirable outcome; it is a legitimately equitable outcome. But the truth is that this outcome, however desirable, is

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1. See *In re Fox*, 83 B.R. 290 (Bankr. E.D. Pa. 1988).
 2. *In re Fox*, 83 B.R. 290, 293 (Bankr. E.D. Pa. 1988).
 3. See *id.*
 4. *Id.*
 5. *Id.* at 290.
 6. *Id.* at 290-91.
 7. *In re Fox*, 83 B.R. at 294.
 8. See *id.*
 9. *Id.*
 10. *Id.*
 11. *Id.*
 12. *In re Fox*, 83 B.R. at 298.
 13. See *id.* at 294-95.

not guaranteed within bankruptcy law. Bankruptcy courts and federal appellate courts severely diverge on this issue.¹⁴ On the one hand, some courts treat sale of land contracts as secured devices, that evade the reach of section 365, as was showcased in *In re Fox*. On the other hand, some courts treat sale of land contracts as executory contracts that must be assumed or rejected in bankruptcy. As illustrated in *In re Fox*, the difference in treatment may have a court reaching a substantially different conclusion, which could adversely impact debtors and their property. Whether a court chooses the former (secured device), or the latter (executory contract), for a sale of land contract really hinges on the state in which the bankruptcy court sits. Meaning, had the debtor in *In re Fox* filed somewhere other than Pennsylvania, she likely would not have been able to keep her family home.

These contrasting theories are what will be explored in this comment. But further, and more intriguingly, the quandary of whether bankruptcy courts should be forced to grapple with these different state law interpretation theories, which results in a lack of uniformity in bankruptcy law across the country. Which in its essence, laughs in the face of the purpose of our Founders making bankruptcy a federal issue. Equity and justice call for the secured

14. See *In re Health Sci. Prods.*, 183 B.R. 903, 936 n.45 (Bankr. N.D. Ala. 1995); Courts that find that sale of land contracts are executory contracts. *In re Frontier Props., Inc.*, 979 F.2d 1358, 1365 (9th Cir. 1992); *In re Aslan*, 909 F.2d 367, 371 (9th Cir. 1990); *In re Terrell*, 892 F.2d 469, 473 (6th Cir. 1989); *Brown v. First Nat'l Bank in Lenox*, 844 F.2d 580, 582 (8th Cir. 1988); *In re Speck*, 798 F.2d 279, 280 (8th Cir. 1986); *In re Cochise Coll. Park, Inc.*, 703 F.2d 1339, 1347 (9th Cir. 1983); *In re Rancho Chamberino, Inc.*, 89 B.R. 597, 600 (Bankr. W.D. Tex. 1987); *In re Dunes Casino Hotel*, 63 B.R. 939, 949 (Bankr. D.N.J. 1986); *Shaw v. Dawson*, 48 B.R. 857, 861-62 (D.N.M. 1985); *In re Von Keisler*, 166 B.R. 620, 621 (Bankr. N.D. Tex. 1994); *In re Churchill Props. VIII Ltd. P'ship*, 164 B.R. 607, 611 (Bankr. N.D. Ill. 1994); *In re Delex Mgmt.*, 155 B.R. 161, 164 (Bankr. W.D. Mich. 1993); *In re Seymour*, 144 B.R. 524, 530 (Bankr. D.Kan. 1992); *In re Raby*, 139 B.R. 833, 835 (Bankr. N.D. Ohio 1991); *In re Pogue*, 130 B.R. 297, 299 (Bankr. E.D. Mo. 1990); *In re Larsen*, 122 B.R. 733, 741 (Bankr. D.S.D. 1990); *In re Bellamah Comty. Dev.*, 107 B.R. 337, 342 (Bankr. D.N.M. 1989); *In re Coffman*, 104 B.R. 958, 963 (Bankr. S.D. Ind. 1988); *In re Henke*, 84 B.R. 693, 698 (Bankr. D.Mont. 1988); *In re Scanlan*, 80 B.R. 131, 135 (Bankr. S.D. Iowa 1987); *In re W & L Assoc., Inc.*, 71 B.R. 962, 966 (Bankr. E.D. Pa. 1987); *In re Buchert*, 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987); *In re Waldron*, 65 B.R. 169, 172 (Bankr. N.D. Tex. 1986); *In re McCallen*, 49 B.R. 948, 952 (Bankr. D.Or. 1985); *In re Hawaii Daiichi-Kanko, Inc.*, 24 B.R. 163, 166 (Bankr. D.Haw. 1982) [hereinafter *Camp of Logic One*].

For courts that find that sale of land contracts are more of a security device and not an executory contract, see *Heartline Farms, Inc. v. Daly*, 934 F.2d 985, 986 (8th Cir. 1991); *In re Sts. & Beard Farm P'ship*, 882 F.2d 233, 234 (7th Cir. 1989); *Frank Seitzinger Farms, Inc. of Iowa v. Waller*, 67 B.R. 869, 872 (Bankr. D.S.D. 1986); *In re Thurmond*, 46 B.R. 723, 724 (Bankr. D.Or. 1985); *In re Adolphsen*, 38 B.R. 780, 780-81 (Bankr. D.Minn. 1983); *In re McDaniel*, 89 B.R. 861, 875 (Bankr. E.D. Wash. 1988); *In re Eldorado, Inc.*, 85 B.R. 555, 557 (Bankr. D.Mont. 1987); *In re Fox*, 83 B.R. 290, 298 (Bankr. E.D. Pa. 1988); *In re Faiman*, 70 B.R. 74, 76-77 (Bankr. D.N.D. 1987); *In re Lemons & Assoc., Inc.*, 67 B.R. 198, 216 (Bankr. D.Nev. 1986); *In re Bertelsen*, 65 B.R. 654, 657 (Bankr. C.D. Ill. 1986); *In re Murtishi*, 55 B.R. 564, 569 (Bankr. N.D. Ill. 1985); *In re Jones*, 54 B.R. 697, 700 (Bankr. E.D. Ark. 1985); *In re Cox*, 28 B.R. 588, 591 (Bankr. D.Idaho 1983) [hereinafter *Camp of Logic Two*].

device camp of logic to prevail as the superseding theory. However, even this is simply putting a Band-Aid on a bullet hole. For bankruptcy law to be as our Founders intended, Congress must take back the reins to bring uniform clarity to bankruptcy law across all fifty states.

First, this comment will explore the background of bankruptcy law, its functions, and the executory contract provision. Next, the comment will examine the split of authority on the issue, which fall into two camps of logic. Here, the comment will demonstrate the reason that the secured device camp of logic is more equitable. And finally, it will be argued that while the secured device route can temporarily fix the problem, Congress needs to reclaim its role, empowered by the Uniformity Clause of the Constitution, and amend the bankruptcy code in order to bring back uniformity to this area and prevent the inequity of equally situated debtors from receiving differing results in bankruptcy, based merely on geography.

II. BACKGROUND ON BANKRUPTCY LAW, GENERAL BANKRUPTCY LAW FUNCTIONS, AND EXECUTORY CONTRACTS

A. BIRTH OF BANKRUPTCY LAW

Bankruptcy has deep roots in our nation's history. Being insolvent or encountering economic instability is not a new trend of the twenty-first century. Before our nation's founding, bankrupt people in colonial America were regularly imprisoned and were classified as criminals.¹⁵ The slogan of the time was, "Let the borrower beware. Do not borrow recklessly, and repay what you owe."¹⁶ Derived from English influences and in colonial and early America, creditors really had only two main avenues of collecting unpaid debts: 1) a creditor could proceed against a debtor's assets; or 2) a creditor could proceed against a debtor's person.¹⁷ Due to a variety of reasons in our nation's early years, the former was rarely used.¹⁸ Far more often instead, a defaulting debtor was thrown into a debtor's prison.¹⁹ Through a medley of bankruptcy laws and private bills, the colonies managed to furnish a shoddy system for bankruptcy relief.²⁰ In the colonies, the domestic bankruptcy and

15. *The Evolution of U.S. Bankruptcy Law*, FED. JUD. CTR., U.S. COURTS, https://www.rib.uscourts.gov/newhome/docs/the_evolution_of_bankruptcy_law.pdf [<https://perma.cc/2HGC-UKR7>].

16. PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900* 5 (The State Historical Society of Wisconsin ed., 1974).

17. Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE W. RESV. L. REV. 319, 327 (2013) (discussing early colonial methods of bankruptcy law).

