

## REVISED ARTICLE 9 OF THE U.C.C. AND MINNESOTA CONTRACTS FOR DEED

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### I. INTRODUCTION

Minnesota contracts for deed have traditionally been governed exclusively by Minnesota law and Minnesota lawyers dealing with such contracts have not had to pay much attention to uniform or other non-Minnesota laws. That has recently changed due to the revision of Article 9 of the Uniform Commercial Code, which deals with secured transactions involving personal property. Effective July 1, 2001, Minnesota – along with virtually every other state – adopted revisions to Article 9, generally known as Revised Article 9.

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At first glance, changes in the law of secured transactions, dealing with personal property, should not have an impact on the law of Minnesota contracts for deed, the somewhat peculiarly-Minnesotan form of seller real estate financing. Nevertheless, due to the broad reach of the provisions of Revised Article 9, certain aspects of Minnesota contracts for deed, particularly those relating to pledges (and transfers) of the seller's interest, will be governed by provisions of the Uniform Commercial Code. Moreover, while Minnesota's version of Revised Article 9 has been tailored as much as possible to accommodate the Minnesota contract for deed and traditional Minnesota real estate practices, certain aspects of Minnesota contract for deed law and conveyancing law and practice must be and have been changed in significant ways.

The changes brought about by Revised Article 9 most directly affect the practice of taking a security interest in a seller's interest in a contract for deed. This certainly does not affect every contract for deed. Nevertheless, for reasons that should be clear by the end of this Article, the changes wrought by Revised Article 9 will potentially affect parties who are not directly involved in the taking of a security interest in a seller's interest under a contract for deed.

Before addressing the somewhat arcane and technical legal issues raised by Revised Article 9 as it applies to contracts for deed, it is important to understand the basic transaction. One starts with a garden-variety contract for deed between a seller (or vendor) and purchaser (or vendee). The contract for deed, sometimes called a land contract in other states, is a form of seller financing whereby the purchaser, who normally takes possession of the real estate, agrees to make payments over time to the seller and the seller agrees that upon completion of such payments, the seller will deliver to the purchaser a deed to the property—hence, a contract for deed. Under the doctrine of equitable conversion, the purchaser acquires an equitable interest in the real estate and the seller retains bare legal title as security for the payment of the debt.<sup>1</sup> From the perspective of the purchaser, the contract for deed is virtually indistinguishable from a seller take-back purchase money mortgage. In the hands of the seller or vendor, the contract for deed is a debt instrument secured by the real estate. The seller is holding bare legal title merely as security for payment of the

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1. *Nichols v. L & O, Inc.*, 293 Minn. 17, 21, 196 N.W.2d 465, 468 fn.7 (1972); *In re S.R.A., Inc.*, 213 Minn. 487, 494, 7 N.W.2d 484, 488 (1942).

purchase price.<sup>2</sup> In other words, the seller under a contract for deed holds a right to a stream of payments plus a security interest in the real estate to secure those payments.<sup>3</sup>

Since the contract is an asset of sorts, the seller under the contract for deed can use the contract to secure another debt that the seller owes to a third party. That is, the seller can pledge or hypothecate its interest in the contract for deed to secure another debt. Thus, we end up with a three-party transaction: seller, purchaser, and the secured party, who has a security interest in only the seller's interest under the contract for deed.<sup>4</sup> The basic legal issues that this Article will address are (i) how the secured party perfects its security interest in the seller's interest under the contract for deed, and (ii) what is the effect on the three parties of the taking of and the exercise of rights with respect to a security interest in the seller's interest in the contract for deed.<sup>5</sup>

## II. MINNESOTA LAW PRIOR TO REVISED ARTICLE 9

The most significant issue regarding a security interest in a

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2. In re S.R.A., 213 Minn. at 494, 7 N.W.2d at 488 (1942); *Summers v. Midland Co.*, 167 Minn. 453, 455-56, 209 N.W. 323, 324 (1926).

3. *Trondson v. Janikula*, 458 N.W.2d 679, 682-83 (Minn. 1990).

4. Where the security consists of not just the seller's interest under the contract for deed, but also the purchaser's interest, one has a garden-variety mortgage that is clearly governed by real estate law and not Revised Article 9. For example, if the seller first grants a recorded mortgage to a lender and only subsequently enters into a contract for deed with a purchaser, the purchaser's interest, in addition to the seller's interest, will, by operation of the recording act, MINN. STAT. § 507.34 (2000), be subject to and encumbered by the mortgage. Thus, the issues discussed in this article arise where it is only the seller's legal interest, but not the purchaser's equitable interest, that is the security for the debt owed to the secured party. Also, where the security for the debt consists only of the purchaser's interest under the contract for deed i.e. a mortgage on only the vendee's interest, one is dealing with a pure real estate mortgage, albeit one constituting a functional second mortgage, subordinate to the first position held by the seller. Lastly, as explained below, although a purchase agreement bears some resemblance to a contract for deed, the somewhat unusual situation where an owner of real estate first enters into a purchase agreement and then subsequently pledges his or her interest in the property as security for a debt does not raise any issues under Revised Article 9 since (a) the debtor is not really pledging a stream of payments and (b) equitable conversion has typically not occurred. This last situation is simply a garden-variety mortgage because the purchaser will take his or her interest in the real estate subject to the security granted by the seller.

5. With one rather significant exception discussed below, if the seller does not pledge his or her interest in the contract for deed, neither Revised Article 9 nor any of the issues discussed in this Article will arise.

seller's interest under a contract for deed is the question of how the secured party goes about perfecting that security interest as against other creditors. Specifically, the question is (a) whether the secured interest is to be treated as a personal property interest to be perfected (and enforced) as other personal property security interests are to be perfected (with a UCC financing statement) or (b) whether such security interest is a real estate security to be perfected (and enforced) as other real estate security interests. Prior to the enactment of Revised Article 9 of the Uniform Commercial Code, the law in Minnesota was not absolutely clear.

A strong argument could be (and was) made that a security interest in a seller's interest under a contract for deed should be perfected as a matter of personal property under the old version of Article 9 of the Uniform Commercial Code by filing a financing statement, normally with the Minnesota Secretary of State. In the first place, a contract for deed is in many respects the functional equivalent to a seller take-back mortgage.<sup>6</sup> Under even the old version of Article 9 of the UCC, a security interest in a note and mortgage i.e. a pledge by a mortgagee to a third party of the debt owed the mortgagee by the mortgagor, had to be perfected under the UCC, even though the underlying collateral, i.e. the mortgage note, was itself secured by real estate.<sup>7</sup> Since the seller's interest in a contract for deed is the functional equivalent to the interest of a mortgagee under a note and mortgage, it was argued by analogy that a security interest in a seller's interest under a contract for deed was personal property (a mortgage on a mortgage) to be perfected under the old version of Article 9 of the UCC. In addition, without the right to the stream of payments, the seller's naked real estate security is meaningless. Since the right to the stream of payments is clearly personal property, security consisting of the stream of payments and security for those payments is essentially a personal property transaction to be governed by Article 9. As a result, the majority rule in the United States had been that perfection of the seller's interest under the contract for deed must be perfected as personalty under the old Article 9 of the

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6. *Nichols*, 293 Minn. at 21, 196 N.W.2d at 468 n.7; *State ex rel. Blee v. City of Rochester*, 260 Minn. 151, 153, 109 N.W.2d 44, 45 (1961).

7. See MINN. STAT. § 336.9-102(3) (2000) (*repealed 2001*); Minn. Laws 2000, ch. 399, art. 1, Sec. 140; *Id* at cmt. 4 (stating "this Article is applicable to the security interest . . . created in the note and the mortgage"). As an instrument, the security interest in the promissory note generally had to be perfected by possession. MINN. STAT. § 336.9-304(1) (2000) (*repealed 2001*).

UCC.<sup>8</sup> Moreover, even under Minnesota law, for many purposes a seller's interest under a contract for deed was deemed to be personalty. For example, a seller's interest under a contract for deed is deemed personal property for probate purposes in Minnesota.<sup>9</sup>

Despite the general personal property attributes of a seller's interest under a contract for deed, however, it is an odd type of personal property that, in Minnesota, has some of the "usual incidents of real property."<sup>10</sup> Most particularly, the seller under a contract for deed holds fee title. As such, while the seller's right to the stream of payments under the contract for deed can be conveyed by an assignment, generally the interest in the real estate (the security for the purchaser's debt) can only be transferred by deed from the contract seller.<sup>11</sup> Furthermore, because of the expeditious, non-judicial cancellation mechanism under Minnesota law, the seller's interest may, in as short a period as sixty days, ripen into real property and emerge as a full bloom fee simple absolute.<sup>12</sup> In addition, it has long been recognized in Minnesota that a seller's interest under a contract for deed (separate from a purchaser's interest under the contract for deed) can be mortgaged.<sup>13</sup> In fact, there is old case law that, in the event of default of a debt secured by a seller's interest under a contract for deed, the security must be foreclosed as a real estate mortgage where the vendee's interest has been terminated.<sup>14</sup> Also, in Minnesota (contrary to many other

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8. See, e.g., *In re Holiday Intervals, Inc.*, 931 F.2d 500 (8th Cir. 1991) (applying Missouri law) (UCC filing required); GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 3.37 (4<sup>th</sup> ed. 2001).

9. *State v. Probate Court*, 145 Minn. 155, 161, 176 N.W. 493, 495-96 (1920). *But see* *Trondson v. Janikula*, 458 N.W.2d 679, 682-83 (Minn. 1990) (rejecting view that seller's interest in a contract for deed is purely a personal property interest).

10. *Minnesota Bldg. & Loan Ass'n. v. Closs*, 182 Minn. 452, 453, 234 N.W. 872, 873 (1913) (vendor's interest is realty for the purposes of the requirement of joinder of a spouse).

11. MINNESOTA TITLE STANDARDS, Standard 76 (Section of Real Prop. Law of Minn. Bar Ass'n., 1994) ("A deed may be used to transfer . . . a seller's . . . interest in a contract for deed, and is required to transfer the fee title. An assignment of a contract for deed may be used to transfer . . . a seller's . . . interest in a contract for deed, but does not transfer the fee title."). Thus, in the situation of a second contract where the transferring seller is itself subject to a senior contract, the seller's interest being conveyed does not constitute the fee and may be conveyed by a mere assignment.

12. MINN. STAT. § 559.21 (2000).

13. *Summers v. Midland Co.*, 167 Minn. 453, 455-56, 209 N.W. 323, 323-24 (1926).

14. *Lamm v. Armstrong*, 95 Minn. 434, 436, 104 N.W. 304, 305 (1905) (must

states), a seller's interest under a contract for deed is treated as real property for purposes of the rule that a judgment creates a lien on the real property of the judgment debtor and a seller's interest under a contract for deed is subject to a judgment lien against the seller.<sup>15</sup> Moreover, in *Trondson v. Janikula*,<sup>16</sup> a case involving an assignment (not a pledge) of a seller's interest in a contract for deed, the Minnesota Supreme Court specifically rejected the line of authority holding that a seller's interest is simply a personal property interest and stated that such a view was not the law in Minnesota.<sup>17</sup>

Finally, the one case directly addressing this issue of perfection of a security interest in a seller's interest under a contract for deed under Minnesota law prior to the enactment of Revised Article 9 was *In re Shuster*,<sup>18</sup> a decision of the 8th Circuit Court of Appeals. In that case, the Shusters sold Minnesota property on a contract for deed. As security for a note issued by the Shusters to the Doanes, the Shusters assigned their sellers' interest in the contract for deed to the Doanes. Thereafter, in order to secure a debt that the Doanes owned to Production Credit Association ("PCA"), the Doanes assigned to PCA their note from the Shusters and their assignees' interest in the contract for deed. Both the Doanes and PCA recorded assignments of the seller's interest in the contract for deed in the Minnesota real state records.<sup>19</sup> Thereafter, the Shusters were subject to a bankruptcy filing and the bankruptcy trustee asserted that his rights, as a hypothetical lien creditor under 11 U.S.C. section 544, were senior to those of the Doanes and PCA since they had not filed financing statements under the UCC with the Minnesota Secretary of State.<sup>20</sup>

The Eighth Circuit Court of Appeals, applying Minnesota law, held that a security interest in a seller's interest under a contract

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foreclose as real estate mortgage where vendee's interest in contract had been terminated).

