White Paper

Earnest Money

April 2002
Revised February 2022

EQUAL HOUSING OPPORTUNITY

REALTOR®

I. INTRODUCTION

Earnest money deposits are involved in almost every real estate transaction. Although not essential to the creation of a valid and binding purchase agreement, it is the rare residential real estate transaction that does not require the buyer to make an earnest money deposit. The earnest money is almost always turned over to the real estate broker who holds the money in trust for the parties to the transaction. Since the Ohio real estate licensing laws place some very definite obligations on the broker with respect to the earnest money deposit, it is the purpose of this paper to discuss generally the law of earnest money and, more specifically, the manner in which the broker should handle the earnest money deposit to comply with the state licensing laws.

II. THE LAW OF EARNEST MONEY

"Earnest money" is nothing more than a deposit of part payment of the purchase price on a sale to be consummated in the future. In the context of a real estate transaction, several courts have defined earnest money as a comparatively small sum of money paid down as an assurance that the party making the offer is acting in earnest and good faith and that " ... if his being in earnest and good faith fails, it will be forfeited." While the terms of the earnest money deposit should be defined in the purchase agreement, generally the deposit is delivered to the real estate broker at the time the offer is made, and the broker deposits the earnest money in his trust account either upon receipt or upon acceptance of the offer by the Seller, depending upon the terms of the purchase agreement. When the real estate transaction is closed, the earnest money is either returned to the buyer or the buyer is given a credit against the purchase price.

Depositing Earnest Money

Brokers must deposit earnest money into their trust or special account as soon as possible upon receipt. The Division generally considers 24-48 hours to be a reasonable time but does weigh the circumstances in determining what is reasonable.

The terms of the purchase contract will also be weighed in determining when the earnest money shall be deposited by the broker. For example, if the contract provides for the earnest money to be deposited upon acceptance of the offer, the duty to deposit will not begin until the offer is accepted. If the contract is silent on this point, the earnest money should be deposited within 24-48 hours after receiving it.

The license law does not dictate whether the listing broker or "selling" broker shall hold the earnest money; instead this is generally a matter of custom that varies across Ohio. The purchase contract should be reviewed for language that indicates which broker will hold the funds. If it is silent, the broker to whom the funds were made payable should deposit it in his trust account.

Seller holding/non-refundable deposit

Occasionally a seller (usually a builder or developer) may want to hold the earnest money. This may be done as long as the buyer agrees and it is specified in the purchase contract. If this is done it is important to delete any references in the purchase contract to the broker holding the earnest

money or refunding it. The earnest money may also be made non-refundable by so specifying in the purchase contract; in this instance it should be paid directly to the seller and not deposited in the broker's trust account. Again, pre-printed references in the purchase contract that do not apply should be deleted.

Interest on Earnest Money

Occasionally the parties may want a large earnest money deposit to earn interest. This goal can be achieved by having a party other than the broker hold the earnest money. Another alternative would be for the parties to establish an account in their joint names. Any such arrangement should be set forth in the purchase contract and should specify to whom the interest will be paid. Again, pre-printed language in the contract referencing the broker holding the money should be stricken.

Notes

Under Ohio license law a promissory note for earnest money may only be accepted with the knowledge and written consent of the seller. Therefore, it is extremely important to clearly identify on the purchase contract if a note is being taken. If the seller accepts the offer, this would constitute his consent to the earnest money being taken in the form of a note.

It is important to realize that if the note is made payable to the broker, the broker is the only party with standing to sue on the note in the event the buyer defaults; therefore brokers may want the note made payable to the seller.

Failure to Collect/Bounced Checks

If a check for earnest money is returned for insufficient funds, or the broker is unable to collect earnest money the buyer is required to pay under the terms of the purchase contract, the seller must be notified of this fact as soon as possible; failure to do so by a broker has been found to be a violation of the license law.

Misrepresentation regarding earnest money

Frequent violations of the license law occur where licensees misrepresent the receipt of earnest money by signing a receipt for it on the purchase contract when in fact they have not received it, have received less than indicated, have received a postdated check, or have taken a note without so indicating. Therefore, licensees must exercise care to make sure that any notations they make or statements they sign on the purchase contract reflect the true circumstances and facts.

Returning earnest money

There is almost never a problem with an earnest money deposit when the real estate transaction actually closes. However, problems do arise when the real estate transaction fails, for whatever reason, and there is no closing. This situation invokes not only the general law with respect to earnest money but should also cause the broker to examine his obligations with respect to the licensing laws.

