

Losing the deposit is far too easy in today's market — especially if a third person isn't holding the cash

Real estate deposits

A number of years ago one of my columns for *Western Investor* dealt with the reasons for and the tricks and traps of deposits in commercial transactions. Unfortunately, not everyone read the column, as a recent case shows. Given that case and the recent surge in real property transactions in the last year, it is appropriate to once again review the correct way to deal with deposits.

On the most basic level, the deposit represents the buyer's commitment to fulfil a contractual obligation. Sometimes the contractual obligation may be dependent on conditions contained in the contract that must be fulfilled by one of the parties to the contract. If the obligations are fulfilled by all parties the deposit is kept and the purchase is completed. However, if the seller does not fulfil his or her obligations under the contract and if the buyer will not accept any change to the terms of the contract, the deposit is returned to the buyer.

In a recent **British Columbia Supreme Court** case, a purchaser made a \$100,000 deposit on the purchase of a piece of property that had a selling price of \$1.2 million. In the contract of purchase and sale, the document explicitly stated that the deposit was "non-refundable." However, after removing the subject clauses, the purchaser realized that he might be unable to get the necessary permit for his business. The purchaser then attempted to break the contract and have his \$100,000 deposit returned. Needless to say, the response of the

and therefore the purchaser would not be getting the money back. Eventually, it was up to the B.C. Supreme Court to resolve the deposit issue. The court ruled that the seller was entitled to keep the deposit as the contract clearly stated that the deposit was nonrefundable. Unfortunately for the purchaser, the \$100,000 was gone and was irretrievable.

If you are a purchaser, you should put some careful thought into the mechanics of how the deposit is to work. When a contract says the

deposit is nonrefundable or will be absolutely forfeited (which is another commonly used term), the deposit will not be returned if the purchaser backs out. The law is clear on how deposits are to be interpreted,

particularly when the deposit is reasonable and is a good estimate of damages or loss to the seller. Note that in this case, the deposit was less than 10 per cent of the purchase price. In my experience, many people don't even consider negotiating the size of the deposit.

The seller will often insist on the deposit being nonrefundable, but the purchaser doesn't have to agree to this. When negotiating a deposit, a purchaser should be taking the point of view that the deposit is not intended to be a "windfall" for the seller if the purchaser has to back out of the contract. On the other hand, the seller

worse off having entered into the transaction. In other words, if the purchaser defaults, the seller shouldn't have to pay a price for it. At a minimum, the deposit is intended to protect the seller from the inevitable costs of choosing to take the path with the purchaser.

What costs can be incurred by the seller? There are many, most notably real estate commissions (which are generally due and owing upon the formation of a binding contract of purchase and sale, not when the transaction is actually completed), legal costs, accounting

costs and the costs of tax advice. All these costs can be significant and it is up to the seller to ensure he or she is protected against these costs which will be payable whether or not the purchaser completes. However, a smart seller will also seek to negotiate a deposit that is in excess of these actual costs because, after all, why not try to get a windfall? The seller has to bear in mind that if the deposit is too high, then it will be considered a penalty and may be refundable, even

if the contract states it is nonrefundable. This is where it is important for the seller to discuss the appropriate level of deposit with his or her lawyers.

The deposit should be a reasonable estimate of damages or loss, if possible, to the seller if the contract is not completed by the purchaser. The general rule of thumb is that the deposit is equal to 10 per cent of the purchase price. However, the deposit may be higher or lower depending on a variety of factors.

Another big mistake which is made by sellers and purchasers is not clearly defining all the points surrounding the giving of a deposit.

For example, sellers and purchasers will always determine the dollar amount of the deposit, but they often forget to state where the deposit is kept, whether it bears interest, who gets the interest, how it is to be released and what happens to it in various circumstances. In

business, as opposed to real estate, the common procedure is to place the language dealing with the deposit in the comprehensive purchase and sale agreement.

However, I always recommend a separate "Deposit Agreement" to deal with the deposit. The reason is that in business purchases and sales, the purchase agreement is usually never signed until the closing date. That means that the issue of what happens to the deposit is not settled until the closing. By then, the seller has incurred all its costs and if the purchaser backs out, there is no written agreement in place as to what happens to the deposit. The inevitable result is a lawsuit over who gets the deposit. A one- or two-page Deposit Agreement solves this problem.

Whether in the contract of purchase and sale or in the Deposit Agreement, the terms and conditions under which the deposit is made, held and released, as well as who holds the deposit, will be stated.

The following are some of the significant terms that are often included in a contract dealing with the deposit:

1. The deposit should be paid to a third party, such as the seller's or purchaser's lawyer.
2. The deposit will only be kept by the seller if the seller is ready to complete and all subjects have been satisfied or waived. If the purchase is completed, the deposit is to be applied towards the purchase price. However, if the purchase does not complete due to no fault of the seller, the seller will keep the deposit as liquidated damages. It is for this reason that the deposit should always be a good estimate of damages to the seller.
3. The deposit will only be returned to the purchaser if the seller is not willing to complete the sale.
4. Either party will have the option to have the deposit paid into court if a dispute arises over who is entitled to the deposit. ♦

Don Sihota is a lawyer with Clark, Wilson Barristers and Solicitors of Vancouver, providing advice on business acquisitions and sales, corporate restructuring and commercial transactions. The information in this column should