15. *In re Consolidation of Sch. Dists. in Olmstead County*, 146 Minn. 403, 178 N.W. 892 (1920); *Wells v. Baldwin*, 28 Minn. 408, 10 N.W. 427 (1881); *Minneapolis & St. Louis R. Co. v. Wilson*, 25 Minn. 382 (1879).

16. 458 N.W.2d 679 (Minn. 1990).

17. *Id.* at 682.

18. 784 F.2d 883 (8th Cir. 1986).

19. Technically, all that PCA had was a collateral assignment of a collateral assignment of the seller's interest in the contract for deed, which is, in effect a mortgage on a mortgage on a mortgage. The *Shuster* court, however, did not draw any distinction between the interests of the Doanes and the PCA. *Id.* at 884.

20. *Id.*

for deed must be perfected in the real estate records, not the UCC records, and recording in the real estate records alone was sufficient. The *Shuster* court reasoned that, since the seller's interest under a contract for deed represented fee title, persons searching for security interests in the seller's interest would naturally search real estate records:

As a practical matter, persons tracing the history of title to land would not expect to examine records in the office of the Secretary of State. The traditional and appropriate location for such a search is the office of the county recorder in the county where the land is located.<sup>21</sup>

The *Shuster* court also pointed out that the seller's interest in a contract for deed constitutes legal title to realty. Relying on the language of the old Article 9 that, with certain exceptions, the article did not apply to "the creation or transfer of an interest in or lien on real estate . . .,"<sup>22</sup> the court held that a transfer of a seller's interest in a contract for deed involved the "transfer of an interest . . . in real estate" within the meaning of that exclusion.<sup>23</sup> In addition, while not relied upon by the *Shuster* court, another argument to support real estate filing would be based upon the need to establish a good chain of title. In order to evidence a proper chain of title to the seller's (fee) interest in the real estate records when the security on the seller's interest is foreclosed, it is necessary for the perfection, foreclosure, and sale of the seller's (fee) interest to appear under the real estate records. Otherwise, a foreclosing lender who had taken security in the seller's interest under a contract for deed would be unable to evidence good and marketable title to the real estate when the time came to convey title. Thus, while not entirely free from doubt, based upon *In re Shuster* and other cases prior to Revised Article 9, the Minnesota law on pledges of a seller's interest under a contract for deed was probably that such security interests must be perfected (and

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21. *Id.* at 884-85.

22. MINN. STAT. § 336.9-104(j) (2000) (*repealed 2001*).

23. *In re Shuster*, 784 F.2d at 884. Interestingly enough, the *Shuster* court relied on the analogy between contracts and mortgages and argued that because assignments of mortgages were governed by real estate law, so were assignments of seller's interests under a contract for deed. *Id.* at 885. This reasoning ignores the fact that old Article 9 expressly *did* apply to a collateral assignment of a mortgage. See MINN. STAT. § 336.9-102(3) (2000) (*repealed 2001*) (stating application of article not affected by fact that obligation itself is secured by a transaction or interest to which this article does not apply); *Id.* at cmt. 4 (article applies to pledge of note secured by mortgage).

enforced) as a matter of real estate law.

As a practical matter, however, this situation was not ideal. Most lenders taking a security interest in the interest of a contract for deed seller, such as the lender in *Shuster*, received from the seller only an assignment (which, by itself, does not transfer the fee interest)<sup>24</sup> and/or a quitclaim deed, which, by its terms, typically recited that it was given only for collateral or security purposes. As a result, the assignment or deed, even if unconditional on its face, normally would only constitute an equitable mortgage on the vendor's interest.<sup>25</sup>

In the event of a default under the debt owed by the seller to the lender, the lender could only realize on and acquire the seller's interest under the contract for deed by the cumbersome process of judicial foreclosure.<sup>26</sup> Moreover, even if a mortgage containing a power of sale was given by the seller to the lender, the foreclosing lender would still have to endure the statutory six month redemption period after the foreclosure sale.<sup>27</sup> In addition, there was no provision under Minnesota real estate law allowing a mortgagee on a seller's interest in a contract for deed to collect payments due under the contract for deed from the purchaser prior to completion of the full foreclosure, sale and redemption process. Thus, a mortgage on a seller's interest under a contract for deed was often of questionable value. Finally, due to the uncertainty of whether perfection in the real estate records alone was sufficient, careful lenders adopted a "belt and suspenders" approach and filed a financing statement in the UCC records, in addition to a mortgage or deed in the real estate records.

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24. MINNESOTA TITLE STANDARDS, No. 76 (Section of Real Prop. Law of Minn. Bar Ass'n., 1994).

25. *Bishop v. LaBree*, 207 Minn. 330, 332, 291 N.W. 297, 298 (1940); *Goodhue State Bank v. Luhman*, 490 N.W.2d 152, 156 (Minn. Ct. App. 1992) (where assignment of vendor's interest was as security for credit to vendee, default by vendee results in foreclosure on vendor's interest). However, as discussed more fully below, where there is no debt involved between the assignor and the assignee, the assignment will be treated as an outright assignment, not an equitable mortgage. See *Trondson v. Janikula*, 458 N.W.2d 679, 682 (Minn. 1990).

26. MINN. STAT. Ch. 581 (2000).

27. MINN. STAT. Ch. 580 (2000).

### III. THE EFFECT OF REVISED ARTICLE 9

#### A. *Revised Article 9 Generally*

As previously noted, the uniform provisions of Article 9 of the Uniform Commercial Code, dealing with secured transactions, have been significantly revised on a national basis. Revised Article 9 was submitted to the fifty states for adoption and went into effect on July 1, 2001. In 2000, the Minnesota Legislature adopted, largely in whole, Revised Article 9 of the Uniform Commercial Code to take effect July 1, 2001.<sup>28</sup> While the broader implications of Revised Article 9 are beyond the scope of this Article, it should be noted that Revised Article 9 makes a significant change in the location of where the UCC financing statement is to be filed. Under the prior version of Article 9, the proper place to file, and the law governing the attachment and perfection of a security interest, was generally determined by the location of the collateral.<sup>29</sup> In other words, the UCC financing statement was filed where the collateral was located. Under Revised Article 9, the law that controls is generally the law where the debtor resides, in the case of an individual debtor, or is incorporated/organized, in the case of an entity debtor. In addition, financing statements must be filed in most cases with the Secretary of State of the state where the debtor is located or formed. Thus, the applicable law is that of (and the financing statement filing is made in) the state of incorporation/formation of a debtor that is a corporation, limited liability company, or other registered entity, and the state of residence of an individual debtor.<sup>30</sup>

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28. 2000 Minn. Laws, Ch. 399, Art. 1, §§1 - 138, MINN. STAT. § 336.9-701 (2000). For a good introduction to the broader impact of Revised Article 9, see Gene H. Hennig, CHANGES IN THE WIND: REVISED UCC ARTICLE 9, BENCH & BAR, Sept. 2000, at 31.

29. MINN. STAT. § 336.9-103 (2000) (*repealed July 1, 2001*).

30. MINN. STAT. § 336.9-301(1) (2000). If the debtor is an individual the filing will be made in the office of the Secretary of State of the debtor's state of residence. MINN. STAT. § 336.9-307(b)(1) (2000). A general partnership is located in and its filings are made in the state of its principal of place of business. MINN. STAT. § 336.9-307(b)(2) (2000). If the debtor is a registered organization, such as a corporation, limited partnership, or limited liability company, the filing will be made in the office of the Secretary of State of the state of incorporation/formation/organization of the debtor. MINN. STAT. § 336.9-307(e) (2000).

*B. Non-Uniform Minnesota Amendments Applicable to Traditional Mortgages*

As previously noted, a security interest in a traditional mortgage on real estate was considered an Article 9 security interest even under the old Article 9. However, certain non-uniform amendments to Revised Article 9 in Minnesota were adopted in 2000 in order to clarify certain issues regarding enforcement of security interests when the collateral consists of traditional real estate mortgages. These non-uniform Article 9 amendments alleviate some problems that had arisen under the prior Article 9 due to the practice whereby mortgages were collaterally assigned to a third party, but, due to the large volume involved, assignments of the mortgages were either not executed or not put of record. Thus, if the secured party realized on the collateral and the mortgagor sought a release or satisfaction from the secured party, record title to the mortgage lien was still in the original mortgagee-debtor and a release or a satisfaction from the secured party/new holder of the mortgage could not be used to clear title.

These concerns were addressed in 2000 in certain non-uniform provisions adopted as part of Minnesota's version of Revised Article 9. Under Minnesota's Revised Article 9, if a secured party exercises rights under a traditional mortgage in which it has been granted a security interest e.g. collects payments under the mortgage, and the mortgagor satisfies the mortgage, the secured party must issue a release or satisfaction of the mortgage to be recorded in the real estate records.<sup>31</sup> In addition, in order for a secured party to foreclose the mortgage in which it has a security interest without court action (foreclosure by advertisement), the secured party must record in the real estate records an instrument evidencing an assignment of the mortgage.<sup>32</sup> Finally, if a secured party holding a security interest in a mortgage exercises any rights under the mortgage, i. e. collects payments, the secured party must "promptly" thereafter execute and file in the real estate records an instrument having the effect of an assignment of the mortgage to the secured party.<sup>33</sup> Thus, these non-uniform amendments to

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31. MINN. STAT. § 336.9-607(a)(2)(A) (Supp. 2001).

32. MINN. STAT. § 336.9-607(b)(1) (Supp. 2001) (stating transferee must file of record an assignment of mortgage or an affidavit of assignment).

33. MINN. STAT. § 336.9-607(f)(3) (Supp. 2001) (stating transferee must file of record an assignment of mortgage, an affidavit of assignment, or a transfer

Revised Article 9 assure that the innocent mortgagor can and will obtain a satisfaction or release from the record holder of the mortgage.

*C. Uniform Revised Article 9 and Contracts for Deed*

What does the uniform Revised Article 9, adopted in Minnesota in 2000 and effective July 1, 2001, say about security interests in a seller's interest under a contract for deed? Minnesota Statutes Section 336.9-102(a) (2) defines an "account" to include "a right to payment of a monetary obligation . . . (i) for property that has been or is to be sold . . ." <sup>34</sup> Thus, under Revised Article 9, a purchaser's obligation to make payments under a contract for deed is deemed an "account" and security consisting of a seller's right to payments under a contract for deed is to be created, perfected, and enforced under the provisions of Revised Article 9. <sup>35</sup> Similarly, under Revised Article 9, the security interest in the right-to-payments under the contract for deed also includes a security interest in the seller's lien on the real property <sup>36</sup> and perfection of the security interest in the right-to-payments constitutes perfection of the security interest in the seller's lien on the real property. <sup>37</sup> This reverses the result in *In re Shuster* and will require that lenders seeking to perfect a security interest in the stream of payments under a contract for deed take a security interest and file a financing statement in the office of the Secretary of State in the state of the debtor's residence, in the case of an individual debtor,

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statement).

34. MINN. STAT. § 336.9-102(a) (2) (2000). Under the old Article 9, a seller's interest under a contract for deed was arguably a "general intangible," but that definition was limited to "personal property." MINN. STAT. § 336.9-106 (2000) (*repealed 2001*). The new definition of "account" quoted in the text would include the sale of real property.

35. See, Nelson & Whitman, *supra*, note 8, § 3.37. Under Revised Article 9 terminology, where the seller has pledged its interest under a contract for deed, the contract purchaser is deemed to be the "account debtor." MINN. STAT. § 336.9-102(a) (3) (2000) ("account debtor" means "a person obligated on an account."). The seller who has pledged the security interest is, of course, termed the "debtor." MINN. STAT. § 336.9-102(a) (28) (A) ("debtor" means "a person having an interest . . . in the collateral").

36. MINN. STAT. § 336.9-203(g) (Supp. 2001) ("[A]ttachment of a security interest in a right-to-payment . . . secured by a . . . lien on . . . real property is also attachment of a security interest in the . . . lien.").

37. MINN. STAT. § 9-308(e) (2000) ("[P]erfection of a security interest in a right-to-payment . . . also perfects a security interest in a . . . mortgage, or other lien on . . . real property securing the right.").

or in the state of incorporation-formation of a debtor that is a corporation, limited liability company or limited partnership. Similarly, contrary to the reasoning of *In re Shuster*, persons searching for prior security interests of a seller under a contract for deed must search for financing statements in the UCC records, not in the Minnesota real estate records, and, in particular, in the UCC records of the state of the debtor's residence or incorporation, not necessarily in Minnesota.

