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## **Rescission of Contract vs. Termination of Contract** **&** **The Return of Earnest Money**

When a purchase and sale agreement (PSA) is terminated, two things must happen. First, the contract must be properly terminated, and second the escrow company must receive written instructions approved by both parties in order to release the earnest money and deduct any title cancellation fee. Many Realtors have been using a Rescission Form 51 to terminate PSAs for any and every reason. Some have been doing this so long, they just assume it is the correct way to terminate a PSA.

A rescission is not a termination. A termination is not the same as a rescission. They are completely different legal concepts with different purposes.

As Realtors, we do not have the legal right to tell our clients to sign a Rescission of a PSA, because that is not one of their legal remedies with the one exception being under RCW 64.06 (Form 17). The right to terminate does exist under several specific circumstances.

The PSA spells out exactly what our clients' rights are when one of the parties wants to terminate or when one of the parties breaches the PSA, and rescission is not one of them. In addition, advising our clients to sign a rescission is completely outside the terms of the PSA. In other words, we as Realtors have no authority to advise them to rescind when that isn't one of their contractual remedies. To give our clients advise to do something that is outside the contract would require that our clients seek independent legal counsel. Taking on that legal responsibility and liability is a dangerous position for a Realtor. Many Realtors assume that because they haven't been caught up in a lawsuit, they never will. That's like saying car accidents always happen to someone else.

**Here's why it is improper to use a Form 51 Rescission Agreement when one of the parties is terminating the contract based on a contractual provision addressing termination.**

### **Rescission and termination are two entirely different legal concepts.**

A rescission is a statement that the parties want to undo their contract as though it never existed. In other words, rescission seeks to erase all history that the contract existed and that the parties had any relationship. It eliminates all the contract rights and responsibilities. That might sound like a termination, but it is not.

In the law for hundreds of years rescission was used primarily when there was fraud or duress involved on one side of a transaction. Courts in equity could grant rescission to one party only under very limited facts in a lawsuit. The other case in which parties could rescind a contract is where there was a

mistake of fact, like when a buyer thought he was going to buy a yellow house on a street corner, but the seller intended to sell a different house. In such a case, it made sense to make the contract go away entirely by rescinding it. The parties had never actually had a meeting of the minds, so there was no contract.

### PSA Contract Language Addresses Termination

There are several cases in which termination of a contract is specifically addressed in our standard Form 21 (PSA) and in the addendums. Here are some examples.

1. **The Home Inspection**. When a buyer issues a Form 35R (Inspection Response) to a seller stating that he is terminating the contract, that is clearly a termination. Using a Rescission Form 51 is not appropriate and NOT authorized in the contract. The Form 35R terminates the contract under the terms of the Form 21 and the Form 35R in para I. The notice affirms the buyer's contractual right to return of the earnest money. This notice only requires the buyer's signature to terminate, but both parties must also sign instructions to the escrow company addressing the return of the earnest money to the buyer, and the payment of any title cancellation fee.
2. **The Septic Inspection**. The same is true of the septic inspection. A buyer can terminate a transaction based on disapproval of the septic inspection report, but it is a termination, not a rescission. The notice affirms the buyer's contractual right to return of the earnest money. This notice only requires the buyer's signature to terminate, but both parties must also sign instructions to the escrow company addressing the return of the earnest money to the buyer, and the payment of any title cancellation fee.
3. **Financing Failure**. If a buyer's financing fails, he terminates under the terms of the Financing Addendum and gives notice with Form 90I. Like the other forms, this notice uses termination language. The notice affirms the buyer's contractual right to return of the earnest money. This notice only requires the buyer's signature to terminate, but both parties must also sign instructions to the escrow company addressing the return of the earnest money to the buyer, and the payment of any title cancellation fee.
4. **Seller's Disclosure**. Here is the one time that we might use a rescission. A buyer can rescind a contract under the terms of the Form 17, Seller's Disclosure Statement. This rescission is specifically called a rescission in **Form 90A, Notice of Rescission of Agreement Pursuant to RCW 64.06**. This legal right to rescission finds its authority in state law, RCW 64.06, and the use of Form 17. Again, the buyers right to return of the earnest money is affirmed. This notice only requires the buyer's signature to rescind, but both parties must also sign instructions to the escrow company addressing the return of the earnest money to the buyer, and the payment of any title cancellation fee.
5. **Disapproval of Park Rules and Regulations**. This is a Form 90N, and the buyer is contractually authorized to terminate the transaction if he does not approve of the park rules and regulations in the purchase of a manufactured or mobile home in a park. This notice only

requires the buyer's signature to terminate, but both parties must also sign instructions to the escrow company addressing the return of the earnest money to the buyer, and the payment of any title cancellation fee.

