

Battle Over Earnest Money

State Appeals Court, Legislature Weigh In on Disputes

By Joshua B. Durham



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You've got the earnest-money deposit. The agreement is signed. Everyone is heading toward the closing wearing rose-colored glasses. Then, the seller and buyer have a falling out. Emotions run high. The seller demands the earnest money, as does the buyer. It can be a difficult time for real estate professionals.

Now try to imagine being tied up in litigation over the money for well over a year and depending not only on a trial court to resolve the issue but also the Court of Appeals. It happens, but there's a way you can avoid it and save considerable time and expense.

In April, the North Carolina Court of Appeals rendered a decision in *Carson vs. Grossman*, perhaps ending a 15-month legal battle over a \$15,000 earnest-money deposit. At issue was a typical contingency clause negotiated by the parties, providing that the buyer's offer was contingent on the sale of the buyer's existing residence. The parties also agreed that the seller would not accept any other offers for 30 days. If the buyer was unable to sell his home within 30 days, the seller could then accept another offer. Finally, the clause stated that the buyer forfeited his \$15,000 earnest-money deposit if he was unable to close the transaction.

Unfortunately, the buyer was unable to sell his home within the subsequent 30 days, and the seller contended that the buyer forfeited the earnest-money deposit. When the parties were unable to agree on the return of the money, the buyer filed suit. Included in the suit was the escrow agent. In this case, an attorney possessed the disputed funds, but it just as easily could have been—and many times is—a real estate salesperson or firm.

Ruling Favors the Buyer

Despite the buyer's inability to close the transaction, which would have allowed the seller to retain the earnest money, the trial court ruled that the contingent nature of the buyer's offer prevented a contract from ever being formed. In law, the contingency is known as a condition precedent. A condition precedent (in this case, the sale of the buyer's house) must occur before any rights under a contract arise. Since the buyer did not act in bad faith in preventing the condition from occurring, the parties never became bound by the contract. Therefore, the language regarding the buyer's inability to close the transaction was irrelevant.

The seller appealed the trial court's decision and, in April, the Court of Appeals affirmed that ruling.

In the end, the decision is the correct one, and salespeople can rest easy knowing their buyers will generally recover their earnest

money as long as the contingency never occurs. But imagine if the funds were in your hands during the entire litigation. Imagine having to pay close attention to months and months of pleadings, notices and hearings to ensure that no adverse action is being taken against your company. The just result in the end is little compensation for the heartache and the hassle.

So, how to avoid it? We are all familiar with A.0107 of the North Carolina Real Estate Commission (NCREC) Rules, which says that in such a dispute, "The licensee shall retain said deposit in trust or escrow account until the licensee has obtained a written release from the parties consenting to its disposition...." However, in many cases, obtaining the consent of emotionally charged buyers and sellers is nearly impossible. For that reason, the North Carolina Legislature created a simple solution for real estate professionals.

The process, contained in section 93A-12 of the General Statutes, is as follows:


- The real estate broker must send a letter, in person or by first-class mail, to all parties claiming ownership of the money.
- The letter must advise the parties that the broker will, in 90 days, deposit the money with the clerk of court for the county in which the property is located.
- The letter must also advise the parties that they may institute a special proceeding to recover the disputed money.
- After 90 days, the broker must complete the court-approved form and deliver the money to the clerk of court. The form, known as AOC-SP-260, is available online at www.nccourts.org/Forms/Documents/945.pdf. Once the money is deposited, the broker is then discharged from liability.

Quick Action Is Vital

Be careful, though, because for all the good the Legislature tried to accomplish, the statute does not address what a broker or salesperson should do when named in a lawsuit filed before the person


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is able to deposit the money with the clerk. The best solution, therefore, is to act quickly and send the notice as soon as the seller and buyer reach an impasse. If no impasse has been reached but either side has obtained an attorney, send the notice. Sending the notice as early as possible will motivate the parties to attempt to resolve the issue sooner, rather than later. It might also prevent you from being named in any subsequent lawsuit since the parties already know the money will be deposited with the clerk of court. There would be no need to include the broker or firm in any litigation.

If you do find yourself in a lawsuit over the earnest money, your broker should consult with the attorneys for the parties to determine whether he may deposit the funds with the attorneys pending the litigation. The attorneys will typically consent to such an arrangement. If the broker is unable to obtain consent, a call to the broker's legal counsel might be all that is necessary to ensure that your and your firm's interests are protected.

Litigation is never fun, but with the notice process created by the Legislature, and these tips, you can avoid the courts and save yourself considerable time and money, while still protecting the earnest money.

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