18. *Id.*

19. *Id.*

20. *Id.* at 337.

insolvency issues were governed by the laws of each colony.²¹ Individual “colonial legislatures [also] passed . . . bills that discharged individual debtors.”²² These early laws really “lacked the collective nature of bankruptcy” as was seen in England at the time, as well as in the United States today.²³ Following the colonies gaining independence from England, bankruptcy laws remained within the power of the newly sovereign states.²⁴ Each state was allowed to define creditor rights, provided separate rules for enforcing debt contracts, and had concepts on how much, or how little, relief could be granted.²⁵ This “meant that anyone [who was] engaged in far-ranging ventures, . . . maritime trade, back-country commerce, land speculation, manufacturing for regional markets, or buying and selling across state lines” had to keep the different laws in mind when conducting themselves.²⁶ If a person lent money or sold on credit, they knew that if their debtor became insolvent they might be repaid only a fraction of what they are owed.²⁷ Enacting national bankruptcy laws was the obvious solution.²⁸

The Articles of Confederation did not lay out any framework for bankruptcy nor empowered Congress to be able to establish uniform federal bankruptcy laws.²⁹ That was until the ratification of the United States Constitution in 1787.³⁰ Article I, section 8 of the United States Constitution authorizes Congress to establish uniform bankruptcy laws across our nation.³¹ Throughout our history, the laws governing bankruptcy have taken many forms.³² But the current state of bankruptcy law lies within Title 11 of the United States Code.³³ A provision of the bankruptcy code that will be a focal point of this paper is 11 U.S.C. § 365. Section 365 has been in place since 1978,³⁴ which kicked off a lot of uncertainty that surrounds bankruptcy law because it is the home of the illusive concept of the executory contract.

21. *ArtI.S8.C4.2.2 Historical Background on Bankruptcy Clause*, CONST. ANNOTATED, https://constitution.congress.gov/browse/essay/artI-S8-C4-2-2/ALDE_00013181/ [<https://perma.cc/FL7W-G2MB>].

22. *Id.*

23. Lubben, *supra* note 17, at 337.

24. *ArtI.S8.C4.2.2 Historical Background on Bankruptcy Clause*, CONST. ANNOTATED, https://constitution.congress.gov/browse/essay/artI-S8-C4-2-2/ALDE_00013181/ [<https://perma.cc/FL7W-G2MB>].

25. COLEMAN, *supra* note 16, at 16.

26. COLEMAN, *supra* note 16, at 16.

27. COLEMAN, *supra* note 16, at 16.

28. COLEMAN, *supra* note 16, at 16.

29. *ArtI.S8.C4.2.2 Historical Background on Bankruptcy Clause*, CONST. ANNOTATED, https://constitution.congress.gov/browse/essay/artI-S8-C4-2-2/ALDE_00013181/ [<https://perma.cc/FL7W-G2MB>].

30. *Id.*

31. *The Evolution of U.S. Bankruptcy Law*, *supra* note 15.

32. *See The Evolution of U.S. Bankruptcy Law*, *supra* note 15.

33. *See* 11 U.S.C. §§ 101-1532.

34. 11 U.S.C. § 365.

B. WHAT IS AN EXECUTORY CONTRACT IN BANKRUPTCY LAW

The proponent of all of this trenchant controversy is within 11 U.S.C. § 365 of the United States Code.³⁵ 11 U.S.C. § 365 reads “(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.”³⁶ Nowhere within Title 11 does the legislature then define what constitutes an “executory contract.”³⁷ This lack of definition is why scholars have said that “no area of bankruptcy has the law become more psychedelic than in the one titled ‘executory contracts.’”³⁸ Without a definition, bankruptcy courts are left grasping for straws, i.e. past precedents to find analogies, state laws, and general decisions within the state the court sits, in order to further its analysis on a particular issue. “It is an area of the law described as a ‘thicket . . . where . . . lurks a hopelessly convoluted and contradictory jurisprudence.’”³⁹ This oversight by Congress has effectively left a missing link in bankruptcy interpretation. This can be shown by the legislative history underlying 11 U.S.C. § 365. The legislative history states:

Though there is no precise definition of what contracts are executory, it generally includes contracts on which performance remains due to some extent on both sides. A note is not usually an executory contract if the only performance that remains is repayment. Performance on one side of the contract would have been completed and the contract is no longer executory.⁴⁰

While this seems to be an explanation for what Congress intended to be included as executory contracts, this legislative history does not give much guidance to judges to interpret when and what is an executory contract. Generally, what can be taken from this is an executory contract is meant to be a contract in which performance by the parties remains on both sides of the contract at the time of filing for bankruptcy. Which exists to some extent in all contracts. That is the purpose of entering into a contract: two parties exchange promises of performance. This leaves the insight from the legislature

35. *Id.*

36. *Id.*

37. *See id.*

38. U.S. Dep’t of Just., Civ. Res. Manual, § 59 (quoting *In re Drexel Burnham Lambert Grp., Inc.*, 138 B.R. 687, 690 (Bankr. S.D.N.Y. 1992)).

39. *Id.*

40. S. REP. NO. 95-595, at 58 (1978).

not very helpful for a court trying to determine if something is or is not an executory contract.

The legislative history does give some insight into saying that a note is not executory because the only performance that remains for a party is repayment of the note.⁴¹ The logic here is that the performance of one party has been completed and all that is left for the other party to do is repay.⁴² This seems simple. But as will be discussed further, this is actually quite convoluted. When talking about sale of land contracts, is there truly nothing left for a party to do but pay the amount under the contract for a term of years? Or is it more complicated because once one party pays the entire sum under the contract the other party then turns over the deed to the property? This legislative history really gives no additional guidance when dealing with executory contracts and many bankruptcy court judges point this out within their analysis of particular sale of land contract issues.⁴³

C. PROFESSOR COUNTRYMAN'S TAKE ON EXECUTORY CONTRACTS

Without a definition for executory contracts, Professor Vern Countryman attempted to clear up some of the confusion in his works *Executory Contracts in Bankruptcy: Part I and Part II*.⁴⁴ Like most scholars, Professor Countryman saw a legal problem and attempted to offer his thoughts on a solution. His article was published in 1973 and has had sweeping influence ever since. Countryman's definition of executory contracts has subsequently been widely accepted amongst bankruptcy courts throughout our nation.⁴⁵ It is very rare that you will read a court opinion regarding the interpretation of section 365 where the court will not cite to, reference, or adopt Professor Countryman's definition of executory contracts.⁴⁶ His definition is reminiscent of the legislative history but gives space for judges to do more practical application. First, Professor Countryman cites Samuel Williston, an influential lawyer and law professor in his own right, who wrote "[a]ll contracts to a greater or less extent are executory. When they cease to be so, they [also] cease to be contracts."⁴⁷ Professor Countryman notes, however, that this definition is far too expansive for the uses of the Bankruptcy Act.⁴⁸ But

41. *Id.*

42. *See id.*

43. *See id.* at 567.

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

45. *See* Camp of Logic One, *supra* note 14; *see also* Camp of Logic Two, *supra* note 14.

46. *See* Camp of Logic One, *supra* note 14; *see also* Camp of Logic Two, *supra* note 14.

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

48. *Id.*

Professor Countryman's definition when adhered to in its strictest form has a similar result. Professor Countryman's definition of executory contracts is as follows: "a contract under which the obligation[s] 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 the performance of the other."⁴⁹ Professor Countryman, more importantly, notes that the executory contract concept should be exercised when it will benefit the debtor's estate.⁵⁰ Countryman, after proposing his seminal definition, goes on in his article to comment on whether a sale of land installment contract is an executory contract within the terms of the Bankruptcy Act.⁵¹ Countryman observes: "Certainly a contract under which the vendee still owes a material part of the purchase price and the vendor has not transferred title, and is not obligated to do so until that price is fully paid, is an executory contract."⁵² And,

The fact that the vendor as a part of the bargain has executed and placed with the escrow agent the formal documents necessary to effect a transfer of title likewise should not alter the result where the vendee is not entitled to have the transfer effected until payments are completed.⁵³

Therefore, under the widely accepted Countryman definition, sale of land contracts would be considered executory contracts.⁵⁴

Another professor, which the court in *In re McDaniel* found persuasive, has a different take on sale of land contracts and whether or not they are executory.⁵⁵ Linda Hume, in her article *Real Estate Contracts and the Doctrine of Equitable Conversion in Washington: Dispelling the Ashford Cloud*, powerfully asserts that the installment land contract is the "poor man's mortgage."⁵⁶ And as alluded to, Hume points out that the installment contract is a financing device that is "virtually identical . . . to [a] common-law mortgage."⁵⁷ Historically, installment land contracts were utilized when

49. *Id.* at 460.

