LEGAL HOTLINE Q & A

GET THE FACTS, JULY 4, 2017

QUESTION: We represent the seller. A buyer is offering a very large nonrefundable deposit in the event that buyer fails to complete the purchase for any reason. RCW 64.04.005 limits the amount of earnest money that seller may keep to not more than 5% of purchase price. Buyer's agent says that seller may keep more than 5% if it is called something other than earnest money deposit, maybe just a simple "deposit" to escrow. Is there any case or way a seller may keep more than 5%?

ANSWER: Yes, there is a way for a seller to retain more than 5% of the purchase price but it has nothing to do with what the deposit is called and seller may not be able to keep all of a "very large" deposit. The only thing truly certain about this answer is that if brokers do nothing more than establish "earnest money" and some other "deposit" and the total of both exceed 5% of the purchase price, then at the time of buyer's breach, state law will limit buyer's forfeiture to no more than 5% of the purchase price. It may be possible to include a provision in the purchase agreement that will allow seller to retain more than 5% of the purchase price in the event of buyer's default but the provision must be carefully crafted and buyer must explicitly consent to the significance of the provision. As is often the case when parties want to include provisions contrary to normal procedure, the parties must have legal counsel draft this provision. Broker is simply not licensed, and most brokers are not qualified, to draft this provision. Frankly, a lawyer who is not familiar with this area of the law will have to conduct research before being able to properly draft a provision.

Some background explanation is helpful to understanding this answer. Washington law disfavors forfeitures that are intended to penalize a contract party. The law recognizes that when a party breaches a contract, the other party is damaged. It is fair for the law to require the breaching party to compensate the other party for the actual losses suffered because of the breach. Washington law will not, however, allow one party to punish or penalize a

defaulting party by extracting an enormous sum, more than necessary to compensate actual losses, in the form of a "forfeiture."

Several years ago, there was a back and forth exchange between the Legislature and the Supreme Court where this legal doctrine was illustrated. Statutory law originally allowed a forfeiture of earnest money, case law explained that the forfeiture had to be reasonably related to the amount of seller's actual losses and both the Court and the Legislature each separately and ultimately concluded that a forfeiture of no more than 5% of the purchase price would be deemed reasonable without seller having to prove seller's actual damages.

In the scenario presented in the question, seller and buyer are attempting to establish a transaction that allows seller to forfeit or seize buyer's money if buyer breaches. While the question does not identify the amount that seller would claim in the event of buyer's breach, it appears to be in excess of 5% of the purchase price.

What RCW 64.04.005 says is that an EM forfeiture of 5% or less of the purchase price is deemed reasonable without any further consideration. In other words, if buyer breaches, seller is entitled to retain, without any analysis or proof of seller's actual losses, up to 5% of the purchase price. However, if EM to be forfeited is greater than 5% of the purchase price, then the forfeiting party must prove the reasonableness of the amount being forfeited.

Typically, in order for a forfeiture of more than 5% of the purchase price to be enforceable, language must be included in the original purchase agreement explaining that the increased amount of earnest money is reasonably calculated to compensate seller for seller's actual losses. Creating an enforceable provision requires more than simply reciting these words. Creating an enforceable provision requires that seller actually contemplates and can prove that losses in excess of 5% of the purchase price are truly anticipated. Frankly, in a market where property values are rapidly increasing, seller's retention of more than 5% of the purchase price may not be possible absent additional facts creating exceptional loss to seller. In any event, a forfeiture of more than 5% of the purchase price requires the purchase

agreement to reflect a negotiated provision between buyer and seller, where seller's reasonably expected, actual losses are quantified and buyer acknowledges the impact of the forfeiture provision.

Broker should advise her seller to seek legal counsel. This is simply not a contract provision that broker is licensed to draft. An improperly drafted forfeiture provision for more than 5% of the purchase price will be deemed unenforceable after buyer's breach and the seller who was counting on the large forfeiture and who relied on seller's broker to draft an enforceable provision will have nowhere to turn for compensation other than to the broker who drafted the unenforceable provision. Broker should advise this seller, in writing, to seek legal counsel for assistance in drafting this forfeiture provision. If seller fails to seek legal counsel, then broker should advise seller, in writing, that the standardized forms that broker is licensed to use, limit the forfeited funds to no more than 5% of the purchase price.

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