THE DEPOSIT IN THE SALE OF LAND: RECENT DEVELOPMENTS

BY THOMAS GIBBONS*

I. INTRODUCTION

The decision of the Supreme Court in *Otago Station Estates Limited v Parker*[1] resolved an important issue; it is now clear that in the absence of agreement to the contrary, a deposit paid pursuant to the REINZ-ADLS agreement for sale and purchase must be made by cash or bank cheque – and in practice, it will generally be the latter.

But *Otago Station Estates* is also worthy of attention for what it did not say. With reference to *Rick Dees Limited v Larsen*,[2] it invites a situation where a deposit paid by electronic means may be subject to dispute as to its validity. Furthermore, the decision in *Otago Station Estates* failed to draw a proper distinction between a deposit as an earnest and a deposit as part payment of the contract price. These matters are each given attention in this article, and each highlights the space between theory and practice in property law that lawyers and the courts must do their best to alleviate.

II. THE SUPREME COURT CONTEXT AND THE REINZ-ADLS AGREEMENT

Otago Station Estates hinged on a basic question: 'whether a purchaser can remedy a default in paying a deposit due under an agreement for sale and purchase of land on the Real Institute of New Zealand / Auckland District Law Society (REINZ/ADLS) form [of agreement for sale and purchase of real estate] by tendering a personal cheque if the vendor objects to that mode of payment.'[3] This was a private law matter of 'general commercial significance' under section 13(2)(c) of the Supreme Court Act 2003 – significant not only to the parties to the case, but also to the hundreds of lawyers, legal executives, real estate agents and other parties throughout New Zealand who conduct property transactions using the REINZ-ADLS form of agreement on a regular basis.

The REINZ-ADLS agreement under which the dispute arose has gone through a number of different versions over the past several years. It is worth noting that Blanchard J, who delivered the judgment of the Court, was involved in drafting some of the earlier editions of this agreement, as well as a widely used commentary on the standard form.[4] The current form, and the one used in this case, was the Seventh Edition (2) July 1999 form, and the decision hinged on the

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* BSocSc, LLB(Hons) *Waikato*. Solicitor, McCaw Lewis Chapman, Hamilton; Tutor in Legal Executive Studies, Waikato Institute of Technology.

1 *Otago Station Estates Ltd v Parker* [2005] 2 NZLR 734.

2 (2005) 5 NZConvC 194,127.

3 *Otago Station Estates Ltd v Parker* [2005] 2 NZLR 734, para 1.

4 P Blanchard, *A Handbook of Agreements for Sale and Purchase* (4th ed, 1988).

interpretation of clause 2 of the form, which provides that any deposit is to be paid to the vendor or the vendor's agent 'immediately upon execution' of the agreement 'and/or at such other time as is specified' in the agreement, time being of the essence. Clause 2.2 states that:

> The vendor shall not be entitled to cancel this agreement for non-payment of the deposit unless the vendor has first given to the purchaser three working days' notice of intention to cancel and the purchaser has failed within that time to remedy the default. No notice of cancellation shall be effective if the deposit has been paid before the notice of cancellation is served.

III. *Otago Station Estates Ltd v Parker*

A. Facts

The case involved two contracts, both dated 22 November 2000, and both relating to rural land in north Otago. The first was between DJ & LM Parker as vendor and Willowbank Holdings Limited or nominee as purchaser, at a price of $2,950,000 (the 'first agreement'). The second was between JR Parker and Livingstone Properties Limited or nominee, at a price of $900,000 (the 'second agreement'). Each contract was conditional on confirmation by the directors of the relevant purchaser company, with an eventual date for satisfaction of 6 March 2001. The second agreement also had a condition for the vendor to obtain a resource consent, with no specified date for satisfaction. Each agreement provided for a deposit of 10 per cent to be paid on confirmation, with the balance payable 'in cash' on the agreed possession date of 1 March 2001.[5]

The purchaser companies confirmed the agreements on 6 March 2001, but the deposits were not paid. The vendors' solicitors confirmed by fax on 20 March 2001 that payment of the deposits could be deferred until after a meeting between the parties scheduled for 28 March 2001, but the deposits remained unpaid following that date. On 27 September 2001, the purchasers nominated Otago Station Estates Limited to complete both agreements, and on 4 February 2002 this company gave notice that it was ready, willing and able to settle and enquired about progress with the subdivision envisaged by the second agreement. On 10 October 2002, the deposits still unpaid, the purchasers issued proceedings for specific performance. On 13 November 2002, the vendors' solicitors issued notice to the original and nominee purchasers stating the vendors' intention to cancel each agreement for non-payment of deposit unless it was paid to the vendors' solicitors office (Berry & Co) within three working days of the date of service. Reference was made to the firm's trust account in a manner which, the Court said at paragraph 7 'clearly invited payment directly to that account.'

