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A Comparison of the Rules and Rationales for Allocating Risks Arising in Realty Sales Using Executory Sale Contracts and Escrows

Robert L. Flores

I. INTRODUCTION

In a typical transaction for the sale and purchase of residential real estate there are two transition periods during which the parties are exposed to risks of sudden significant loss. One risk is of destruction of the premises by fire or other casualty ("realty loss"). Another risk is that money deposited in escrow will be lost through embezzlement or poor caretaking by an escrow holder ("escrow loss"). The two risk periods often overlap, and the two risks clearly are part of the same overall transaction. However, the rules for allocating such risks between the buyer and seller have been separately developed, without recognition of their relationship. Consequently, the two rules are inconsistent with one another as to both results and underlying theories, although they do have some features in common. Because the two types of risk are commonly associated, the theories, doctrines, and rules developed to address allocation of the two risks should be examined in light of one another. It is undesirable to have inconsistencies between the two areas of law unless sound policies are found to dictate otherwise.

The functional relationship of the two types of risk and the inconsistency of the two rules for allocating risks can be seen in an example composed from several actual cases. Seller and buyer enter a contract for the sale of a suburban residence. They agree to use the seller's real estate agent as an escrow holder to carry out the sale. The buyer deposits in escrow a substantial portion of the purchase price in cash, with the remainder to be supplied later through an institutional mortgage loan. The seller deposits a warranty deed. The parties instruct the escrow holder to hold both deposits until a title insurance policy is issued, and then "close" the escrow and the sale simultaneously by recording and delivering the deed to the buyer and releasing the money to the seller. The seller is to remain in possession of the residence until the closing.

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Shortly before the title insurance policy is issued, two catastrophic losses occur at roughly the same time. Fire destroys the home, and the escrow holder disappears with the money. Neither loss has been adequately insured against, neither party is clearly at fault for either loss, and the parties had not previously agreed upon an allocation of risks of such losses.

In a majority of jurisdictions the buyer will be required to bear both losses.1 The buyer must replace the lost money, and must proceed with the purchase of the realty at full price, regardless of the fire damage, or be subject to an action for specific performance or damages for breach of contract.2 Both types of loss are allocated on theories of ownership. Risk is considered an attribute of ownership. Risk must be imposed on one of two parties, and cannot be shared by both. Risk allocation is accomplished by determining which of two parties was the owner at the time of the loss.

The body of law controlling the realty loss dictates that under these circumstances the buyer was the true owner of the realty and the seller was the true owner of the money.3 The body of law controlling the escrow loss dictates that the buyer was the true owner of the money in escrow and the seller was the true owner of the deed in escrow and the realty.4

The rule controlling the realty loss is based on the doctrine of equitable conversion by contract, and will be referred to in this Article as the "conversion rule."5 The doctrine holds that when a contract for the sale of realty is formed the buyer becomes in equity "the owner of the estate from the time of the contract of sale."6 From that flows the rule that, as equitable owner, the buyer "must sustain the loss if the estate be destroyed between the agreement and the conveyance."7 The underlying doctrine also dictates that the seller is to be treated as equitable owner of the purchase price, although it is still in the hands of the buyer or an escrow holder. The seller is said to retain the bare

1. See infra text accompanying notes 225-86.
2. See infra text accompanying notes 225-86.
3. See infra text accompanying notes 225-62.
4. See infra text accompanying notes 263-86.
5. The doctrine is described infra text accompanying 225-62. The term "conversion rule" is not one used in the cases and literature but is adopted here for convenience.
legal title of the realty and to hold it "in trust" for the buyer, while the buyer "becomes the trustee of the purchase money" for the seller.  

Courts following the conversion rule will impose realty loss on the buyer even if no deed has been executed, no money has changed hands, and the buyer has no right to possess or otherwise use the realty at the time of the loss. The doctrine of equitable conversion by contract and the conversion rule for loss allocation have long been followed by a majority of jurisdictions.