50. *Id.* at 450.

51. Countryman, *supra* note 44, at 450; *see also In re McDaniel*, 89 B.R. 861, 870 (Bankr. E.D. Wash. 1988).

52. Countryman, *supra* note 44, at 469; *see also In re McDaniel*, 89 B.R. 861, 870 (Bankr. E.D. Wash. 1988).

53. Countryman, *supra* note 44, at 469; *see also In re McDaniel*, 89 B.R. 861, 870 (Bankr. E.D. Wash. 1988).

54. *See* Countryman, *supra* note 44, at 469.

55. *See In re McDaniel*, 89 B.R. at 871.

56. Linda S. Hume, *Real Estate Contracts and the Doctrine of Equitable Conversion in Washington: Dispelling the Ashford Cloud*, 7 SEATTLE U. L. REV. 233, 233 (1984).

57. *Id.* at 245.

institutional funds were not attainable for either buyer or seller;⁵⁸ resulting in stigma for this instrument regardless of its similarities to a mortgage.⁵⁹ Hume, cited in *In re McDaniel*, states that the, “[c]onfusion results from the failure to distinguish between the installment contract, wherein seller retains legal title as security for performance, and the marketing or earnest money contract, wherein the parties intend that title will be transferred to the buyer after a short closing period.”⁶⁰ In Hume’s opinion an “installment contract resembles a mortgage because it divides the incidents associated with property ownership between the parties to the contract.”⁶¹ Treating the real estate installment contract as a security device or like a lien, rather than an executory contract, actually increases the value of the debtor’s estate and helps to facilitate rehabilitation.⁶² Which, admittedly, within Countryman’s own article, he articulated should be the main objective of the executory contract principle.⁶³ Meaning, if it is better for the bankrupt estate to treat a sale of land contract as a security device, rather than an executory contract, to better the estate itself, it should, arguably, be prioritized.⁶⁴

Unfortunately, Hume’s understanding of sale of land contracts is not what bankruptcy courts religiously turn to for its interpretations. Through the building of precedent upon adoption of his definition, Professor Countryman’s theory is what courts currently abide by. Judges have taken what would otherwise be mere scholarship and endowed it with the power of the weight of law. Unless the legislature becomes so inclined to define executory contracts itself, this is the definition we seem to be stuck with. And consequentially, the strict application of this definition renders nearly all agreements executory, because it is rare there is an agreement that does not have some unperformed obligations on either side.⁶⁵ As will be discussed further, treating sale of land contracts as executory contracts can result in inequitable results.

D. WHAT EXECUTORY CONTRACTS TURN ON

1. Assumption

When a contract is assumed in bankruptcy, the contract is allowed to continue operating and does not change any of the obligations of the parties

58. *Id.* at 233.

59. *See id.* at 245.

60. Hume, *supra* note 56, at 234, *quoted in In re McDaniel*, 89 B.R. 861, 871 (Bankr. E.D. Wash. 1988).

61. Hume, *supra* note 56, at 234, *quoted in In re McDaniel*, 89 B.R. at 871.

62. *In re McDaniel*, 89 B.R. at 872.

63. Countryman, *supra* note 44, at 450.

64. *See* Countryman, *supra* note 44, at 450.

65. *See* Countryman, *supra* note 44; *see also In re Sts. & Beard Farm P’ship*, 882 F.2d 233, 235 (7th Cir. 1989).

under the contract.⁶⁶ Exceptions are provided in the bankruptcy code which are: (1) allow the debtor to make defaults; (2) allow the debtor to ignore ipso facto clauses; and (3) allow the debtor to resume contractual obligations if statutory tests are met.⁶⁷ A debtor who assumes an executory contract has to assume the contract in its entirety.⁶⁸ A debtor cannot assume in part or reject in part.⁶⁹ This means the burdens and benefits of the contract must be taken on; the debtor has to continue performing the contract as if the bankruptcy court never intervened.⁷⁰ One thing that the assumption of an executory contract triggers is “an administrative expense status for all obligations under the contract.”⁷¹ This is true regardless of if the expenses arose pre- or post-bankruptcy petition.⁷² Administrative expenses include “liabilities [that flow] from the rejection of a previously assumed executory contract.”⁷³

To assume an executory contract, it is done by motion by either the trustee or debtor-in-possession.⁷⁴ The motion can be objected to by the “creditor,” i.e., the person on the other side of the executory contract.⁷⁵ And the assumption of the contract is always subject to court approval.⁷⁶ The proceeding for a motion to assume is not akin to normal trials; there is no lengthy trial nor long discovery process.⁷⁷ It is merely a summary proceeding where the court will establish a “likelihood of success” standard, which, in layman’s terms, is the court balancing tentative concerns about defaults and claims that could arise from the assumption.⁷⁸ The debtor bears the burden to persuade the court that the contract is, itself, subject to assumption, but also that all the requirements of section 365 are met.⁷⁹ The non-debtor party usually has to prove if there are any defaults; but the burden will then shift back to the debtor party to prove that they can adequately cure those defaults.⁸⁰

These decisions are not only final but will also have to pass the “business judgment” analysis done later.⁸¹ The “business judgment standard” is when “[b]ankruptcy courts must [either] approve a debtor’s decision to assume or reject an executory contract ‘unless there is bad faith or a gross abuse

66. U.S. Dep’t of Just., Civ. Res. Manual, § 60.

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *See* U.S. Dep’t of Just., Civ. Res. Manual, § 60.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *See* U.S. Dep’t of Just., Civ. Res. Manual, § 60.

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *See* U.S. Dep’t of Just., Civ. Res. Manual, § 60.

of discretion.”⁸² Put in other words, the bankruptcy court must decide “whether the decision of the debtor is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, whim, or caprice.”⁸³

2. Rejection

A rejection of an executory contract is considered to be a breach of the contract immediately before the date of the filing of the bankruptcy petition.⁸⁴ The non-debtor party to the contract then becomes an unsecured creditor to the rejected contract.⁸⁵ This means that the non-debtor/creditor has “(1) a claim against the debtor for damages” that arise from the breach of the contract, which is deemed to have arisen from the filing of the petition for bankruptcy (which is considered a prepetition claim), and “(2) an expense of administration claim for any benefits [that the debtor receives] in possession prior to [the] rejection.”⁸⁶ The rejection does not cancel the prepetition contract, but rather only constitutes a breach.⁸⁷ This means that the non-debtor/creditor can make claims against the estate of the debtor.⁸⁸ This can have significant consequences on the non-debtor/creditor because they can only receive damages from the breach of the contract.⁸⁹ The amount of damages against the estate could potentially reduce the amount received by the non-debtor/creditor but also result in forgoing the past payments already made.⁹⁰ Further, the non-debtor/creditor also loses the property.⁹¹

The debtor can reject an executory contract through motion or through a reorganization plan pursuant to section 1123(b)(2) of the bankruptcy code.⁹² “An executory contract [can] only be rejected if the [debtor] satisfies the business judgment test,” as previously discussed.⁹³ The paramount issue is whether the rejection will benefit the general unsecured creditors; not a specific unsecured creditor.⁹⁴ Other factors courts consider are whether: (a)

82. U.S. Dep’t of Just., *supra* note 66 (quoting *In re Health Sci. Prods., Inc.*, 191 B.R. 895, 909 n.15 (Bankr. N.D. Ala. 1995)).

83. U.S. Dep’t of Just., *supra* note 66 (quoting *In re Health Sci. Prods., Inc.*, 191 B.R. 895, 909 n.15 (Bankr. N.D. Ala. 1995)).

84. See U.S. Dep’t of Just., Civ. Res. Manual, § 60.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. See Seong-hee Lee, *Installment Land Contracts in Purchaser Bankruptcy*, 29 EMORY BANKR. DEV. J. 425, 426 (2013).