The general rule with respect to earnest money deposits is that the buyer should be entitled to a return of the deposit if the contract does not close through no fault of the buyer. Conversely, the seller should be entitled to the earnest money deposit if the buyer breaches the purchase agreement. The purchase agreement should specify that the retention of the earnest money by the seller should not be the seller's exclusive remedy, but he should also be permitted to pursue an action for specific performance or damages. Most purchase contracts contain contingencies (most commonly relating to financing and inspection), which excuse the parties from performance if the contingencies are not satisfied or removed. If the contingencies are not satisfied, notwithstanding good faith efforts by the parties, then the contract is null and void, and the buyer should be entitled to a return of the earnest money deposit. However, if the buyer does not act in good faith in attempting to satisfy the contingency, then a court may rule that the seller is entitled to the earnest money even though the contingency has not been satisfied or removed.

When a real estate transaction fails, the parties often want the broker to decide which party is entitled to these funds. This is a position in which a broker should never place himself because the decision as to the proper recipient of the earnest money is a legal decision which should be made by a lawyer or the courts. The difficulty of this decision is compounded by the fact that the broker owes fiduciary duties to at least one of the parties, and naturally those duties include obeying the lawful instructions of that client. In this situation, the broker's duties to their client would compete with the broker's duty to determine which party, if any, breached the purchase agreement, if he were to attempt to dispose of the earnest money on his own.

To avoid placing the broker in this difficult position, the Ohio Real Estate Commission and the Division of Real Estate and Professional Licensing took a longstanding position that a broker was not permitted to disburse earnest money to any party unless the other party to the transaction has provided him with a release or authorization to do so. If the parties refuse to give the broker appropriate authorization to disburse the funds, then the broker was required to keep the funds in his trust account until the parties provide him with an appropriate authorization or until a court of law orders him to disburse the funds. However, this policy was not set forth in the Ohio license law.

2009 Earnest Money Legislation

On January 6, 2009, Governor Strickland signed into law legislation that provides greater statutory authority and options to brokers regarding the handling of disputed earnest money. This legislation was the result of an Ohio Association of REALTORS® Task Force that studied the problems created when a transaction fails to close and the parties cannot agree on who is entitled to the earnest money.

One of the goals of HB 130 was to clearly set forth in the license law, the broker's obligation to maintain earnest money in the broker's trust account. This is now codified in Section 4735.24 (A) of the Ohio Revised Code. (See EXHIBIT A) This section also clearly states that a broker must maintain earnest money in his trust account until one of the following occurs:

1) The transaction closes and the broker disburses the earnest money to the closing or escrow agent or otherwise disburses the money pursuant to the terms of the purchase agreement;

2) The parties provide the broker with written instructions that both parties have signed that specify how the broker is to disburse the earnest money;
3) The broker receives a copy of a final court order that specifies to whom the earnest money is to be awarded; or
4) The funds become unclaimed as defined in Section 169.02 (M)(2) of the Ohio Revised Code and the broker remits the earnest money to the Division of Unclaimed Funds.

It is important that both the buyer and seller understand the broker's legal obligations with respect to an earnest money deposit. Therefore, there should be some discussion of these legal obligations in the purchase agreement that the parties execute. Many form purchase agreements recite only that the broker has received a specified sum of money as an earnest money deposit, and then when the transaction fails, the parties are surprised that the broker cannot simply return the deposit to the buyer or turn it over to the seller. It is recommended that there be included in the purchase agreement a provision that sets forth the broker's obligations under Ohio Revised Code Section 4735.24(A). Namely, that if the transaction fails to close, the broker must maintain the earnest money in his trust account until the parties provide him with written instructions signed by both parties, a court order specifying to whom it is to be awarded or it becomes unclaimed under Ohio law and is remitted to the Ohio Division of Unclaimed Funds.

Optional Purchase Contract Provision

A second goal of HB 130 was to create a process that would create a time limit on how long a broker must continue to hold such disputed funds. It accomplishes this by allowing a broker to include a provision in the purchase contract that creates a sort of "statute of limitations" on the obligation to hold the funds. Such a provision is optional under HB 130.

Under this optional provision, the parties will have two years from the date the earnest money was deposited in the broker's trust account to resolve the dispute or initiate legal action. If they fail to notify the broker that they have done either one of these two things, then under the terms of the contract, the broker will return the earnest money to the purchaser without any further notice to the seller. By including such a provision, brokers are able to disburse these disputed earnest money deposits after two years from the date of deposit. It is believed this is ample time for the parties to either resolve the problem on their own or to initiate the necessary legal action to do so.

