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## EARNEST MONEY

**Question:** What is the difference between the "forfeiture of earnest money" option in the purchase and sale agreement and the safe harbor clause in the optional clauses addendum?

**Answer:** The forfeiture of earnest money option in the purchase and sale agreement (NWMLS Form 21) is a contractual limitation on the seller's remedies against the buyer. The Optional Clauses addendum (NWMLS Form 22D) contains the statutory safe harbor clause. Both have the same effect. The statutory safe harbor clause is included in the Optional Clauses addendum because some brokers and attorneys do not believe it is enforceable to limit the buyer's liability by agreement without the statutory clause. I (and most real estate attorneys) disagree with that position and believe the contractual limitation of remedies clause in the purchase and sale agreement is sufficient. The contractual limitation of remedies approach does not require the parties to separately sign or initial the clause.

**Question:** Is it necessary to have an Earnest Money Deposit or Note to have a binding contract?

**Answer:** Earnest money is not an essential element of a valid and binding contract, unless "Forfeiture of Earnest Money" is selected as the sole remedy for the buyers' default, because the contract would then be illusory (i.e., there would be no substance to the buyers' promise to buy).

**Question:** A title insurance company is requesting that we sign an indemnity agreement before it will release nonrefundable earnest money. The purchase and sale agreement has expired and provides that the \$1,500 earnest money is nonrefundable.

**Answer:** It is typical that title insurance and escrow companies take a conservative approach to disbursing earnest money. We should agree to indemnify the title company, but only to the extent of the funds being released to us. If the entire deposit is being released to the sellers, then the sellers (not us) should agree to indemnify the title company.

**Question:** Does the 2 days for delivery and 3 days for deposit of the earnest money under the new NWMLS purchase and sale agreement fall under the general computation of time provision (i.e., 5 days or less includes business days only)?

**Answer:** Yes.

**Question:** Is there any way a seller can get more than 5% earnest money? A builder of a presale home wants to request more than 5%, and the buyers agree. Does the 5% limit apply only to liquidated damages?

**Answer:** It is not illegal to obtain more than 5% of the purchase price as earnest money. However, if the buyer defaults, the seller will have to prove that the seller incurred actual damages to the extent of the earnest money or that extraordinary risk existed at the time the agreement was entered into. Advise the seller to consult its attorney before requiring more than 5% earnest money -- the seller may be shooting himself in the foot.

**Question:** What happens in the case of a dispute over who should receive an earnest money deposit?

**Answer:** The broker or closing agent cannot disburse the earnest money to either party without a written release signed by all parties or court order. If the parties do not agree within 30 days after the sale has failed, then the broker or closing agent should commence an interpleader action in superior court and deposit the funds with the clerk of the court. Alternatively, the parties could "agree not to agree" in order to buy some time to attempt alternative dispute resolution, such as mediation or arbitration. The closing agent could modify and use JLS Form 420 for this purpose.

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An interpleader action is a lawsuit, in which both parties must retain attorneys to protect their interests. If the amount in controversy is \$35,000 or less, and after the required pleadings are filed, then the case will be transferred to mandatory arbitration, where a retired judge or attorney hears and decides the case. It usually takes about six to eight months after the interpleader action is filed to get an arbitration hearing. Either party may then request a trial de novo, which is a regular trial in superior court. However, if the party requesting the new trial fails to improve its position from the arbitration award to the court's judgment, that party must pay the other party's attorney's fees incurred after the arbitration. In an earnest money dispute, the attorney's fees incurred by each party usually exceed the amount in controversy, so the parties are well-advised to compromise and settle the dispute without litigation. The prevailing party is entitled to recover their attorney's fees and court costs in an earnest money dispute, but the court often does not award all fees incurred, especially if the case is a close call.

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