The expiry of the three working day period was 5 pm on 18 November 2002. At 4.32 pm on that day, the solicitors for Otago Station Estates Limited sent a fax to Berry & Co advising that $433,892.78 (being the deposits plus interest) had been deposited into the Berry & Co trust account that afternoon. The purchaser's solicitors also sent a copy of the deposit slip and the cheque – the latter being a personal cheque of Otago Station Estates Limited. The following day, Berry & Co advised that the personal cheque was not legal tender and therefore not in compliance with clause 2.2 of the agreement, and gave notice of cancellation of the agreements. The purchaser did not stop payment on the cheque and it was refunded by bank cheque a few days later.

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5 *Otago Station Estates*, above n 3, paras 2-3.

B. Proceedings

The case was initially heard in the High Court.[6] Here, Chisholm J drew a distinction between payment of a deposit in usual circumstances – where a personal cheque was a common and valid form of tender, and the 'much less common situation where payment was being made in response to a cl 2.2 notice'.[7] The issue of a default notice triggered a right of cancellation, and it was essential for a vendor to be able to cancel immediately without having to wait for a cheque to clear. A bank cheque was required to satisfy a default notice, unless the vendor was prepared to accept something less, and the purchaser had to take the initiative in obtaining such a concession to modify clause 2.2. The personal cheque was therefore not good tender and the vendors were entitled to reject it and cancel the agreement.[8]

The Court of Appeal did not accept the distinction drawn in the High Court between deposits paid in ordinary circumstances (under clause 2.1), and deposits paid after notice of intention to cancel (under clause 2.2). Personal cheques was not valid tender under 2.1, even if vendors or their agents made a practice of accepting them. The practice of accepting personal cheques for deposits was, in the Court's view, illustrative of a payee accepting a cheque without objection to its form, and thereby waiving its right to payment by cash or bank cheque. If not accepted, the legal obligation to pay in clear funds remained. The vendors' solicitors' advice to pay the deposit direct to the trust account did not waive the requirement that payment of the deposit be made in legal tender. The Supreme Court granted leave the appeal the case, but declined to hear a new point raised by counsel.

C. The Reasoning

1. *The Deposit*

The Court began with a definition of a deposit from Black's Law Dictionary (7th edition): '[m]oney placed with a person as earnest money or security for the performance of a contract. The money will be forfeited if the depositor fails to perform' – the deposit being 'security to the vendor against the purchaser's unlawful repudiation of the contract'. Under general law, the Court determined, time for payment of the deposit is of the essence, with failure to pay in due time a breach of an essential stipulation enabling immediate cancellation by the vendor under sections 7(3)(b) and 7(4)(a) of the Contractual Remedies Act. The REINZ-ADLS form then modifies this to require, even if the deposit is already overdue, that the vendor give notice that the purchaser has three working days to pay the deposit before the vendor will cancel.[9]

2. *Payment*

The Court observed that clause 2 of the REINZ-ADLS form is silent on the mode of payment of a deposit. The Court was of the view that the words 'pay', 'non-payment' and 'paid' in clause 2 must be interpreted against the general law of vendor and purchaser and in the context of the REINZ-ADLS agreement as a whole. The general law required that any payment towards the purchase price (such as a deposit) be in cash, by bank cheque,[10] or by other cleared funds, and a

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6 [2003] 3 NZLR 567.

7 *Otago Station Estates*, above n 3, para 14.

8 Ibid, paras 15-17.

9 Ibid, paras 21-22.

number of earlier cases[11] were clear that a personal cheque was not good tender, even if it came from someone of good credit or was often accepted in practice. It was submitted for the purchaser that the legal requirement that a deposit be paid in legal tender rather than by means of a personal cheque was something of a fiction – for example, where an auction was conducted outside business hours and the terms required that the deposit be paid immediately on the fall of the hammer, the bank cheque requirement might be impossible to fulfil. The Court disagreed, emphasising that 'the certainty of actual receipt' could be all-important to a person entitled to payment of a deposit,[12] and going on to say that the law relating to how deposits must be paid was 'well understood and workable in practice':

