EMDs: It Never Stops

For many years, approximately 25% of the calls made to the MAR Legal Hotline ("Hotline") involved some dispute or issue about earnest money deposits ("EMDs"). While the percentage of calls to the Hotline regarding EMDs dropped during the height of the foreclosure and short sale frenzy, the percentage of calls regarding EMDs is again on the rise. Thus, a short refresher on handling EMDs when a transaction craters seems to be in order.

In order to understand where we are today on EMDs, it helps to understand how we got here. During the 1990s, both MAR and the then Department of Commerce ("Department") advised REALTORS® in the case of dispute over an EMD in a failed transaction, the REALTOR® holding the EMD should not make the decision as to which party was entitled to the EMD, but instead should either hold the EMD until the dispute was resolved or interplead the EMD into a court. The theory was that a REALTOR® holds an EMD in trust for both the buyer and seller and cannot make the decision to deliver it to one party over the claims of the other party. Unfortunately, years ago a REALTOR® who followed this advice was sued by a buyer under the provisions of the Michigan Consumer Protection Act ("MCPA") for allegedly wrongfully withholding the EMD. A judge determined that neither the Department's position nor MAR's advice to hold the EMD in case of a dispute had any legal consequence. The jury then found the REALTOR® guilty of violating the MCPA. The buyer was awarded only a few hundred dollars damages but attorney's fees in excess of $20,000. This case led to an avalanche of lawsuits against REALTORS® under the MCPA for the alleged wrongful withholding of an EMD during a dispute between a seller and a buyer.

In response, MAR undertook two courses of action to eliminate what was then a very real threat against REALTORS®. First, MAR, through its Legal Action Committee and its Board of Directors, committed significant resources to obtain a decision from the Michigan Supreme Court that REALTORS® were exempt from the MCPA. Ultimately, such a decision was obtained from the Michigan Supreme Court and REALTORS® remain exempt from the MCPA to this day.

Second, MAR sought to have the rules governing EMDs modified so that no judge could find that a REALTOR® had done anything wrong by holding an EMD when a seller and buyer were in a dispute over who was entitled to the EMD. This resulted in an amendment to Rule 313(6), which now provides as follows:

> *. . . any deposit in the trust account of the broker for which the buyer and seller have made claim shall remain in the broker's trust account until a civil action has determined to whom the deposit must be paid, or until the buyer and seller have agreed in writing, to the disposition of the deposit. The broker may also commence a civil action to interplead the deposit with the proper court (the "Rule").*

Insofar as we know, since the adoption of the Rule, there have been no further lawsuits against REALTORS® who have held EMDs when both the seller and buyer claimed the EMD. Presumably, there have been no lawsuits because the Rule does not permit a REALTOR® to release an EMD when there is such a dispute.

The language in the Rule that permits a REALTOR® to release an EMD when " . . . the buyer and seller have agreed, in writing, to the disposition of the deposit" has resulted in a misunderstanding of the Rule by some REALTORS®. It has been recommended by me on many occasions that as a best practice and risk reduction strategy, a REALTOR® should obtain a written release from both the seller and buyer every time a transaction fails and the EMD is to be returned to the buyer or, alternatively, delivered to the seller. Obtaining a written release from the seller and the buyer, even in friendly situations, eliminates potential future claim from the buyer or seller who has forgotten that they made no claim to the EMD. However, REALTORS® must distinguish between what is a good risk reduction practice, *i.e.*, obtaining a written release, and what is required under the Rule.

As quoted above, the Rule requires a REALTOR® to hold an EMD only when both the seller and buyer both claim the EMD. In other words, the Rule only prohibits the REALTOR® from releasing the deposit when there is a dispute over who is entitled to receive the EMD. Based on the calls received over the Hotline, there appears to be a fairly common scenario involving undisputed EMDs. In this scenario, the transaction has failed based on the inability of the buyer to satisfy a contingency in the purchase agreement. The seller makes no claim to the EMD. However, for whatever reason, the seller wants nothing more to do with the buyer and refuses to sign a written release. Alternatively, the buyer simply demands

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the EMD and refuses to sign the written release. In this situation, the REALTOR® holding the EMD is not protected by the Rule. The seller has made no claim to the EMD, *i.e.*, there is no dispute. The Rule does not authorize a REALTOR® to withhold delivery of the EMD because one or more of the parties refuses to sign the written release. If a seller refuses to sign a written release, it is generally recommended that the REALTOR® holding the EMD send a communication to the listing agent or to the seller indicating that it is the REALTOR®'s understanding that the seller does not claim the EMD, and that if no claim is made writing within a specified period of time, *e.g.*, seven (7) days, the REALTOR® will release the EMD to the buyer. This practice is not as foolproof as obtaining a written release from the seller and buyer, but a REALTOR® simply cannot continue to hold an EMD indefinitely if only one party is claiming the EMD.

As an aside, the fact that there is a dispute over the EMDs does not prevent sellers from re-listing their home or buyers from looking for another house. If either party has terminated the transaction, even wrongfully, the transaction is terminated even if one or more of the parties is unwilling to sign a release.

Finally, many REALTORS® have asked how long they must hold an EMD after both the seller and buyer have claimed it. The answer is that there is no statute of limitations or specified period after which REALTORS® are free to release an EMD. Many REALTORS® end up holding EMDs in their trust accounts in which both the seller and buyer appear to have lost any interest. Frequently, the REALTOR® has not heard from either party for a number of years. The question then becomes what can the REALTOR® do with these apparently abandoned EMDs. What is clear is that REALTORS® cannot claim these abandoned EMDs for themselves. If no claim has been made against the EMD for three years, and if other criteria are met, the EMD escheats to the State of Michigan, *i.e.*, the government gets the money.

Hopefully, REALTORS® who read this article will share its contents with their colleagues to help spread the word. Anything that can be done to reduce the volume of calls to the Hotline so that all REALTORS® can get through in a timely manner will be appreciated. Thank you. **MAR**

Michigan REALTORS® can stay informed of legal issues with updates through our Legal Lines.