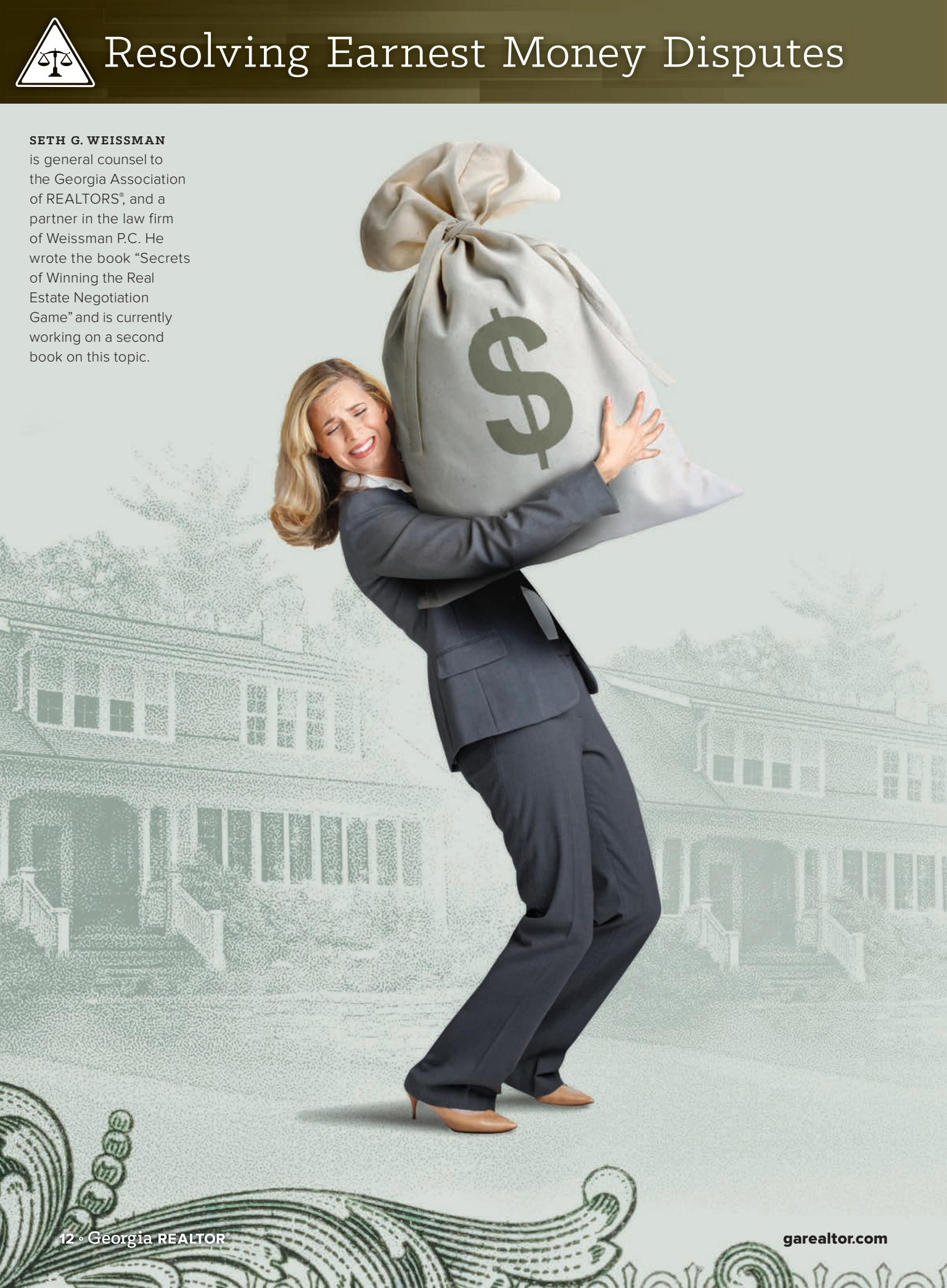
Resolving Earnest Money Disputes

SETH G. WEISSMAN is general counsel to the Georgia Association of REALTORS®, and a partner in the law firm of Weissman P.C. He wrote the book "Secrets of Winning the Real Estate Negotiation Game" and is currently working on a second book on this topic.



10 Questions AND Answers TO HELP YOU Navigate THIS Tricky Territory

One of the results of having been in an extreme seller's market is that the amount of earnest money that buyers deposit in real estate transactions has increased significantly. The days of $500 earnest money is increasingly a thing of the past. It is now common to see earnest money in the $5,000 to $50,000 range, with earnest money of one to two percent of the purchase price becoming standard. When there is an alleged breach of contract by the buyer, we are now seeing more earnest money disputes than ever. With higher earnest money deposits, this largely appears to be because there is more money to fight about. Below are 10 questions — with answers — surrounding earnest money disputes.

{1} When the broker is holding the earnest money, what are the broker's remedies when there is a dispute over earnest money?