> It was undoubtedly known to those who prepared the seventh edition of the standard form that a contractual requirement for the making of a payment must, as a matter of law, be performed by means of legal tender, bank cheque or other cleared funds unless the payee by words or conduct indicates a preparedness to accept a personal cheque.[13]

The Court observed that a vendor may accept a personal cheque (or knowingly allow his or her agent to do so) without objection specifically to its form, and is then estopped from asserting that the mode of payment has not complied with the terms of the contract. In the case of an auction or sale outside working hours (and not using the REINZ-ADLS form), the Court's 'tentative' view was that a personal cheque could implicitly be used when a bank cheque would not be immediately obtainable and the deposit's size made a cash payment unlikely – though this would often be in the vendor's interests as well.[14]

The Court also suggested that if it were to insist that a vendor accept a personal cheque tendered in payment of a deposit, then under clause 2 of the REINZ-ADLS form:

> a notice given by a vendor after the purchaser's personal cheque for the deposit had been dishonoured could be met by the tendering of a personal cheque. That tender could be made at any time prior to the service of a cancellation notice, thereby suspending the vendor's right to cancel, or even to sue for the debt, until it was known whether the second cheque was met on presentation … that could take four or five days … [and] would produce an uncertain and thoroughly unsatisfactory situation. The vendor would not yet know whether he or she had the security of a deposit.[15]

The Court therefore determined that the appeal should be dismissed, and that a purchaser could not remedy a default in payment of a deposit due under the REINZ-ADLS agreement for sale and purchase of land by tendering a personal cheque if the vendor objected to that mode of payment. The rule in *William v Gibbons*[16] – that a bank cheque must, unless the payee reasonably believes the bank is insolvent, be accepted as legal tender equivalent to cash – was also approved.

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10 Following *William v Gibbons* [1994] 1 NZLR 273, where the Court stated that a bank cheque must be accepted as legal tender unless the recipient has reasonable grounds to believe that the bank is insolvent and may not be able to honour it.

11 See *Johnstone v Boyes* [1899] 2 Ch 73 and *Stembridge v Morrison* (1913) 33 NZLR 621.

12 See *Henderson v Ross* [1981] 1 NZLR 417, 433.

13 *Otago Station Estates Ltd*, above n 3, para 27.

14 Ibid.

15 Ibid, para 30.

16 [1994] 1 NZLR 273.

D. Conclusion

On its fact, the decision in *Otago Station Estates* appears entirely reasonable and commercially sound. Indeed, it is difficult to how the Court could properly have made any other decision: where cleared funds are required, a personal cheque is insufficiently reliable. A bank cheque, on the other hand, is, following *Williams v Gibbons*, prima facie as good as cash, and considerably safer for day to day use.

However, considered and reasonable as the decision in *Otago Station Estates* is – and useful as it is to practitioners in clarifying the method of payment for deposits – the decision is also silent on some important matters. Primarily, it does not make clear whether a deposit may be paid by electronic means, and it does not determine the nebulous issue of what a reasonable deposit must be. Each of these issues is now examined in turn, the first with particular reference to the High Court decision in *Rick Dees Limited v Larsen*.[17] These matters indicate considerable uncertainty – both doctrinal and practical – in the law relating to deposits.

IV. Rick Dees Limited v Larsen

A. Introduction

The case of *Rick Dees Limited v Larsen* was decided shortly after *Otago Station Estates*, and touched on many of the same issues. The first main question before the High Court was whether tender of settlement by means of the lodgement by electronic funds transfer of purchase moneys into the vendor's solicitor's bank account was a sufficient tender of settlement, when the vendor had agreed to payment into that account by deposit of bank cheque. The second was whether tender of settlement also required facsimile notification to the vendor's solicitor of the lodgement. Finally, if facsimile notification was required, the Court had to consider whether the facsimile notice was complete when the purchaser's solicitor attempted transmission of the facsimile to the vendor's solicitor's facsimile number, upon actual transmission, or only upon receipt by the vendor's solicitor. These questions were set against clause 3.7 of the REINZ-ADLS agreement, which provides for the purchase to pay or satisfy the balance of the purchase price on the settlement date, and for the vendor to provide a memorandum of transfer and all other documents to allow the purchaser to register the memorandum of transfer.

B. The Facts

The plaintiff entered into 10 agreements to purchase 10 flats in November 2003, each on the Seventh Edition (2) July 1999 REINZ-ADLS form. Each agreement was on its face independent, and the agreements became unconditional on 8 December 2003, with settlement set for 10 February 2004.