On the other hand, what will be referred to here as the "entitlement rule" is used to allocate losses of money deposited in escrow. The rule has been adopted in all jurisdictions that have considered the issue, including jurisdictions following the conversion rule as to realty loss. The rule is based on one or both of two theories: ownership and agency. It is usually said that the loss of the money in escrow falls on the buyer because as

8. Brewer, 30 Md. at 308.
9. Id. at 310. Minority rules would impose the loss on whichever party had possession of the premises at the time of loss. See Uniform Vendor and Purchaser Risk Act § 1, 14 U.L.A. 471 (1990).
10. See infra text accompanying notes 225-62.
11. "[A] loss occasioned by the . . . wrong of an escrow holder, must . . . be borne by the one who, at the time of its occurrence, was lawfully entitled to the right or property affected." H.D. Warren, Annotation, Who Must Bear the Risk of Loss Resulting From Defaults or Peculations of Escrow Holder, 15 A.L.R. 2d 870, 871 (1951). See also 28 Am. Jur. 2d Escrow § 20 (1966).
12. It is clear that both the conversion rule and the entitlement rule are followed in at least four states. See supra notes 6-7 and infra note 13 for cases cited from Florida, Maryland, New Jersey and Pennsylvania. Arkansas and Utah may also apply both rules. There is some indication Arkansas follows the conversion rule. See Smith v. MRCC Partnership, 792 S.W.2d 301, 304 (Ark. 1990) (generally approving equitable conversion doctrine but not addressing conversion rule); Moose v. Moore, 608 S.W.2d 3, 6 (Ark. 1980) (using equitable conversion theory for purposes other than loss allocation); William B. Putman, Comment, Equitable Conversion by Contract, 7 Ark. L. Rev. 45, 51-52 (1952) (concluding that dictum of several cases indicates likelihood of following conversion rule). Arkansas clearly follows the entitlement rule. See Foster v. Elswick, 4 S.W.2d 946 (Ark. 1928).

Utah clearly follows the conversion rule. See Utah State Medical Ass’n v. Utah State Employees Credit Union, 655 P.2d 643 (Utah 1982). There is some indication that it would follow the entitlement rule. See Clark v. Campbell, 65 P. 496 (Utah 1901) (depositor of shares in escrow retains some ownership rights).

Most jurisdictions following the conversion rule have not reported cases addressing escrow loss. The likelihood of their adopting the entitlement rule is enhanced by the fact that all jurisdictions that have considered escrow loss problems have adopted the entitlement rule, and no reported case has considered any alternative rule.
depositor of the money, the buyer "retains legal title thereto" until the closing. The doctrine of equitable conversion is ignored for purposes of determining which party is the true owner who must bear the loss of money in escrow. The entitlement rule is also supported by a theory of agency: that the escrow holder was acting as agent for the depositor-buyer in holding the money, and the buyer must bear the loss occasioned by the wrongdoing of the agent.

The buyer bears the risk of loss of money in escrow even if the escrow holder was the seller's real estate agent or attorney, and despite recognition of a fundamental feature of escrow practice by which the buyer "loses control of the . . . money" while it is in escrow.

There are numerous cases dealing separately with realty loss, and several cases addressing escrow loss. There have apparently been no reported cases in which courts have had to allocate both types of loss and thereby simultaneously consider both bodies of law. Perhaps it is this coincidental lack of such a case that has allowed courts to ignore the

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16. Paul, 102 A.2d at 159. Thus the seller, who has remained in possession of the realty, does not bear the risk of loss affecting that realty, while the buyer, who has given up control of the money, bears the risk of loss of that money.


18. Many of the cases are collected in J.Q.L., Annotation, Effect of Unauthorized Delivery or Fraudulent Procurement of Escrow on Title or Interest in Property, 54 A.L.R. 1246 (1928) (updating 48 A.L.R. 405); Warren, supra note 11.

19. The case coming closest to presenting such a combination of problems was Frankiewicz v. Konwinski, 224 N.W. 368 (Mich. 1929), described infra note 64. It did involve realty loss. Rather than loss of money in escrow, it involved loss of title documents.

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functional relationship of the two types of risk and the disturbing doctrinal inconsistency in the law controlling allocation of such risks.

