EARNEST MONEY Q & A

Q: Is it legal to accept an offer without any earnest money even if the seller agrees to no earnest money?

A: Yes, unless otherwise directed in writing by the seller. The Indiana Real Estate Commission requires all offers to be submitted to the sellers for their formal acceptance or rejection (876 IAC 1-1-23). The sellers can authorize you in writing not to present such offer. With regard to earnest money constituting the consideration, we have taken the position that the mutual promises to buy and sell constitute sufficient consideration to support the contract and make it binding on both parties. As a practical matter, however, it may be foolish in the ordinary transaction to accept an offer without sufficient earnest money. Usually, it is in the seller's best interest to have as large an earnest money deposit as reasonably possible.

Q: The seller accepted an offer, but the earnest money check bounced. At about the same time that the check bounced, another offer came in. Is the first offer dead because the earnest money check bounced? Can the seller accept the second offer?

A: The seller should give the first buyers a reasonable but short period of time to make the earnest money check good. There may have been justifiable reasons (for example, bank error or incorrect addition or subtraction in the checkbook register) to explain the bounced check. Make sure the notice is in writing and make sure they understand that unless the check is made good in say, 24 hours, that the seller will consider the offer to be dead. At the same time, if the second offer is acceptable, it may be accepted as a back-up offer. Be sure that the acceptance is clear that it is a back-up offer and that it will become the primary offer if, in fact, the first offer is terminated.

Q: Is it possible to change the amount of earnest money on a counter-offer?

A: Yes, either party on countering may offer to change or request a change in the amount of earnest money.

Q: A buyer has reported me to the Real Estate Commission and to my board for not returning the earnest money on a sale that fell through. I wrote both parties that I would return the earnest money when they agreed as to how it should be disbursed or when one got a court order directing me to make payment to one or the other. What should I do now?

A: Do not release the earnest without a written release signed by both parties. You may file an interpleader proceeding in the county court, asking the court to determine which party is entitled to the money. Notify your board and the Attorney General's Office in writing of your position.

Q: Whose obligation is it to pay the attorneys' fees in connection with the legal settlement of an earnest money dispute?

A: It is the primary obligation of all parties to pay their own attorney fees in settling a dispute between buyers and seller over the proper disposition of earnest money where the sale aborts and the parties cannot initially agree on the return of the earnest money.

However, Indiana law permits a stakeholder in a situation like this to file an interpleader petition with the court, paying the disputed fund into court and asking the court to determine which party is entitled to it. In an interpleader case, the court has discretion to award attorney fees to the stakeholder. Therefore, if it comes to the point where you and your lawyer must file an interpleader case, we recommend that you ask the court to make an award of attorney fees to you.

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Q: Does a listing principal broker need a release from the parties to return earnest money when the purchase agreement was contingent upon financing, and the purchaser's financing was denied in writing by the purchaser's lender?

A: It is recommended that whenever a transaction does not close the listing principal broker must obtain either a written mutual release from the parties or a court order directing payment of the earnest money. This is always true regardless of the reason for the transaction failing to close between the parties.

Q: What can be done when a buyer stops payment on an earnest money check?

A: The buyer may be liable for three times the face of the check if it is not made good, pursuant to Indiana bad check law. The listing broker should notify the sellers immediately, as soon as the listing broker learns that a check has been dishonored or stopped under a stop payment order.

Q: The Buyer's broker is insisting that such broker deposit the earnest money in the principal broker's account. May he or she do this?

A: The listing principal broker should hold the earnest money, as Rule 23 states that the listing broker must deposit all earnest money in his or her trust account. Rule 23 also states that the listing principal broker may delegate that responsibility to the co-op (selling) broker. However, the commission will nevertheless hold the listing broker responsible for the earnest money. In other words, if you as listing broker allow the selling broker to hold the earnest money and the money is mishandled or stolen, you may be required to make good the loss. Note that the listing and selling principal brokers holding any earnest monies are not required to make payment to the buyers or sellers unless the parties enter into a mutual release or a court issues an order for payment.

Q: Can our MLS adopt a rule that an offer without earnest money need not be submitted to the sellers?

A: No. Rule 23 of the Indiana Real Estate Commission requires all offers to be submitted to the sellers for their formal acceptance or rejection. (876 IAC 1-1-23). The sellers can authorize you in writing not to present such offers, but no MLS or board may adopt such a rule.

Q: We received an earnest money check from a buyer for a large sum of money ($10,000) and the buyer stipulated in his offer that he is to receive the interest earned on the deposit. Can a principal broker earn interest on a trust account?

A: It is a violation of the law for a broker to earn interest on earnest money deposits unless the interest is paid to the client. (I.C. 25-34.1-4-5). For example, if you as listing broker receive earnest money on a transaction, you cannot earn interest on that deposit for yourself, but you may deposit the earnest money in an interest bearing account that will pay the interest to either the seller or the buyer. In any event, if buyer and seller have a written agreement about the disposition of earnest money and any interest earned, the money may be placed in an interest-bearing account, but you should not attempt to write up such an agreement. That is a job for the parties' counsel or the title company.