The deposits for the properties were originally $3,500 each, though this was varied by agreement to $2,500 each, with the total of $25,000 to be paid on 19 December 2003. The vendor's solicitor wrote to the purchaser's solicitor on 8 December 2003 confirming that payment on 19 December 2003 would be acceptable, and enclosing a copy of the vendor's solicitor's trust account deposit slip '[i]n order that the deposit can be paid directly to our trust account on the 19

17 (2005) 5 NZ ConvC 194,127.

December, 2003'. The $25,000 was deposited in the vendor's solicitor's trust account on 19 December 2003 by way of electronic funds transfer, and the purchaser's solicitor sent a standard letter on the same day confirming the electronic transfer and undertaking not to reverse the transaction.[18]

Though settlement had been set for 10 February 2004, the vendor's solicitor did not deliver settlement statements for the properties to the purchaser's solicitor until 17 February 2004, nominating that day as the day for settlement. The letter, with a copy of the firm's trust account deposit slip attached, confirmed that the required title documents were held and contained an undertaking that these would be forwarded to the purchaser's solicitor on receipt of the purchaser's solicitor's faxed undertaking that a bank cheque for the settlement figure had been credited to the vendor's solicitor's trust account in accordance with the settlement statement; and a faxed copy of the bank cheque, endorsement and stamped deposit slip. Settlement was not completed on 17 February 2004 and the following day a settlement notice was issued in accordance with the terms of the REINZ-ADLS form. This gave the purchaser until 5.00 pm on 5 March 2004 to cancel, or the vendor would be entitled to cancel the agreements.

An issue arose at this point as to whether the purchaser could settle only four of the 10 transactions at one time. The vendor argued that this was not the case, and the purchaser did not pursue the matter, believing settlement in full would be possible by 5 March 2005. Amended settlement statements were sent to the purchaser's solicitor on 5 March 2004, and these made no mention of the proposed or required method of settlement. Due to lender difficulties, the funds to settle were not available to the purchaser until after 4 pm on 5 May 2004. The purchaser's solicitor then had some discussions with the vendor's firm, in which electronic funds transfer was discussed. At 4.25 pm, however, the vendor's solicitor faxed the purchaser stating that settlement was required to be completed in person. This was unsatisfactory – perhaps even impossible – to the purchaser, who attempted (unsuccessfully) to telephone the vendor's solicitor. The transactions to complete settlement were then processed electronically at 4.50 pm, with transmission reports confirming this had been completed by 4.54 pm.

It is here that things turn ugly – and that practising conveyancers must hold their breath. The purchaser's solicitor attempted to send an undertaking with the confirmation reports. The fax number was engaged, and one attempt went to the wrong number. At 5.07 pm the fax (on automatic redial) was transmitted to and received by the vendor's solicitors. A few minutes earlier, however, at 5.03 pm, the purchaser's solicitor had received a fax letter purporting to cancel the contract, noting that the purchaser had failed to settle in accordance with the terms of the contract. The vendor's solicitor confirmed on 8 March 2005 that the moneys paid had been redeposited in the purchaser's solicitor's trust account – by electronic funds transfer!

C. The Reasoning

There was some discussion as to common practice in settlements. As the Court noted at paragraph 24, the REINZ-ADLS form 'clearly contemplates a face to face settlement', but remote settlements (with faxed undertakings by each solicitor) are very common. The vendor's solicitor had allowed for remote settlement by the letter enclosing the settlement statement on 17 February 2004. The vendor's solicitor was of the view that the subsequent issue of a settlement notice

18 Ibid, paras 3-5.

negated previous arrangements, requiring, in the absence of further agreement, face-to-face settlement. The Court disagreed – finding that the parties had agreed on remote settlement, and that the vendor could not unilaterally alter this arrangement (para 29). Furthermore, the vendor's solicitor's actions in requiring face to face settlement at 4.25 pm on the final settlement date when this was practically impossible 'would fall foul of the rule that a contracting party is itself in breach of contract if it engages in conduct which can be said to amount to 'of its own motion' bringing about the impossibility of performance'.[19]

While the purchaser argued that settlement was complete on deposit of the monies into the vendor's account, or alternatively when fax confirmation was sent, the vendor argued that fax confirmation of deposit must be *received* to complete settlement. The Court again referred to the vendor's settlement requirements, which required confirmation to be sent. This was logical:

