A man owned a tract of land in fee simple. He and the owner of a neighboring tract entered into a written agreement under which the neighbor agreed to buy the man's tract for $100,000, its fair market value. The agreement contained all the essential terms of a real estate contract to sell and buy, including a date for closing. The neighbor made the required $50,000 down payment that, pursuant to the contract, the man could retain as liquidated damages in the event of the neighbor's breach.

Before the date set for the closing in the contract, the neighbor died. After the closing date, the neighbor's daughter was duly qualified as administrator of the estate and immediately made demand for return of the $50,000 deposit. The man responded by stating that he took such demand to be a declaration that the daughter did not intend to complete the contract and that he considered the contract at an end. The man further asserted that he was entitled to retain, as liquidated damages, the $50,000. The reasonable market value of the disputed tract had increased to $110,000 by this time.

The daughter brought an appropriate action against the man to recover the $50,000. In his answer, the man made no affirmative claim but asserted that he was entitled to retain the $50,000 as liquidated damages as provided in the contract.

Who is likely to prevail?

A. The daughter, because the neighbor's death terminated the contract as a matter of law.

B. The daughter, because the provision relied upon by the man is unenforceable.

C. The man, because the court should enforce the express agreement of the contracting parties.

D. The man, because the doctrine of equitable conversion prevents termination of the contract upon the death of a party.

Explanation:

The **doctrine of equitable conversion** applies during the period between contract formation and closing. During this **executory period**, the seller acquires the equitable right to the purchase price and the **buyer acquires equitable title** to the property. Since equitable title is treated as an interest in real property, it **can be transferred** like any other property interest—subject to the seller's equitable lien for the purchase price. So when the neighbor died, equitable title passed to the beneficiary of his estate and the contract remained in effect **(Choices A & D)**.

The daughter, as the administrator of the neighbor's estate, then breached the land-sale contract when she demanded return of the $50,000 deposit in lieu of completing the contract. The deposit constitutes **liquidated damages** since the contract allows the seller to retain this money in the event of the neighbor's breach. Liquidated damages are recoverable only if they reasonably compensate the injured party. As a result, they are ***not* recoverable if** they constitute a **penalty**—eg, when the liquidated amount **exceeds 15%** of the **purchase price**.

Here, the neighbor's $50,000 down payment is equivalent to 50% of the purchase price. This means that the court will likely hold that the liquidated damages constitute a penalty and that this express contractual provision is unenforceable **(Choice C)**. As a result, the daughter is likely to prevail.

Educational objective:

Equitable conversion allows a buyer's equitable title to be transferred upon his/her death, thereby keeping the land-sale contract in effect. Liquidated damages under the contract are recoverable only if they reasonably compensate the injured party—eg, if the liquidated amount is less than 15% of the purchase price.

References

77 Am. Jur. 2d Vendor and Purchaser § 478 (2020) (seller's recovery of liquidated damages).

27A Am. Jur. 2d Equitable Conversion § 13 (2020) (equitable conversion under land-sale contracts).

Equitable conversion under land-sale contract