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876 IAC 1-1-23 Written offers to purchase; disposition of money received

Authority: IC 25-34.1-2-5

Affected: IC 25-34.1-2-5

Sec. 23. (a) Any and all written offers to purchase or authorization to purchase shall be communicated to the seller for his or her formal acceptance or rejection immediately upon receipt of the offer, and the offers or authorizations shall be made in quadruplicate, one (1) copy to the prospective purchasers at the time of signing, one (1) copy for the principal broker's files, one (1) copy to the sellers, and one (1) copy to be returned to the purchasers after acceptance or rejection. The listing principal broker shall, on or before the next two (2) banking days after acceptance of the offer to purchase by the seller, do one (1) of the following:

(1) Deposit all money received in connection with a transaction in his or her escrow/trust account.

(2) Delegate the responsibility to the selling principal broker to deposit the money in the selling broker's escrow/trust account.

In any event, the commission shall hold the listing principal broker responsible for the money. In the event the earnest money deposit is other than cash, this fact shall be communicated to the seller before his or her acceptance of the offer to purchase, and the fact shall be shown in the earnest money receipt. All money shall be retained in the escrow/trust account so designated until disbursement thereof is properly authorized. Provided the beneficiary agrees in writing, the listing or selling principal broker holding the earnest money may voluntarily transfer any interest earned on the broker's escrow/trust account to a fund established for the sole purpose of providing affordable housing opportunities in Indiana that meets the requirements of Internal Revenue Service Code 501C3. The listing or selling principal brokers holding any earnest money are not required to make payment to the purchasers or sellers when a real estate transaction is not consummated unless the parties enter into a mutual release of the funds or a court issues an order for payment, except as permitted in subsection (b).

(b) Upon being notified that one (1) or more parties to an offer to purchase intend not to perform, the listing or selling principal broker, holding the earnest money, may release the earnest money deposit as provided in the offer to purchase or, if no provision is made in the offer to purchase, the selling or listing principal, holding the earnest money, may initiate the release process. The release process shall require the selling or listing principal broker to notify all parties at their last known address by certified mail that the earnest money deposit shall be distributed to the parties specified in the letter unless:

(1) all parties enter into a mutual release; or

(2) one (1) or more of the parties initiate litigation;

within sixty (60) days of the mailing date of the certified letter. If neither the buyer nor the seller initiates litigation or enters into a written release within sixty (60) days of the mailing date of the certified letter, the broker may release the earnest money deposit to the party identified in the certified

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letter. *(Indiana Real Estate Commission; Rule 24; filed Sep 28, 1977, 4:30 p.m.: Rules and Regs. 1978, p. 800; filed Dec 11, 1986, 10:40 a.m.: 10 IR 878; readopted filed Jun 29, 2001, 9:56 a.m.: 24 IR 3824; filed Aug 15, 2001, 9:50 a.m.: 25 IR 102; filed Oct 28, 2002, 12:01 p.m.: 26 IR 789; filed Jan 27, 2006, 10:45 a.m.: 29 IR 1931; readopted filed Jul 19, 2007, 12:57 p.m.: 20070808-IR-876070067RFA)*

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Earnest Money & Trust Accounts

Part One - Basic Rules

The largest number of complaints received by the Indiana Real Estate Commission involve earnest money/trust account violations. Its not surprising that one of the most frequent topics of calls on the Hotline concerns earnest money/trust account issues. To be sure your house is in order, we thought it might be helpful to review these issues presented in this two-part series of articles which discuss the (1) basic rules on trust accounts, found either in the license laws or rules of the Commission and (2) use of an interpleader petition or BBB Program to settle earnest money disputes between parties.

Basic Rules

1. Every principal broker must keep a separate bank account to hold funds of others, such as earnest money. Trust accounts must be identified as such and are subject to audit. You must keep a detailed record of all funds in and out of the account. License law I.C. 25-34.1-4-5.
2. Generally, trust accounts are noninterest bearing accounts in our state. You cannot earn interest for yourself from a trust account. If the account earns interest, you must pay the interest to the client/ beneficiary. In the case of a large deposit of earnest money, the buyer and seller may stipulate that the funds be placed in an interest bearing account for the benefit of buyer or seller. Such an escrow agreement between the parties should be in writing and prepared by an attorney or the title company. License Law I.C. 25-34.1-4-5.
3. You cannot commingle your funds with clients' or customers' funds. Commission Rule 876 IAC 1-1-23. You cannot deposit your personal or business funds in the trust account. You cannot take trust account funds for your own use, or pay a commission to yourself from earnest money in the account until the sale is closed.
4. The principal broker must deposit all earnest money received in the trust account within two banking days after acceptance of the purchase agreement. Commission Rule 876 IAC 1-1-23. It is illegal to hold an earnest money check until closing. You will not only become responsible for the money, but be subject to discipline as well.
5. The listing principal broker is required to either (a) to deposit earnest money in his or her account or (b) delegate that responsibility to the selling (co-op) principal broker. If you let the co-op broker hold the earnest money, you as listing principal broker are still ultimately responsible to make good any loss if the money is lost or embezzled. All monies should be retained in the broker's trust account until disbursement is properly authorized. Note that effective no later October 1, 2001, the listing and selling principal brokers holding any earnest monies are not required to make payment to the buyers or sellers unless the parties enter into a mutual release or a court issues an order for payment. Commission Rule 876 IAC 1-1-23.