> When a settlement is face to face the vendor's solicitor is immediately aware of tender of payment by the purchaser. Therefore when the parties agree to a remote settlement and it is stipulated as part of that, that there be confirmation of payment and related undertakings communicated, this stipulation is significant both practically and contractually. The purchaser has not tendered settlement until the agreed confirmation is given in the agreed manner.[20]

Clause 1.2(3)(c) of the agreement stated that facsimile notice was deemed to have been served 'when sent … to the facsimile number of the solicitor's office'. However, the settlement requirements of the vendor stipulated that the vendor's solicitor must actually have received the fax confirmation and undertakings. The Court found this a valid variation of the terms of the standard agreement, with the settlement requirements contemplating actual receipt rather than deemed service. In any case, facsimile notice was not 'sent' merely be the recipient's number having been dialled – the Court's view being that business efficacy demanded that 'once the facsimile is *transmitted* to the facsimile number it is deemed served'.[21] The Court was therefore satisfied that settlement was not effectively tendered before the vendor's cancellation of the contract.

D. Electronic Funds Transfer

The standard agreement is silent as to the method of payment. Cash payment often being impractical, in *Williams v Gibbons*[22] the High Court had determined that it was an implied terms of contracts for the sale of land that tender of a bank cheque on settlement was equivalent to cash, and could be refused only if the recipient had reasonable grounds to believe that the bank might not honour it because of insolvency. As discussed above, *Otago Station Estates* had also determined that payment by bank cheque was required for payment of deposits as well as for settlement monies. In the present case, there was expert evidence that electronic funds transfer was less risky than paying by bank cheque, 'because payment by electronic transfer is payment of cleared funds whereas some banks still require clearance of bank cheques'.[23] Though the Court noted that electronic funds transfer is now an accepted means of payment according to 2004

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19 Ibid, para 30, citing *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701, 717.

20 Ibid, para 35.

21 Ibid, para 42 (emphasis added).

22 [1994] 1 NZLR 273, 277.

23 *Rick Dees Ltd v Larsen*, above n 17, para 47.

NZLS guidelines, it is the writer's experience that many firms are more willing to accept fax settlement by bank cheque than by electronic transfer – or unwilling to accept the latter entirely.

The judge commented:

> Although I am not required to decide the point in this case it may well be that the time has come to imply a term to similar effect to that implied in *Williams v Gibbons* in relation to electronic funds transfer. The evidence before me is that the transfer gives the payee an unconditional right to the immediate use of the funds.[24]

The Court then referred to the *Otago Station Estates* decision, noting that the Supreme Court had equated bank cheques with 'other forms of cleared funds', 'other cleared funds' and 'bank transfer in cleared funds'. Unfortunately, neither the Court in *Rick Dees* nor that in *Otago Station Estates* drew a distinction between the different kinds of cleared funds used in practice. Probably the most common method of electronic funds transfer involves sending a fax undertaking that payment has been made and that it will not be reversed, together with a copy of the transmission printout. However, while the funds may be used by the recipient against this undertaking, they do not 'clear' until the next day. We could assume from *Otago Station Estates*' reference to 'cleared funds' that this would not be sufficient tender of settlement. On the other hand, *Rick Dees* is less clear on this point. Another method of electronic funds transfer (primarily used by ASB Bank, though are versions have been or are being developed) involves a 'real time' transfer. However, both parties must use ASB Bank systems. While the funds clear immediately (and so would presumably be acceptable under both *Otago Station Estates* and *Rick Dees*) this system is not widely used in practice.

E. Of Rick Dees and Otago Station Estates

It should also be noted that the Court's finding on as to the acceptability of electronic funds transfer was immediately ameliorated by the Court agreeing with the vendor's position. The Court found that even if electronic funds transfer was sufficient payment under the agreement for sale and purchase, because the vendor had agreed to remote settlement (as against the default of face to face settlement), the vendor was entitled to require a particular form of settlement. Deposit by electronic transfer rather than bank cheque was not strictly compliant with the vendor's requirements, notwithstanding that this was a difference of form rather than substance.[25] The Court therefore found for the vendor. The effect of this finding is that if electronic settlement is intended, then the purchaser should provide for this in the agreement. The vendor will not necessarily then be able to insist on strict compliance with its settlement requirements. It may be that future versions of the REINZ-ADLS agreement provide for remote settlement in the standard terms, thereby removing the difficulties of purchasers having to pay overly-rigorous attention to the details of settlement requirements.

