

# 2020-2021 General Update Course

## Section Two Contracts



1. Mark, a buyer's agent, submits an offer on behalf of his clients for \$27,000. The listing agent reviews the offer with his seller. The seller marks out \$27,000, writes in \$37,000, initials the change, and signs all pages.  
Was a contract created? Why or why not? \_\_\_\_\_
2. Mae, a buyer's agent with ABC Realty, submits an offer on behalf of her buyer-client to Tammy, a seller's agent with XYZ Realty. The offer includes a \$1000 due diligence fee (DDF) and a \$2000 initial earnest money deposit (EMD). Tammy presents the offer to her seller-client, and the seller signs the offer as-is, without making any changes. Tammy calls Mae to let her know the seller has signed the contract. Tammy reminds Mae that the DDF and EMD checks must be delivered to Tammy's office by the end of the day.  
Are the parties under contract? Yes / No  
If YES, when was the contract formed? \_\_\_\_\_  
If NO, what is required for contract formation? \_\_\_\_\_
3. Sam, a buyer's agent, submits an offer on behalf of his buyer-client to Malik, the listing agent. Malik presents the offer to his seller-client. The seller agrees to all terms except the due diligence fee. The seller wants to increase the fee from \$2500 to \$5000. Malik calls Sam to discuss the DDF change, and Sam tells him the buyer will agree to the increase. Malik adjusts the amount of the DDF on the Offer to Purchase form, and the seller initials the change and signs all pages. Malik forwards the paperwork to Sam.  
A few hours later, Malik calls Sam again and tells him the seller is rescinding the offer, because the seller has accepted another offer.  
Did Malik's and Sam's clients form a contract? Why or why not?  
\_\_\_\_\_

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## LEARNING OBJECTIVES

By the end of this section, you should be able to:

- define offer and acceptance;
- list methods of communicating acceptance;
- explain the difference between a due diligence fee and earnest money deposit;
- explain whether a due diligence fee or earnest money deposit is required for a valid contract; and
- describe a broker's fiduciary duties related to multiple offers and contract preparation.

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## TERMINOLOGY

- **Offer:** A promise (that is definite in terms) by an offeror calling for a promise or an action by an offeree.
- **Offeree:** A party to whom an offer is made.
- **Offeror:** A party making an offer.
- **Acceptance:** A promise by offeree to be bound by the terms of an offer.
- **Contract:** A deliberate agreement between two or more competent parties supported by legal consideration to perform or abstain from some act.
- **Due Diligence Fee:** *Standard Form 2-T* defines due diligence fee as a negotiated amount, if any, paid by Buyer to Seller with the contract that gives the Buyer the right to terminate the contract for any reason or no reason during the Due Diligence Period.
- **Earnest Money Deposit:** An amount of money deposited by the Buyer to the Seller that is evidence of good faith.

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## CONTRACT BASICS

A contract is

- a deliberate agreement,
- between two or more competent parties,
- supported by legal consideration,
- to perform or abstain from performing some act.

Under contract law, any agreement between two or more parties must meet certain requirements to be legally valid. The essential elements of a contract are:

- **consideration**, meaning something of value passing between the parties that supports their agreement;
- **lawful objective** (purpose) and a means of accomplishing that objective;
- **mutual assent**, meaning a “meeting of the minds” where all parties understand and agree to all material terms of their negotiated agreement; and
- **legal contractual capacity of the parties**, meaning all parties to the agreement must be legally capable of entering into a contract.



Additionally, the NC Statute of Frauds dictates that contracts for the sale or lease\* of real property must be IN WRITING to be enforceable.

\*Leases exceeding three years.

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## THE OFFER

Under basic contract law, an offer:

- is a promise by an offeror,
- to enter into a contract on certain terms.

An offer is made **BY** an offeror **TO** an offeree.



Rule 58A .0112, Offers and Sales Contracts, states a broker acting as an agent in a real estate transaction shall not use a preprinted offer or sales contract form unless the form describes or specifically requires certain information. Additionally, this rule specifies provisions that should not be included in the preprinted offer or sales contract.



*Does an offer to purchase real estate have to be in writing to be enforceable?*

YES. The NC Statute of Frauds requires an offer (and any resulting contract) for the purchase of real estate to be **IN WRITING** and:

- identify the parties to the contract by individual legal name;
- identify the subject matter of the contract;
- contain all material terms and conditions; and
- be signed by the offeror (party making the offer).