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6. You must keep copies of closing statements five years. Commission Rule 876 IAC 1-1-24. We recommend that you retain earnest money records that long as well.

Earnest Money & Trust Accounts - Part Two

Use of Interpleader And The BBB Program

As often the case when a sale falls through, both parties are claiming entitlement to the earnest money deposit. The broker, of course, is caught in the middle and must decide how to proceed with regard to the disputed funds. Our recommendation to the broker is to have the parties enter into a "Mutual Release", which clearly states to whom the earnest money is to be paid. If the parties refuse to sign a Mutual Release, then the broker can continue to hold the earnest money and wait for either the buyer or seller to file suit (usually in small claims court) for release of the earnest money. The court will then issue an order for payment. If neither party chooses to file suit, the broker may file a petition for interpleader and deposit the disputed funds with the clerk of the court.

Interpleader

Historically, there were basically two types of remedies available to plaintiffs. An "equitable" remedy is a type of relief sought in court dealing with something other than monetary damages such as an injunction or specific performance. "Equity "' is concerned with what is fair and just. For example, a plaintiff may join as defendants or other persons having or asserting claims against the plaintiff and require them to interplead when their claims are such that the plaintiff is or may be exposed to double or multiple liability.

Our courts have determined that the equitable remedy of interpleader depends on the following elements:

1) Both or all parties must claim the same thing, debt or duty, and there is some doubt as to which of the parties is entitled to the debt or money.
2) All their adverse titles or claims must be derived from a common source. (i.e., purchase agreement).
3) The person seeking relief must not have or claim any interest in the subject matter.
4) The person seeking relief must stand perfectly neutral between them in the position merely of a stakeholder.

Interpleader in earnest money disputes involves a judicial proceeding where the listing principal broker deposits the stake (money in dispute) into the court, and the judge decides whether the buyer or seller is entitled to the money. Sometimes the broker is dismissed from the case, leaving the buyer and seller in the lawsuit to defend their rightful claims to the money.

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Why would a principal broker want to file for interpleader? Some of the advantages include the following:

1) Interpleader is available in small claims court, which means less expense for everyone concerned.
2) Hamilton County Bank v. Hinkle Creek Friends Church, 478 N.E. 2d 639 (1985), Indiana case holding that if a party files a legitimate interpleader proceeding, that party is exempt from any liability arising from punitive damages.

In an interpleader proceeding, the judge has broad discretion to award attorney fees and costs to the broker out of the disputed fund. Remember that interpleader is useful in cases where a broker is being threatened by a disgruntled buyer or seller or their attorney for the return of the earnest money deposit. It is simply a way to stay out of the line of fire.

BBB Program

Use of an interpleader or waiting for a buyer or seller to take legal action is not the only way to resolve an earnest money dispute, if the amount is less than $3,500. A dispute resolution program is administered by the Better Business Bureau ("BBB") and has proven to be an effective alternative to filing suit in a court. The parties can agree "up-front" on how a dispute will be resolved by attaching an Alternative Dispute Resolution Addendum to their purchase agreement. If a dispute arises, either party can then contact the local BBB and explain the situation to one of the counselors. If the dispute is one that can be handled by the BBB, a form will be sent to your client. Once the form has been completed and filed, the other party will be contacted to attempt to resolve the dispute. If that fails, the dispute will proceed through the arbitration process. After selection of the arbitrator a hearing will be scheduled and heard at the local BBB office. Both parties will be given an opportunity to present their case. Within approximately ten days of the hearing, all parties will be notified of the arbitrator's decision, which is legally binding on the parties.

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SAMPLE 60 DAY LETTER

DATE

SENT VIA CERTIFIED MAIL, RETURN RECEIPT REQUESTED
Mr. / Mrs. Seller
Last known address
City, State Zip

Mr. / Mrs. Buyer
Last known address
City, State Zip

Dear Buyer(s) & Seller(s):

An agreement for the purchase of residential real estate located at _____ was entered into on _____(DATE)_____ between _____(BUYER)_____ and _____(SELLER)_____. Earnest money in the amount of _____ is currently being held in escrow through the agency of _____.

Notification has been received that one or more of the parties to the purchase agreement intends not to perform and no clear provision for the release of the earnest money has been made. Pursuant to 876 IAC 1-1-23, the earnest money will be released to _____(BUYER or SELLER)_____ unless either: 1) all parties enter into a mutual release; or 2) one or more parties initiates litigation within sixty (60) days of the mailing date of this certified letter.

If neither the buyer nor the seller initiates litigation, nor the parties enter into a mutual release, within sixty (60) days of the mailing date of this certified letter, the broker will release the earnest money deposit to the party identified above.

Further, pursuant to the Purchase Agreement, the parties have agreed to hold the Broker harmless from any liability, including attorney's fees and costs, for the good faith disbursement of the earnest money in accordance with 876 IAC 1-1-23.

Sincerely,

_____
Principal Broker holding the earnest money