

Research article

Legal nature of earnest and its influences in Iranian law

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Abstract

Although there are uncertainties in the nature of earnest and the regulation codes are totally devoid of any records on the issue, the norm fully accepts the giving and taking of the earnest and people use it in their transactions. So we need to make the issue clear and analyze its nature and influences.

We proved in the present paper that earnest could not make a pledge to contract because it's a binding contract and could not be considered as an independent and separate contract because of the issue committed. Also, since the earnest is not meant as a contract revocation option, and the parties are not allowed to violate the agreement, and any violation may lead to making good the loss, it can not contain a prejudice for the original contract; besides, the contract may not get revoked because its fulfillment depends on the due time. Ultimately, we came to the conclusion that agreement to the fulfillment of the future contract by earnest is inherently an executor contract. In terms of its influences we concluded that if the contract is realized, the earnest would be part of the contract and the margin cost may be attributed to the violator. Since the contract unfulfillment is actually a loss to the other party, the money is not considered unlawful.

It's noteworthy that while searching for the related information on the issue, a treatise was found which helped us a lot in understanding the actual problem in Iran and abroad. But, our point of view is totally different and is centered on deciding a legal framework for the institution. We considered various ideas and finally provided ours. However, in the section "Earnest Influences", we made a deeper derivation from the reference.

Key words: earnest, norm, cost, binding

Introduction

In the present paper, we intend to describe the nature and influences of earnest. Note that despite the lack of record in law, earnest plays an important role in transactions and businesses. This usage has made clear the significance of surveying the problem.[1]

The questions which come to mind are:

1. Is earnest only a primary pledge which compels no binding?
2. Is this agreement a record of the original contract or an independent contract in itself?

3. Is it unlawful money if someone does NOT pay the earnest back due to the violation on the customer side? Otherwise, what kind of payment is it?

We make the following hypotheses considering above-mentioned questions:

H1. Pledge is only a primary intention and the earnest could never be a simple intention without any binding.

H2. The agreement may be a record of the original contract if its theme is the same as the agreement; also, it may be an independent contract if we regard the earnest as the price for owner's pledge to fulfill his commitment.[2]

H3. Not paying back the earnest is synonymous with unlawful money, because we've got nothing in return of the payment.

We try to prove or reject the above hypotheses by an analytical-descriptive and library research.

Regarding the topic "legal nature of earnest and its influences", three sections are provided:

1. Different legal views towards the problem:

This section consists of two parts: The west legal view, Iran's legal view

1.1 The west legal view towards the problem

In the Western law we see that an agreement on sale or loan would be a binding contract in the future and if it is by two parties, its binding for both (which is called the primary agreement in the modern jurisprudence); in addition, if it is by one party (ex. someone agrees to keep the product for the other party to sell it), this would be binding just for him, which is called pledge to contract.[3]

So this is a proper contract with all of the contract's influences; except its effect is not objective attainment of the right to transfer property, but it's an obligation to meet the commitments promised by person, i.e. future sale or loan. Therefore, if he violates the agreement to fulfill the pledge, he would be inevitably forced to do it.[4]

In this way, all the conditions of contract and pledge validity, such as capacity to both parties satisfaction, absence of intention defects, and other conditions in the contract and agreement, would be necessary.[5]

Therefore, in the Western law, this primary agreement is, in itself, an independent contract, and it's a case of pledge to fulfill the future contract. In effect, the earnest is the money that customer pays to buy the owner's pledge, or promise, to keep the product and not to sell it.

1.3. Iran's legal view toward the problem

Since there is no written law in this case, we turn to "norm" which has influenced the issue.

If there's an agreement between the parties to fulfill a future sale or lease, as a result of the due time (on the primary agreement which is binding for the two parties), or because of the buyer's tendency (on the account of one party, binding only himself), the primary (original) agreement would be the final contract without any new contract. Besides, the earnest would be a part of the price or labour. In case the buyer violates the agreement (doesn't buy the product), this would be a payment on revocation and would not get relapsed. But, if the seller defaults, it's necessary to pay twofold of the earnest back to the buyer.[6]

2. Legal analysis of earnest:

We analyze the following five hypotheses in this section:

- 2.3. Earnest as a pledge to contract
- 2.4. Earnest as a separate and independent contract
- 2.5. Earnest as a record of the original contract with repeal option
- 2.6. Earnest as a suspended contract
- 2.7. Earnest as executory contract

2.1. Earnest as a promise to contract

As far as we know, primary agreement is only a kind of a promise to sale or a promise to loan, without any collusion or pledge. That said, there remains no doubt that this promise would not be a "contract" and is, therefore, not binding. Not only there is no reason on this being a contract, but also jurisconsults came to the consensus that the primary agreement is not binding. The promise is nothing but will or intention. And this intention, even if it is declared, does not imply a record of any binding or commitment. [7]

But this idea is no way true, because the pre-payment itself reveals the implicit intention of the parties to make their agreement binding. In norm, too, the parties are bound to the primary agreement; which if they violate, the earnest may not be paid back in case the customer is the violator, and twofold of it may be paid back, otherwise. If this is an unbinding promise, the nature of the agreement would be uncertain. [8]

2.2. Earnest as an independent and separate contract

We can take the earnest, like the West does, as a separate and independent contract, so that the customer makes a pre-payment of a property other than the price as separate money, and in turn, the owner gives him the right to sell or lease it such that he has no domination himself. [9] But this doesn't sound right either, because this is an authorized and legal ownership which could not be transferred to someone else. In addition, the reasons to the validity of these contracts would not make authorized something that its transfer right is still unclear. For example, if we are uncertain about authorization of the right to transfer a property, we cannot prove this right by generalities like "fulfilled contracts", because these legal functions wouldn't contain independent gain, thus they could not be compared to actual functions (which may be owned), and transferring their ownership to others may not be done with the requirement of having independent gain; so, this ownership could not prevent selling the function to others.