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## ACCEPTANCE = CONTRACT FORMATION

Upon receipt of an offer, an offeree may choose to:

- 1) reject the offer outright;
- 2) accept the offer as tendered without any modifications;
- 3) alter or change some of the terms and return it to the original offeror; or
- 4) neither accept nor reject the offer and engage in oral negotiations with the offeror concerning terms the offeree would consider more favorable.

### Any Change in Offer Terms = Counteroffer

Once an offeree changes any term in an offer, the original offer is rejected and a COUNTEROFFER is created.

A counteroffer is basically a brand new offer. Once an offeree submits a counteroffer, that former offeree becomes the offeror. The initial offer was rejected, so it is no longer in existence. Should the parties wish to return to the terms of the initial offer, they would have to create a new offer.



### Acceptance

Acceptance occurs when an offeree...

- 1) signs an offer without making any changes, and
- 2) communicates that the offer has been signed to the offeror.

Acceptance is not complete until the last offeree has actually signed the offer and that fact is communicated to the last offeror or his/her agent. Once the offeree's written

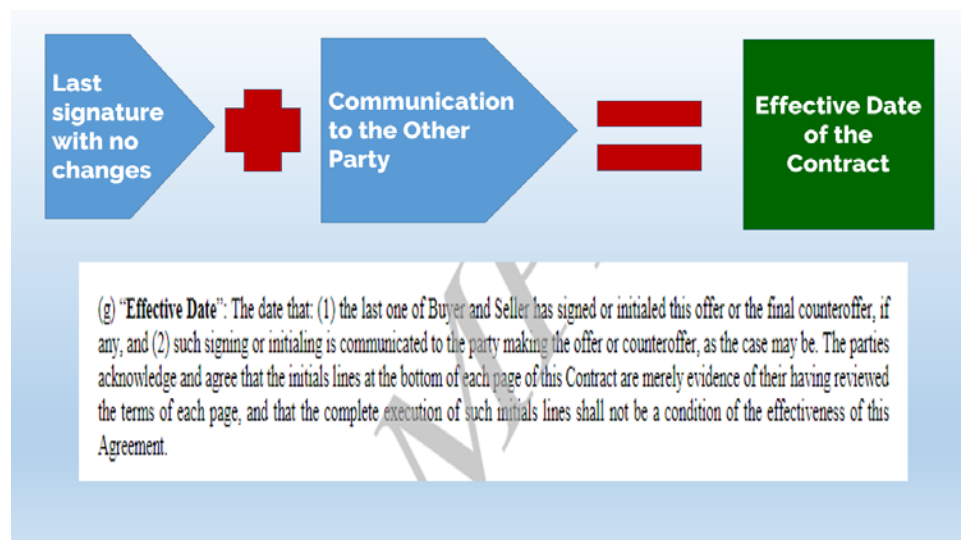
acceptance has been communicated to the last offeror, then the parties have an enforceable contract.

Until acceptance is communicated to the last offeror or his/her agent, that offeror may still withdraw his/her offer even though it has been signed by the offeree.

## Effective Date = Date of Acceptance

Standard Form 2T - Offer to Purchase and Contract defines Effective Date as the date that:

1. the last one of Buyer and Seller has signed or initialed this offer or the final counteroffer, if any, and
2. such signing or initialing is communicated to the party making the offer or counteroffer, as the case may be.



**BIC ALERT:** If an offer, acceptance, and/or contract will be created electronically ensure that all requirements dictated by the North Carolina Uniform Electronic Transactions Act (UETA) are met.



1. A buyer's agent submits an offer to Holly, a listing agent, at a cooperating firm. Holly sends the offer via email to the seller and reviews it. The seller agrees to the terms, signs the offer, and scans and emails it back to the listing agent.

Was a contract created? \_\_\_\_\_

2. Thomie, a dual agent, represents Jay in purchasing a home listed by his firm. Jay and the seller provide written authority for Thomie to act as a dual agent. Thomie assists Jay with preparing an offer. Thomie then presents the offer to the seller, and the seller signs it.