90. *Id.*

91. *Id.*

92. U.S. Dep’t of Just., Civ. Res. Manual, § 60.

93. *Id.*

94. *Id.*

the contract will burden the estate financially; (b) the rejection will result in a substantial claim against the debtor's estate; (c) the debtor can show actual economic benefits that will result from the rejection; and (d) balancing equities of if the rejection will cause more harm to the non-debtor party than the debtor if the contract is not rejected.⁹⁵ Generally speaking, without showing some sort of bad faith or a showing of abuse of business discretion, the debtor's business judgment won't be changed by the court.⁹⁶

3. Relevancy to Sale of Land Contracts

Assumption or rejection is of utmost importance when talking about sale of land contracts in the executory contract context. This is why finding a sale of land contract to be executory could result in severe outcomes for the debtor and creditor parties of the contract. If a sale of land contract is found to be executory, it must be assumed or rejected.⁹⁷ If a debtor decides to assume a sale of land contract, that means they must take the contract as is, benefits and burdens, without the ability to modify the terms.⁹⁸ The debtor must also be able to show the court that they are able to continue performing under that contract.⁹⁹ This can be extremely burdensome to a debtor who is insolvent and needed to turn to a bankruptcy court for relief. They may not have the means or the financial ability to be able to accept an executory contract, even if they want to.

Conversely, if the debtor decides to reject a sale of land contract, it is considered to be a breach of that contract.¹⁰⁰ The non-debtor party on the other side of the sale of land contract then becomes an unsecured creditor to the rejected contract, or put in other terms, becomes an unsecured creditor to the debtor's bankrupt estate.¹⁰¹ In a sale of land context, this becomes particularly unequitable when the debtor is the seller of the sale of land contract. The buyer's only recourse, as the non-debtor/creditor, is to receive damages from the breach of the sale of land contract.¹⁰² This buyer would then only be able to hope they could recuperate the money paid on the sale of land contract from the bankrupt estate, which would potentially be less than what they had already paid.¹⁰³ This would leave the buyer to forgo some or all of the past payments already made under the contract.¹⁰⁴ Further, and even more

95. *Id.*

96. U.S. Dep't of Just., *supra* note 66 (quoting *In re G Survivor Corp.*, 171 B.R. 755, 757-58 (Bankr. S.D.N.Y. 1994)).

97. U.S. Dep't of Just., Civ. Res. Manual, § 60.

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *See Lee, supra* note 88.

103. *See generally Lee, supra* note 88.

104. *See generally Lee, supra* note 88.

detrimental, the buyer, non-debtor/creditor, would also lose the property that they had been paying on and living in over a period of time, despite no fault of their own.¹⁰⁵

Furthermore, if the buyer is the individual who files for bankruptcy, the seller of the property would similarly become a creditor of the estate.¹⁰⁶ Again, the buyer would be out the money that they have paid onto the sale of land contract as they have defaulted on the land and, without having possession of the deed, the property would return to the seller.¹⁰⁷ Resulting again, in the buyer losing possession of the land they had been paying on.¹⁰⁸

This is laid out to articulate what can be at stake when a bankruptcy court is deciding whether a sale of land contract is executory or not, because if it is found to be executory, it puts immense stress on the debtor but also can have extreme consequences to the non-debtor party to the sale of land contract.

III. SPLIT IN AUTHORITY ON WHETHER SALE OF LAND CONTRACTS ARE EXECUTORY CONTRACTS

Due to the ambiguous nature of this area of law, courts come to differing conclusions on how to interpret sale of land contracts under section 365. There is a mix of authority on this issue.¹⁰⁹ Broadly speaking, there are two camps of logic that courts fall into when interpreting whether sale of land contracts are executory.¹¹⁰ The first camp of logic that will be discussed, is the camp of logic that finds sale of land contracts to be executory under state contract law principles when applying Countryman's definition of executory contracts.¹¹¹ The second camp of logic, and the more equitable of the two, finds that sale of land contracts are not executory contracts because instead they treat them as akin to security devices outside of the reach of section 365.¹¹² By the end of this section, it should become clear as to why the second camp of logic results in more equitable outcomes and persuades the reader that this should be the accepted theory.

105. Lee, *supra* note 88.

106. U.S. Dep't of Just., Civ. Res. Manual, § 60.

107. *Id.*

108. *Id.*

109. See Camp of Logic One, *supra* note 14; see also Camp of Logic Two, *supra* note 14.

110. See Camp of Logic One, *supra* note 14; see also Camp of Logic Two, *supra* note 14.

111. See Camp of Logic One, *supra* note 14; see also Camp of Logic Two, *supra* note 14.

112. See Camp of Logic One, *supra* note 14; see also Camp of Logic Two, *supra* note 14.

A. CAMP OF LOGIC ONE: SALE OF LAND CONTRACTS ARE EXECUTORY CONTRACTS

The first camp of logic we will delve into is that sale of land contracts are executory contracts.¹¹³ Courts that find that sale of land contracts are executory usually go through the same process of analysis. First, the court will refer to Professor Countryman's definition of executory contracts: "a contract under which the obligation of both the bankrupt and the other party are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."¹¹⁴ The courts will then look under the particular state's laws to determine if the interest is a security device or executory contract.¹¹⁵ Courts will then apply state contract law principles to the sale of land contracts.¹¹⁶ When looking at it through this lens, a sale of land contract would classify as executory.¹¹⁷ In sale of land contracts, the buyer will pay on the contract for sale for a term of years and begin occupying the property and in exchange the seller will retain the deed for the property until the contract amount is paid. At that time, the seller will then turn over the contract to the buyer. When applying the Countryman definition, this would constitute obligations of both the bankrupt and the other party being so far unperformed that the failure of either to complete performance would constitute a breach.¹¹⁸ This is the conclusion that courts come to when they find that sale of land contracts are executory contracts.

The following case illustration highlights the rationale of these courts. In the case of *Shaw v. Dawson*,¹¹⁹ the debtors assumed a contract to purchase from the seller approximately an 800 acre tract of land in New Mexico.¹²⁰ The contract's purchase price was \$160,000, with \$10,000 due upon execution, \$10,000 due on or before a specified date, and the principal balance of \$140,000, plus interest.¹²¹ The monthly payment for the property was also to be \$1,175.¹²² The debtors allegedly made thirty-seven payments under the contracted monthly payment plan.¹²³ Eventually, the debtors became financially unable to make the monthly payments under the contract and ceased

113. Camp of Logic One, *supra* note 14.

114. See also *In re Speck*, 798 F.2d 279, 279-80 (8th Cir. 1986).

115. *In re Terrell*, 892 F.2d 469, 471-72 (6th Cir. 1989).

116. *Id.* at 472.

117. *Id.* at 472-73.

118. *Id.* at 473.

119. *Shaw v. Dawson*, 48 B.R. 857 (D.N.M. 1985).

120. *Id.* at 858.

121. *Id.*

122. *Id.*

123. *Id.*

making payments.¹²⁴ The seller sent the debtors a thirty day notice.¹²⁵ The debtors subsequently filed a Chapter 11 bankruptcy petition before the thirty day “notice” period had run.¹²⁶ The bankruptcy petition triggered an “automatic stay” and the seller filed a motion for relief from the automatic stay attempting to terminate his contract with the debtors and repossess the property.¹²⁷ The debtors attempted to file a disclosure statement to attempt to keep possession of the property, to develop it, subdivide it, and sell off portions to make payments due to the seller under the contract.¹²⁸ The bankruptcy court denied approval of the disclosure statement and ruled that the real estate contract was an executory contract, and that the “debtors-in-possession must either assume or reject the contract.”¹²⁹ The debtors appealed, contending that the real estate contract being found to be executory was an error and they were attempting to not lose their property.¹³⁰ The issue the court was confronted with on appeal was “whether the Bankruptcy Court was correct in holding that a real estate contract, in which the debtors are the purchasers of the land, is an executory contract subject to [section 365 of the bankruptcy code].”¹³¹ The court acknowledged that the ultimate consequence of its decision to hold that the real estate contract is within the scope of section 365 is that the debtors would have to forfeit the land.¹³² However, it applied the Countryman definition and hold that the real estate contract fell squarely within that definition.¹³³ To the contention that other courts have applied the secured device analysis, the court was not persuaded.¹³⁴ The essence of the court’s rationale is that, “[a] Debtor [cannot] . . . ‘change an ugly duckling (agreement of sale) into a beautiful swan (mortgage)’ by the utilization of the bankruptcy court.”¹³⁵ The court believed that if Congress thought an exception was necessary, it would have created it.¹³⁶ The court points to “the fact that Congress was silent in regard to the situation in which the debtor is the purchaser under such a contract should not be interpreted as giving license to the courts to create an additional exception for debtor-purchasers.”¹³⁷ “Congress’ express action in [considering uncompleted contracts as executory

124. *Shaw*, 48 B.R. at 858.

