



Earnest Money & Trust Accounts

Part One - Basic Rules

The largest number of complaints received by the Indiana Real Estate Commission involve earnest money/trust account violations. Its not surprising that one of the most frequent topics of calls on the Hotline concerns earnest money/trust account issues. To be sure your house is in order, we thought it might be helpful to review these issues presented in this two-part series of articles which discuss the (1) basic rules on trust accounts, found either in the license laws or rules of the Commission and (2) use of an interpleader petition or BBB Program to settle earnest money disputes between parties.

Basic Rules

1. Every principal broker must keep a separate bank account to hold funds of others, such as earnest money. Trust accounts must be identified as such and are subject to audit. You must keep a detailed record of all funds in and out of the account. License law I.C. 25-34.1-4-5.
2. Generally, trust accounts are noninterest bearing accounts in our state. You cannot earn interest for yourself from a trust account. If the account earns interest, you must pay the interest to the client/ beneficiary. In the case of a large deposit of earnest money, the buyer and seller may stipulate that the funds be placed in an interest bearing account for the benefit of buyer or seller. Such an escrow agreement between the parties should be in writing and prepared by an attorney or the title company. License Law I.C. 25-34.1-4-5.
3. You cannot commingle your funds with clients' or customers' funds. Commission Rule 876 IAC 1-1-23. You cannot deposit your personal or business funds in the trust account. You cannot take trust account funds for your own use, or pay a commission to yourself from earnest money in the account until the sale is closed.
4. The principal broker must deposit all earnest money received in the trust account within two banking days after acceptance of the purchase agreement. Commission Rule 876 IAC 1-1-23. It is illegal to hold an earnest money check until closing. You will not only become responsible for the money, but be subject to discipline as well.
5. The listing principal broker is required to either (a) to deposit earnest money in his or her account or (b) delegate that responsibility to the selling (co-op) principal broker. If you let the co-op broker hold the earnest money, you as listing principal broker are still ultimately responsible to make good any loss if the money is lost or embezzled. All monies should be retained in the broker's trust account until disbursement is properly authorized. Note that effective no later October 1, 2001, the listing and selling principal brokers holding any earnest monies are not required to make payment to the buyers or sellers unless the parties enter into a mutual release or a court issues an order for payment. Commission Rule 876 IAC 1-1-23.



6. You must keep copies of closing statements five years. Commission Rule 876 IAC 1-1-24. We recommend that you retain earnest money records that long as well.

Earnest Money & Trust Accounts - Part Two

Use of Interpleader And The BBB Program

As often the case when a sale falls through, both parties are claiming entitlement to the earnest money deposit. The broker, of course, is caught in the middle and must decide how to proceed with regard to the disputed funds. Our recommendation to the broker is to have the parties enter into a "Mutual Release", which clearly states to whom the earnest money is to be paid. If the parties refuse to sign a Mutual Release, then the broker can continue to hold the earnest money and wait for either the buyer or seller to file suit (usually in small claims court) for release of the earnest money. The court will then issue an order for payment. If neither party chooses to file suit, the broker may file a petition for interpleader and deposit the disputed funds with the clerk of the court.

Interpleader

Historically, there were basically two types of remedies available to plaintiffs. An "equitable" remedy is a type of relief sought in court dealing with something other than monetary damages such as an injunction or specific performance. "Equity" is concerned with what is fair and just. For example, a plaintiff may join as defendants or other persons having or asserting claims against the plaintiff and require them to interplead when their claims are such that the plaintiff is or may be exposed to double or multiple liability.

Our courts have determined that the equitable remedy of interpleader depends on the following elements:

- 1) Both or all parties must claim the same thing, debt or duty, and there is some doubt as to which of the parties is entitled to the debt or money.
- 2) All their adverse titles or claims must be derived from a common source. (i.e., purchase agreement).
- 3) The person seeking relief must not have or claim any interest in the subject matter.
- 4) The person seeking relief must stand perfectly neutral between them in the position merely of a stakeholder.

Interpleader in earnest money disputes involves a judicial proceeding where the listing principal broker deposits the stake (money in dispute) into the court, and the judge decides whether the buyer or seller is entitled to the money. Sometimes the broker is dismissed from the case, leaving the buyer and seller in the lawsuit to defend their rightful claims to the money.



Why would a principal broker want to file for interpleader? Some of the advantages include the following:

- 1) Interpleader is available in small claims court, which means less expense for everyone concerned.
- 2) Hamilton County Bank v. Hinkle Creek Friends Church, 478 N.E. 2d 639 (1985), Indiana case holding that if a party files a legitimate interpleader proceeding, that party is exempt from any liability arising from punitive damages.

In an interpleader proceeding, the judge has broad discretion to award attorney fees and costs to the broker out of the disputed fund. Remember that interpleader is useful in cases where a broker is being threatened by a disgruntled buyer or seller or their attorney for the return of the earnest money deposit. It is simply a way to stay out of the line of fire.

BBB Program

Use of an interpleader or waiting for a buyer or seller to take legal action is not the only way to resolve an earnest money dispute, if the amount is less than \$3,500. A dispute resolution program is administered by the Better Business Bureau ("BBB") and has proven to be an effective alternative to filing suit in a court. The parties can agree "up-front" on how a dispute will be resolved by attaching an Alternative Dispute Resolution Addendum to their purchase agreement. If a dispute arises, either party can then contact the local BBB and explain the situation to one of the counselors. If the dispute is one that can be handled by the BBB, a form will be sent to your client. Once the form has been completed and filed, the other party will be contacted to attempt to resolve the dispute. If that fails, the dispute will proceed through the arbitration process. After selection of the arbitrator a hearing will be scheduled and heard at the local BBB office. Both parties will be given an opportunity to present their case. Within approximately ten days of the hearing, all parties will be notified of the arbitrator's decision, which is legally binding on the parties.