Was a contract created? \_\_\_\_\_

## Communicating Acceptance

Under contract law, acceptance of an offer may be communicated in a variety of ways such as:

- oral communication;
- hand delivery;
- mail ("snail mail" or other services, such as FedEx or UPS); or
- electronic communication such as email, text, or fax.

If the contract is "silent" about the method(s) of communication, whatever method the party customarily uses will be considered reasonable. Reasonable communication is determined by the Courts to be the usual way in which parties handled the transaction and the intent of the parties.



Communication to a party that the offer will be signed or the parties accept the offer without evidence of a signed offer does not create an enforceable contract.

## WHAT ABOUT TEXT MESSAGING?

Disclaimer: The following case mentioned in this section is not a NC or Federal court ruling. Therefore, it does not have jurisdiction in NC. However, most brokers utilize electronic communication in brokerage transactions; therefore, this case provides valuable knowledge and a warning regarding the usage of text messages.

Real estate transactions must be in writing to comply with the Statute of Frauds. In *St. John's Holding, LLC v. Two Electronics, LLC*, NO 16 MIS 000090RBF (2016), the Court stated that during the negotiations, the parties' agents extensively used electronic communication (i.e. email, text) and phone to communicate.

Therefore, the issue before the Court was whether text messaging sufficiently satisfied the Statute of Frauds. The Court analyzed the following:

1. whether text messaging can be considered a "writing" under the Statute of Frauds;
2. whether *alleged writing* contains sufficiently complete terms and an intent to be bound by those terms;
3. whether the text message is signed; and
4. whether there is an offer and acceptance.

In this case, the Court found negotiations and exchanges between the parties contained sufficient terms to create a binding contract between the Buyer and Seller. The multiple text messages evidenced:

- that the subject matter of the agreement contained all material terms; and
- was authenticated by the sellers' agent signature at the end of the text message which evidenced the intent for the parties to be bound.

On appeal, the Court reversed the lower court's disposition and held:

- the seller-agent lacked implied authority to bind the parties; but
- text messages are considered writings under the Statute of Frauds.

So, the moral of the story is: If text messaging is normally used between parties, the Courts may consider them "writings" sufficient enough if they contain:

- all material terms;
- a signature;
- intent to bind the parties; and
- memorialize the offer and acceptance.



In conclusion, if brokers are communicating via text messaging, it is plausible that an acceptance of an offer can be communicated via text messaging as long as the offer has been signed by the respective party. Court cases like *St. John Holdings, LLC v. Two Electronics, LLC*, NO 16 MIS 000090 RBF (2016), reminds brokers that the law will continually adapt to modern technology.



**BIC ALERT:** Any communication (e.g. text, email, direct message) regarding a real estate transaction must be retained in the transaction file per Rule 58A .0108, Record Retention.

## Mailbox Rule

Though not frequently used in today's electronic age, the "mailbox rule" does still apply in some situations. According to the mailbox rule, acceptance of an offer is communicated by means of dropping the signed offer in the mail to the offeror (or offeror's broker). Acceptance occurs at the time the item is dropped into the mailbox. This rule operates only as a method of communicating acceptance of an offer. It does not pertain to rejection of offers or to counteroffers. Rejections and counteroffers are only effective upon receipt by the addressee and not at the time of mailing.

## Questions for Review



*How does acceptance occur?*

Acceptance occurs when an offeree signs an offer without making any changes and communicates to the offeror that the offer has been signed.



*How will I be notified of the other party's acceptance of my offer?*

An individual will be notified about the acceptance in the manner in which they specified in the offer (i.e. in writing, personal delivery, orally, or electronic means) or, when the contract does not specify a means of communication, by a reasonable method.



Communication to a principal's broker is the same as communicating directly to the principal. Remember that a broker stands in the place of the principal, at least for communication of acceptance purposes.

## **Additional Information about Offer and Acceptance**

To assist consumers in understanding offers and acceptance, the Commission publishes the "Questions and Answers on Offer and Acceptance" brochure.

The brochure is provided on the Commission's website at <https://www.ncrec.gov/Brochures/Print/OfferandAcceptance.pdf>

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## **WHAT ARE THE DIFFERENCES BETWEEN A DUE DILIGENCE FEE (DDF) AND AN EARNEST MONEY DEPOSIT (EMD)?**

### **Due Diligence Fee (DDF)**

The due diligence fee is defined in the Standard Form 2T, Offer to Purchase and Contract, as:

...a negotiated amount, **if any**, paid by Buyer to Seller with this Contract for Buyer's right to terminate the contract for any reason or no reason during the Due Diligence Period.