2.3. Earnest as a record of the original contract or revocation option

Another theory is that the primary agreement is actually a record of the original contract, and the earnest is part of the original price set out in the contract, except for this contract, revocation option until a due date is predicted; in other words, this is a voidable contract until the fulfillment of the contract; for which each party may have the right to revoke. And if they do not revoke the contract until the due date, it becomes binding; that is, the customer has to pay the rest of the price and the owner must transfer the ownership. [10]

But this theory is not perfect, because paying the earnest in a contract does not mean having the sanction or revocation of the contract; differently, it shows customer's decisive intention and owner's obligation to fulfill his commitment. Actually, the earnest is a monetary guarantee to fulfill the commitment. On the other hand, if revocation of the contract is a right saved for the parties, application of this right wouldn't make the dealers bound to making good the loss; however, this is not the case. As described, if customer revokes the contract, the earnest, and if the seller does the same, twice that price, may be paid to the other party.

2.4. Earnest as a suspended contract

In this perspective, the legal nature of contract is defined as suspended; that is, the parties agree to fulfill the transaction on a due date, and the completion of the contract relies on the arrival of the specific date. In this respect, we refer to the clause 184 in the civil law which accepts suspended contract as a kind of contract in itself. [11]

But, the problem with this viewpoint is that the suspended contract is not properly defined. Note that the contract would be suspended if its effect depends upon a probable event, which would make the contract either complete or null. However, the arrival of a due time may not be considered as a probable event, it is inevitable. And, the contract may not depend upon an inevitable event. [12] So, this viewpoint could not be accepted.

2.5. Earnest as an executory contract

This contract is an executory one, meaning that the parties promise to deal on a due time; in which, the transfer of ownership depends on the arrival of that time. In this theory, the earnest is part of the price or lease. Thus, if the contract fails, the prepayment would be allocated because of refusal of fulfillment of the contract.

This theory seems perfect. By definition, execution of the contract does not mean an unbinding promise, and the agreement, both before and after completion, is an irrevocable contract. Actually, the agreement is a record of the original contract as executory, without any right of revocation for the parties.[13]

3. Earnest Effects

Now that we acknowledge agreement as an executory contract, and earnest as part of the price, we can say that depending upon the principles "fulfilled contracts" and "believers in their own terms" the parties are bound to their agreement. Thus, if the contract is fulfilled on the due date, the earnest would be subtracted from the price and the customer would pay the remainder, so that the owner transfers the property. However, if the parties fail to complete the contract on the due date, as described before, the trespasser customer is not paid back the earnest and the trespasser owner has to pay twice the earnest. So, the question comes to mind "does this payment or ownership typify the unlawful property?" .[14]

The verses "do not devour the wealth among you unjustly, unless it be a trade amongst you" shows that any kind of property ownership, without anything in return, and which is not declared free by the owner, would be unlawful and unjust. In our case too, if the agreement fails and the contract is not completed, the prepayment is paid with nothing in return; therefore, the prepayment is inevitably an unlawful property (money).

This is fault reasoning since a wealth paid as earnest of the contract actually makes the parties bound to complete the contract; that is, the owner must not sell or lease to others and the customer has to prepare the rest of the money. Each of these bindings, if not fulfilled, would make the parties guilty. This binding has some financial burden; so, receiving money in return, would not imply unlawful wealth. Besides, "trade amongst you" not only means exchanging two properties, but also contains something in return for the property; otherwise, it is required that giving property in return for dropping the option or preemption (survivorship) be unlawful, while we know it's not true. Moreover, it's clear that comparing our case with gamble, gavel and burglary is incorrect.[15]

Another objection is this kind of paying and ownership of the earnest, on the account of violation of the contract, does not suggest the principle of repealing to subtract from the real price, and seizing some property in return for revocation of the contract is not authentic. In response to this objection we may suggest that repealing on the condition of price alteration is not authentic (repealing in return for decreasing or increasing the price of sale or lease). But the jurisconsults came to the consensus that seizing another property in return for repealing, as royalty or provision would be authentic. In our case, with revocation of the contract, the earnest would be taken in return for the revocation.[16]

In conclusion it must be said that if we consider this prepayment a contract or agreement, fulfillment of which is binding, the owner has the right to say that the customer has to fulfill the contract or gives the prepayment over to him. We can also justify that the refusal from sale or lease is, by itself, something of value and price. Moreover, since this has been done by customer's intention and permission, he would be responsible for the pledge and the fee. In other words, the opportunity for sale or lease is taken from the owner for some time and this, in people's view, would be a loss for him. So, the one who made this loss is responsible and the earnest is the price of this responsibility. However, here we don't encounter objective loss, but it may be losing an opportunity.[17]

Conclusion

In Iranian legal system, there's no official record for the conditions and nature of earnest. There's a lack of law in this respect. But reviewing the norm it seems that an agreement to pay the earnest in order to complete the future contract is actually an executory contract; the influence of which is that if the contract is complete, the earnest would be a part of the price (or payment or lease). However, if the parties fail to complete the contract, the violator will be responsible for the loss.

Finally, we suggest that since this issue (earnest) is an accepted and practical norm, this gap in law is accounted for by clear and specific legislation.

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