

## EARNEST MONEY DEPOSITS

Hello Michigan Realtors® and welcome back to Letter of the Law, a monthly video series designed to provide a primer on various legal issues impacting the real estate industry. Today's legal primer will be on the topic of "Earnest Money Deposits."

Since the beginning of the Michigan Realtors® Legal Hotline in the late 1980's, the number one topic has been earnest money deposits (or "EMDs"). In this legal update, I will address the most frequently asked questions about EMDs.

A. Neither the law nor the Code of Ethics dictates whether the listing office or the selling office must hold the earnest money deposit. Traditionally, the EMD has been held by the selling office, but this is not legally required.

1. Regardless of which office holds the EMD, the role of the escrow agent is a neutral role. If, for example, a buyer's broker acts as the escrow agent, the buyer's broker still has a duty to disclose to the seller if the EMD check bounces or if there is another problem with the EMD funds.

2. When a transaction is handled electronically, Realtors® occasionally forget to collect the EMD. Realtor® offices should implement procedures designed to prevent this from happening.

3. If there is any problem with the EMD, the broker should notify the seller immediately. Otherwise, when the buyer defaults under the purchase agreement and the seller discovers that despite what it says in the purchase agreement, there is no EMD, the seller may demand that the buyer's broker pay the EMD to the seller out of his own pocket.

B. A seller and buyer can agree that someone other than a broker hold the EMD. If a third party (most often a title company) holds the EMD, that escrow agent is not subject to the Occupational Code or the rules on handling EMDs. If a title company is to hold the EMD, a Realtor's® responsibility is to simply deliver the check to the named escrow agent within 2 banking days of receiving notice of acceptance by all parties.

C. If a Realtor® holds the EMD, then the Realtor® must comply with the following rules governing EMDs.

1. A salesperson cannot wait until there is a binding contract before turning the EMD over to her broker. The Occupational Code requires that the salesperson turn over the EMD check to her broker "upon receipt."

2. The broker, on the other hand, is not required to deposit the check into its trust account immediately, but may hold the check until the purchase agreement is accepted.

3. A broker must deposit the EMD in its trust account within 2 banking days after the broker has received notice that there is a binding purchase agreement. A seller/buyer cannot agree, for example, that the EMD check will not be cashed until the inspection contingency is waived or until the short sale lender signs off. (If the seller and buyer wish to agree to such a provision, then a title company or someone else will need to hold the EMD.)

4. If the transaction falls apart and there is a dispute over the EMD, the EMD must remain in the broker's trust account until the buyer and seller have agreed in writing or there is a court order directing the disbursement of the EMD. The real estate licensee can also interplead the funds with a court.

- i. This rule prohibiting the broker from disbursing the EMD only applies where there is a dispute over the EMD. If there is no dispute, the Occupational Code permits a licensee to release the EMD without a signed release.
- ii. If there is a dispute over the EMD, a Realtor<sup>®</sup> cannot release the funds even if either the sellers or buyers are wrong about their being entitled to the EMD.
- iii. The rule that permits the release of the EMD without a signed release only applies in the absence of a contractual provision to the contrary. Some Realtor<sup>®</sup> purchase agreement forms provide that if the transaction fails for any reason, the EMD will not be released without a signed release from both parties. If the parties' purchase contract contains this language, then this is a contractual obligation which must be followed.
- iv. A Realtor<sup>®</sup> cannot condition the release of the EMD on the sellers' and buyers' agreement to release the Realtor<sup>®</sup> from all liability in connection with the transaction.
- v. A purchase agreement may be deemed terminated even if there is a dispute over the EMD. Ordinarily, the fact that there is a dispute over the EMD does not prevent the sellers from re-listing or the buyers from looking for a new home. On the other hand, if one of the parties insists that the purchase contract is still enforceable, a Realtor<sup>®</sup> should always advise his or her client to consult with an attorney.
- vi. Realtors<sup>®</sup> are not entitled to keep abandoned EMDs; rather, the funds must be turned over to the State of Michigan. Realtors<sup>®</sup> have an obligation to report unclaimed EMDs after three years. Failure to do so can result in the broker having to pay significant fines.

D. It is not always the case that a buyer can walk away from a transaction with no adverse consequences other than the forfeiture of the buyer's EMD. Many purchase agreements provide that in the event the buyer defaults, the sellers can keep the buyer's EMD and sue the buyer for damages. If a Realtor<sup>®</sup> is advised by buyer-clients that they wish to get out of a purchase agreement, the Realtor<sup>®</sup> should advise them to consult with an attorney about the ramifications of doing so.

As always, thank you for tuning in and watching this legal video primer. If you have questions or would like to suggest topics for future videos, please send suggestions to the email below. Again, thanks for watching and see you next time.