The amount of the DDF may be influenced by such matters as the market for the property, number of days on the market, personal circumstances of buyer and seller, and the length of the "Due Diligence Period."

### ***Is a DDF required?***

No. A DDF is not required to create a valid contract.

### ***To whom does the buyer pay the DDF?***

The buyer pays the DDF directly to the seller, generally at the time the contract is executed. The amount of the DDF is credited to buyer at closing against the purchase price unless the contract is otherwise terminated.

### ***If the contract is terminated, which party gets to keep the DDF?***

Answer: The seller. Per paragraph 12 in Form 2T: the DDF is non-refundable, except in the event of a material breach of the contract by the seller or if the property is destroyed prior to closing.

## Earnest Money Deposit (EMD)

An EMD is a negotiated amount of money deposited by the buyer with an escrow agent to evidence the buyer's good faith.

### *Is an EMD required?*

No. An EMD is not required to create a valid contract.

### *To whom does the buyer pay the EMD?*

The buyer pays the EMD to the escrow agent identified in the contract. Often, the escrow agent is a real estate company or an attorney or a title company.

The Standard Form 2T, Offer to Purchase and Contract states:

...the initial earnest money deposit, the additional earnest money deposit, and any other earnest monies paid or required to be paid in connection with this transaction, collectively the "Earnest Money Deposit", shall be deposited and held in escrow by Escrow Agent until Closing, at which time it will be credited to Buyer, or until this Contract is otherwise terminated.

In other words, all earnest monies are to be held by the named escrow agent and credited to buyer at closing against the purchase price unless the contract is otherwise terminated.

### *If the buyer terminates the contract, which party gets to keep the EMD?*

It depends on WHEN the buyer terminates.

According to Form 2-T, all earnest money deposits will be refunded to the buyer IF the buyer terminates prior to the expiration of the Due Diligence Period (DDP). If the buyer terminates AFTER the expiration of the DDP, the EMD will be retained by the seller.

### *If the seller terminates the contract, which party gets to keep the EMD?*

If the seller breaches the contract, then Form 2-T dictates that all EMDs are to be refunded to the buyer upon buyer's request, but "... shall not affect any other remedies available to Buyer for such breach."

## Additional Information about EMDs

To assist consumers in understanding EMDs, the Commission publishes the “Questions and Answers on Earnest Money Deposits.”

This brochure is provided on the Commission’s website at <https://www.ncrec.gov/Brochures/EarnestMoney.pdf>.

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## WHAT IF THE CONTRACT INCLUDES A DDF OR AN EMD BUT THE BUYER DOESN’T DELIVER THE FUNDS RIGHT AWAY? DO WE HAVE A CONTRACT?

In order to create a valid real estate sales contract, there must be a written offer, an acceptance of the offer, and communication of the acceptance to the last offeror. Neither a DDF nor an EMD is required for a valid contract.

If the contract requires the remittance of a DDF and/or EMD, and the buyer fails to timely submit the required funds with the contract or by the specified due date, a valid contract still exists. However, the buyer may be in breach depending upon the provisions agreed upon by the parties.

Standard Form 2T, Offer to Purchase and Contract, includes a provision that provides the Sellers a remedy if the Buyer fails to deliver the DDF and/or EMD or if the bank dishonors the funds. The provision states:

Should Buyer fail to deliver either the Due Diligence Fee or any Initial Earnest Money Deposit by their due dates, or should any check or other funds paid by Buyer be dishonored, for any reason, by the institution upon which the payment is drawn, Buyer shall have one (1) banking day after written notice to deliver cash, official bank check, wire transfer or electronic transfer to the payee. In the event Buyer does not timely deliver the required funds, Seller shall have the right to terminate this Contract upon written notice to Buyer.

The provision provides Sellers with a remedy to terminate the contract after notifying the Buyer. Therefore, it is up to the Sellers to decide whether they wish to continue with the contract even if the Buyer fails to remit funds after given written notice. Standard Form 2T indicates that a valid contract exists absent a due diligence fee(s) or remittance of insufficient due diligence fee(s).