The broker holding earnest money basically has three options when there is an earnest money dispute. First, the broker can encourage the parties to resolve the dispute and give them a reasonable amount of time to do so. This is generally in the range of one to two months. If both parties agree in writing on some compromise within that time frame that resolves the dispute, the broker can disburse based on that written agreement. Usually, a termination and release agreement is signed to memorialize the agreement regarding earnest money.

Second, the broker can disburse earnest money after making a reasonable interpretation of the contract. In this instance, the broker has to first send out what is referred to as a "10-day letter," stating the proposed disbursement and giving the parties 10 days from the date of the letter to object. Third, the broker can interplead the funds into Superior Court. Technically, this means the broker files a lawsuit against both parties and as part of this, the broker deposits the earnest money into the registry of the applicable Superior Court and asks the court to decide who should get it.

{2} If the seller objects to the broker disbursing the earnest money to the buyer, but the objection is not valid, is the broker allowed to interplead the funds into court?

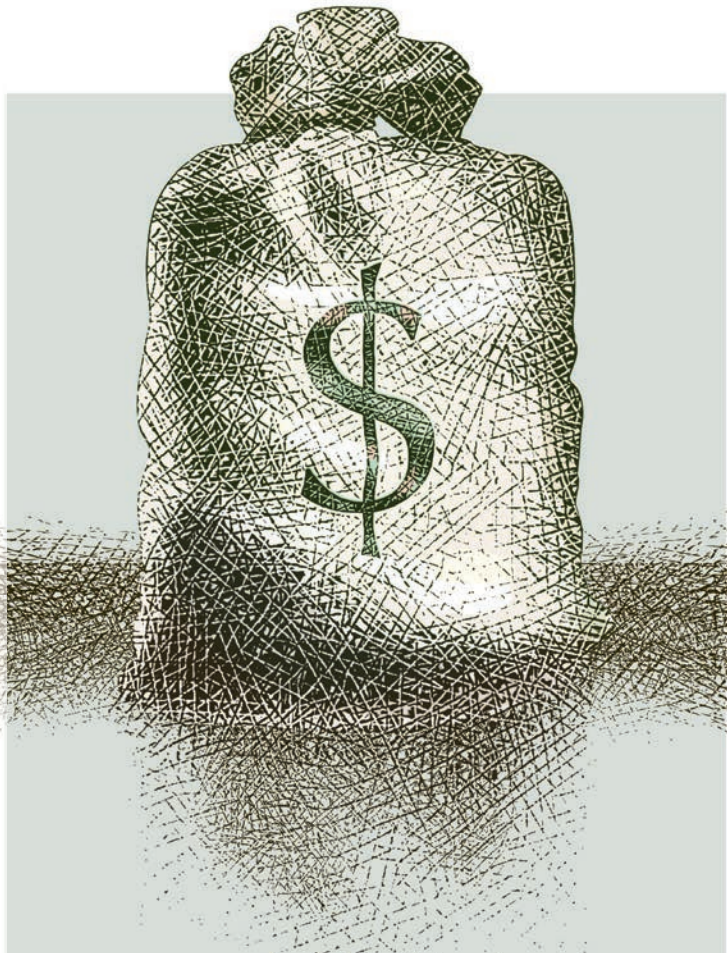
The answer to this question is no. The dispute has to be a bona fide dispute where the broker is genuinely uncertain as to who should get the earnest money. So, for example, let's say that the buyer terminates the contract during the due diligence period. The seller gets mad and will not sign a termination and release agreement. The seller even demands the earnest money to compensate them for the house being off the market. In this situation, there may be a dispute, but it is not a legitimate dispute that would prohibit the broker from disbursing the earnest money to the buyer. It is clear that the buyer is entitled to get back

their earnest money because the contract was properly terminated during the due diligence period. Even though the seller is upset, the broker should still go ahead and make a reasonable interpretation of the contract to disburse to the buyer, send out a 10-day letter and then disburse accordingly. Judges expect holders of earnest money to make reasonable interpretations of the contract and not to simply pass the buck to the nearest Superior Court judge.

The passage of time often helps resolve earnest money disputes. A seller who was angry with a buyer for terminating the contract, or not closing, often sells the property in the meantime to someone else and their anger dissipates.

{3} When there is a dispute, can the broker just hold onto the money and not disburse until the parties resolve the dispute?

The answer to this question is no. The broker can hold onto the funds for a reasonable period of time. In truth, the passage of time often helps resolve earnest money disputes. A seller who was angry with a buyer for terminating the contract, or not closing, often sells the property in the meantime to someone else and their anger dissipates. When the parties also face the prospect of going to court to defend themselves in an interpleader lawsuit, it tends to make all parties think twice. If the holder holds onto earnest money for months on end, the holder risks a lawsuit against itself in which it is alleged that the holder has effectively converted the funds to the holder's own use. While there is not an appellate court decision on the validity of such a claim, it can be a hassle for the holder to defend.