Below is sample language that has been approved by the Ohio Division of Real Estate and Professional Licensing that satisfies the new law. Again, it is not required that brokers include this language in their contracts; instead, it is an option available to brokers who choose to use such a provision to resolve earnest money disputes.

> *In the event of a dispute between the seller and purchaser regarding the disbursement of the earnest money, the broker is required by Ohio law to maintain such funds in his trust account until the broker receives (a) written instructions signed by the parties specifying how the earnest money is to be disbursed or (b) a final court order that specifies to whom the earnest money is to be awarded. If within two years from the date the earnest money was deposited in the broker's trust account, the parties have not provided the broker with such signed*

instructions or written notice that such legal action to resolve the dispute has been filed, the broker shall return the earnest money to the purchaser with no further notice to the seller.

In addition to the above language, brokers will of course still want to also include contract language indicating the amount of earnest money received, stating that the earnest money will be deposited in the broker's trust account and a provision that specifies how it will be disbursed at closing (i.e., credited to purchaser at closing, returned to purchaser at closing, applied to the commission owed the listing broker, etc.).

Under HB 130, brokers who are obligated to return earnest money to a buyer under such a provision in the purchase agreement will have no later than September 1 of that calendar year to disburse the money to the buyer. While brokers certainly will want to make this disbursement as soon as the two year time period has run, this September 1 date was included in the legislation to provide a clear, definable deadline. In the event the broker is unable to locate the buyer, the broker should follow the Unclaimed Funds Laws and disburse the money to the Ohio Division of Unclaimed Funds. (See section on p. 7 regarding Ohio's Unclaimed Funds law.)

Legal Action to Resolve Disputes

Section 4735.24 specifies that a broker may disburse earnest money from his trust account if he is doing so pursuant to a final court order. Such a court order will usually be the result of litigation initiated by either the buyer or seller.

In some instances, however, the broker may choose to file the legal action to obtain the necessary court order to determine entitlement to the earnest money. A broker might choose to do this where the parties' demands for the funds become excessive and unreasonable or where the broker is closing his business.

In this type of action, the broker would be the plaintiff in the case and would name as defendants both the buyer and the seller. In his complaint he would ask the court to determine whether the earnest money deposit should be paid to either the buyer or the seller. In this kind of "interpleader" action, the broker would be the "stake holder," and the buyer and seller would be required to set up their claims to the funds and convince the court that one or the other is entitled to the money.

Procedurally, it would probably be easiest for the broker to wait for the buyer and seller to commence an action, rather than commencing the action himself. Nevertheless, there may be situations in which the broker may want to commence the action himself so as to clear his trust account of the earnest money deposit. This is especially so if a broker does not include the new optional contract language discussed on page 5.

Attached, hereto as EXHIBIT B, is a form complaint that can be used in these situations. This complaint complies with the local rules of the Franklin County Municipal Court, Small Claims Division, and we have been advised that the Franklin County Small Claims Court would indeed handle cases such as this. Although, the Franklin County Small Claims Court has advised that the broker could pay the money into court at the time he filed the complaint, ORC Section 4735.24 doesn't specifically allow this. Therefore, the broker should keep the money in his trust account pending an order of the court.

The Small Claims Courts in the State of Ohio have jurisdiction over disputes up to $6,000. They are "informal" courts and are convenient since parties are typically not represented by counsel in Small Claims proceedings. The cost (filing fees) are also substantially less than filing fees for the regular Municipal Court or the Common Pleas Court. There are some other limitations on the use of the Small Claims Court, and therefore, it is important that the attached EXHIBIT B be reviewed with legal counsel in the particular county in which the action is to be brought or that the broker at least discuss the complaint form with his local Small Claims Court. Small Claims Court Administrators are typically very helpful and will advise the broker of any changes that must be made to the form to comply with the law in that particular jurisdiction. Many Small Claims Courts have particular forms that can be used for handwritten complaints, and therefore, it is very easy to commence an action in these courts. Attached as EXHIBIT C is a blank form that is used by the Franklin County Small Claims Court.