## The Contractual Process Outlined in the Offer to Purchase & Contract



Brokers should advise their clients (i.e. Buyers and Sellers) on the contract provisions and the consequences of failing to comply with those terms, such as a breach or termination of the contract.

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## PRESENTING OFFERS

Under the law of agency, a seller's agent (listing agent) has a duty to communicate (present) all offers on a listed property to the seller as soon as possible and to disclose to the seller all information in the agent's possession that might affect the seller's decision to accept an offer.

In addition, Real Estate Commission Rule 58A .0106 dictates

"...every broker shall deliver a copy of any written agency agreement, contract, offer, lease, rental agreement, option, or other related transaction document to their customer or client within three days of the broker's receipt of the executed document."

It is important to note that this Commission rule applies to all agents involved in a transaction regardless of whom they represent or from whom they will receive compensation.

The three-day provision specified in Rule 58A .0106(c) is included to allow for situations where the seller is not immediately available, and represents an outside time limit within which offers must always be presented.

In cases where the seller is available, all offers, the likelihood of future offers, and information that may affect the seller's decision, should be presented as soon as possible and delivered to the client via electronically, face-to-face, or via postal mail.

Even if a contract is pending on the property, all offers should still be submitted to the sellers.



License Law and Commission rules do not allow brokers to accept or reject an offer on behalf of their client. For example, a seller's agent has no authority to reject an offer on behalf of the seller, even if the offer is clearly disadvantageous to the seller. Instead, the broker must present all offers and disclose the advantages/disadvantages of the offer to the seller.

## Multiple Offers

If a broker receives more than one offer on a subject property, the broker is considered to have multiple offers that must be presented to the seller as soon as possible but no later than three days after receipt according to Rule 58A .0106(c).



***Should the broker submit offers to the seller in a certain order?***

No. If a broker receives multiple offers on a listed property at about the same time, the broker should not present one offer to the seller and withhold a second offer until the seller makes a decision on the first offer. It does not matter which offer was reviewed first, or was the lowest; all offers should be presented at the same time.



***Is it a material fact that there are multiple offers?***

No. The existence of multiple offers is not a material fact that must be disclosed to other brokers and/or their principals. A listing broker must get the seller's consent to disclose that the owner has received or is considering more than one offer. However, if the owner provides consent, the broker has a duty to disseminate information to everyone fairly, equally, and honestly.



***When can a broker disclose confidential terms, such as price and financing, with competing buyers?***

Commission Rule 58A .0115, states a broker shall NOT disclose the price or other material terms contained in a party's offer to purchase, sell, lease, rent, or to option real property to a competing party without the express authority of the offering party.

In other words, you must have the permission of the BUYER to disclose the terms of their offer to other buyers. It is not sufficient to have the permission of the seller.

**Best Practice:** Brokers should document receipt of all offers upon submission and immediately deliver them to the seller for consideration.

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## REVIEWING OFFERS AND CONTRACTS

A real estate broker must have an active, current license in order to:

- assist and advise clients on the completion of contract offers and counteroffers;
- use preprinted forms; and
- communicate offers and acceptances.

### *Brokers owe Skill, Care, and Diligence to Clients*

Agency law requires that a real estate broker exercise a high degree of skill, care, and diligence in the conduct of the agent's duties. Agents who do not perform with the required degree of skill, care, and diligence, or are guilty of negligence or misconduct, not only are liable to the principal for any damages the principal may sustain, but may also forfeit any claim to compensation.

A broker exhibiting skill, care, and diligence, assists clients by:

- competently and accurately completing approved preprinted sales contract forms, and
- understanding general terminology and contract provisions.

Brokers are expected to know when it is appropriate to use a particular contract form and to recognize situations where sellers and buyers should be referred to an attorney to have a suitable contract drafted.

## QUESTIONS FOR DISCUSSION



*Are brokers in violation of License Law and Commission rules if they fail to review contract provisions with a client?*

Reviewing and explaining the provisions of offers and contracts to clients are part of a broker's responsibility for proper skill, care, and diligence. However, brokers are reminded to refer their clients to an attorney for an in-depth explanation of legal concepts to prevent the practice of law.