In this regard, it should be noted that the definition of "mortgage" under Revised Article 9 is "a consensual lien on real property . . . which secures payment or performance of an obligation."<sup>38</sup> Thus, in addition to constituting an "account" under Revised Article 9, a seller's interest under a contract for deed is deemed a "mortgage" under Revised Article 9. This, of course, is consistent with Revised Article 9's equation of a traditional mortgage and a seller's interest in a contract for deed.

Given the fact that a seller's interest under a Minnesota contract for deed is generally the functional equivalent of a mortgage and is generally personal property, is there anything wrong with this characterization and result under the uniform provisions of Revised Article 9? The short answer is "plenty."

Unlike a mortgage, which is merely a lien in favor of the mortgagee, a seller's interest under a contract for deed normally constitutes fee title to the real estate, a sacrosanct interest that normally can only be transferred by a real estate deed.<sup>39</sup> Under a typical transaction, the financing statement evidencing the security interest on the seller's right to receive payments under a contract for deed will be filed in the Secretary of State's UCC records in the state where the debtor resides or is incorporated. If there is a default in the secured debt, the secured party, as its right under Revised Article 9, will collect payments due under the contract for deed. In such case, if only the 2000 non-uniform Minnesota amendments dealing with traditional mortgages were applicable, the secured party would file in the real estate records an instrument evidencing an assignment of the seller's interest under the contract for deed to the secured party/transferee. When the purchaser under the contract for deed completes paying off the

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38. MINN. STAT. § 336.9-102(a)(55) (Supp. 2001).

39. The seller's interest also encompasses an obligation of the seller to convey such title to the purchaser under the contract for deed by deed (generally with warranties of title).

contract for deed, he or she will be entitled to a deed. However, the secured party who has realized on the seller's right to payments under the contract for deed will have obtained only an assignment of that right to payments, not any real estate rights (which cannot be secured by a mere Revised Article 9 security interest). All the secured party will have received is an assignment of the original seller's interest in payments under the contract for deed. While an assignment may be sufficient to transfer the seller's interest under the contract for deed, it does *not* transfer the fee title, which may only be accomplished by a deed.<sup>40</sup> Fee title still resides in the original seller, not in the secured party. For that reason, a deed from the secured party, not in the real estate chain of title, will not be sufficient to deliver marketable title to the contract for deed purchaser.

Thus, there is a risk of long-term separation of the right to payments from the fee (the holder of which is the party from whom the deed must be obtained). If the record fee owner is no longer getting payments (and particularly if the original seller has not been getting payments for some time), it may be difficult to obtain the deed from the seller when the contract is paid off. Simply put, since the seller is not getting payments, he or she will not be motivated to deliver the deed. Thus, by reason of this long-term separation of the right to payments from the fee title, the purchaser is at risk of not being able to obtain the record fee title. Sophisticated or well-represented contract purchasers will likely condition the last contract payment (often a balloon payment) on delivery of a deed from the record fee owner. However, many purchasers are unlikely to be that sophisticated or represented by legal counsel and, in any event, the secured party who is receiving payments may be unable to compel the original seller to issue the deed.

If the contract purchaser is unable to obtain the required deed from the record fee owner, the purchaser will not have marketable title and will be unable to re-sell or finance the property. The only remedy for the purchaser is to commence and prosecute to conclusion a quiet title action (or a proceeding subsequent on registered land) with a significant time delay and the expense of legal fees.

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40. MINNESOTA TITLE STANDARDS, Standard No. 76 (Section of Real Prop. Law of Minn. Bar Ass'n., 1994).

#### IV. WHAT IS TO BE DONE?

##### A. *What Can't Be Done*

At one point, a group of real estate lawyers working with the Real Property Section of the Minnesota State Bar Association contemplated legislation recognizing a new instrument, a seller mortgage, which would be a real estate mortgage on a seller's interest in a contract for deed. That seller mortgage would be a lien or security interest not only on the seller's real estate interest under the contract for deed (an interest to which even uniform Revised Article 9 probably has no applicability), but also a security interest in and a collateral assignment of the stream of contract payments due from the purchaser under the contract. The problem that would arise with any such legislation is that, as noted above, the stream of payment under the contract for deed is an "account" under Revised Article 9. As such, a security interest in such "account" would constitute an Article 9 security interest to be granted, perfected, and enforced under the rules of Article 9. That, in itself, would not be so bad because Minnesota could, in theory, amend its version of Article 9 to provide that contract for deed accounts, unlike other accounts, would not constitute an account under Article 9, but would be treated as a real estate security under Minnesota real estate laws, a la *In re Shuster*.

The real problem arises because, as noted previously, the issue of perfection and priority of Article 9 security interests are governed by the laws of the state in which the debtor resides or is incorporated or organized, which is also the state in which the financing statement is filed.<sup>41</sup> Thus, if a Minnesota seller sells Minnesota real estate on a Minnesota contract for deed, but then moves to Florida where the seller then grants a Florida bank a security interest in the contract for deed, Article 9 conflict rules provide that Florida law, not Minnesota law, will govern the perfection and priority of the security interest. Thus, it will not matter one whit that Minnesota law treats the seller's right to payments under the contract for deed not as a UCC "account," but as a real estate security to be perfected in real estate records. Florida law, which will treat the seller's right to payments under the

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41. MINN. STAT. § 336.9-301(1) (2000). On issues other than perfection and priority, such as attachment and enforcement, the lender's documents can designate a choice of law other than the state of the debtor. *Id.* at cmt. 2.

Minnesota contract for deed as an “account” and a Revised Article 9 security interest to be perfected by filing with the Florida Secretary of State, not in any Minnesota real estate records, will control. If a seller’s interest in a Minnesota contract for deed is pledged by a seller residing or incorporated out-of-state, a Minnesota statute would have no effect. Thus, the issue of whether the security consisting of a seller’s interest in a contract for deed was to be treated as real estate, if Minnesota law applied, and personal property under Revised Article 9, if another state’s law applied, would depend upon such things as the residence of the debtor, a fact that cannot be determined by real estate records.

As a result, no one could rely upon Minnesota’s real estate records to be assured that Minnesota law applied and that security in the seller’s contract for deed interest was properly perfected. Such a scheme would simply not be workable. Therefore, Minnesota could not adopt legislation purporting to treat a security interest in a seller’s right to payments under a Minnesota contract for deed as real estate. Such security interest will have to be perfected under Article 9. Like the death of Marley in Dickens’ *A Christmas Carol*, only once this is understood does the solution that was adopted in 2001 by the Minnesota Legislature make any sense.

*B. What Can and Has Been Done—2001 Non-Uniform Contract for Deed Amendments to Revised Article 9*

As previously noted, because of the unavoidable applicability of Revised Article 9 to a seller’s interest under a contract for deed, lenders taking a security interest in the seller’s right to payments under a contract for deed must enter into a security agreement with the seller-borrower granting the lender a security interest and the lender must perfect their security interest by filing a financing statement with the secretary of state in the state of the seller-borrower’s residence or incorporation/organization. Because of this inescapable situation, the only amelioration that could be accomplished in Minnesota was to avoid adverse consequences to innocent contract for deed purchasers who might otherwise be caught up in problems not of their own making. Therefore, certain non-uniform amendments were tacked onto the 2001 UCC technical amendments bill and these amendments dealing with contracts for deed have been adopted by the Minnesota Legislature

and signed into law.<sup>42</sup> In general, what these amendments, which took effect on July 1, 2001, along with the rest of Revised Article 9, sought to do was to accept that security interests in a seller's interest in a Minnesota contract for deed are now to be governed by Revised Article 9. These non-uniform 2001 amendments also accept the usage of the transfer mechanisms enacted in the non-uniform 2000 amendment for traditional mortgages, but carve out the special requirements and limitations applicable to situations with contracts for deed. In other words, the theory of the Minnesota non-uniform contract for deed amendments to Revised Article 9 is: "if you can't beat 'em, join 'em."

### 1. *Definition of a Contract for Deed*

Because of the desire to avoid having to add a special non-uniform definition to the plethora of definitions already in the uniform Revised Article 9, the term "contract for deed" was neither defined nor used in Revised Article 9. Rather, the Minnesota non-uniform provisions dealing with contracts for deed refer to "an executory contract for the sale of real estate or of an interest in real estate that entitles the purchaser to possession of the real estate."<sup>43</sup> This language was adopted from language in other Minnesota statutes dealing with contracts for deed, including the contract deed termination statute,<sup>44</sup> the deed tax statute,<sup>45</sup> and the mortgage registry tax statute.<sup>46</sup> The reference to having the right of possession has the effect of excluding the typical purchase agreement from the scope of these provisions. Such a purchase

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42. See Uniform Commercial Code - General Amendments, Ch. 195, 2001 Minn. Laws 525.

43. *Id.* at §§ 5, 16, 18, 19, 21, and 22, 2001 Minn. Laws at 527-546. As a clarification, the definition of "mortgage" was also amended to make it clear that such executory contracts i.e. contracts for deed, were included within the definition of a "mortgage." MINN. STAT. § 336.9-102(a)(55) (Supp. 2001).

44. MINN. STAT. § 559.21, subs. 1b, 1c, 1d, 2a (2000)(using the terms "contract for the conveyance of real estate or an interest in real estate"); MINN. STAT. § 559.211, subd.1 (2000)("contract for the conveyance of real estate or any interest therein").

45. MINN. STAT. § 287.22(1) (2000)("[A]n executory contract for the sale of real estate under which the purchaser is entitled to or does take possession of the real property" is exempted from deed tax.).

46. MINN. STAT. § 287.04(d) (2000) ("[A] contract for the conveyance of any interest in real property, including a contract for deed" is exempted from mortgage registry tax.). Previously, "an executory contract for the sale of land under which the vendee is entitled to or does take possession" was deemed a mortgage subject to mortgage registry tax. MINN. STAT. § 287.02 (*repealed 1987*).

agreement is usually a short-term holding instrument under which the buyer normally does not go into (or have the right to go into) possession until the subsequent closing, at which time there is the execution and delivery of a separate deed (or contract for deed). In contrast, a contract for deed is a longer-term financing device whereby the purchaser normally does go into possession (or has the right to) and makes periodic payments. Where the security interest is granted after a fee owner has merely entered into a purchase agreement to sell the real estate, generally the security holder will take priority over the purchase agreement and the security granted the lender consists of both equitable and fee title to the real estate i.e. a traditional mortgage.<sup>47</sup> Inclusion of purchase agreements within the ambit of the Revised Article 9 amendments would include what are clearly real estate mortgage transactions within Revised Article 9. Therefore, the operative language excludes purchase agreement i.e. contracts where the purchaser does not have the right to go into possession.

## 2. *Transfer Statement For A Contract For Deed*

The Minnesota 2001 amendments made various changes and additions to Revised Article 9 and to other provisions of Minnesota real estate law in order to deal with contracts for deed. Most importantly, Revised Article 9 now deals with the problem of transferring fee title from the seller/debtor to the secured party by validating a Revised Article 9 transfer statement as the means whereby the interest of the seller under the contract for deed and fee title are transferred in the real estate records.