6. **Breach of Contract.** If a buyer breaches the contract, we only need to look at the contract language to see what the other party's remedy is. For example, if the buyer does not have the funds to close on the day of closing, he has breached the contract. If closing comes and goes, the seller can say the buyer breached. The Seller can issue the statewide form for this, which is Form 90D entitled, **Failure to Close, Notice of Termination by Seller—Seller to Keep Earnest Money**. The right of the Seller to keep the earnest money is in the main purchase and sale agreement. To call this a rescission would be wrong. The buyer breached and the seller has the contractual right to terminate—not rescind the contract. That's why Form 90D is called a Termination.

It is possible for a buyer and seller to both change their minds and decide to not go through with their transaction, and in such a case, they could mutually agree to rescind. But that's not within the contract language in the PSA governing any of the standard terminations listed above. And it would be extraordinarily rare for a buyer and seller to both decide not to go through with a transaction when there were no other failures or breaches. In 37 years in real estate I've never seen that happen. Again, this kind of mutual rescission is not contractually authorized when there is a specific provision addressing termination.

I have seen a rescission of a PSA as the result of litigation that lasted two years, but that involved a host of unique facts and complex legal issues that the judge decided merited the rare equitable remedy of rescission.

### **Return of Earnest Money**

Once a transaction is properly terminated with the correct notice within the deadline, even though it may be clear in the contract that the buyer is entitled to a return of the earnest money, escrow companies still need something signed by both parties in order to comply with their own legal responsibilities in-house.

The reason is because escrow companies are not a party to the PSA. In other words, they have no privity of contract with the buyer or seller, so that's why escrow companies have the parties sign escrow instructions. The escrow companies then have one contract between them and the buyer and one contract between them and the seller.

When it comes to returning earnest money, escrow companies will be in a very difficult legal position if they release earnest money to one party without both parties agreeing in writing that that is what should be done. Escrow companies have gotten caught in nasty lawsuits, and in order to protect themselves, they need something signed by both the buyer and seller before they release earnest money.

The NWMLS has a clumsy form for the release of the earnest money. It is **Form 50, Authorization to Disburse Earnest Money**. Any time there is a termination, this is the additional step required by the

escrow company. The reason I call this form “clumsy,” is because it is a full page of information we have to complete, and we have to call the title company to get the cancellation fee + tax, for inclusion under para 1 so the escrow company can take out the cancellation fee. It is clumsy, because there is a far simpler process, that eliminates the need for this lengthy form, the phone call to the title company, and reduces the termination and authorization to release earnest money to one simple form. The single step to terminate a transaction would be to use the proper termination form, and to include on that form one very simple sentence to be initialed by both the buyer and seller. That sentence is:

**The parties hereby instruct escrow to release the earnest money to buyer (or seller if to seller), less any cancellation fee to the title and escrow company.**

That's it. That satisfies the terms of the contract and the relevant addendum, and it satisfies the title and escrow companies. It complies with contract law, state law, case law, and the rules and regulations governing title and escrow companies.

If Broker/Owners do not feel comfortable typing this one sentence on the proper termination notice, they could do it in two steps. The first step is the proper termination notice, and the second step is to use the Form 50 Authorization to Disburse Earnest Money.

What some have been doing is using a Rescission form instead of the proper Termination form. To make matters worse, the MLS has a Rescission form that includes language that should be entirely separate. Since Rescission is the wrong form to terminate a contract for cause under a contractual provision as stated above, it should not be used period.

Unfortunately, the NWMLS Form 51 Rescission Agreement inappropriately includes other language that is totally unrelated language stating that the agent will still be entitled to a commission if within six months the buyer buys that property. I believe it is inappropriate to shove that language down a client's throat on the wrong form. There are other legal doctrines protecting a broker's commission, including the contractual rights in the listing agreement itself and the doctrine of procuring cause. If a Broker insists on having a client sign such language, it should be done on a separate document.

This Form 51 also includes the language authorizing the release of the earnest money, which is probably the trap that catches most Realtors into using this form. It is the wrong form. A termination is not a rescission. Again, this is not a small legal issue. It is a legal issue with a couple of hundred years of contract law and case history.

**Termination and Rescission are two separate legal means to end a contract. You either terminate a contract or you rescind a contract, but not both.** Since every reason we see a transaction terminated is governed by the termination language in the contracts and addendums and notices, (with the exception of the Form 17), we are obligated to use the proper termination notices. Once a client issues a notice of termination, the contract is terminated, and any further effort to rescind is not just unauthorized, it is arguably void or with no effect. The contract was previously terminated.

I understand that for Realtors who have been using a Rescission Agreement as their default termination,

this may be hard to accept. Do something for 10 years and you begin to believe it is the right way to do it. I recommend taking this letter to any attorney who specializes in real estate and has the experience. He will affirm this basic contract law and the logic.

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