125. *Id.*

126. *Id.* at 858-59.

127. *Id.* at 859.

128. *Id.*

129. *Shaw*, 48 B.R. at 859.

130. *Id.*

131. *Id.* at 858.

132. *Id.* at 859.

133. *Id.*

134. *Shaw*, 48 B.R. at 861.

135. *In re Fox*, 83 B.R. 290, 296 (Bankr. E.D. Pa. 1988) (quoting *In re Anderson*, 36 B.R. 120, 124 (Bankr. D. Haw. 1983)); see also *Shaw v. Dawson*, 48 B.R. 857 (D.N.M. 1985).

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

137. *Id.*

contracts], in conjunction with its silence [on an exception], compels [the court to believe] that Congress did not intend that an exception exist.”¹³⁸ Therefore, the court applied the statute as written.¹³⁹ The court ultimately held that the bankruptcy court was correct and that the real estate contract was an executory contract subject to section 365 of the bankruptcy code.¹⁴⁰ The contract fell squarely within the definition of executory contracts and therefore it “must be treated as an executory contract.”¹⁴¹ The court noted that an exception for this needed to be created by Congress and “is for Congress to decide.”¹⁴² And this is not the only court to point out that this is an issue for Congress to resolve due to adverse results for debtors.

Other courts that find that sale of land contracts are executory contracts have shown some reservation and acknowledgement that other remedies exist.¹⁴³ But they are bound to abide by what the courts in their circuit and their bankruptcy courts are doing.¹⁴⁴ Regardless of the fact that they know the secured device route may be a more equitable remedy. These reasons vary from sympathetic sentiment, like we saw in *Shaw* where the court acknowledges the debtors would lose their property,¹⁴⁵ to courts saying they understand that the other remedial option exists but showing adherence to precedent and putting the onus on Congress to affirmatively act before the court will.¹⁴⁶ An example is *In re Coffman*. The court in that case ultimately held the sale of land contract was executory but noted that it would be “undoubtedly easier” from the standpoint of reorganization, “to allow the debtors to treat a contract for deed as an ordinary security device.”¹⁴⁷ But to do so would be contrary to, what it believed to be, the “intent” of Congress.¹⁴⁸ Therefore, it upheld their status quo. This can be seen again in the case *In re Buchert*, where the

138. *Id.*

139. *Id.*

140. *Id.* at 861-62.

141. *Shaw*, 48 B.R. at 862.

142. *Id.* at 860, 862.

143. See *In re Coffman*, 104 B.R. 958, 963 (Bankr. S.D. Ind. 1988); see also *In re Scanlan*, 80 B.R. 131, 134-35 (Bankr. S.D. Iowa 1987); *In re Buchert*, 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987); *In re Waldron*, 65 B.R. 169, 173 (Bankr. N.D. Tex. 1986); *In re Churchill Properties VIII Ltd. P’ship*, 164 B.R. 607, 611 (Bankr. N.D. Ill. 1994).

144. See *In re Coffman*, 104 B.R. 958, 963 (Bankr. S.D. Ind. 1988); see also *In re Scanlan*, 80 B.R. 131, 134-35 (Bankr. S.D. Iowa 1987); *In re Buchert*, 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987); *In re Waldron*, 65 B.R. 169, 173 (Bankr. N.D. Tex. 1986); *In re Churchill Properties VIII Ltd. P’ship*, 164 B.R. 607, 611 (Bankr. N.D. Ill. 1994).

145. See *Shaw v. Dawson*, 48 B.R. 857 (D.N.M. 1985).

146. See *In re Coffman*, 104 B.R. 958, 963 (Bankr. S.D. Ind. 1988); *In re Scanlan*, 80 B.R. 131, 134-35 (Bankr. S.D. Iowa 1987); *In re Buchert*, 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987); *In re Waldron*, 65 B.R. 169, 173 (Bankr. N.D. Tex. 1986); *In re Churchill Properties VIII Ltd. P’ship*, 164 B.R. 607, 611 (Bankr. N.D. Ill. 1994).

147. *In re Coffman*, 104 B.R. 958, 963 (Bankr. S.D. Ind. 1988) (quoting *In re Speck*, 50 B.R. 307, 308 (Bankr. D.S.D. 1985)).

148. *Id.*

court said “[a]bsent a clearly stated federal interest, the relationship between the parties is to be determined by the governing state law.”¹⁴⁹ And again in *In re Waldron*, the court concluded that, although Congress had the power to do so, it did not define an executory contract in the present context and the Court must look to Texas state law for interpretation. And again in *In re Scanlan*, the court held that because there is no compelling federal interest that defines the relationship of the parties to sale of land contracts, it is defined by state law.¹⁵⁰ It states that, “[c]ertainly, it is beyond dispute that a land contract, like a mortgage, serves as a security device used for the purchase of real estate. However, fundamental differences exist between these two instruments warranting disparate treatment under the Bankruptcy Code.”¹⁵¹ Again and again, without intervention by Congress, these courts defer to state law even though they are very aware of the disparate impact it is having on debtors. This shows a compelling reason for Congress to amend the bankruptcy code because it is currently not working as written for sale of land contracts.

B. CAMP OF LOGIC TWO: SALE OF LAND CONTRACTS ARE NOT EXECUTORY CONTRACTS

The other camp of logic is that sale of land contracts, rather than executory contracts, are a form of security device out of the reach of section 365 of the bankruptcy code.¹⁵² Courts who come to this conclusion usually end up citing to the analysis in *In re Booth*.¹⁵³ But furthermore, courts will look to state law to determine if the state considers sale of land contracts akin to secured devices, like purchase-money mortgages.¹⁵⁴ By coming to this conclusion, section 365 of the bankruptcy code can be set aside because the sale of land contract is not considered executory triggering the further obligations for section 365.¹⁵⁵

The case *In re Booth* is the foundational case that other courts point to when using this camp of logic.¹⁵⁶ The conclusion and analysis this court uses is often cited in other cases where courts conclude that sale of land contracts are secured devices. The conclusion the court came to was that the contract for deed, when the debtor was the purchaser, was classified as a lien rather than an executory contract.¹⁵⁷ The main reasons that the court came to this conclusion is because the classification benefited the bankrupt estate,

149. *In re Buchert*, 69 B.R. 816, 820 (Bankr. N.D. Ill. 1987).

150. *In re Scanlan*, 80 B.R. 131, 134-35 (Bankr. S.D. Iowa 1987).

151. *Id.* at 134.

152. Camp of Logic Two, *supra* note 14.

153. *See* Camp of Logic Two, *supra* note 14.

154. *See In re Fox*, 83 B.R. 290, 297 (Bankr. E.D. Pa. 1988).

155. *Id.* at 298.

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

157. *Id.* at 64.

furthered the rehabilitation of the debtor, and provided adequate protection to the vendors as lienors.¹⁵⁸ The classification benefits the estate because the priority of “bankruptcy court, as a court of equity, regards substance over form, demands equality of treatment among creditors, and . . . [does not seek out] forfeiture.”¹⁵⁹ If sale of land contracts are treated as liens or security devices, the debtor will be on equal footing as the lienors, which can prevent forfeiture and loss of equity.¹⁶⁰ As for furthering the rehabilitation of the debtor’s estate, executory contracts, according to Congress and Professor Countryman, should be handled to “assist in the debtor’s rehabilitation.”¹⁶¹ If the contract is treated as a lien or secured interest, section 365 is irrelevant and allows more latitude in modifying or planning the rehabilitation of the debtor.¹⁶² Lastly, as to adequate protection of creditors, while payments are suspended, the property is adequately protected because it “strikes a balance between [debtors], other creditors, and the estate.”¹⁶³ If the debtor is treated the same as a mortgagee, they “are protected against any decrease in the value of their liens.”¹⁶⁴

The following case illustrations highlight the rationale of these courts. First, in *In re Frank Seitzinger Farms Inc.*,¹⁶⁵ the debtor entered into a contract for deed with the seller/non-debtor to purchase a 288-acre farm for \$158,400.¹⁶⁶ The contract scheduled payments in writing between the parties.¹⁶⁷ The seller/non-debtor assigned the contract for deed over to a bank as security.¹⁶⁸ The debtor later defaulted on the contract for deed.¹⁶⁹ Additionally, the debtor failed to make his payment obligation of \$7,308.80, which constitutes the principal payment of \$3,500 owing, including interest.¹⁷⁰ Subsequently, the debtor filed a Chapter 11 bankruptcy petition.¹⁷¹ The seller/non-debtor and the bank, as creditors, responded by filing a motion for relief from the automatic stay.¹⁷² The main issue in this case on appeal was whether the bankruptcy court erred in determining that the contract for deed was an executory contract under section 365 of the bankruptcy code.¹⁷³ The

158. *Id.* at 58.