In dealing with contracts for deed, the 2001 Minnesota

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47. The theory here is that the typical purchaser under a purchase agreement is not a good faith purchaser for valuable consideration under the recording act until after he or she has closed since the purchaser has not paid more than nominal consideration before the mortgage is granted by the seller-fee owner. MINN. STAT. § 507.34 (2000). As a result, where a purchaser has paid only a nominal consideration, the purchaser will take subject to any recorded liens against the seller's interest granted prior to payment of the full purchase price by and delivery of a deed to the purchaser. *See generally* Westpark, Inc. v. Seaton Land Co., 171 A.2d 736, 743-44 (Md. 1961)(citation of authorities). *But see* M. L. Gordon Sash & Door Co. v. Mormann, 271 N.W.2d 436, 440 (Minn. 1978) (interest of purchaser under option agreement who had previously made partial payment of the purchase price under a series of purchase agreements with the vendor and built and occupied home on the property was senior to vendor's judgment creditor, whose judgment docketed prior to the option agreement and vendor's conveyance of title).

legislation created a new concept called a “transfer statement for a contract for deed.”<sup>48</sup> The “transfer statement for a contract for deed” is defined as a document that (i) is a transfer statement made in compliance with section 336.9-619(a) and (ii) “transfers a seller’s interest in an executory contract for the sale of real estate or of an interest in real estate that entitles the purchaser to possession of the real estate [or, in the case of Torrens property, the land].”<sup>49</sup> Section 336.9-619(a) deals generally with all transfer statements. The uniform Revised Article 9 generally recognizes the concept of a “transfer statement,” which is a record, authenticated by a secured party, stating that the debtor has defaulted in connection with an obligation secured by specified collateral, the secured party has exercised its post-default remedies with respect to the collateral, and that, by reason of such exercise, the transferee has acquired the rights of the debtor in the collateral.<sup>50</sup> In addition, the transfer statement must recite the names and mailing addresses of the secured party, the debtor, and the transferee.<sup>51</sup> The effect of the transfer statement generally is to transfer of record all rights of the debtor to the transferee in the specified collateral.<sup>52</sup>

In addition to these uniform provisions applicable to all transfer statements, section 336.9-619(a) (adopted as part of the non-uniform amendments in 2000 applicable to all “mortgages”) provides that where the transfer statement is to be filed in the real estate records concerning collateral consisting of a mortgage (which includes a contract for deed),<sup>53</sup> the statement must reference the names of the parties and the document, the date, and the recording information regarding the recorded mortgage (including contract for deed).<sup>54</sup> In addition, a transfer statement dealing with a mortgage (including contract for deed) must contain the statutory acknowledgment by the secured party.<sup>55</sup> Finally, in the case of a contract for deed (but not in the case of a

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48. MINN. STAT. §§ 507.236, 508.491, and 508A.491 (Supp. 2001).

49. *Id.*

50. MINN. STAT. § 336.9-619(a)(1)(A)-(C) (Supp. 2001).

51. MINN. STAT. § 336.9-619(a)(1)(D) (Supp. 2001).

52. MINN. STAT. § 336.9-619(b) (Supp. 2001). The old Minnesota Article 9 had a less comprehensive provision, not found in the old uniform Article 9, allowing the secured party to record a report of proceedings of the sale of collateral. MINN. STAT. § 336.9-508 (2000) (*repealed 2001*).

53. MINN. STAT. § 336.9-102(a)(55) (Supp. 2001).

54. MINN. STAT. § 336.9-619(a)(1)(E) (Supp. 2001).

55. MINN. STAT. § 336.9-619(a)(2) (Supp. 2001).

traditional mortgage),<sup>56</sup> the transfer statement must contain the legal description of the real property subject to the contract.<sup>57</sup> All of this allows the transfer statement for a contract for deed to be recorded or filed (and indexed) with the real estate records for the underlying property being sold on the contract for deed.

The point of all these requirements is to have a means of memorializing in the real estate records the transfer of the fee interest in the real estate from the original seller to the secured party. Moreover, the point of memorializing this transfer in the real estate records is the most significant change of all — the transfer statement for a contract for deed conveys fee title to the underlying real estate. Despite the fact that the “transfer statement for a contract for deed” will, consistent with the normal UCC practice, be signed (and acknowledged) by only the secured party/transferee, the statute explicitly provides that it will have the legal effect of both an assignment and a deed.<sup>58</sup> Specifically, the 2001 amendments provide that upon recording (and subject to certain additional requirements regarding registered (Torrens) property), a transfer statement for a contract for deed “transfers from the contract seller named as debtor in the statement to the transferee all title and interest of the contract seller in the real estate described in the statement.”<sup>59</sup> In order to avoid any possibility of uncertainty, the statute goes on to provide that a recorded transfer statement for a contract for deed “has the same effect as an assignment and a deed from the contract seller to the transferee.”<sup>60</sup> Since such a transfer statement for a contract for deed has the effect of a deed transferring fee title from the original seller to the secured party, the secured party will now be in the chain of real estate title and the contract purchaser will be able to obtain marketable title to the real estate from the secured

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56. The general practice in Minnesota has been to *not* put legal descriptions of the mortgaged property on assignments or satisfactions of mortgages (in order to avoid the risk of errors in the legal description); the transfer statement of a traditional mortgage similarly does not require the legal description of the mortgaged property.

57. MINN. STAT. § 336.9-619(a)(1)(E)(vii) (Supp. 2001). Only a transfer statement can be used to transfer a seller’s interest in a contract for deed to a secured party/transferee. The affidavit of assignment and assignment, discussed *supra*, apply only to the transfer of a traditional mortgagee’s interest, not a contract for deed seller’s interest.

58. MINN. STAT. §§ 336.9-607(b)(3), 507.236, subd. 3 (Supp. 2001).

59. MINN. STAT. § 507.236 subd. 3(1) (Supp. 2001).

60. MINN. STAT. § 507.236 subd. 3(2) (Supp. 2001).

party/transferee. Finally, such a transfer statement for a contract for deed constitutes a conveyance for purposes of the Minnesota recording act, section 507.34.<sup>61</sup>

This represents a very significant change from prior Minnesota real estate conveyancing law and practice. It is the only situation, aside from a court order, where fee title can be transferred by a means other than a deed signed by the grantor (or his or her representative). It is particularly ironic that this Revised Article 9 instrument will have the effect of acting as a substitute for a purely real estate conveyancing document, the deed, when uniform Revised Article 9 (like old Article 9) expressly does not apply to real estate interests,<sup>62</sup> and a 2001 Minnesota amendment specifically provides that Revised Article 9 security interests do not constitute an interest in real estate.<sup>63</sup> Thus, acceptance of a “transfer statement for a contract for deed” as the complete equivalent to a deed (and assignment of the contract for deed) means a significant conceptual change in Minnesota law.<sup>64</sup>

### 3. *Other Provisions Implementing the Transfer Statement for a Contract for Deed*

New provisions were added in 2001 to statutes dealing with recording to provide for the recording of a transfer statement for a contract for deed in the real estate records in the county where the affected land is located.<sup>65</sup> In addition, other chapters dealing with

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61. MINN. STAT. § 507.236 subd. 3(3) (Supp. 2001). Thus, a recorded transfer statement for a contract for deed will defeat a subsequent judgment creditor against the contract for deed seller or a subsequent conveyance of the subject property by the original seller to a third party. *Id.*

62. MINN. STAT. § 336.9-109(d)(11) (2000) (Uniform Revised Article 9 does not apply to “the creation or transfer of an interest in or lien on real property.”).

63. *See infra* note 73.

64. In addition to the fact that the transfer statement for a contract for deed only requires a acknowledged signature of the secured party/transferee, in a change from the old Article 9, no signature of the debtor is required on the initial financing statement. MINN. STAT. § 336.9-502 cmt. 3 (2000). Thus, it is possible for an unscrupulous party to fraudulently file a financing statement and then obtain record fee title under a fraudulent transfer statement for a contract for deed, which interest then might be sold to an unsuspecting third party. Such a scheme would, however, require a statutory acknowledgement of the purported “secured party” on the transfer statement. In addition, the risk of that scenario is probably no greater than the normal risk of a forged deed and, in any event, the legislation reflects a judgment that these risks are outweighed by the need to assure contract purchasers that they will be able to get good titles.

65. MINN. STAT. § 507.236 subd. 2 (Supp. 2001).

registered (Torrens) property were amended to permit the memorial of a transfer statement to be filed on a certificate of title and to provide that, upon completion of a proceeding subsequent, a new certificate can be issued to the transferee.<sup>66</sup>

In addition, other non-uniform amendments to Revised Article 9 were adopted in 2001 to make sure that the transfer statement for a contract for deed works with other provisions of Minnesota law. If the contract for deed is canceled, a transfer statement cannot thereafter be used to transfer the seller's interest and any such transfer statement is not effective as a conveyance.<sup>67</sup> This provision was inserted to make sure that the transfer statement would not serve as a deed substitute where the contract for deed seller (by means of cancellation of the contract for deed purchaser) has acquired both equitable and legal title since, in that situation, the seller's interest being conveyed is purely a real estate interest and any transfer by the original seller should be by a normal deed. Moreover, once the contract for deed is canceled and the purchaser's obligation to make contract payments is terminated, the secured party will have lost any Revised Article 9 interest so there is no longer any Revised Article 9 asset to transfer.<sup>68</sup> Conversely, a secured party is permitted to exercise rights to non-judicially cancel the contract for deed<sup>69</sup> once the secured party has recorded a transfer statement in the real estate records.<sup>70</sup>

The 2001 non-uniform amendments also provide that if a secured party exercises the right of the seller to collect payments under the contract for deed, the secured party must deliver to the contract purchaser a deed to the real property "in accordance with the terms of the contract."<sup>71</sup> Thus, if the contract for deed requires the seller to deliver a warranty deed or to deliver partial deeds as the contract is being paid off, a secured party who has exercised rights under the contract, e.g. collected payments from the purchaser, will be required to deliver such deeds.<sup>72</sup>

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66. MINN. STAT. § 508.491 subds. 2, 3 (Supp. 2001); MINN. STAT. § 508A.491 subds. 2, 3 (Supp. 2001).

67. MINN. STAT. § 336.9-619(a)(3) (Supp. 2001).

68. As discussed below, the possibility that the contract for deed will be cancelled raises other issues as far as the secured party is concerned.

69. Such cancellation is normally pursuant to MINN. STAT. § 559.21 (2000).

70. MINN. STAT. § 336.9-607(b)(3) (Supp. 2001). Under this provision, the transfer statement must be accepted for recording and, upon recording, constitutes a conveyance of the seller's interest under the contract. *Id.*

71. MINN. STAT. § 336.9-607(a)(2)(B) (Supp. 2001).

72. In contrast, a secured party who exercises rights with respect to a

4. *Avoiding Clouds on Title Arising from a Contract for Deed Security Interest*

Another 2001 amendment will help avoid title issues that might otherwise arise by reason of a security interest in the interest of a seller under a contract for deed. As noted previously, under Revised Article 9, the security interest in the right-to-payments under the contract for deed also includes a security interest in the seller's lien on the real property.<sup>73</sup> The issue is whether such lien constitutes a lien on the real estate that is the subject of the contract. In the context of a traditional mortgage, a security interest on the mortgagee's mere lien interest could not conceivably constitute a lien on the underlying real estate. However, the result is not so clear in the case of a security interest in a seller's interest under a contract for deed. Since the security interest in the stream of payments extends to a security interest in the seller's lien on the property and since the seller's interest under a contract for deed, in addition to being a lien on the real estate, is also fee title, arguably, the secured party's lien on the right to payments is a lien on the fee title. Thus, where a seller has granted a financing statement on his or her interest under the contract for deed and the contract for deed is paid off, arguably the deed of the seller to the purchaser is not free of the interest of the secured party. If the Revised Article 9 security interest is not released, the contract purchaser might be subject to a lien on the fee title when he or she gets their deed from the seller. While Minnesota law is clear that a recorded contract purchaser takes free of a subsequent judgment or tax lien against the contract seller's interest,<sup>74</sup> the uniform provisions of Revised Article 9 do not specifically preclude such a result.

Nor is uniform Revised Article 9 absolutely clear where the

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mortgage must simply furnish a mortgagor with a release or satisfaction. MINN. STAT. § 336.9-607(a)(2)(A) (Supp. 2001).

73. MINN. STAT. § 336.9-203(g) (Supp. 2001).

74. *Greenfield v. Olson*, 143 Minn. 275, 277, 173 N.W. 416, 416 (1919); *Berryhill v. Potter*, 42 Minn. 279, 280-81, 44 N.W. 251, 251 (1890); MINNESOTA TITLE STANDARDS, Standard No. 90 (Section of Real Prop. Law of the Minn. State Bar Ass'n, 2000). However, the vendee cannot disregard a recorded notice of action to enforce such lien. MINNESOTA TITLE STANDARDS, Standard No. 90 (Section of Real Prop. Law of the Minn. State Bar Ass'n., 2000). Although a mortgage on the vendor's interest would seem analogous to a judgment or tax lien, Standard No. 90 does not identify a mortgage on the vendor's interest as a real estate lien that a previously-recorded contract purchaser would take free of.

seller has previously granted a security interest in the contract for deed that, if the contract for deed is cancelled, the seller's interest is no longer subject to the interest of the secured party. Thus, under uniform Revised Article 9, when the seller seeks to sell the property (both equitable and fee title) after properly canceling out the contract for deed purchaser, a new purchaser arguably might be subject to a lien on the fee title if the secured party's security interest is not released. Unless addressed, these issues would raise clouds on the title of any seller who had previously granted a security interest in the seller's interest in the contract for deed. This risk would possibly require UCC searches and releases by secured parties despite the fact that the collateral that was the subject of the secured transaction i.e. the contract for deed, is no longer in existence.

