

Dated: September 08, 2004
The following is ORDERED:





Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re:
CHARLES HUNT GALLINA
Debtor.

Case No. 03-26316-L
Chapter 11

ORDER ON TRUSTEE'S MOTION TO DETERMINE RIGHT TO EARNEST MONEY

ON AUGUST 5, 2004, there came on for hearing before this court the Trustee's Motion to Determine Right to Earnest Money ("the Motion"). The issue raised in this motion is whether the Chapter 11 Trustee as the seller has the right to retain earnest money deposited in connection with a real estate sales contract. Memorandums of law were filed by Wright Lovitt, Inc. ("Wright Lovitt") and Trustee George W. Emerson, Jr. ("Trustee"), and a copy of the contract and addendums were also submitted to the court. For the reasons set forth below, the court will order the return of the earnest money to Wright Lovitt. This is a core proceeding. 28 U.S.C. § 157 (b)(2)(N).

FACTS

The Trustee was permitted by order dated November 20, 2003, to execute a contract for sale and purchase of 29 residential lots belonging to Debtor at an agreed upon price of \$1,334,000.00. Pursuant to the contract, Wright Lovitt deposited \$21,750.00 in earnest money. Wright Lovitt later elected not to purchase the real estate and sought return of the earnest money, which the Trustee refused. The contract contains a clause in Addendum #8 which states as follows:

Purchaser is granted the right, privilege and obligation to satisfy itself solely to determine the feasibility and condition of the subdivision for a period of time expiring 60 days from final acceptance of contract by Seller and Purchaser, which includes written approval by Bankruptcy Court.

It is uncontested that the Trustee received timely and proper notification of Wright Lovitt's intent to cancel the contract under the terms of the addendum.

Despite this addendum, the Trustee contends that Wright Lovitt is not entitled to the return of the earnest money. The Trustee argues that since Wright Lovitt did not perform under the contract, the Trustee is entitled to retain the earnest money. The Trustee contends in essence that Wright Lovitt should forfeit the earnest money so that the Trustee may be adequately compensated for the time during which Wright Lovitt performed its due diligence and the Trustee was unable to convey the property to other hypothetical purchasers.

Wright Lovitt asserts that Addendum #8 gave it the absolute right in its sole discretion to determine whether the purchase would be economically and otherwise feasible, and to notify the Trustee within sixty (60) days if it desired to cancel the contract and receive a refund of its earnest money. Wright Lovitt states that it made a good faith effort to determine the feasibility of the purchase and concluded that it was not economically feasible, and seeks the return of its earnest money.

At the hearing on the matter, counsel for Wright Lovitt noted that the contract at issue was

not an option contract but a contract for the sale and purchase of real estate. This fact was not in dispute. The Trustee in this case was not compelled under the terms of the contract to refuse other offers to purchase the real estate or to stop marketing the real estate. It would have been well within the Trustee's rights to have accepted backup contracts for some or all of the residential lots. At the hearing, counsel for the Trustee stated that no backup contracts had been accepted, and that the real estate was marketed, with inquiries on only about four single lots prior to Wright Lovitt's termination of the contract.

ANALYSIS

This is a case of contract interpretation. Bankruptcy courts look to governing state law in matters of contract interpretation. *See In re Karfakis*, 126 B.R. 719, 725 (Bankr. E.D. Pa. 1993). In this case, it is undisputed that Tennessee law controls. Tennessee courts have long held, "[w]hen the language of a contract is plain and unambiguous, the court must determine the parties' intention from the four corners of contract [*sic*], interpreting and enforcing it as written." *Simonton v. Huff*, 60 S.W. 3d 820, 825 (Tenn. Ct. App. 2000)(citations omitted).

The Trustee argues that the contract contains no explicit provision for the return of earnest money under these circumstances, and thus he is entitled to retain the earnest money deposit. Wright Lovitt counters that satisfaction of the condition set out in Addendum #8 was a condition precedent to the formation of a contract. Addendum #8 appears to support Wright Lovitt's interpretation. When a contract for the purchase and sale of real estate contains an express condition, the parties' obligation to perform is dependent upon the happening of that condition; if the condition is not met, the earnest money is to be returned to the would be purchaser. *Pate v. C & S of Tennessee*, 2001 WL 575567, at *3 (Tenn. Ct. App. 2001). If the condition is met but the purchaser still refuses to complete the purchase, then the seller is entitled to keep the earnest money.

See, e.g., Moore v. Moore, 603 S.W.2d 736 (Tenn. Ct. App. 1980)(holding that earnest money must be returned when a condition in the real estate contract is not met).

In sharp contrast, an option contract is “an offer to sell, irrevocable for a specified period . . . [which] confers on the optionee the right to purchase within the stipulated time subject to the terms of the option.” *Pinney v. Tarpley*, 686 S.W. 2d 574, 580 (Tenn. Ct. App. 1984)(citations omitted). The optionee in an option contract generally gives valuable consideration for the option, and explicitly agrees to forfeit escrowed money as liquidated damages in the event that optionee fails to purchase; the optionor cannot revoke the option during the option period. *See Mott v. Graves*, 1995 WL 755926, at *3 (Tenn. Ct. App. 1995); *Jones v. Horner*, 260 S.W. 2d 198, 199 (Tenn. Ct. App. 1953).

The Trustee asserts that the language of Addendum #8 created an option rather than a condition. The Trustee claims that the earnest money was “earned” when the contract was signed, giving Wright Lovitt sixty days to determine the feasibility of developing the property.

The Trustee’s interpretation is not supported by the language of the contract. Addendum #8 falls under the heading “Contingencies” and is referred to in the main contract as one of several “conditions” to which the contract was subject. Addendum #8 gives the purchaser sole discretion to determine the feasibility of development. The contract makes no attempt to limit the ability of the Trustee to enter into back-up contracts, nor does it prevent the Trustee from continuing to market the property.

Addendum #8 is an express condition to which the entire contract is subject. When Wright Lovitt notified the Trustee that it had completed its feasibility analysis and determined in its sole discretion that the purchase was not economically feasible, Wright Lovitt was entitled to the return of the earnest money and the Trustee was entitled to treat the contract as void and without effect.

Had the Trustee desired to require the forfeiture of the earnest money upon Wright Lovitt's exercise of its rights under Addendum #8, the Trustee could have negotiated to include such a term in the contract.

CONCLUSION

For the foregoing reasons, the Trustee is directed to return the earnest money to Wright Lovitt.