

## GIVING AWAY A DEPOSIT

*By James Goldsmith*

**Q:** The buyer and seller have agreed that once the buyer's mortgage commitment is issued, if the transaction fails to close for any reason, seller gets the full deposit. Further, the seller insists that no release signed by the buyer will be required; the listing agent will simply tender the deposit to seller the day following date scheduled for the settlement if it does not occur. Can this be done?

**A:** Before answering this question, allow me to ask the question you are all thinking: "Why would any buyer in their right mind even think of agreeing to such a proposal?" It is unanswerable, but not beyond the bounds of what some of your clients think or do!

As ill-advised as this provision may be, there are other questions we receive about disbursing deposit monies based on the language of the agreement. For example, the mortgage contingency clause in the *Standard Agreement* provides that "if this Agreement is terminated . . . or the mortgage loan is not obtained for settlement, all deposits will be returned to Buyer . . ." So, when the buyer fails to secure their mortgage loan by settlement, this language should suffice to empower the broker holding escrow to return to buyer, right?

Not so fast. While the Agreement directs that the deposit money is to be returned to buyer, there is always the possibility that a dispute exists. If the seller correctly asserts that the buyer never even made a completed mortgage application, would not that change the outcome? For this reason, broker's holding escrow will not release that escrow even if it is clearly stated in the Agreement where that deposit is to go.

If you read the default provision found at Paragraph 22 of the *Standard Agreement* (ASR), you will see the clause that underscores the broker's inability to disburse deposits even when directed by the Agreement. "Regardless of the apparent entitlement to deposit monies, Pennsylvania law does not allow a Broker holding deposit monies to determine who is entitled to the deposit monies when settlement does not occur." Brokers holding escrow money cannot act as the judge even when the case of entitlement seems crystal clear!

Like every rule or law, there are exceptions. If a court of law has reached a final decision in an escrow dispute and the appeal period has passed, then the funds can be released pursuant to that order. There are other exceptions, but the only one that allows a broker to disburse escrow in the absence of a court order, release or agreement between the parties is when the parties have pre-agreed to a plan for disbursement when there is a dispute over the deposit. The *Standard Agreement* has such a provision, also found in the Default clause, Paragraph 22, where it states that if the dispute over a deposit is unresolved in 365 days, the broker holding the deposit can return it to the buyer upon 30 days written notice unless suit has been filed (simplified summary of the provision).

Let us see if we can make sense of this by applying it to the original question. Assume that the agreement of sale is amended by a provision that states that once the buyer receives her mortgage commitment, failure by buyer to close for any reason will result in the broker paying the deposit to the seller without the requirement of a signed release or final court order. And assume further, that the buyer gets her commitment and is prepared to settle. At the pre-settlement walk-through, the buyer observes slimy black and green mold along a wall previously obscured by boxes and other items. The buyer, who has health issues and a susceptibility to mold, refuses to settle and the argument over entitlement to the deposit ensues. Seller relies on the plain language of the agreement and the buyer counters that the language was never intended to give a benefit to a seller who lied about the condition of his property.

Even though the agreement makes clear that the seller is to get the deposit, can the broker holding escrow pay it? No. Where there is a dispute over the entitlement to deposit, the only way money can be released in the absence of a court order, release or agreement is where the parties have specifically agreed as to the means of disbursing disputed deposit funds. In other words, the agreement would have had to have stated something like this: Subsequent to Buyer's receipt of a written mortgage commitment, any failure to close on the part of Buyer will result in deposits being paid directly to Seller without the need for release, court order or agreement. In the event that buyer disputes seller's entitlement to the deposit, for any reason, that dispute shall be resolved by the terms of this Agreement empowering and directing Broker to tender the full amount of Buyer's deposit monies to Seller. Broker shall not be liable to any party for observing these instructions agreed to by Buyer and Seller as to the disposition of the deposit monies in the event of a dispute." This would be the revision made to the *Standard Agreement*, Paragraph 22(C), that I summarized above.

Revising Paragraph 22(C) is dangerous.

A provision that allows for the disbursement of a deposit when there is a dispute is dangerous because the parties can never anticipate the subject of a future dispute. Disputes arise because both sides believe that are reasons that support their position. The seller claims that buyer was to forfeit the deposit if the buyer did not settle for any reason. Buyer now claims that she never contemplated that the seller would try to sell a home with mold and that a bad act of a seller should not work to the advantage of seller.

So, if these distribution-in-the-event-of-default clauses are so dangerous, why does PAR have it in its Agreement of Sale? Yet another good question. PAR's clause is rather benign. First, the broker is not allowed to disburse disputed deposit funds for one year. Next, the deposit is only disbursed upon written notice from the buyer, and even then the broker has 30 days within which to return the deposit. The broker has a reasonable duty to inquire whether litigation has been initiated and certainly can advise the seller of buyer's request. The seller will have had a least a year to do something about his claim to entitlement to the deposit money. All-in-all, the clause has worked rather well and I am aware of no court opinions critical of its language. Tampering with this clause or

amending it in any way that does not give both sides a legitimate shot of protecting themselves is bound to lead to trouble.

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