The importance of settlement requirements in determining the arrangements between the parties highlights that *Rick Dees* and *Otago Station Estates* may create some difficulties in future when read together. Settlement requirements are not in practice issued for the payment of deposits. Where there is a real estate agent, as is the case in normal residential transactions, the deposit is generally paid by personal cheque to that agent. The Real Estate Agents Act 1976

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24 Ibid, para 49.

25 *Otago Station Estates Ltd v Parker* [2005] 2 NZLR 734, para 50.

requires in section 57 that agents hold deposits for 10 days unless the parties agree otherwise, and this 10 day period is invariably sufficient to give the cheque time to clear. In addition, the real estate agent will often advise (on behalf of the vendor) that a personal cheque is acceptable. The dispute that arose in *Otago Station Estates* would not have arisen in the average residential sale and purchase where an agent was involved.

However, where a deposit is to be paid directly between the parties (as was the case in *Otago Station Estates*), the decision of the Supreme Court in that case makes it clear that payment by cash or bank cheque is acceptable, but that a vendor may refuse to accept payment by personal cheque as this is not cleared funds. *Rick Dees* then suggests that payment by electronic means should be considered equivalent to payment by bank cheque. Therefore, a deposit could, unless the parties had agreed to the contrary – that is, in normal circumstances – be paid by electronic means.

It may be that *Rick Dees* has simply misinterpreted *Otago Station Estates*, and that the Supreme Court never meant to explicitly equate bank cheques with an electronic transfer of funds. As it is, however, these cases may create practical difficulties for the future when read together. Where there is no real estate agent and a deposit is paid by electronic transfer directly from one party to another, the vendor may be required to accept such payment. On settlement, the vendor may on the other hand provide settlement requirements that, read strictly, do not allow settlement by electronic transfer. One solution from the vendor's perspective may be to send out settlement requirements in relation to the payment of the deposit. Another may be to amend the agreement so that the requirements for payment of a deposit are as strict as those for payment of settlement monies. In either event, however, the current situation is unclear, and those attempting to rely on both *Otago Station Estates* and *Rick Dees* may find themselves in a further dispute – perhaps all the way to the Supreme Court again!

V. Deposits and Earnests

A. The Function(s) of a Deposit

Otago Station Estates also deserves some attention for what it did not say about the twin functions of a deposit. It was noted above that the Court drew its definition of 'deposit' from *Black's Law Dictionary*:

> Money placed with a person as earnest money or security for the performance of a contract. The money will be forfeited if the depositor fails to perform.

This definition is however insufficient.[26] A deposit is indeed 'earnest money' that may be forfeited if the depositor (invariably the purchaser) fails to perform. But it is also a part payment of the purchase price – a point so obvious that it was perhaps silently assumed by both the editor of *Black's* and the Supreme Court. If so, it was a dangerous assumption, because a sum paid in part payment of the purchase price might be different from a sum paid as an earnest, even though, in common parlance, both are referred to as a 'deposit'.

Reference to the standard REINZ-ADLS agreement illuminates this point. The front page of the Seventh Edition (2) July 1999 provides space after the words 'Deposit: (refer clause 2) $' for a

26 Compare *Laws of New Zealand* 'Sale of Land' para 13: 'A deposit is both a part payment of the purchase price and an earnest for the performance of the purchaser's contractual obligations.'

deposit to be inserted. Clause 2.2 was the key provision in *Otago Station Estates*, while clause 2.3 provides 'The deposit shall be in part payment of the purchase price.' There is no mention at this point of the deposit being an earnest.

Clause 9 of the agreement provides for one party to issue a settlement notice to the second if the second has defaulted on settlement. Clause 9.4 provides (in part):

> If the purchaser does not comply with the terms of the settlement notice served by the vendor then:
> 1) Without prejudice to any other rights or remedies available to the vendor at law or in equity the vendor may:
> a) sue the purchaser for specific performance; or
> b) cancel this agreement by notice and pursue either or both of the following remedies namely:
> i) forfeit and retain for the vendor's own benefit the deposit paid by the purchaser, but not exceeding in all 10 per cent of the purchase price; and/or
> ii) sue the purchaser for damages.

Clause 9.4(1)(b) illustrates the point of an earnest. If the purchaser is in default (and does not comply with the vendor's settlement notice), then the deposit paid is forfeited and may be retained by the vendor. This forfeiture is not however absolute. The deposit will only be forfeited and may only be retained by the vendor if it does not exceed 10 per cent of the purchase price.