If the amount of the earnest money deposit exceeds $6,000, then it will be necessary to file the action in the regular Municipal Court. The same complaint language as found in EXHIBIT B can be used, but the reference to the Small Claims Court should be deleted. Furthermore, there will be a different filing fee depending upon the county, and the broker should check with the Clerk of the Municipal Court in his jurisdiction to determine the amount of the filing fee. If the amount of the earnest money deposit exceeds $15,000, then in most counties it will be necessary to file the case in the Common Pleas Court. Once again, the same form language as in EXHIBIT B can be used, but the broker should check with the Clerk of the Court of Common Pleas to determine the filing fee and any other peculiarities associated with these kinds of "interpleader" actions in the local jurisdiction.

Unclaimed Funds Law

Ohio's unclaimed funds law requires "holders" of "unclaimed funds" to submit an annual report and remit any "unclaimed funds" to the Division of Unclaimed Funds. A real estate brokerage is considered a "holder" and subject to the unclaimed funds regulations for the yearly reporting of various types of unclaimed funds, including wages, commissions, earnest money and other funds due and payable to others. Funds become "unclaimed funds" when the funds become dormant. This occurs when the holder has not had correspondence with the owner of the funds for the dormancy period. The dormancy period for funds held in a broker's trust account is two years.

Disputed earnest money deposits being held in a broker's trust account can be turned over to the Division of Unclaimed Funds if certain requirements are met. The first requirement is that the broker has had no correspondence with the buyer and seller for a period of two years. This is required to classify the earnest money as "unclaimed funds." After the two year period, if the earnest money being held is $50.00 or more, the broker is required to give the buyer and seller a "due diligence notice" (Form OUF-8 Notice of Unclaimed Funds). If the deposit is less than $1,000, then the notice must be sent by first class mail to the buyer and seller's last known address and must include a self-addressed stamped envelope. If the deposit is $1,000 or more, then the notice must be by certified mail. The notice provides that the buyer/seller has 30 days to show an interest in the funds by responding to the broker or the earnest money will be transferred to the Division of Unclaimed Funds. If no response is received or if the notice is returned for a bad address, the broker can remit the earnest money to the Division of Unclaimed Funds. However, if either the buyer or seller responds to the notice, the earnest money is then not considered unclaimed and the broker

must continue to hold the earnest money in his/her trust account. The broker is required to have another two-year period with no correspondence with the buyer and seller before the due diligence notice could be sent again.

The unclaimed funds law requires all brokers to file an Annual Report with the Division of Unclaimed Funds (Form OUF-1 Unclaimed Funds Reporting Form). The Annual Report is due by November 1 of each year even if there are no unclaimed funds to report. The Annual Report is due by November 1 for funds dormant as of the preceding June 30.

Additional information regarding the unclaimed funds regulations, reporting requirements and reporting forms can be obtained from the Division of Unclaimed Funds website at www.com.ohio.gov/unfd.

III. CONCLUSION

Although not required by law, earnest money has become a customary part of real estate purchase contracts in Ohio. Brokers and agents must be knowledgeable regarding the license law requirements to deposit, maintain and disburse such funds from the brokerage trust account. The duties concerning disputed earnest money have been codified in Ohio law, clarifying a broker's obligations in this area. Language allowing brokers to disburse disputed earnest money after two years may now be included in purchase agreements by brokers in their discretion. Such a provision is recommended to avoid maintaining such disputed funds indefinitely.

EXHIBIT A

Sec. 4735.24. (A) Except as otherwise provided in this section, when earnest money connected to a real estate purchase agreement is deposited in a real estate broker's trust or special account, the broker shall maintain that money in the account in accordance with the terms of the purchase agreement until one of the following occurs:

(1) The transaction closes and the broker disburses the earnest money to the closing or escrow agent or otherwise disburses the money pursuant to the terms of the purchase agreement.

(2) The parties provide the broker with written instructions that both parties have signed that specify how the broker is to disburse the earnest money and the broker acts pursuant to those instructions.

(3) The broker receives a copy of a final court order that specifies to whom the earnest money is to be awarded and the broker acts pursuant to the court order.

(4) The earnest money becomes unclaimed funds as defined in division (M)(2) of section 169.02 of the Revised Code and, after providing the notice that division (D) of section 169.03 of the Revised Code requires, the broker has reported the unclaimed funds to the director of commerce pursuant to section 169.03 of the Revised Code and has remitted all of the earnest money to the director.

(B) A purchase agreement may provide that in the event of a dispute regarding the disbursement of the earnest money, the broker will return the money to the purchaser without notice to the parties unless, within two years from the date the earnest money was deposited in the broker's trust or special account, the broker has received one of the following:

(1) Written instructions signed by both parties specifying how the money is to be disbursed;

(2) Written notice that a court action to resolve the dispute has been filed.