159. *Id.*

160. *Id.* at 60.

161. *In re Booth*, 19 B.R. at 60.

162. *Id.* at 61.

163. *Id.*

164. *Id.*

165. *In re Frank Seitzinger Farms, Inc. of Iowa v. Waller*, 67 B.R. 869, 872 (Bankr. D.S.D. 1986).

166. *Id.* at 870.

167. *Id.*

168. *Id.*

169. *Id.*

170. *In re Frank Seitzinger Farms, Inc. of Iowa v. Waller*, 67 B.R. at 870.

171. *Id.*

172. *Id.*

173. *Id.* at 871.

court ended up reversing the bankruptcy court's decision and found that the contract for deed was not an executory contract under section 365 of the bankruptcy code.¹⁷⁴ The court reasoned that while South Dakota has adopted Professor Countryman's definition of an executory contract, it therefore follows that a contract for deed, under South Dakota law, fits Professor Countryman's definition since "the right of the contract vendor to receive payment and the right of the vendee to take merchantable title upon completion of those payments are dependent covenants."¹⁷⁵ However, Minnesota takes an antithetical position.¹⁷⁶ Under Minnesota law, "Professor Countryman's definition of an executory contract . . . is inapplicable to a contract for deed, particularly where the debtor is the vendee."¹⁷⁷ In Minnesota, "contracts for deed . . . are treated as secured debts financing arrangements [because] the contract for deed benefits the [bankrupt] estate more when viewed as a lien [rather] than as an executory contract."¹⁷⁸ This is important for three reasons: (1) "by treating the contract for deed as a lien the value of the estate is enlarged"; (2) treating the contract for deed as a lien "further[s] the rehabilitation of the debtor"; and (3) it "provide[s] adequate protection for all creditors."¹⁷⁹ The court ultimately says, "[t]o hold otherwise, in Minnesota, 'would be inconsistent with the code's underlying policies of 'benefit to the estate' and 'rehabilitation.'"¹⁸⁰

Further, in *In re McDaniel*,¹⁸¹ the debtors entered into a contract to purchase commercial real estate from the seller.¹⁸² The contract's total purchase price was \$210,000.¹⁸³ The "[d]ebtors paid \$34,317 at closing and agreed to pay the balance, including interest at the rate of 10 per cent per annum, in monthly installments in the amount of \$1,500, together with a balloon payment in the amount of \$25,000."¹⁸⁴ "The contract provided that significant incidents of ownership of the property were transferred to [the] debtors."¹⁸⁵ This entitled the debtors to immediate possession of the property and the sellers then assigned the commercial leases and rental agreements to the debtors.¹⁸⁶ The debtors defaulted by failing to make the balloon payment under

174. *Id.* at 872.

175. *In re Frank Seitzinger Farms, Inc. of Iowa v. Waller*, 67 B.R. at 871-72.

176. *Id.* at 872.

177. *Id.*

178. *Id.*

179. *Id.*

180. *In re Frank Seitzinger Farms, Inc. of Iowa v. Waller*, 67 B.R. at 872 (quoting *In re Adolphsen*, 38 B.R. 776, 781 (Bankr. D. Minn. 1983)).

181. *In re McDaniel*, 89 B.R. 861 (Bankr. E.D. Wash. 1988).

182. *Id.* at 862.

183. *Id.*

184. *Id.*

185. *Id.* at 863.

186. *In re McDaniel*, 89 B.R. at 863.

the contract.¹⁸⁷ The sellers “served [the] debtors with a notice of intent to forfeit debtors’ interest in the property.”¹⁸⁸ The debtors ultimately filed for Chapter 11 bankruptcy.¹⁸⁹ The main issue was “whether [the] real estate installment sales contract should be treated as an executory contract . . . or as a lien/mortgage security device.”¹⁹⁰ The court held that there are “no compelling Bankruptcy reasons or precedents for overriding Washington’s treatment of real estate installment sales contracts as security devices,” and as a result, “the contract between [the debtor] and [the seller] is not an executory contract under section 365 of the Bankruptcy Code.”¹⁹¹ In the court’s analysis, it acknowledges the significant difference between the two types of treatment.¹⁹² If the real estate installment sales contract is an executory contract, the debtor “must either assume or reject the contract” under section 365 of the bankruptcy code.¹⁹³ Conversely, if the real estate installment sales contract is treated as a security device, the burdens associated with section 365, do not need to be met.¹⁹⁴ The debtor does not need to cure any defaults to be able to keep the property and rather the debtor can be given the opportunity to modify the terms of the contract.¹⁹⁵ The court finally acknowledges that “if the real estate installment sales contract is treated as a lien/mortgage as opposed to an executory contract,” it would be “easier for a debtor to retain the property in question.”¹⁹⁶ In coming to its decision, the court applies a three-step analysis from the Supreme

Court of the United States case under *Butner v. United States*.¹⁹⁷ The three steps are as follows: “(1) [u]nder Washington law, what property interest, if any, are acquired by a purchaser under a real estate installment sales contract”; “(2) [u]nder Washington law, does the seller under a real estate installment sales contract retain a security interest in the property”; and “(3) [d]o Bankruptcy considerations require that real estate installment sales contracts be considered as executory contracts under section 365 of the Bankruptcy Code.”¹⁹⁸ Under the first two prongs, the court concludes that under Washington law that the debtors had an interest in the property as well as it being a security interest.¹⁹⁹ But under the third prong, the court ultimately concludes that,

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *In re McDaniel*, 89 B.R. at 875.

192. *See id.* at 863.

193. *Id.*

194. *Id.*

195. *Id.*

196. *In re McDaniel*, 89 B.R. at 864.

197. *Id.*

198. *Id.*

199. *Id.* at 864-70.

[a]lthough Congress has expressed an overriding federal interest in certain executory contracts, i.e. collective bargaining agreements and the real property sales contracts when the debtor is the seller, there is [not a] compelling federal interest to define the relationship of the parties to a real property sales contracts when the debtor is the contract purchaser other than as that relationship is defined under controlling state law.²⁰⁰

Therefore, “[section] 365 does not require that real estate installment sales contracts be treated as executory contracts if that is contrary to state law.”²⁰¹

This camp of logic would be an equitable solution to the problem. By treating installment sale of land contracts as a security device, it would never become a problem for bankruptcy courts to resolve because it would not be subject to section 365. This would allow flexibility for the parties in the contract to modify the contracts terms and if a default still occurs the remedy could be sought through individual state courts rather than federal bankruptcy courts. However, for this camp of logic to be adopted in all states it would require each state to treat installment sale of land contracts the same. Which is not just unlikely but completely implausible. That is where the impasse with federal appellate courts and bankruptcy courts lies and why there is a split in authority. In looking to individual state laws for guidance, they come to contrary conclusions. Therefore, while this is the equitable outcome, to just advocate for this outcome would merely be applying a Band-Aid over this gaping bullet hole wound in our statutory bankruptcy law. There needs to be express action from the legislature to stop the hemorrhaging.

IV. PUTTING A BAND-AID ON A BULLET HOLE

While, as previously discussed, between the two competing theories, the secured device route is the one that will result in the least number of unequitable outcomes. However, the bigger issue is that this is not a sure-fire fix. The intention of our Founders, by making bankruptcy a federally regulated issue for our courts, was to ensure uniformity within bankruptcy law across the country. These two competing theories illustrate what happens when Congress does not take the initiative to create new bankruptcy laws when the Code is not adequately giving guidance. It results in bankruptcy courts deferring to state laws, which produces drastically different results for debtors based on geography.

200. *Id.* at 869-75.

201. *In re McDaniel*, 89 B.R. at 875-76.