{4} Can the broker simply give the funds to their own client?

The answer to this question is also a big no. In holding earnest money, the holder agrees to disburse the funds only upon a reasonable interpretation of the contract. It is fundamentally unreasonable and an act of bad faith to simply give the money back to the holder's client. While the holder is indemnified against claims from all parties in a real estate transaction, it is unclear whether such an indemnity would apply to a bad faith, unreasonable disbursement.

{5} Does an attorney holding earnest money owe the same duties as a broker holding earnest money?

The answer to this question is yes. GAR Form F510, Closing Attorney Acting as Holder of Earnest Money Exhibit, provides as follows on this point: "Notwithstanding any provision to the contrary contained in the Agreement, Closing Attorney acting as Holder shall have all of the pre-printed rights and duties of Holder set forth in the GAR Purchase and Sale Agreement …".

{6} Does the holder have any legal liability if the buyer does not pay the earnest money and the holder does not timely notify the parties?

The answer to this question is maybe. Holders sometimes do not realize that they have not received the earnest money and, therefore, forget to notify the parties that it has not been received. Can a claim for the earnest money be asserted against the holder for this error? The answer is clearly yes. However, in defending against such a claim, the holder can argue that while he or she failed to timely notify all parties that the earnest money was not received, had such a notification been given, there is still no assurance that the earnest money would ever have been paid. About the only thing that can be clearly proven is that had the holder notified the seller when the earnest money was not timely received, the seller would have had more time to demand the earnest money be paid and terminate the contract if this did not occur. As result, most sellers in this situation choose to sue the buyer who failed to deposit the earnest money, as per the contract.

{7} Can the holder of the earnest money decide to give each party half?

The answer to this question is no. There is nothing in the earnest money section of the GAR Purchase and Sale Agreement that gives the holder the right or the ability to divide the earnest money between the parties. Instead, the earnest money section simply gives the holder the right to decide who is entitled to the earnest money. In other words, it either all goes to the buyer, or all goes to the seller. Dividing up the earnest money would likely be something a Superior Court judge might be able to do in exercising its equitable powers. But no such authority is vested with the holder.

{8} Why does the threat of filing an interpleader action cause so many buyers and sellers to settle?

When buyers and sellers truly understand what an interpleader is, they tend to settle whatever dispute they may be having with each other. Normally, I recommend that the holder send a 10-day letter (as

The one major downside to the closing attorney holding earnest money is if the transaction is for all cash. In such situations, the closing attorney is representing the buyer.

discussed in question #1) to both parties stating that since the dispute cannot be resolved, the holder will move forward to file an interpleader lawsuit within a week or two thereafter. The key points to be made in the letter are as follows:

i. *an interpleader action is a lawsuit that the holder of the earnest money files in Superior Court against the buyer and seller;*

ii. *because the suit is in Superior Court, which is the highest trial court in Georgia, both buyer and seller are urged to hire attorneys;*

iii. *the losing party in the lawsuit pays the attorneys fees of the winning party so, the losing party may end up losing a lot more than just earnest money.*

iv. *the holder is allowed to deduct its fees from the earnest money reducing the amount of money that will ultimately be paid to the winning party; and*

v. *litigation often takes a couple of years to go to trial so the resolution of the dispute will likely be far into the future.*

When most buyers and sellers consider the costs and risks involved with an interpleader lawsuit, they often agree to simply split the earnest money. The 10-day letter that is sent to the parties advising them that the earnest money will be interpleaded should encourage the parties to try to come to some compromise of the dispute while the holder's attorney begins work drafting the lawsuit.

{9} Why is it that more closing attorneys are being asked to hold earnest money?

There is a trend toward having more closing attorneys hold the earnest money. This is probably for two reasons. First, it avoids the uncomfortable situation of the broker having to sue its own client if the broker needs to interplead the funds into court. Second, it saves the broker from having to use staff time to track earnest money deposits and decide who gets the earnest money in the event of a dispute. This can result in a significant savings to the broker. Most closing attorneys are willing to hold the earnest money as an accommodation to their clients.

{10} Are there any downsides to the closing attorney holding earnest money?

The one major downside to the closing attorney holding earnest money is if the transaction is for all cash. In such situations, the closing attorney is representing the buyer. In the event of a dispute over the earnest money in that situation, "the Closing Attorney shall not disburse based upon a reasonable interpretation of the Agreement". Instead, the closing attorney "is required to interplead the funds into a court of competent jurisdiction". This provision was included to avoid the situation in which the closing attorney might have to take a position that is adverse to their client's wishes since this would violate the lawyer's ethical duties. Therefore, this might be a situation in which it is better to have a broker hold the earnest money rather than the closing attorney.

As long as buyers put up earnest money, there will be earnest money disputes. Hopefully, this article provides guidance for REALTORS® on the most commonly asked questions regarding the resolution of such disputes.