The greatest opportunities for joint consideration of these two related areas have come in the strong movement for reform of the conversion rule. The rule has long been under severe criticism from commentators, 20 and a sizeable minority of jurisdictions have either judicially or legislatively adopted alternative rules. 21 However, even within that well developed reform

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21. The judicially developed "Massachusetts doctrine" and the related Uniform Vendor and Purchaser Risk Act represent the most significant alternatives. Both of these alternatives adopt the transfer of legal title to the realty as one determining factor for transferring risk of loss from the seller to the buyer. See Libman v. Levenson, 128 N.E. 13 (Mass. 1920); UNIFORM VENDOR AND PURCHASER RISK ACT § 1, 14 U.L.A.
movement there have not been adequate efforts to consider the related body of law dealing with escrow loss.

There has been little literature addressing allocation of losses affecting money in escrow, and for the most part that literature has not referred to the relationship of the two problems of loss allocation.\textsuperscript{22} The literature, however, has labeled each area as deeply troubled. Allocation of realty loss has been described as "[p]erhaps the most debated question in the law of vendor and purchaser\textsuperscript{23} and it has been said that the relationship of the parties to an escrow arrangement is "one of the most anomalous in our system of jurisprudence."\textsuperscript{24}

Comparative analysis of the two bodies of loss allocation law is much needed. There are benefits to be gained from jointly examining the policies, doctrines, and rules of risk allocation related to these overlapping transaction mechanisms. Granted, these are separate problems, which may very well require separate solutions. It would be unwise to attempt to coordinate the

\textsuperscript{22} Missouri Law Review, Vol. 59, Iss. 2 [1994], Art. 2

471 (1935). By doing so, they may even further intertwine the functional relationship of sale contracts and escrow arrangements because the use of an escrow arrangement can affect the point at which transfer of legal title to realty is thought to occur. Many jurisdictions hold that when a deed is to be delivered through escrow, the legal title to the realty is effectively transferred when the escrow conditions are fulfilled, not when the deed is actually delivered to the buyer. There is also some authority for a relation-back doctrine, under which the transfer of legal title is deemed to relate back to the point at which the deed was deposited in escrow. See Cunningham et al., supra note 20, \S\ 11.4.


24. Friedman, supra note 20, \S\ 1.2(d).
two bodies of law merely for the sake of consistency without regard for specific consequences and underlying policies which might well drive the separate bodies of law in different directions. Nevertheless, thoughtful examination of both areas may not only bring to light doctrinal inconsistencies and confusion that will provide impetus for reform; such examination may also bring to light ways in which the work of courts and scholars in one area would be useful in addressing problems in the other area.25

This Article begins the long overdue process of comparing the two areas of law. Section I elaborates upon the two types of risk, the contexts in which the risks arise, and the extent to which the risks overlap. It will be seen that both types of risk typically arise during roughly the same periods of time and as part of the same overall transactions. Section II more fully describes the two rules for loss allocation and makes an initial comparison of the two, revealing their shared and dissimilar features. In both areas loss will be allocated on the basis of fault or agreement if either is applicable, and if not, on the basis of status, which is to say status of ownership or status of agency.

The conflicting conversion and entitlement rules will then be further examined first by a study of the separate histories that led to the current inconsistency between the two rules, and then by a study of their common defects of theory and practical application.

II. CONTEXT: OVERLAPPING RISKS IN EXECUTORY REALTY SALES CONDUCTED THROUGH ESCROWS

A buyer and seller bring to a realty sale transaction two things of great value, the realty and the purchase price. The rules of risk allocation of concern here deal only with a limited set of risks affecting those things of

25. The benefits that might be had through such comparative analysis are suggested by Professor Williston's seminal article on allocation of realty risk. His thorough examination of and call for reform of the conversion rule was buttressed by comparing that body of law with two others: loss in sales of goods, and destruction of leased premises. See Williston, supra note 20. Both of those comparisons might profitably be revisited in light of substantial developments that have occurred in the fields of sales of goods and landlord-tenant law during this century. The comparisons may be particularly insightful because of a characteristic shared by loss allocation problems arising in sales of realty, use of escrows, sales of goods, and leaseholds. All bring into play the rules, doctrines, and policies associated with the law of property and agency (allocation according to status), contract law (allocation according to consent), and tort law (allocation according to fault). To strike a metaphor, these problems share the characteristic of arising within what Professor Prosser has called the "borderlands and penumbras" of law. They "cut across" or "straddle" what we tend to view as "distinctly segregated compartments in the law." WILLIAM L. PROSSER, SELECTED TOPICS ON THE LAW OF TORTS 380 (1954).
value. They are risks that are sudden and unforeseen, that are not fully borne by someone other than the buyer or seller, and that arise within one or both of the overlapping transition periods associated with the use of sale contracts and escrows.