(C)(1) If the parties dispute the disbursement of the earnest money and the purchase agreement contains the provision described in division (B) of this section, not later than the first day of September following the two year anniversary date of the deposit of the earnest money in the broker's account, the broker shall return the earnest money to the purchaser unless the parties provided the broker with written instructions or a notice of a court action as described in division (B) of this section.

(2) If the broker cannot locate the purchaser at the time the disbursement is due, after providing the notice that division (D) of section 169.03 of the Revised Code requires, the broker shall report the earnest money as unclaimed funds to the director of commerce pursuant to section 169.03 of the Revised Code and remit all of the earnest money to the director.

EXHIBIT B

IN THE FRANKLIN COUNTY MUNICIPAL COURT
SMALL CLAIMS DIVISION

Broker (name and address)	:	
Plaintiff,	:	
-vs-	:	Case No.
Seller (name and address)	:	
and	:	
Buyer (name and address)	:	
Defendants.	:	

COMPLAINT

1. _____(hereinafter "Buyer") and _____(hereinafter "Seller") entered an agreement ("Purchase Agreement") dated_____ by which Buyer agreed to purchase from Seller certain real property located at _____. A copy of the Purchase Agreement is attached hereto and incorporated herein as Exhibit A.

2. In accordance with the terms of the Purchase Agreement, Buyer deposited with _____ ("Broker") the sum of _____as an earnest money deposit.

3. Broker has deposited the earnest money in its trust account and holds the deposit for the benefit of the Defendants pursuant to the terms of the Purchase Agreement.

4. Both Defendant-Buyer and Defendant-Seller now claim a right to the earnest money, and neither will authorize Broker to pay the deposit to the other.

5. The Ohio real estate licensing law (O.R.C. 4735.01 et seq.) prohibits Broker from paying the earnest money deposit to either Buyer or Seller in the absence of an agreement of the parties or an order of a court specifying to which party the earnest money should be paid.

6. Since neither Buyer nor Seller will authorize Broker to pay the earnest money to the other, Broker seeks an order from the Court specifying the party to whom Broker should pay the deposit.

WHEREFORE, Plaintiff-Broker demands that the Court require Buyer and Seller to come forward and set forth the bases of their claims to the earnest money; that the Court issue an Order directing Broker to pay the earnest money to Buyer or Seller, and that Plaintiff-Broker recover its costs herein expended.

Respectfully submitted:

_____
Plaintiff-Broker:

_____

_____

_____
Address and Telephone Number

EXHIBIT C

IN THE FRANKLIN COUNTY MUNICIPAL COURT
SMALL CLAIMS DIVISION

(Please Print or Type) Case No. _____ CV I_____

_____ _____
_____ _____
_____ _____
_____ v. _____
_____ _____

Plaintiff(s) Name, Address, ZIP Code, Telephone number **Defendant(s)** Name, Address, ZIP Code, Telephone number

Has this dispute been to mediation? [ ] Yes [ ] No

Is the Defendant currently in the United States Military Service? [ ] Yes [ ] No

The Summons (Defendant's Notice of the Complaint) will be sent by certified mail. If you waive notice of failed service and the certified mail is returned as "Refused" or "Unclaimed," the Court will resend by ordinary mail and set a new trial date. Do you want to waive notice of failed service? [ ] Yes [ ] No

COMPLAINT

_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____ Please use additional page if necessary.

Plaintiff demands judgment against Defendant in the sum of $_____, plus court costs andinterest.

COMPLAINNT'S OATH

_____(print first and last name), is (check one) [ ] Plaintiff [ ] Plaintiff's attorney [ ] an officer or salaried employee of the Plaintiffcorporation. Complainant also states the following:

"I declare under penalty of law that this Complaint is true and correct to the best of my knowledge."

Do you need an interpreter? Select language.

- ☐ español (Spanish)
- ☐ العربية (Arabic)
- ☐ 普通话 (Mandarin)
- ☐ русский (Russian)
- ☐ Sign Language
- ☐ Français (French)
- ☐ Soomaali (Somali)
- ☐ खस भाषा (Nepali)
- ☐ አማርኛ (Amharic)
- ☐ Tigrigna (Tigrinya)
- ☐ Other _____

Signature:_____Date: _____ Plaintiff, Plaintiff's attorney, or Plaintiff's officer or salaried employee.

Attorney Registration #: _____Plaintiff, Plaintiff's attorney or Plaintiff's officer or salaried employee