A. INTENTION OF OUR FOUNDERS

The bedrock of the idea of there being uniform laws across the United States is derived from the United States Constitution.²⁰² In Article I, Section 8 is where, what is referred to as the Uniformity Clause, resides.²⁰³ The Uniformity Clause empowers Congress, “[t]o establish [...] uniform Laws on the subject of Bankruptcies throughout the United States.”²⁰⁴

Uniformity for bankruptcy in the United States seemed to be of enough importance that the founders included it in the Constitution.²⁰⁵ The Uniformity Clause was able to survive several edits during the ratification process of the Constitution.²⁰⁶ This includes Amended Draft Constitution Submitted to the Committee of Style, 10 September; Draft Constitution by the Committee of Style, as Amended by the Convention 12-17 September; and finally the final ratified Constitution.²⁰⁷ And in all renditions, the language survived being, “uniform Laws on the subject of Bankruptcies.”²⁰⁸

The fact that out of all of the countless issues our Founders, who were quite skeptical of large government power, chose to have bankruptcies be part of our federal system is curious. And not just bankruptcies but the emphasis on uniformity of “[those] Bankruptcies throughout the United States.”²⁰⁹ The Federalist Paper 42 sheds more light on the thoughts of the Founders regarding bankruptcy.²¹⁰ James Madison states in relevant part:

The power of establishing uniform laws of bankruptcy, is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.²¹¹

The Founders in contemplating and completing our Constitution thought it so fundamental that bankruptcy must be expedited to the federal system to ensure that parties and their property not be removed to different states, but be dealt with uniformly at the federal level under the control of the

202. See U.S. CONST. art. I, § 8.

203. *Id.*

204. *Id.*

205. See generally *id.*

206. See VOL. 1. CONSTITUTIONAL DOCUMENTS AND RECORDS, 1776-1787 (Merrill Jensen ed., 1976), <https://search.library.wisc.edu/digital/ATR2WPX6L3UFLH8I> [<https://perma.cc/9CJF-HYNL>].

207. *Id.* at 275, 289, 309.

208. See *id.*

209. See U.S. CONST. art. I, § 8, cl. 4.

210. THE FEDERALIST NO. 42 (James Madison).

211. *Id.*

legislature.²¹² Other commentators at the time, around ratification, also spoke to the importance of the federal government handling bankruptcies.²¹³ According to Judge Joseph Story, there were independent reasons, besides the general considerations, as to why the federal government of the United States should be entrusted with the power of bankruptcies.²¹⁴ The reasons are rooted in “the importance of preserving harmony, promoting justice, and securing equality of rights and remedies” for all of the citizens in all the states.²¹⁵ Judge Story cautioned that if the power of bankruptcies was exclusively vested in the states, each one would have the liberty to frame their bankruptcy system through legislation that would best serve its own local interests and pursuits.²¹⁶ If those circumstances were to exist, there would be no uniformity of the systems or operations of bankruptcy within the United States.²¹⁷

One state may adopt a system of general insolvency; another, a limited or temporary system; one may relieve from the obligation of contracts; another only from imprisonment; another may adopt a still more restrictive course of occasional relief; and another may refuse to act in any manner upon the subject. The laws of one state may give undue preferences to one class of creditors, as for instance, to creditors by bond, or judgment; another may provide for an equality of debts, and a distribution pro ratâ without distinction among all. One may prefer creditors living within the state to all living without; securing to the former an entire priority of payment out of the assets.²¹⁸

Judge Story warned that to leave bankruptcy in the states’ hands could cause an infinite variety of problems within local systems which may result in gross injustice and inequality between the states.²¹⁹ Judge Story also pointed out that this was not speculation but, before ratification of the Constitution, was a reality of what was happening amongst the different states.²²⁰

212. *See id.*

213. Joseph Story, *Commentaries on the Constitution of the United States*, UNIV. CHI. PRESS (1833), https://press-pubs.uchicago.edu/founders/documents/a1_8_4_bankrupt-cys14.html [<https://perma.cc/FQ4F-22UW>].

214. *Id.*

215. *Id.*

216. *Id.*

217. *Id.*

218. Story, *supra* note 212.

219. Story, *supra* note 212.

220. Story, *supra* note 212.

Judge Story concludes by saying that, “[t]here can be no other adequate remedy, than giving a power to the general government, to introduce and perpetuate a uniform system.”²²¹

All of this to show that the Founders’ intention of including the Uniformity Clause within the Constitution was to promote what the name implies: uniformity. When it comes to sale of land contracts, the current strategies that bankruptcy courts have concocted to deal with the statutory gap in interpretation have led to exactly the opposite of uniformity. Depending on what state the bankruptcy court sits in results in different relief and outcomes in bankruptcy proceedings. Put simply, sale of land contract interpretation in bankruptcy varies from state to state. This interpretation inherently laughs in the face of the Founders’ objective to establish uniformity.

B. SUPREME COURT OF THE UNITED STATES PRECEDENTS

The Supreme Court has tried to step in and bring some clarity in this area of law but has also been hamstrung by the lack of congressional intervention. In the case *Butner v. United States*,²²² the Court was faced with the issue of whether or not rights to rents were subject to “a federal rule of equity or by the law of the State where the property is located.”²²³ Further, it looked at “whether a security interest in property extends to rents and profits derived from the property as one that should be resolved by . . . state law.”²²⁴ The Court starts off its rationale by addressing that it will not decide whether the applicable state law was applied correctly.²²⁵ The Court also points out that the applicable state law will vary from state to state, which means that the federal bankruptcy outcomes will also differ depending on which approach is adopted by each circuit.²²⁶ It even points out that the third and seventh circuits have chosen to adopt a rule of equity.²²⁷ Then, however, the Court runs into a standstill. It states, “[t]he constitutional authority of Congress to establish ‘uniform laws on the subject of Bankruptcies throughout the United States’ would clearly encompass a federal state defining the mortgagee’s interest in the rents and profits earned by property in a bankrupt estate.”²²⁸ But it goes on to say that, “Congress has not chosen to exercise its power to fashion any such rule.”²²⁹ Congress has generally left the determination to the states, and unless Congress enacts legislation that creates some federal

221. Story, *supra* note 212.

222. *Butner v. United States*, 440 U.S. 48 (1979).

223. *Id.* at 49.

224. *Id.* at 52.

225. *Id.*

226. *Id.* at 53.

227. *Butner*, 440 U.S. at 53.

228. *Id.* at 54.

229. *Id.*

interest that requires a different result, there is no reason why such an interest should be analyzed differently because a party is involved in a bankruptcy proceeding.²³⁰ Put simply, the Court fashions its decision with the understanding that there is no legislative command by Congress to change the status quo, and therefore bankruptcy courts can look to state law to make these determinations.²³¹ The Supreme Court cannot legislate; it can merely interpret laws. Therefore, the Court essentially had to cook with the ingredients it had, resulting in a rule that will inevitably result in a lack of uniformity because states' laws inevitably differ.

In the recent 2022 Supreme Court of the United States case *Siegel v. Fitzgerald*,²³² the Supreme Court was tasked with determining if an amendment to the Bankruptcy Judgeship Act violated the Uniformity Clause of the Constitution.²³³ To clarify, the discussion of this case is not to say that it is factually similar to issues regarding sale of land contracts. But rather, the focus should be on the rationale and arguments the Supreme Court makes in relation to Congress and the Uniformity Clause of the Constitution. In 2017, Congress passed an amendment to the Bankruptcy Judgeship Act, which increased the quarterly fees for larger Chapter 11 bankruptcy cases within the Trustee program.²³⁴ Circuit City Stores, Inc., a large national chain for electronics, filed for a Chapter 11 bankruptcy and then refused to pay the increased fees under the amendment, challenging that it was unconstitutional.²³⁵ They argued the unconstitutionality was based on a violation of the Uniformity Clause of the Constitution.²³⁶ The Court, in a unanimous decision, found that the 2017 amendment to the Bankruptcy Judgeship Act violated the uniformity requirement of the Bankruptcy Clause of the Constitution because the Constitution's Bankruptcy Clause "does not permit Congress to treat identical debtors differently" based on external and geographical differences.²³⁷ The Court reasoned that while the Bankruptcy Clause is flexible and empowers Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States," it "does not permit arbitrary geographically disparate treatment of debtors."²³⁸ While the Bankruptcy Clause "confers broad authority on Congress, the Clause also imposes a limitation on that authority," which requires that the laws that are enacted are "uniform."²³⁹ The Court articulates that "[its] precedent provides that the

230. *Id.* at 54-55.