Therefore, an amendment to section 336.9-203(g) was adopted to resolve these uncertainties by stating that the security interest on either a contract for deed or a traditional mortgage does not create an interest in the underlying real property.<sup>75</sup> As a result, even if a security interest was previously granted in the seller's interest under a contract for deed, once the contract for deed has been extinguished, either by deed from the seller to the purchaser or by cancellation of the purchaser's interest, no one need be concerned about any residual real estate interest of the secured party.

##### 5. *Secured Party's Obligation to Acquire Fee Title*

Finally, once a secured party commences to collect contract for deed payments from the contract purchaser (the "account debtor"), the secured party must "promptly" file an instrument transferring the contract for deed seller's interest of record to the secured party by means of a transfer statement.<sup>76</sup> Thus, where a seller grants a security interest in the contract for deed and the seller subsequently defaults in its obligations to the secured party and the secured party commences collecting contract for deed

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75. MINN. STAT. § 336.9-203(g) (Supp. 2001) ("the attachment of a security interest in the . . . lien on real property does not create an interest in real property").

76. MINN. STAT. § 336.9-607(f)(2) (Supp. 2001) (This provision is a variation of the provision in MINN. STAT. § 336.9-607(f)(3) (Supp. 2001), applicable to traditional mortgages requiring the secured party to record an assignment of mortgage, transfer statement, or affidavit of assignment).

payments from the purchaser, the Minnesota statute requires that “promptly after beginning to” collect such payments, the secured party must record in the real estate records a transfer statement for a contract for deed.<sup>77</sup> In addition to being able to terminate the contract for deed if the purchaser defaults on the contracts (as discussed previously), the secured party will thereby be in a position to provide, as required by another non-uniform Minnesota amendment,<sup>78</sup> the requisite deed to the purchaser when the purchaser completes performance of the contract. The transfer statement for a contract for deed transferring real estate title from the seller to the secured party will put the secured party in the real estate chain of title so as to enable the secured party to convey marketable title to the contract purchaser. In addition, since the secured party must effectuate the transfer of a real estate interest to itself “promptly” after first beginning to collect contract payments, in theory this will avoid any long-term separation of the right to payments from the real estate interest that might otherwise prejudice the contract purchaser.

Unlike the provision (originally adopted in 2000) requiring a secured party collecting traditional mortgage payments “promptly” to become the holder of the mortgage, however, this provision dealing with contracts for deed might, at least initially, be seen as more onerous to at least some secured lenders. Generally, absent the unusual situation where a mortgagee’s affirmative acts makes it a “mortgagee in possession,” the holder of a traditional mortgage who has not acquired title by foreclosure of the mortgage has virtually no exposure to liability related to the real estate. This is basically because a mortgagee who has not foreclosed is not in the chain of title to the real estate and is not subject to environmental and other liabilities arising by reason of being an “owner.” In contrast, the holder of fee title is, by definition, in the chain of title, even if the holder acquired the fee interest by a transfer from the seller under a contract for deed. Some secured parties may be reluctant to come into the chain of title for fear of exposure to environmental and other liabilities. In addition, as noted previously, if a secured lender comes into title to a seller’s interest under a contract for deed and the contract for deed is paid off, the secured party will be required to deliver a deed to the purchaser

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77. MINN. STAT. § 336.9-607(f)(2) (Supp. 2001).

78. MINN. STAT. § 336.9-607(a)(2)(B) (Supp. 2001).

“in accordance with the terms of the contract.”<sup>79</sup> This is likely to entail giving a warranty deed with all the risks attended thereto.<sup>80</sup> Furthermore, given that once a secured party commences collecting contract payments it is required to execute and record a transfer statement for a contract for deed thereby putting itself in the chain of title, some secured lenders may be reluctant to demand (or at least think twice about demanding) the contract for deed payments when their own debtor goes into default. At the very least, these secured parties are likely to want to be assured that with respect to whatever warranties of title they may be ultimately required to give to the contract purchaser, (a) they have previously been given those same warranties by their debtor in their security agreement with the seller-debtor, and (b) such deed-required warranties are consistent with the status of title that they are acquiring from the original seller under the transfer statement.<sup>81</sup>

Nevertheless, the secured party’s exposure to liability by reason of its obligation to deliver a deed and by reason of its being in the chain of title is probably more theoretical than real. Under long-standing Minnesota law, an assignment of the vendor’s interest under a contract for deed without an express assumption by the assignee does not impose personal liability for the assignor’s obligations under contract.<sup>82</sup> There is nothing in the transfer statement for a contract for deed that would impose personal liability on the secured party/transferee for obligations under the contract.<sup>83</sup> In addition, under Revised Article 9, the claims of the

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79. *Id.*

80. In contrast, if the collateral consists of a traditional mortgage, even if the secured party becomes the owner of the mortgage, all the secured party will ever be obligated to do is give a release or satisfaction to the mortgagor. *See supra* note 72.

81. To that end, lenders taking a security interest in a seller’s interest under a contract for deed are advised to examine the seller’s real estate title so as to assure themselves that if and when the secured party does come into fee title by means of a transfer statement for a contract for deed, the secured party will acquire fee title consistent with any obligations to the contract for deed purchaser. Most lenders taking such security interests probably do so anyway in order to assure themselves regarding the collateral itself. In addition, the due diligence to be undertaken by a lender taking a security interest in a seller’s interest in a contract for deed is really no different than the due diligence of an investor purchasing outright a seller’s interest in a contract for deed, in which the investor will have to eventually deliver a deed to the contract purchaser.

82. *Pelser v. Gingold*, 214 Minn. 281, 288, 8 N.W.2d 36, 40 (1943).

83. If the secured party/transferee eventually gives a warranty deed to the contract purchaser, it seems clear that the secured party/transferee would have personal liability under the deed it has given.

contract for deed purchaser against the secured party/transferee are generally limited to a reduction of the amount owed on the contract and do not give rise to an affirmative recovery against the transferee.<sup>84</sup> Thus, the secured party who acquires title by means of a transfer statement for a contract for deed will not be personally liable for the seller's obligations under the contract for deed. Moreover, any such potential liability has rarely deterred passive investors who, as discussed later, frequently purchase outright a seller's interests under a contract for deed.<sup>85</sup> Nor has it typically deterred a secured lender from foreclosing a traditional mortgage and thereby coming into the chain of title. Just as a lender evaluates risks and benefits before commencing foreclosure in the traditional mortgage situation, a lender will have to evaluate risks and benefits before exercising its right to collect contract payments and, as a result, thereby come into fee title. In fact, it would only be upon subsequently canceling the purchaser under the contract for deed (and thereby acquiring all equitable interests in the real estate) that a secured party would really be exposed to any of the risks whatsoever of being an owner. Even then, a secured party who ends up canceling the purchaser may have immunity from liability in various situations.<sup>86</sup> Thus, acquiring bare fee title by

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84. MINN. STAT. § 336.9-404(b) (2000) ("the claim of the account debtor against an assignor may be asserted against an assignee . . . only to reduce the amount the account debtor owes"). Revised Article 9 "generally does not afford the account debtor the right to an affirmative recovery from an assignee." MINN. STAT. § 336.9-404 cmt. 3 (2000).

85. Nor is there potential exposure from a contract purchaser who receives a deed from someone other than the original contract seller. There is some old case law to the effect that a vendee is not required to take title from someone other than the original vendor. *See* *McNamara v. Pengilly*, 64 Minn. 543, 546, 67 N.W. 661, 662 (1896); *see also* *McChesney v. Oppek*, 156 Minn. 260, 262, 194 N.W. 882, 882 (1923) ("vendee is not required to take title through some one other than the vendor."); *Meyers v. Markham*, 90 Minn. 230, 96 N.W. 787, 787 (1903) (vendee can't complain where only promised quitclaim deed, distinguishing *McNamara*). Given the existence of title insurance and the lack of reliance on title warranties, the holdings of these cases seem very questionable. The modern rule is that a vendor under a contract for deed is free to sell his or her interest. *Summers v. Midland Co.*, 167 Minn. 453, 455, 209 N.W. 323, 324 (1926). Moreover, MINN. STAT. § 336.9-406(f)(2) (2000) invalidates any rule of law, such as the aforementioned old case law, that provides that an assignment or pledge of an account gives rise to a defense or other claim by the account debtor, i.e., the contract purchaser.

86. *See e.g.* MINN. STAT. § 115B.03 subd. 7 (2000) (declaring that a vendor under a contract for deed who is not otherwise a responsible party under the Minnesota environmental liability law does not become one by reason of statutory cancellation of the contract for deed).

means of a transfer statement for a contract for deed is itself one or more steps removed from being an owner with full attendant liability. As a result, it would seem unlikely that the obligation to come into fee title after collecting contract payments would discourage lenders from accepting contracts for deeds as security. In any event, however, the legislation reflects a judgment that such potential risks to a lender are outweighed by the need to protect innocent contract purchasers from the real risks of unmarketable titles.

*C. What Won't Change and What You Still Need to Know, i.e. Traps for the Unwary*

Revised Article 9 in Minnesota will address the immediate problems raised by Revised Article 9 as applied to sellers' interests in contracts for deed, will provide a way for contract purchasers to be protected, and will allow contract for deed sellers to finance their debt using the payment stream on a contract for deed. Still, there are a number of problems that are not addressed by the non-uniform Minnesota amendments. These problems or issues appear to be inherent in Revised Article 9 and are here with Minnesota lawyers to stay.

*1. Still Need Belt and Suspenders*

The Revised Article 9 security interest is only a security interest in personal property and is not a security interest in real estate. A Revised Article 9 filing on a contract for deed will grant a security interest only in the stream of payments due from the purchaser under the contract for deed and in the seller's lien to secure those payments. It will not, however, constitute a mortgage or security interest in the underlying real estate interest held by the seller under the contract for deed.<sup>87</sup> Only a separate real estate mortgage will grant security in the underlying fee title. As a result, if the purchaser's interest is canceled under section 559.21 (presumably before the secured party starts collecting payments and acquires outright the seller's interest by means of a transfer statement), the secured party who files only a Revised Article 9 financing statement against a seller under a contract for deed will lose all its security. Since the stream of contract payments is no longer in existence,

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87. MINN. STAT. § 336.9-203(g) (Supp. 2001).

there is no collateral left. Moreover, the non-uniform Minnesota amendments specifically provide that once the contract for deed is canceled, a secured party cannot file a transfer statement concerning that contract for deed and any such transfer statement is not effective as a conveyance.<sup>88</sup> Therefore, in order for a lender to be fully secured by a seller's interest in a contract for deed, the lender must take not only a Revised Article 9 security interest perfected by a financing statement filed with the correct Secretary of State, but also a real estate mortgage filed in the Minnesota real estate records against the real property which is the subject of the contract for deed. If the lender does take a mortgage, the contract purchaser's interest is canceled, and the seller's debt to the lender goes into default, the lender must foreclose its security as a real estate mortgage.<sup>89</sup> Thus, both belt and suspenders still are required.<sup>90</sup> Ironically, even though Revised Article 9 was intended to simplify secured transaction practice, in this context it has the effect of making secured transactions even more complicated.

## 2. *Buyer-Investors Beware*

Revised Article 9 does not distinguish between a pledge and an outright sale of an account. Sales of accounts, in addition to pledges of accounts, are within the scope of Revised Article 9.<sup>91</sup> Thus, Revised Article 9 requires that even an outright purchaser of a Revised Article 9 account must file a financing statement. As a result, there is a zinger built in to Revised Article 9 that affects outright buyers of sellers' interests under a contract for deed.

Under longstanding prior Minnesota law, the assignment of a vendor's interest in a contract for deed when no security interest is involved gives the assignee the same rights the seller possessed in the property and in the contract for deed, including the right to

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88. MINN. STAT. § 336.9-619(a)(3) (Supp. 2001).

89. *Lamm v. Armstrong*, 95 Minn. 434, 437, 104 N.W. 304, 305 (1905).

