EARNEST MONEY DEPOSITS

A. Receipt of Earnest Money Deposits

At one time, any earnest money deposit check received by a real estate licensee had to be deposited in that licensee's trust account. While buyers and sellers could agree that a title company or other third party would hold the earnest money deposit, in such a situation, the State took the position that it was impermissible for a licensee to deliver or otherwise handle the check. Instead, buyers and sellers who wanted to use title companies as escrow agents were required to make their own arrangements regarding the delivery of the deposit check.

The Code was amended in 2002 to expressly address this problem. Section 2512(j)(iv) now says that a broker must deposit in his trust account only those checks received by him that **are made payable to the broker**. If the earnest money check is made payable to, for example, a title company, the licensee has 2 banking days after the acceptance of the offer to deliver the check to the title company. MCL 339.2512(j)(vi). Title companies who hold earnest money deposits are not subject to Article 25 of the Occupational Code or the rules governing trust accounts. That being said, title companies are typically quite cautious when handling these funds and may require that the parties sign a separate escrow agreement.

When a broker holds the earnest money deposit, he must place it in his trust account. This deposit must take place within 2 banking days after the broker receives notice that an offer to purchase has been signed by all parties. MCL 339.2512(j)(iv). A broker cannot wait until all contingencies in the purchase agreement are removed prior to depositing the buyer's earnest money check into his trust account.

The rules require a broker to keep two "sets of books" for his trust account – one is a chronological record which includes all deposits and withdrawals, and a second one which is broken out by transaction. According to the Department, many of the most common violations uncovered during an audit involve improper recordkeeping for the broker's trust account. Brokers are urged to re-familiarize themselves with the specific trust account recordkeeping requirements contained in Rule 313.

B. Termination of Contract/Releases

REALTORS® are sometimes approached by buyers or sellers who have changed their minds and want to be released from the contract. The REALTOR® may be inclined to try and convince his clients that they must go forward with the sale so that the REALTOR®'s commission is not jeopardized. However, REALTORS® should be wary of doing so in light of their fiduciary duties. It may be in the client's best interest to obtain a release. If a REALTOR® is approached by a client who now wants out of the contract, the REALTOR® should advise the client to seek the advice of an attorney. It is in a REALTOR®'s best interest to have his client rely on the advice of an attorney as to the enforceability of the contract.

It is not uncommon for both parties to agree to terminate the contract. For example, the buyer may be having difficulty obtaining financing at the desired interest rate, and the seller may have other interested buyers in a position to close. The parties may agree to terminate the purchase agreement by signing mutual releases. Such releases should always provide for the disbursement of the earnest money deposit.

When a sale does not close, the earnest money is frequently in dispute. In the event there is a dispute over the earnest money, the rules prohibit a licensee from releasing the earnest money deposit to either party in the absence of signed releases or a court order. R 339.22313(6). A REALTOR® faced with a buyer and seller who both claim the earnest money deposit can bring an interpleader action, in which a court will make the determination as to the proper disbursement of the funds. REALTORS® are not required to bring such an action. Rather, they can retain the money until such time as the parties agree -- or a court issues an order -- as to the disbursement of the funds.

Even if the parties do not mutually agree to a release, if one party refuses to go forward with closing, the contract is terminated by the party's breach of contract. The non-breaching party may have legal remedies including specific performance or damages incurred as a result of the breach. Based upon calls received on the Legal Hotline, there appears to be a common misconception that if the contract is terminated, a house cannot be sold to someone else while the earnest money is in dispute. This is incorrect. The status of the earnest money has no bearing on the seller's ability to sell the home. While a breach of contract by the buyer likely means the seller is free to sell the home to someone else, in the absence of a release, this determination should be made by an attorney. A REALTOR® does not want to be responsible for putting a client in a position where two buyers are claiming they have a valid purchase contract.

Where one party has breached a purchase agreement, the other party's damages are typically NOT limited to the amount of the earnest money deposit. While parties to a purchase agreement can at the outset – through a liquidated damage clause – agree that the damages will be so limited, few residential purchase agreements do so. Ordinarily, if the buyer breaches the contract, the seller is free to pursue not only the earnest money deposit, but also any additional damage amounts he has suffered.

REALTORS® should keep in mind that the rules only prohibit the release of the earnest money deposit when there is a dispute. If there is no dispute, a REALTOR® may choose to release the deposit, even though for some reason he cannot obtain the parties' signatures to a release. Keep in mind, however, that a broker who releases these funds is taking some risk. If a court should later decide that the broker released the funds to the wrong party, the broker will be obligated to reimburse that party from the broker's own funds. While in such event, the broker, in turn, can seek reimbursement from the party who wrongfully received the escrowed funds, the burden of collecting those funds will fall on the broker. Obtaining a release, whether or not one is legally required, is always the safest course of action.

Keep in mind that when we discuss a "release," we are only talking about an agreement as to the "release" of the earnest money. The requirement that the broker retain the earnest money where there is a "dispute" does not cover all types of disputes between the parties. The rule does not require an all-encompassing release of all possible claims. A REALTOR® should never condition the release of earnest money funds on both parties' agreement to release the REALTOR® from any liability relating to the transaction. Likewise, it is possible, although perhaps not probable, for a buyer and seller to agree as to the release of the earnest money without settling the remaining issues between them.

Finally, as an aside, some purchase contracts expressly provide for the arbitration of disputes over earnest money deposits. This clause is perfectly acceptable and does not violate the Occupational Code or its rules.