231. *See id.*

232. *Siegel v. Fitzgerald*, 596 U.S. 464 (2022).

233. *Id.* at 471.

234. *Id.*

235. *Id.*

236. *Id.* at 472.

237. *Siegel*, 596 U.S. at 479.

238. *Id.* at 473.

239. *Id.* at 476.

Bankruptcy Clause offers Congress flexibility, but [it] does not permit the arbitrary, disparate treatment of similarly situated debtors based on geography.”²⁴⁰ This means the greatest take away from the Supreme Court’s precedent is that, while Congress has a lot of leeway, it cannot arbitrarily and disparately treat “similarly situated debtors based on geography.”²⁴¹ While in this case it dealt with actual actions of Congress, there is an interesting argument that can be made from this analysis. Does the omission or lack of action by Congress that also results in discrimination on similarly situated debtors also violate the uniformity requirement of the Bankruptcy Clause?

When applying this logic to sale of land contracts, what has resulted due to the conflicting authority amongst our country is that, depending on the state in which you reside and the authority it follows, will depend on the interpretation of your bankruptcy proceeding when dealing with a sale of land contract.²⁴² Let us look back to *In re Fox*, which was illustrated in the introduction.²⁴³ As alluded to in the introduction, had the debtor in *In re Fox* filed in another jurisdiction that follows the camp of logic that finds that sale of land contracts are executory contracts, the outcome would have been entirely different for the debtor.²⁴⁴ This outcome is inherently non-uniform, and it is based on the geographical difference in how bankruptcy courts and circuits are interpreting the missing link in the bankruptcy code. These geographical differences and the analysis of the Supreme Court are compelling, and it logically follows that Congress is disregarding the commands of the Constitution. Without Congress stepping in and amending the bankruptcy code to bring uniformity back to this area, equally situated debtors with sale of land contracts will continue to receive non-uniform treatment within bankruptcy law.

C. EXAMPLES OF CONGRESSIONAL INTERVENTION IN SECTION 365

It is not unheard of for Congress to amend the bankruptcy code when new matters become an issue under the current framework. Under 11 U.S.C. § 365(n), lies a section of the bankruptcy code that was added by Congress when intellectual property became a hot button topic within bankruptcy courts.²⁴⁵ The subsection reads as follows:

If the trustee rejects an executory contract under
which the debtor is a licensor of a right to

240. *Id.* at 478.

241. *See id.*

242. *See Siegel v. Fitzgerald*, 596 U.S. 464 (2022).

243. *See supra* Part I.

244. *See Camp of Logic One*, *supra* note 14; *see also Camp of Logic Two*, *supra* note 14.

245. *See* 11 U.S.C. § 365(n).

intellectual property, the licensee under such contract may elect--

(A) to treat such contract as terminated by such rejection if such rejection by the trustee amounts to such a breach as would entitle the licensee to treat such contract as terminated by virtue of its own terms, applicable nonbankruptcy law, or an agreement made by the licensee with another entity; or

(B) to retain its rights (including a right to enforce any exclusivity provision of such contract, but excluding any other right under applicable nonbankruptcy law to specific performance of such contract) under such contract and under any agreement supplementary to such contract, to such intellectual property (including any embodiment of such intellectual property to the extent protected by applicable nonbankruptcy law), as such rights existed immediately before the case commenced, for--

(i) the duration of such contract; and

(ii) any period for which such contract may be extended by the licensee as of right under applicable nonbankruptcy law.²⁴⁶

Congress clearly laid out options for debtors under section 365 for what to do in bankruptcy in the situation where intellectual property is involved in a bankrupt estate. It lays out their options and how a licensor of intellectual property may proceed in a situation of bankruptcy.²⁴⁷

The backdrop of the amendment of the bankruptcy code was addressing court decisions that “stripped intellectual property licensees of their right to continue to use the licensed property.”²⁴⁸ One important case was *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.*, which interpreted section 365 as allowing a basis for a licensor of intellectual property to deprive a licensee of their continued right to use the licensed intellectual property by the rejection of the license as an executory contract in bankruptcy.²⁴⁹ This view left licensees in an insecure position and threatened the very flexible and “beneficial system of intellectual property licensing which has developed in the United States.”²⁵⁰ According to Congress, it “never anticipated that the presence of executory obligations in an intellectual property license would

246. *Id.*

247. *See id.*

248. S. REP. NO. 100-505, at 2 (1988).

249. *Id.*

250. *Id.* at 3.

subject the licensee to [this] risk . . . upon bankruptcy of the licensor,” and would result in the licensee losing “future affirmative performance required of the licensor under the license, but also [the] right of the licensee to continue to use the intellectual property as originally agreed [to] in the license.”²⁵¹ Not changing section 365 would threaten the system of licensing of intellectual property, which created the mutual benefit of both the licensor and the licensee.²⁵²

This is an example of how Congress could approach the situation of sale of land contracts and section 365 of the bankruptcy code and reconcile some of the inconsistencies that have arisen due to the federal silence. The current way court decisions are determining the rights of parties to sale of land installment contracts is resulting in insecurity and deprivation of property after the filing of bankruptcy. This would also be an opportunity for Congress to codify the security device camp of logic or attempt to distinguish sale of land contract in another way. If Congress was willing to modify section 365 to protect intellectual property, which itself is not tangible property, Congress should be willing and able to make a modification to the code to protect real tangible property.

V. CONCLUSION

The missing link in the bankruptcy code, besides the lack of definition for executory contracts, is the lack of intervention and express legislation regarding how to deal with sale of land installment contracts within bankruptcy. Between the two camps of logic that appellate courts and bankruptcy court apply, it is clear that treating sale of land contracts as security devices is more equitable.²⁵³ But without legislative action, there will be no substantial changes. The Supreme Court has not been able to resolve the issue, and courts continue to be split on which camp of logic to apply. This results in “[the] disparate treatment of similarly situated debtors based on geography.”²⁵⁴ Which, according to *Siegel*, Congress may not do.²⁵⁵ And Congress’ inaction is causing exactly that. This was never the intentions of our Founders when they included the Bankruptcy Clause in the Constitution.²⁵⁶ Nothing should be standing in the way of Congress to include this in the bankruptcy code either, as they have before in the instance of intellectual property.

Some of the underlying resistance to legislating on this issue is a stigma against these forms of contracts. In the words of the court in *In re Fox*, “[a] Debtor [cannot] . . . ‘change an ugly duckling (agreement of sale) into a

251. *Id.*

252. *Id.*

253. *See supra* Part IV, Section B.

254. *Siegel v. Fitzgerald*, 596 U.S. 464, 478 (2022).

255. *Id.*

256. *See supra* Part IV, Section A.

beautiful swan (mortgage)’ by the utilization of the bankruptcy court.”²⁵⁷ While there is a stigma for these “poor man’s mortgage[s],” this is not an issue that can continue to be ignored.²⁵⁸ According to *Pew*, there are risks for homebuyers who use sale of land contracts as a finance instrument to purchase a home that can result in them being worse off than when they began. In the last eighteen years, nearly half a million sale of land contracts have been recorded in the United States, and that’s not to say there are not more, as they are not necessarily required in every state to be recorded.²⁵⁹ Further, the estimated number of active sale of land contracts in the United States is 689,000.²⁶⁰ With the current inaccessibility of homeownership and the desire for people to have their “American Dream,” this is not an issue that can continue to be brushed aside. If any person who is a party to the 689,000 active land sale contract files for bankruptcy, they are going to receive disparate treatment in whatever bankruptcy court they file in. Without change, the result is the punishment of debtors who dared to try to own a home.

257. *In re Fox*, 83 B.R. 290, 296 (Bankr. E.D. Pa. 1988) (quoting *In re Anderson*, 36 B.R. 120, 121 (Bankr. D. Haw. 1983)); see also *Shaw v. Dawson*, 48 B.R. 857 (D.N.M. 1985).

258. Hume, *supra* note 56, at 233.

259. Adam Staveski, Linlin Liang & Tara Roche, *Land Contracts Pose 5 Major Risks for Homebuyers*, PEW (July 18, 2024), <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2024/07/land-contracts-pose-5-major-risks-for-homebuyers> [<https://perma.cc/DMC5-K8RV>].

260. *Id.*