B. Worsdale v Polglase and Workers Trust

The words in the standard agreement reflect the common law position. The leading New Zealand case is *Worsdale v Polglase*.[27] Here, A agreed to purchase a house from B for $60,000. The deposit of $6,000 was paid to B on signing. There was no express clause in the agreement used permitting B to retain the deposit if A defaulted. A defaulted on the agreement and B entered into a new agreement to sell the property and retained A's deposit. A sued B for the deposit (less the real estate agent's commission). Though the case primarily concerned the application of the then-new Contractual Remedies Act 1979, there was also some commentary on deposits generally. In particular, the following definition cited by the Court is clearly superior to that used by the Supreme Court in *Otago Station Estates*:

> Everybody knows what a deposit is. The purchaser did not want legal advice to tell him that. The deposit serves two purposes – if the purchase is carried out it goes against the purchase-money – but its primary purpose is this, it is a guarantee that the purchaser means business; and if there is a case in which a deposit is rightly and properly forfeited it is, I think, when a man enters into a contract to buy real property without taking the trouble to consider whether he can pay for it or not.[28]

The Court in *Worsdale v Polglase* determined that a deposit of 10 per cent was 'normal' in property transactions and would not be held to be penal in usual circumstances. However, if the deposit was 50 per cent of the purchase price, and that sum was retained by the vendor for the purchaser's default, then that earnest would be penal and the Court would order a refund to the purchaser.[29]

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27 [1981] 1 NZLR 722.

28 *Soper v Arnold* (1889) 14 App Cas 429, 435, per Lord Macnaghten, cited ibid at 725.

29 *Worsdale v Polglase* [1981] 1 NZLR 722, 727.

The Privy Council offered its thoughts on the matter in *Workers Trust and Merchant Bank Ltd v Dojap Investments Ltd*,[30] a Jamaican appeal. Here, the deposit was 25 per cent of the purchase price. The purchaser defaulted and the vendor sought to retain the deposit as an earnest. The Privy Council emphasised that a deposit must be of a reasonable amount, and that 50 per cent of the purchase price was clearly unreasonable. The 25 per cent deposit was also found to be unreasonable, and the Board ordered the entire earnest retained to be refunded – not simply that amount that exceeded 10 per cent of the purchase price.

The *Workers Trust* case, though not binding on New Zealand courts, would no doubt be of considerable persuasive authority. It expands on the approach taken in *Worsdale v Polglase*: while that case found a 10 per cent deposit reasonable and a 50 per cent deposit unreasonable, *Workers Trust* states that a 25 per cent deposit is similarly unreasonable. In addition, it makes it clear that the payment of a deposit of 50 per cent of the purchase price by a purchaser will not entitle the vendor, if such purchaser defaults, to retain 10 per cent of the purchase price and refund the other 40 per cent. The entire deposit may be found to be unreasonable and a penalty, and the vendor will be required to refund the entire deposit to the purchaser (less damage). The applicability of the decision could however be questioned on the basis of New Zealand's unique Contractual Remedies Act.

C. Garratt v Ikeda

Garratt v Ikeda is a more recent case, revisiting *Worsdale v Polglase* and the Contractual Remedies Act 1979 in the context of the payment of deposits. Here, a deposit just under 10 per cent of the purchase price was payable in three instalments, with the final instalment not being paid on time. After some delay, the vendor gave notice that unless the final instalment of the deposit was paid within three working days, the contract would be cancelled (pursuant to clause 2.2 of the REINZ-ADLS terms). Payment was not made within the relevant period, and the vendor cancelled the contract and issued proceedings for payment of the third instalment. The vendor was also able to re-sell the property for more than the original contract price. With reference to clause 9.4 of the REINZ-ADLS agreement, the Court stated:

> The primary nature of a deposit as expressed in the authorities … and both the popular and legal usage of the word, support the view that when the parties describe as a deposit a sum not exceeding 10 per cent, paid or payable to seal the bargain, they must be taken as knowing and intending that if the purchaser defaults the deposit will be liable to forfeiture or recovery by the vendor. There can be few, if any, purchasers in New Zealand who do not understand and accept that a 10 per cent deposit is not refundable if they default.[31]

The Court went on to clarify that this 10 per cent sum may not only be forfeited under clause 9.4. It may also be recovered from the defaulting purchaser through proceedings. In the Court's view:

> Although the deposit is part of the purchase price its primary function is as an earnest. It is when the purchaser is in default and the vendor cancels and there is no purchase price payable any more, that the question of forfeiture or recovery of the deposit arises. That is why the primary function of the deposit is to seal the bargain. In a sense it is the price paid by the purchaser for the vendor's willingness to commit to a sale. If the sale goes off through the purchaser's default, it has been axiomatic since Roman times that the vendor may keep or recover the price of such commitment.[32]

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30 [1993] 2 All ER 370.

