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Alaska REAL ESTATE
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EARNEST MONEY—MYTHS AND LEGENDS

Earnest Money: Is the amount paid to demonstrate that someone is so intensely serious about entering into a contract that they will put money on the table. Actually, it can be something other than money too, jewelry, your boat or some other physical item.

Earnest Money is not an essential element to make a contract valid. If your Realtor says you must put down earnest money, this is a myth. If the seller would agree, though unlikely, earnest money can be zero.

What is true is that, in order for a contract to be valid, it must contain certain elements. There are at least 10 such elements, one of which is that the contract must involve an exchange of value, or "Consideration".

So, you don't buy a house for zero dollars, or for nothing at all, though it could be for 200 sets of waders, 60 boxes of chocolates, or even a Bristol Bay fishing license. So long as there is an exchange of value (and that consideration is legal), a binding contract can exist.

Earnest money is not the consideration in a real estate transaction. The purchase price is the consideration. Earnest money simply shows good faith, usually on behalf of the buyer.

The issue is one of how to evoke enough trust from the other party that they will enter into contract and assure its performance.

In fact, while it is reasonable for a buyer to put down the token money to show he is earnest, one could argue that a seller put down earnest money too. The issue is one of how to evoke enough trust from the other party that they will enter into contract and assure its performance.

As usual, tradition rules and, frankly, I have not seen a buyer yet demanding earnest money from a seller. All kinds of commercial contracts can require similar deposits but legend has it that 'earnest money' has mostly been a real estate matter. In other contracts, it would simply be described as a 'deposit'.

Once earnest money is deposited, the contract should stipulate its disposition in the event of certain events transpiring. This is why the MLS Purchase and Sale Agreement has a multitude of references to it. What happens to the earnest money if the transaction does or does not close is what the fuss is all about. If closing happens, the earnest money is treated as part of the buyer's down-payment or, at least, as a credit towards his closing costs. If the sale does not close, that is when the fireworks begin.

Typically, the buyer puts down earnest money, held in trust by someone (see later) and, if the contract terminates, the disposition of that money is usually determined by who is at fault. Provided the buyer is not at fault, the contract generally provides for its return to the buyer. You should be very sure about how the earnest money is going to be handled before writing your check.

Who holds the Earnest Money: This also is entirely negotiable, though certain real estate companies will seek to direct you in a manner that

makes their life easier, not yours. The fact is that a homebuyer's earnest money can be held by the Nordstrom Service Counter, your local Pastor, or even the Great Alaska Bush Company if the parties agree. Tradition has tended towards the buyer's Broker holding the buyer's earnest money.

If I am representing a seller, I favor the buyer's earnest money being transferred at some point to the seller, since there are many escape clauses for homebuyers in the MLS recommended document while the seller has little protection for the time and trouble wasted while he waits, with baited breath, for the pending sale to actually close. The contract can designate that the earnest money will transfer to the seller following removal of the early contingencies, such as the home inspection.

A real estate transaction is, arguably, the biggest financial event in which you will participate, so demand professionalism and beware of myths and legends.

From the buyer's point of view, the money is best held by the buyer's Broker since the buyer will, that way, have a little more control over outcomes, especially if the seller defaults. Some real estate offices may ask you, as a buyer, to deposit your earnest money with a Title Company but this is not in your best interest and you should ask them why they want you to do that. Whereas the buyer's Broker can make a determination to give you, the buyer, your earnest money refund due to a clear contractual default by the seller, a Title Company will not do this. A Title Company will only release earnest money with a signed agreement between buyer and seller, and that may not be so easy to obtain.

Earnest Money disputes often arise and you, either as buyer or seller, want as many aces in your hand as possible. Make sure your Realtor, and the company they work for, sincerely have your best interests at heart here. Also, make sure that your Realtor clearly explains the contract into which you are entering. Should the licensee not be able to do that, don't hesitate to obtain legal counsel before signing anything.

Some disputes may require mediation, or even arbitration, and this is provided for in the contract also. Ask your real estate licensee to explain all this. When trouble occurs, buyers and sellers often react emotionally because they did not understand the legal ramifications of their contract.

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MLS Forms: Are far from perfect and you are wise to ask lots of questions about them, or have a legal review by your Attorney. For example, Paragraph 18 (a) limits buyer's liability in the event of default to the amount of the Earnest Money. These words favor the buyer and limit the seller's recourse in the event that the buyer simply 'pulls the plug' on a deal just before closing.

Every State has its own forms and rules and Alaska has its own quirks and traditions, not always fair. I personally would favor wording that emphasizes the seller's recourse of Specific Performance and does not limit the buyer's liability. It's a question of fairness. Sellers can be hurt far in excess of the 1% earnest money typically collected.

The MLS forms committee makes many such determinations about contract verbiage that have serious legal consequences. Lines 32 thru 34 of Page 8 of the contract should be in **BOLD FONT** - - - - or at least be read carefully by parties before signing the Purchase and Sale Agreement: "This Purchase Agreement has significant legal and financial consequences. You are advised to seek independent legal and financial counsel, including tax advice from a tax attorney or CPA, before signing. The Brokers and Licensees cannot give legal, tax or financial advice."

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