N.C. Gen. Stat. §93A-6(a)(8) authorizes the Commission to discipline a licensee who is found to be "... unworthy or incompetent to act as a real estate broker in a manner as to endanger the interest of the public."

A real estate broker who:

- completes a sales contract improperly;
- uses forms that are not legally adequate; or
- fails to adequately explain the contract provisions and protect the interests of their clients

may be deemed to be in violation of License Law and Commission rules.



*My company transmits all transaction documents to clients and customers using an electronic management system. When clients and customers receive documents, the software shows them where to insert their initials and signatures. Am I still expected to explain the forms and contracts?*

YES! Brokers must review contract provisions with their clients regardless of whether they are using printed copies or an electronic platform. Brokers may violate License Law and Commission rules if they utilize an electronic program for document management and fail to review the provisions with their clients before they sign. Brokers should ensure clients are knowledgeable about the provisions of offers, contracts, and other forms before the clients affix their initials or signatures.

Further, as a "fiduciary" for a client, the broker is obligated to act in the client's best interests, placing the client's interests before any self-interest. For example, a broker or firm may prefer to use electronic documents. However, if a client is uncomfortable with the technology, or prefers to receive printed copies of executed documents, the broker should provide information and documentation in a way that suits the client's needs.



If a broker fails to review the contract provisions with a client, the broker may be found to be in violation of License Law and Commission rules.



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## ANSWER TO DISCUSSION QUESTIONS

### For Discussion on page 27

1. Mark, a buyer's agent, submits an offer on behalf of his clients for \$27,000. The listing agent reviews the offer with his seller. The seller marks out \$27,000, writes in \$37,000, initials the change, and signs all pages.

Was a contract created? Why or why not? *No, because the seller rejected the buyer's offer and created a counteroffer by changing the price.*

2. Mae, a buyer's agent with ABC Realty, submits an offer on behalf of her buyer-client to Tammy, a seller's agent with XYZ Realty. The offer includes a \$1000 due diligence fee (DDF) and a \$2000 initial earnest money deposit (EMD). Tammy presents the offer to her seller-client, and the seller signs the offer as-is, without making any changes. Tammy calls Mae to let her know the seller has signed contract. Tammy reminds Mae that the DDF and EMD checks must be delivered to Tammy's office by the end of the day.

Are the parties under contract? YES

If YES, when was the contract formed? *When Tammy called Mae to let her know the seller had signed without making any changes to the buyer's offer. Delivery of DDF and EMD are not required for contract formation.*

If NO, what is required for contract formation? *An offer must be signed without making any changes and the signed acceptance is communicated to the offeror or their agent.*

3. Sam, a buyer's agent, submits an offer on behalf of his buyer-client to Malik, the listing agent. Malik presents the offer to his seller-client. The seller agrees to all terms except the due diligence fee. The seller wants to increase the fee from \$2500 to \$5000. Malik calls Sam to discuss the DDF change, and Sam tells him the buyer will agree to the increase. Malik adjusts the amount of the DDF on the Offer to Purchase form, and the seller initials the change and signs all pages. Malik forwards the paperwork to Sam.

A few hours later, Malik calls Sam again and tells him the seller is rescinding the offer, because the seller has accepted another offer.

Did Malik's and Sam's clients form a contract? Why or why not? *No, because the original offer was rejected when the seller changed the amount of the DDF. To form a contract, the buyer would have had to*

*sign the counteroffer, and the buyer's agent would have had to communicate to the listing agent that the buyer had signed.*

### For Discussion on page 33

1. A buyer's agent submits an offer to Holly, a listing agent, at a cooperating firm. Holly sends the offer via email to the seller and reviews it. The seller agrees to the terms, signs the offer, and scans and emails it back to the listing agent.

*Was a contract created? No, because the fact that the seller signed the contract was not communicated to the buyer or the buyer's agent.*

2. Thomie, a dual agent, represents Jay in purchasing a home listed by his firm. Jay and the seller provide written authority for Thomie to act as a dual agent. Thomie assists Jay with preparing an offer. Thomie then physically presents the offer to the seller, and watches as the seller signs it.

*Was a contract created? Yes, because Thomie is a dual agent, representing both the buyer and the seller. When the seller signed the offer in front of Thomie, communication of acceptance to the buyer occurred.*