31 *Garratt v Ikeda* [2002] 1 NZLR 577, 591.

Worsdale v Polglase was overturned inasmuch as it allowed a defaulting purchaser to make a claim under section 9 of the Contractual Remedies Act. Section 9 allows the court to grant relief on such terms as the court thinks fit where one party has cancelled a contract and it is just and practicable to do so. The Court in *Garratt* found that where the deposit was not more than 10 per cent of the purchase price, the purchaser was deemed to have agreed that section 9 of the Act would not apply. Furthermore, section 5 of the Act states that if the contract expressly provides for a remedy, then that express provision overrides section 9 and other provisions of the Act. Relief under section 9 was therefore not granted.

D. Commentary

The *Worker's Trust* case might at first blush seem rather harsh – a vendor who collects a proportionally large deposit and, on the purchaser's default, attempts to retain this as an earnest risks losing the entire sum – as it may be seen as penal. On the other hand, there are circumstances where, due to the nature of the transaction (such as the risks assumed by the vendor, the opportunity cost of the vendor in dealing with one purchaser rather than another, or other similar matters) an earnest above 10 per cent might be reasonable. Indeed, where the parties are commercially astute and understand fully the nature of the transaction, there are times when the application of *Worker's Trust* may lead to injustice. On the other hand, *Garratt v Ikeda* has clarified that a deposit of 10 per cent can be received and retained by a vendor with confidence that it will not be required to be repaid pursuant to the Contractual Remedies Act.

The uncertainty in the current law is obvious when a deposit of 15 per cent of the purchase price is considered. This will in many circumstances be a reasonable sum in part payment of the purchase price. It would also appear in many circumstances be a reasonable earnest. If it is to be retained as an earnest, then the standard terms of the REINZ-ADLS form will need to be altered (clause 1.1(3) of the standard form provides that any inserted terms prevail over the standard terms). The writer has seen clauses of this nature stating that the purchaser acknowledges that, if in default, the entire deposit may be retained by the vendor as an earnest and none of this sum is to be seen as a penalty. However, whether this would be sufficient to overcome the common law position as stated in *Worker's Trust* is regrettably unclear. *Garratt v Ikeda*, with its use of the words 'not exceeding 10 per cent' (quoted above) indicates that 10 per cent is a maximum, but many lawyers in practice take it only as a guideline.

A deposit of 10 per cent will, it appears, never be unreasonable – either as a part payment or as an earnest. Retention of an earnest of 50 per cent will clearly be penal, and so too will an earnest of 25 per cent – though a deposit in part payment of the purchase price may be either of these and still be acceptable to the Courts. However, a vendor seeking to retain more than 10 per cent of the purchase price as an earnest runs the risk that this will be seen as penal, and that a Court will order repayment of the entire sum to the purchaser. Where the line should be drawn (11 per cent, 17.5 per cent or 24 per cent) is unclear, and the circumstances of the case may be the deciding factor. The role of the contract drafter in drawing attention to the circumstances justifying an earnest of (say) 15 per cent - and in avoiding the application of the Contractual Remedies Act – may well be crucial.

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32 Ibid, 592.

VI. Conclusion

This article has, with reference to *Otago Station Estates Ltd v Parker* and *Rick Dees Ltd v Larsen*, illustrated some of the difficulties surrounding the law of deposits, and has also sought to clarify the role of a deposit both as part payment of the purchase price and as an earnest which may be forfeited for non-performance of the contract. Though a deposit as part payment may be any sum, a deposit retained as an earnest may not normally exceed 10 per cent of the contract price, and *Garratt v Ikeda* has not clarified precisely when a deposit becomes unconscionable. These uncertainties may invite future disputes.

The difficulties and inconsistencies of this area of law also illustrate that as business is transacted at an increasingly rapid pace, the law governing property transactions must work to govern the space between theory and practice. The courts may try to narrow this space, but they will not always succeed. Within this space lie considerable risks for those involved in property transactions, and it is the task of lawyers to attempt to ameliorate these risks. As the courts work to try to eliminate uncertainty in the law in the context of particular disputes, property lawyers must also work to ensure, as much as is possible, that uncertainty and dispute between particular parties is minimised and averted.