90. For similar reasons, prior to taking a financing statement on a seller's interest under a contract for deed, a prudent lender, in addition to doing a UCC search on the seller, will also examine the real estate records to determine whether the seller is the record owner and whether there are any prior mortgages or other liens.

91. MINN. STAT. § 336.9-109(a)(3) (2000) (Revised Article 9 applies to "a sale of accounts . . ."). In addition, Revised Article 9 amended the definition of "security agreement" to include "any interest of . . . a buyer of accounts . . . in a transaction that is subject to article 9." MINN. STAT. § 339.1-201(37) (2000).

the contract for deed payments.<sup>92</sup> Prior to Revised Article 9, where a transaction involved an outright purchase, not a loan, of the seller's interest, a buyer of a seller's interest in a contract for deed would take a deed and assignment and file that document (or documents) in the real estate records.<sup>93</sup> Nothing else would be required in order to fully vest the assignee in both the right to payments under the contract for deed and the real estate security.<sup>94</sup> In fact, if, following such an outright assignment, the assignee served a statutory cancellation notice upon the purchaser and the purchaser failed to timely cure the default, the assignee would end up owning the real estate outright, free and clear of any interest of either the original seller or the purchaser.<sup>95</sup>

However, since the right to payments due under the contract for deed is an "account" under Revised Article 9, sales of sellers' interests under contracts for deed must be perfected under Revised Article 9.<sup>96</sup> As a result, in order to perfect their outright ownership of the right to the contract payments, buyers of sellers' interests in contracts for deed must file a deed and assignment in the real estate records<sup>97</sup> and, in addition, must also file a financing statement with the secretary of state of the appropriate state.<sup>98</sup> In

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92. *Trondson v. Janikula*, 458 N.W.2d 679, 682-83 (Minn. 1990); *Pelser v. Gingold*, 214 Minn. 281, 287-88, 8 N.W.2d 36, 40 (1943).

93. MINNESOTA TITLE STANDARDS, Standard No. 76 (Section of Real Prop. Law of the Minn. State Bar Ass'n, 1994) (generally deed is required to convey the vendor's security interest in the real estate).

94. An assignment alone would only be sufficient if the seller did not hold fee title i.e. the seller was buying the property on a prior contract for deed. *Trondson*, 458 N.W.2d at 682-83; MINNESOTA TITLE STANDARDS, Standard No. 76 (Section of Real Prop. Law of the Minn. State Bar Ass'n, 1994).

95. *Trondson*, 458 N.W.2d at 682-83.

96. According to its drafters, inclusion under Revised Article 9 of sales is due to the difficulty in many commercial transactions of distinguishing between secured financings and outright sales. MINN. STAT. § 336.9-109 cmt. 4 (2000). Of course, in most transactions involving contracts for deed, the distinction is clear.

97. The investor-buyer should still perfect in the real estate records by filing a deed since (a) the investor-buyer will need to be in the chain of record title in order to deliver the requisite marketable title to the contract purchaser when the contract is paid off, and (b) as explained in the immediately-preceding section, if the contract for deed is cancelled, the investor-buyer will otherwise lose all interest in the property.

98. Under Revised Article 9 terminology and for purposes of filling out a financing statement, the original seller under the contract for deed is deemed the "debtor," MINN. STAT. § 336.9-102(a)(28)(B)(2000) ("debtor" includes "a seller of accounts"), and the buyer-investor of the seller's interest in the contract for deed is deemed the "secured party." MINN. STAT. § 336.9-102(a)(72)(D)(2000) ("secured party" includes "a person to which accounts . . . have been sold").

addition, since the initial financing statements expire after five years,<sup>99</sup> the buyer-investor must file continuation statements with the secretary of state every five years thereafter for the life of the contract for deed, which frequently has a term of greater than five years.<sup>100</sup> Otherwise, the investor-buyer of the contract for deed will be unperfected in the contract stream of payments and the original seller would still be in a position to pledge that account to a secured party. If that secured party files a financing statement with the appropriate secretary of state, the secured party would be entitled to the payment stream ahead of the investor-buyer even if that person had first recorded a deed and assignment in the real estate records.<sup>101</sup> Also, in addition to filing a financing statement in the state of the debtor, an investor-buyer of a seller's interest in a contract for deed must examine the UCC records in the debtor's state to determine that there are no prior interests in the contract payments.<sup>102</sup>

While the risk of outright fraud by a contract for deed seller who first sells the contract to an investor-buyer and then later specifically pledges the contract to a lender may be relatively uncommon, there may be a somewhat greater risk of a contract for deed seller later granting a blanket security interest to a lender which security interest inadvertently picks up the otherwise unperfected interest in the stream of payments. There is also the risk that the original seller might later become subject to the rights of a judgment creditor who levies on the stream of payments. Such judgment creditor would have priority over an investor-buyer who failed to file a financing statement.

Also possible is the risk that the original seller might file for bankruptcy. In such event, under the bankruptcy "strong-arm" statute, the bankruptcy trustee has the status of a hypothetical lien creditor and hypothetical bona fide purchaser who beats out any creditor or purchaser who has not perfected as required by local

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99. MINN. STAT. § 336.9-515(a) (2000).

100. MINN. STAT. § 336.9-515(e) (2000).

101. There is no need for an outright purchaser of a promissory note secured by a real estate mortgage to file a financing statement since a security interest arising from the sale of a promissory note is, under a special exemption, perfected when it attaches. MINN. STAT. § 336.9-309(4) (2000). Generally, the security interest arising from the sale of a promissory note attaches by possession and possession of the promissory note is normally given to a note purchaser.

102. Similarly, the prudent investor-buyer should examine the real estate records to determine that the seller is the record owner of the real estate interest and that there are no prior encumbrances on title.

law.<sup>103</sup> If an investor-buyer of a seller's interest under a contract for deed does not perfect its interest in the stream of payments by filing the requisite financing statement, the bankruptcy trustee will have rights superior to the investor-buyer in the stream of contract payments. As a result, investor-buyers of sellers' interests in contracts for deed are well advised to perfect their rights to the payment stream by complying with Revised Article 9 and filing UCC financing and continuation statements (in addition to filing the deed or assignment in the real estate records to perfect their real estate interest).<sup>104</sup> None of the non-uniform provisions adopted in Minnesota address or alleviate this issue of the outright sale of the seller's interest under a contract for deed.<sup>105</sup>

To a certain extent, the burden on an investor-buyer of a contract for deed is even more onerous than at first glance. As previously noted, unlike the old Article 9, under Revised Article 9, the financing statement must be filed in the state of the debtor's residence or incorporation, not the state of the location of the collateral. Moreover, if the debtor changes its state of residence or incorporation, the secured party generally has four months to file a

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103. 11 U.S.C. § 544 (2000). This was the same provision relied upon by the bankruptcy trustee in *In re Shuster*, although that case involved a pledge, rather than an outright sale, of the seller's interest under a contract for deed. *In re Shuster*, 784 F.2d 883, 884 (8th Cir. 1986)

104. MINN. STAT. § 336.9-607(b) and (f) (Supp. 2001), provides that the "secured party" (which includes the buyer of an account under MINN. STAT. § 336.9-102(72)(D) (2000)) must record a transfer statement for a contract for deed in the real estate records "promptly after beginning to" collect payments and also in order to exercise statutory cancellation. Arguably, these provisions would require the outright buyer of a seller's interest under a contract for deed to record a transfer statement for a contract for deed once the investor starts collecting payments under the contract or prior to canceling the contract. Such a conclusion is anomalous since (i) in accordance with customary practice, the investor-buyer would have already received and recorded a deed and/or assignment which would have the same effect as a transfer statement for a contract for deed, and (ii) in an outright sale context, the "secured party" would not be able to state in the transfer statement, as required by MINN. STAT. § 336.9-619(a)(1)(A) and (B) (Supp. 2001), that the "debtor" has defaulted in connection with obligations secured by the contract and that the "secured party" has exercised post-default remedies with respect to the collateral. In fact, a transfer statement for a contract for deed should *not* be recorded by an outright buyer of a seller's interest and no adverse consequences should accrue to such investor by reason of such failure to do so, notwithstanding the statutory language suggesting the contrary.

105. In fact, even in states other than Minnesota that utilize contracts for deed, this will be a matter of concern whether or not those states opt to provide some sort of contract-purchaser protections adopted by Minnesota.

new financing statement in the new state of residence or incorporation or else the original financing statement lapses and the security interest becomes unperfected.<sup>106</sup> Thus, where an individual contract for deed seller residing in Minnesota sells or pledges his contract, the secured party perfects his security interest by filing a financing statement in Minnesota, and then the original seller relocates his principal residence to Florida, the secured party will lose his perfected security interest unless the secured party files a new financing statement in Florida within four months after the debtor has moved to Florida. This is presumably not a great burden where the contract for deed seller has merely pledged his or her seller's interest to secure another debt. The secured party will normally be in frequent contact with the original seller and will normally be able to readily determine whether the seller has changed his or her primary residence and, thus, can timely file a new financing statement if necessary. Also, this is not likely to be a frequent problem with corporate or other entity contract sellers since they only infrequently reincorporate in another state. Individual contract sellers, however, particularly those who have sold their home or farm on a contract, do frequently relocate.<sup>107</sup> They are also the most common parties assigning out their contract interests. Furthermore, where the contract seller has sold the contract outright (in contrast to a pledge), normally the investor-buyer never again hears of or sees from the original seller, there being no continuing obligations to the investor-buyer. It is likely to be difficult for an investor-buyer to ever find out that the original contract seller has relocated to Florida, let alone find out and file anew within the requisite four months.

This problem may be exacerbated in the occasional situation where a contract for deed seller discounts the contract to an investor-buyer who subsequently re-sells the contract to another

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106. MINN. STAT. § 336.9-316(a)(2) (2000).

107. The drafters of Revised Article 9 were principally focused on commercial transactions and were not especially concerned about relocation of individuals, as evidenced by the fact that all seven of the examples dealing with relocation of the debtor deal with relocation of partnerships or corporations and none deal with individuals changing their principal residence. *See, e.g.*, MINN. STAT. § 336.9-316 at cmt. 2, 3 (2000) (providing examples of when parties must re-perfect under the law of a different jurisdiction). The drafters of Revised Article 9 were also of the view that collateral moves more often than debtors. MINN. STAT. § 336.9-301 at cmt. 4 (2000). In fact, in the case of contracts for deed, the collateral, the right to payment secured by real estate, never moves, but the debtor, the seller, frequently does.

investor-buyer (and the process can go on indefinitely). The first investor-buyer will perfect its security interest by a financing statement against the original seller. The second investor-buyer will have to perfect its interest by a filing against his immediate transferor, the first investor-buyer (since this constitutes the sale of an account), although the second investor-buyer will not have to re-file the financing statement on the original seller.<sup>108</sup> However, if the contract for deed is not paid off within five years of either filing, the second investor-buyer will have to file a continuation statement both on the financing statement of the original seller and on the financing statement of the first investor-buyer. Moreover, if either the original seller (with whom the second investor-buyer has never dealt) or the first investor-buyer (with whom the second investor-buyer is likely to never have any future contact) change states of residences, in order to remain perfected, the second investor-buyer would have to file financing statements in the new states within four months of such change. On the face of things, all this would appear to present a fairly impossible burden to investor-buyers of contracts for deed.

In fact, however, most of these risks to an investor-buyer appear more theoretical than real. Absent real fraud, a contract for deed seller who has sold his contract outright will not expressly sell or pledge the contract. In addition, while a blanket UCC-type security agreement might pick up an unperfected contract for deed seller's interest, individuals, who are the typical parties who sell on a contract and then discount the contract to an investor-buyer, normally are not asked to sign blanket security agreements. Finally, even if an investor-buyer has failed to perfect his or her interest, a bank holding a blanket pledge or a bankruptcy trustee will be unlikely to discover the existence of the unperfected interest in the contract. Since the original seller will have received the full value of his or her contract interest and will not have been receiving any payments on the contract for deed, he or she will be unlikely to regard the contract as an asset to be disclosed to the bank in a financial statement or to the trustee in a bankruptcy filing.

In view of the foregoing, can a title insurance company feasibly insure an investor's purchase of a seller's interest under a contract

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108. MINN. STAT. § 336.9-310(c) (2000) ("If a secured party assigns a perfected security interest . . . , a filing . . . is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.").

for deed? Upon recording of a deed/assignment of the seller's interest, the title insurance company can certainly insure the real estate interest (exclusive of the right to receive payments). Moreover, with a UCC-search in the debtor's state and a filing of a financing statement in the debtor's state, the title insurance company can also insure the right to receive payments, subject to lapse of the financing statement (by reason of failure to timely file a continuation statement or failure to timely re-file after relocation of the debtor).<sup>109</sup> Presumably, filing 5-year continuation statements is a relatively manageable risk. Also, the risk to an investor of lapse due to the failure to timely re-file after relocation of the debtor will be significantly reduced in the case of a contract seller who is a registered organization, such as a corporation or limited liability company. Unlike individual debtors who are mobile, such organizations only very rarely re-organize in a new state. In fact, in order to make their seller's interests more saleable to investors, sellers might consider incorporating before selling on a contract for deed so as to virtually eliminate the risk to an investor of a financing statement lapsing.<sup>110</sup>

### 3. *Limited Grandfathering*

These rules under Revised Article 9 are not just applicable to sales or pledges of sellers' interests in contracts for deed that take place on or after July 1, 2001. Rather, the general rule that a person acquiring a seller's interest under a contract for deed (either outright or for security purposes) must perfect their interest in the stream of payments by effecting a UCC filing also applies to sales or pledges of sellers' interests in contracts for deed

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109. The First American Corporation's recently developed EAGLE 9 UCC Insurance Policy is one policy that does provide coverage for Article 9 interests. Notably, the policy excludes from protection losses resulting from lapse of the original financing statement filing. Steven O. Weise, Philip Ebling, Dena M. Cruz, Theodore H. Sprink and Randall L. Scott, *IT'S TIME TO TAKE A CLOSE LOOK AT UCC ARTICLE 9*, 19 Calif. Real Prop. J. 3, 11-12 (2001).

110. Incorporation (or creation of an LLC) would entail some additional expenses. Also, sellers would need to make sure that such a technique would not result in adverse tax consequences, such as loss of the exclusion of capital gains for the sale of a personal residence or the premature acceleration of capital gain for sale of investment property (where the original seller does not plan to immediately sell the contract). Incorporating the seller after the contract for deed is entered into will not avoid the risk of lapse due to relocation since, as discussed *supra*, perfection must be maintained as against the original individual seller (in addition to the corporate first-assignee).

consummated before July 1, 2001. There is only limited grandfathering protection for pre-July 1, 2001 sales (or pledges) of contracts for deed where the investor-buyer (or secured party) had not previously properly filed a UCC financing statement.<sup>111</sup> If a security interest was attached and perfected (other than by financing statement) prior to July 1, 2001, under the law that applied to it before Revised Article 9 applied, then it remains perfected for one year and thereafter the security interest no longer attaches or is perfected.<sup>112</sup> In order to perfect the interest in the seller's interest under a contract for deed in Minnesota prior to July 1, 2001 (particularly in the case where the seller's interest has been sold outright) one had to file a deed and instrument in the real estate records.<sup>113</sup> Thus, if a party who acquired outright a seller's interest in a contract for deed prior to July 1, 2001, filed a deed and assignment in the real estate records, that party is protected for one year after Revised Article 9 takes effect. Similarly, where a party took a pledge of a seller's interest under a contract for deed prior to July 1, 2001, and filed a mortgage in the real estate records, that party will also be perfected for one year after July 1, 2001. Thereafter, however, the rights of the investor-buyer of (or the secured party in) the contract for deed stream of payments will no longer be perfected. Thus, as of July 1, 2002, even pre-July 1, 2001 acquisitions (or pledges) of sellers' interests in contracts for deed will have to be perfected by filing UCC financing statements and thereafter filing periodic continuation statements.<sup>114</sup>

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111. If a UCC financing statement was filed prior to July 1, 2001, generally the secured party will remain perfected until the original statement would lapse under old Article 9. Under MINN. STAT. § 336.9-705(c) (2000), an effective financing statement that is on file as of July 1, 2001, will generally remain perfected and with the same priority for as long as it would have remained effective under prior Article 9 law, generally five years (which the date when a continuation statement would have to be filed), but in no event later than June 30, 2006. To continue a pre-July 1, 2001 financing statement filing, the secured party must file in accordance with the Revised Article 9 rules and if the state in which the pre-July 1, 2001 filing was made is not the proper jurisdiction under Revised Article 9, a new financing statement (not a continuation statement) must be filed in the correct jurisdiction. MINN. STAT. §§ 336.9-705(d) and 336.9-706 (2000).

112. MINN. STAT. § 336.9-703(b) (2000).

113. MINNESOTA TITLE STANDARDS, Standard No. 76 (Section of Real Prop. Law of the Minn. State Bar Ass'n., 1994) (deed sufficient to perfect outright sale of seller's interest); *In re Shuster, supra* (filing of mortgage in real estate records is sufficient to perfect pledge of seller's interest).

114. It may behoove diligent counsel to review their files to determine whether

#### 4. *Creditor-Debtor Rights Governed by Revised Article 9*

The rights as between a secured party and a seller regarding who is entitled to receive the contract for deed payments are wholly governed by Revised Article 9. Prior to Revised Article 9, as a matter of real estate law, a holder of a security interest on a contract seller's interest had no right to collect contract payments prior to acquiring the entire seller's interest by means of a real estate foreclosure. Now, under Revised Article 9, basically once there is a default in the underlying security agreement, a secured party has free rein to require the contract purchaser to make all payments to the secured party, instead of the seller/debtor, simply by giving notice to the contract purchaser.<sup>115</sup> Essentially, Revised Article 9 gives the secured party rights to collect contract payments similar to rights held by a mortgagee under an assignment of leases and rents to collect lease payments.<sup>116</sup> However, unlike the assignment of rents statutes, there are only limited procedural safeguards to protect the contract purchaser. Under Revised Article 9, once the contract purchaser receives notice that the contract payments are to be made to the secured party, authenticated by either the original contract seller or the secured party, payments thereafter made to the original contract seller will *not* discharge the contractual obligation.<sup>117</sup> If requested by the contract purchaser, the secured party must "seasonably" furnish reasonable proof that the pledge (or outright assignment) has been made.<sup>118</sup> Finally, as discussed earlier, under the Minnesota non-uniform amendments, a secured party who commences collecting contract for deed payments must thereafter "promptly" file a transfer statement in the real estate records (which has the effect of transferring fee title to the secured party).<sup>119</sup>

It is not clear how the requirement to file the transfer statement "promptly" will be enforced. What happens if the secured party fails to file a transfer statement for a contract for deed after beginning to collect payments under the contract for

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present or former clients will be exposed to the risk of being unperfected as of July 1, 2002 and to advise such clients accordingly.

115. MINN. STAT. § 336.9-607(a)(1)(A) (Supp. 2001).

116. MINN. STAT. § 559.17 subd. 2(b) (2000).

117. MINN. STAT. § 336.9-406(a) (2000) ("After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.").

118. MINN. STAT. § 336.9-406(c) (2000).

119. MINN. STAT. § 336.9-607(f) (2) (Supp. 2001).

deed? The debtor/contract seller has no incentive to make sure it is divested of its interest. Nor is it entirely clear what rights the contract purchaser will have to enforce the requirement. If a secured party fails to comply with Revised Article 9 requirements, an injured party can recover actual damages caused by the failure to comply.<sup>120</sup> Query: Can the contract purchaser use the failure to file the transfer statement as a defense to a cancellation commenced by the secured party?<sup>121</sup> In any event, if the transfer statement is not filed, there may still be a risk of long-term separation of the right to receive payments and fee title with resulting difficulties for the contract purchaser in getting the necessary deed.

Given the complications facing a contract purchaser when the seller's interest is pledged or assigned, can the contract for deed specifically prohibit or restrict the seller's right to pledge or assign the seller's interest in the contract? The answer is "no." Revised Article 9 makes ineffective any agreement between the account debtor (the contract purchaser) and an assignor (the original contract seller) that would prohibit, restrict, or require the consent of the account debtor to the assignment or pledge of the contract or that provides that an assignment or pledge of the contract gives rise to a defense or other claim by the contract purchaser.<sup>122</sup>

Moreover, with the requirement that after the secured party commences collecting contract payments, the secured party must "promptly" execute and file a transfer statement transferring the fee interest to the secured party, the secured party will effectuate a virtually immediate strict foreclosure on the interest of the contract seller/debtor, but without any notice, public sale, or right of

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120. MINN. STAT. § 336.9-625(b) (2000).

121. Generally, a seller's lack of current fee title does not excuse a contract purchaser as long as the seller is capable of obtaining good title. *True v. Northern Pac. Ry. Co.*, 126 Minn. 72, 77, 147 N.W. 948, 950 (1914). Here, the secured party-transferee remains capable of obtaining fee title by means of later filing a transfer statement. *See also* MINN. STAT. § 336.9-406(f)(2) (2000). This section generally invalidates any rule of law under which enforcement of a security interest gives rise to a defense under the account. Arguably, this would prevent a contract purchaser from raising the failure of the secured party to file a transfer statement for a contract for deed as a defense under the contract. However, the requirement of filing a transfer statement does not prohibit enforcement of a security interest, but only imposes an additional burden on the secured party for purposes independent of limiting the granting or enforcement of a security interest. *Id.* at cmt. 5, 6.

122. MINN. STAT. § 336.9-406(d) (2000).

redemption.<sup>123</sup> While this is customary practice under the UCC, it is a very significant change from the customary foreclosure of real estate interests, which involves personal notice, publication, pre-sale right of reinstatement, public sale, and at least a six-month post-sale redemption period.<sup>124</sup> Thus, sellers pledging their interests in contracts for deed should be aware of their much more limited UCC rights of redemption.

In addition, the rights of judgment creditors and holders of tax liens may be affected by Revised Article 9. As previously noted, under long-standing Minnesota law, a seller's interest under a contract for deed is subject to a judgment lien and to levy and sale on execution.<sup>125</sup> In other words, judgment creditors against a contract seller have a right to levy and execute on the seller's interest and acquire that interest at the judgment sale. Since Revised Article 9 does not generally affect real estate interests, a seller's real estate interest under a contract for deed, as contrasted to the right to the stream of payments, will continue to be fully bound by the lien of judgment creditors. However, with respect to the right to receive payments, prior to levy, the holder of a judgment lien will lose out to a previously perfected Revised Article 9 secured party.<sup>126</sup>

Finally, what about the following scenario: A secured party files a financing statement against the seller's interest in the contract and, before the secured party records a transfer statement for a contract for deed (by reason of the seller's default and the secured party's collection of the contract payments), an intervening interest, such as a judgment against the seller, is perfected against the seller's interest in the real estate. Subsequently, the secured party (now holding the fee after filing the transfer statement)

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123. MINN. STAT. § 336.9-607(f) (2) (Supp. 2001).

124. See MINN. STAT. Chs. 580 and 581 (2000). It might be argued that transfer of fee interest to the secured party without foreclosure of a mortgage constitutes an equitable mortgage. Such an argument seems misplaced given the fact that (a) under Revised Article 9, this is a personal property security interest, not a real estate security, and (b) the Minnesota non-uniform amendments to Revised Article 9 specifically provide that the transfer statement has the effect of a deed absolute and transfers all right and title of the seller.

125. See *supra* note 15 and accompanying text.

126. MINN. STAT. § 336.9-317(a)(2)(A) (2000) ("a security interest . . . is subordinate to the rights of . . . a person that becomes a lien creditor before . . . the time the security interest . . . is perfected . . .") Lien creditor means "a creditor that has acquired a lien on the property involved by attachment, levy, or the like." MINN. STAT. § 336.9-102(52)(A) (2000).

cancels the contract for deed due to the purchaser's default under the contract. Result? It would appear that the secured party's fee title will be subject to the intervening interest. While the transfer to the secured party arose by reason of the prior financing statement, the prior Article 9 interest was not an interest in the real estate (even aside from the question of whether foreclosure by means of a transfer statement for a contract for deed might relate back to the date of a financing statement). Arguably, a secured party who takes a real estate mortgage in addition to a financing statement might have a means of trumping the intervening real estate interest (by means of foreclosure of the mortgage) but for the fact that the transfer statement for a contract for deed probably has the effect of extinguishing its prior mortgage as a deed in lieu of foreclosure. If, however, the secured party, instead of collecting payments under the contract for deed and triggering the transfer statement for a contract for deed, commences and completes a real estate foreclosure of its prior mortgage, it will acquire fee title free and clear of the intervening real estate interest.

##### 5. *The Overlooked Contract for Deed.*

Revised Article 9 will have no impact where a lender is lending based solely upon real estate—a traditional mortgage, and where there is no pre-existing contract for deed. There is, however, one more potential trap for the unwary. That is the situation where the lender believes that it is making a traditional real estate mortgage, but the mortgagor has, undisclosed to the lender, previously entered into an *unrecorded* contract for deed to a purchaser who is in possession of the real estate. Possession by a contract for deed purchaser prior to the recording of the real estate mortgage constitutes notice under the recording act, and, as a result, the lender's mortgage will be subject to the contract purchaser's interest.<sup>127</sup> At most, such a lender can obtain a security interest in the seller's interest under the unrecorded contract for deed. Since, however, the lender is assuming that it is making a traditional real estate mortgage and will file only a real estate mortgage and will not have perfected with a UCC financing statement, the lender's

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127. MINN. STAT. § 507.34 (2000). If the purchaser under the unrecorded contract for deed is not in possession, under the recording act the mortgage will be senior to the purchaser's interest and encumber both seller's and purchaser's interests. *Id.*

security will essentially be unperfected.

How could this happen? While a Minnesota statute specifically requires that all contracts for deed be recorded within four months, the statute is not a particularly effective incentive to encourage purchasers to record their contracts.<sup>128</sup> In addition, despite the potential problems for a contract purchaser, who, instead of recording, will have to prove up actual possession in order to obtain protection under the recording act, contract for deed purchasers often do not record their contracts. They do not record, sometimes in order to avoid property tax increases resulting from recording, sometimes in order to avoid disclosure of their identity to municipal authorities investigating building code compliance, and sometimes simply due to a lack of sophistication.<sup>129</sup>

In theory, if the purchaser is in possession of the real estate under a prior, unrecorded contract for deed, the existence of the contract or the fact that there is a party in possession other than the mortgagor should be disclosed to the lender and its title company in the customary borrower's affidavit. Upon such disclosure, the lender can either obtain a subordination of the contract purchaser's interest or decline to make the loan. Such affidavits are, however, not always carefully (or truthfully) filled out and the interest of the purchaser in possession under the unrecorded contract may not be properly disclosed. In addition, even if the affidavit does disclose the presence of a "tenant," but does not disclose the unrecorded contract for deed to that "tenant," the lender may not insist upon receiving an estoppel certificate from such "tenant" that would either disclose the unrecorded contract or estop that party from later claiming a contract interest.<sup>130</sup> In such cases, the lender will see no reason to

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128. MINN. STAT § 507.235 (2000). Under that statute, a two percent penalty may be imposed on the contract purchaser and his or her interest under the contract, but only after a separate written demand on the contract purchaser from the city or county attorney. *Id.*; see also Larry M. Wertheim, SELECTED DEVELOPMENTS IN CONTRACTS FOR DEED, THE HENNEPIN LAWYER, Sept.-Oct. 1988, at 6-7. It appears that the remedy is rarely enforced.

129. Since there is no third-party institutional lender involved in a contract for deed sale, contract purchasers often use the services of neither a title company nor an attorney who would see that the contract is recorded.

130. Where a party is in possession, a lender is required to inquire of such party as to its interest and if it fails to do so, the lender will take subject to the interest that would have been disclosed had proper inquiry been made. *Claffin v. Commercial State Bank of Two Harbors*, 487 N.W.2d 242 (Minn. Ct. App. 1992)

file a UCC financing statement. As a result, it is possible that a lender will make what it thinks is a traditional real estate mortgage, but, due to the existence of an unrecorded contract for deed to a purchaser in possession, is, in fact, a loan to a seller under a contract for deed.

Prior to enactment of Revised Article 9, such a lender would certainly be disappointed in not having perfected security in the entire real estate, including the contract purchaser's equitable interest. Nevertheless, under *In re Shuster*, the recorded mortgage would still constitute a perfected security interest in the seller's interest in the contract for deed. In contrast, under Revised Article 9, where a lender inadvertently takes only a real estate mortgage subject to an unrecorded contract for deed purchaser in possession, the lender will have no practical perfected security whatsoever.<sup>131</sup> The only way for lenders to minimize this risk is added vigilance regarding mortgagor affidavits and requiring estoppel certificates from all parties in possession other than the mortgagor.

#### *D. Any Loopholes?*

Given the apparently unavoidable classification of a seller's interest under a contract for deed as an "account" subject to Revised Article 9, is there any argument that those dealing with a seller's interest are *not* subject to Revised Article 9? In other words, are there any loopholes? The short answer is "probably not."

The issue is not so pressing for lenders who loan on the security of a seller's interest in a contract for deed. They are likely to be relatively sophisticated and will be able to use the necessary

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*rev. den.* (mortgagee who knows of third party's possession must direct inquiry to third party in possession; inquiry of mortgagor, who may have reason to conceal the truth, is not sufficient).

131. Of course, as against the mortgagor, the lender will have valid security on the mortgagor's Revised Article 9 interest as seller under the contract for deed. The problem is that such security is not perfected as against third parties. Also, as previously noted, by recording a real estate mortgage from the seller, the lender will have a perfected lien on the seller's fee interest in the real estate, but that will only be of any value if the contract for deed is subsequently canceled. If the contract for deed is not canceled and the contract purchaser obtains a deed from the seller, the purchaser's real estate title should not be encumbered by the junior real estate mortgage against the seller. *Cf.* MINNESOTA TITLE STANDARDS, Standard No. 90 (Section of Real Prop. Law of the Minn. State Bar Ass'n, 2000) (recorded contract purchaser takes title free of subsequent judgments and tax liens on the seller's interest).

loan documents as part of the initial loan transaction. (In the majority of transactions prior to the enactment of Revised Article 9, Minnesota lenders who took a security in a seller's interest probably filed a UCC financing statement anyway out of an excess of caution.) As previously noted, the real rub comes in the case of persons, usually individuals, who are buying outright a seller's interest in a contract for deed for investment purposes. The idea of treating the conveyance of fee title outright and not in connection with a loan to the original seller as a financing transaction—requiring the filing of a financing statement and periodic continuation statements as long as the contract for deed is outstanding—is deeply counterintuitive in Minnesota. As a result, there is a real danger that many of such investor-buyers of sellers' interests under contracts for deed will be at least at a theoretical risk.

The only exception in Revised Article 9 to the requirement that financing statements be filed for the assignment of "accounts" is contained in Revised Section 9-309(2). That section provides that a security interest is perfected when it attaches, i.e. without the need to file a financing statement, in the case of "an assignment of accounts . . . which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts . . ." <sup>132</sup> Thus, if a seller has sold several properties on different contracts for deed and only assigns the seller's interest in one of those contracts for deed to a particular investor-buyer, that assignment will be perfected without the need to file a financing statement since that assignment does not constitute "a significant part of the assignor's outstanding accounts." The exception apparently reflects the drafters' view that the typical sale or pledge of accounts consists of the sale or pledge of a number of accounts, like a business' accounts receivable, which are typically dealt with in quantities. According to this view, if, for example, just one account receivable is sold or pledged, no financing statement should be required.

However, with respect to contracts for deed, the more typical case is where a seller has sold on only one contract for deed and assigns that one contract for deed to an investor-buyer. That one contract for deed constitutes "a significant part" of the seller's contracts; in fact, all of them. Thus, it will not be the case that the

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132. MINN. STAT. § 336.9-309(2) (2000).

assignment “does not . . . transfer a significant part of the assignor’s outstanding contracts” and the exception apparently is not applicable to the typical seller of a seller’s interest in a contract for deed.

Oddly enough, however, Comment 4 to Revised Section 9-309 states that the purpose of 9-309(2) is to “save from *ex post facto* invalidation casual or isolated assignments — assignments which no one would think of filing. Any person who regularly takes assignments of any debtor’s accounts should file.”<sup>133</sup> This suggests that the exception might be applicable if one or both of the following apply: (a) the assignment of the contract is the only contract that the assignor ever assigns (“a casual or isolated assignment”) or (b) the party who purchases the contract is not in the business of purchasing contracts (not a person who “regularly takes assignments”).<sup>134</sup> Thus, in the typical one-time sale of a seller’s interest under contract for deed to an investor who does not regularly purchase such interests, the comment suggests that the exception might apply. Too much weight should not be placed on this argument, however, since it cannot be gleaned from the actual statutory language.<sup>135</sup> In any event, careful investor-buyers of contracts for deed should file financing statements.

## V. CONCLUSION

In Minnesota, contracts for deed are valuable financing devices because of the speedy and cheap cancellation remedy which promotes sales of real property to purchasers with poor credit or for little down payment. It is a wise public policy that encourages the use of contracts for deed and the willingness of sellers to sell by contracts for deed. By making a seller’s interest in a contract for deed a more financeable form of collateral that will be granted, perfected, and enforced under the Uniform Commercial Code, it is hoped that Revised Article 9 will have the effect of encouraging sellers to sell by

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133. MINN. STAT. § 336.9-309 cmt. 4 (2000).

134. See NELSON & WHITMAN, *supra* note 8, § 3.37.

135. The only other support for exempting a seller’s one-time assignment of a contract for deed is the reference in MINN. STAT. § 336.9-109(a)(3) (2000) that Revised Article 9 applies to “a sale of accounts,” suggesting that the sale of a single account is not covered by Revised Article 9. See also MINN. STAT. §§ 336.1-201(37) (2000) (“security agreement” includes “any interest of . . . a buyer of accounts . . . in a transaction that is subject to article 9”), 336.9-102(a)(28)(B) (2000) (“debtor” defined as a “seller of accounts”), 336.9-102(a)(72)(D) (2000) (“secured party” defined as “a person to which accounts . . . have been sold”) (emphasis supplied)

contract for deed.<sup>136</sup> Lenders may be more willing to lend since (a) they can perfect a security interest in the right to payments by a simple financing statement, rather than the more complicated mortgage (and also choose to avoid the cost of mortgage registry tax), (b) they will have a new ability to collect contract payment whenever their own debtor goes into default simply by serving notice on the contract purchaser, and (c) they can avoid the cumbersome and expensive process of foreclosing a real estate mortgage. In addition, the non-uniform Minnesota amendments adopted to Revised Article 9 in 2001 dealing with contracts for deed should avoid trouble for innocent contract for deed purchasers getting a deed where, due to the seller's default in its third-party debt, the secured party exercises remedies under the contract for deed. Finally, because many sellers are willing to sell on a contract for deed only if they are able to sell their interest to an investor, it is hoped that investor-buyers of sellers' interests under contracts for deed will not be dissuaded from buying contracts by reason of the probable need to file financing statements under Revised Article 9 and the largely theoretical risks arising from the failure to file or allowing filed statements to lapse.

The contract for deed has been a long-standing and valuable institution in Minnesota real estate practice and law. Revised Article 9, as adopted and adapted in Minnesota, is a new structure of rules to which lawyers and their clients dealing with contracts for deed will have to adjust. Revised Article 9 may make contracts for deed stronger in Minnesota or may weaken their hold in the state. In any event, Minnesota contracts for deed no longer are the same.

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136. Contracts for deed have generally come under challenge as being an outmoded financing device that should be replaced by traditional seller take-back mortgages. Grant Nelson has been a leading critic of the use of contracts for deed generally. See Grant S. Nelson, *THE CONTRACT FOR DEED AS A MORTGAGE: THE CASE FOR THE RESTATEMENT APPROACH*, 1998 *BYU L. REV.* 1111 (1998); Nelson & Whitman, *supra*, note 8, § 3.38. Nelson does recognize, however, that in states such as Minnesota (and Iowa) that have statutory forfeiture remedies, the argument against contracts for deed is significantly less strong. *Ibid.* Nelson at 1161, 1165-66; Nelson & Whitman, *supra*, note 8, § 3.38. Nevertheless, Nelson still argues against the wisdom of contracts for deed in Minnesota because of problems arising by reason of third party creditors, including problems arising from mortgaging the vendor's interest. Nelson at 1156-61, 1165; Nelson & Whitman, *supra*, note 8, § 3.38. By providing a working method of mortgaging the vendor's interest and meshing the contract for deed with Revised Article 9, the new Minnesota legislation tends to undermine Nelson's critique of Minnesota contracts for deed.