The body of cases through which these rules have been formulated have not concerned risks that were foreseeable or gradual, such as fluctuations in the relevant market for realty, or fluctuations in the value of currency. From the limited scope of circumstances dealt with in the cases, it appears that gradual and foreseeable losses are thought to go with the territory, so to speak. One who contracts to buy realty implicitly assumes the risk that its value will decrease because of changes in the local realty market. One who contracts to sell realty assumes the risk that the specified purchase price will become less valuable because of general currency inflation. Of course, these gradual foreseeable losses have counterparts on the positive side, as the general economic conditions may become more favorable as well as less favorable.

The sudden unforeseeable risks affecting realty that have been sources of litigation have most often been of injury to buildings, most frequently caused by fire, and less frequently by storm, and other forces of nature, and occasionally by vandalism. In a few instances the risks have involved injury to the land itself, as by erosion or earth movement, or injury to crops or landscaping, as by severe weather.

26. One of the more spectacular instances arose from the great fire of 1906 in San Francisco. See Conlin v. Osborn, 120 P. 755 (Cal. 1911). California's realty loss allocation laws may well be called into operation again shortly, in the aftermath of the terrible brush fires that swept through the Malibu area in the autumn of 1993, and the earthquakes so frequently occurring in much of the state.

27. A notable recent example is the massive destruction wrought in 1992 by Hurricane Andrew damaging some 63,000 homes in south Florida alone. See generally Gaffney, supra note 20. The massive losses caused by flooding along the Mississippi River in the summer of 1993 may also be expected to create loss allocation problems, as some of the damaged parcels must have been subject to sale contracts at the time of the flooding.

28. A survey of the types of loss by physical damage is found in John E. Macy, Annotation, Vendor and Purchaser: Risk of Loss By Casualty Pending Contract for Conveyance, 27 A.L.R. 2d 444 (1963). The annotation describes cases involving loss by erosion, fire, flood, freezing, lightning, vandalism, and windstorm. The annotation also lists the example of a structure collapsing due to defective construction, although one might wonder whether that would more appropriately be treated as a question of warranty. See also Friedman, supra note 20, § 4.11 nn.1-4.


30. See, e.g., Palos Verdes Properties v. County Sanitation Dist. No. 5, 2 Cal. Rptr. 537 (1960) (damage to a sewer by landslide).

31. See, e.g., Felt v. Morse, 85 So. 656 (Fla. 1920) (freezing of grove of citrus
Disputes have also arisen over losses resulting from governmental taking of realty by condemnation, or imposition of more restrictive zoning regulations. For the most part, the risks of loss by governmental taking have been treated by the same rules governing loss by fire or storm.

The sudden unforeseeable risks affecting the purchase price that have been the bases for litigation have involved outright loss or embezzlement of money. Other scenarios involving sudden losses affecting funds come to mind, although they do not appear to have come to the attention of appellate courts.

trees).

32. See Woerner, supra note 17.

The number of such cases litigated suggests that there is not much validity to the theory that the government gives fair value for land taken through condemnation, at least not as seen through the eyes of these litigants. See, e.g., Gammon v. Blaisdell, 45 Kan. 221 (1891) (condemnation award amounted to about one-third of contract purchase price).


34. It is arguable that the similarity of treatment is inappropriate. Governmental action actually presents the possibility of either loss or gain, as the price paid upon condemnation might either exceed or fall below the price under the sale contract, and zoning changes might either raise or lower the market value. Fire and storm are almost certain to cause loss and virtually incapable of causing gain, except perhaps in rare instances in which fire reduces the cost of demolishing unwanted buildings. The balance of risks of loss and chances of gain has been an important part of the debate over appropriate rules for allocating risks of loss affecting realty. See, e.g., Williston, supra note 20, at 121.

35. See, e.g., Foster v. Elswick, 4 S.W.2d 946 (Ark. 1928) (failure of bank in which purchase price was placed while in escrow). A slight variation from this problem was dealt with in Jones v. Lally, 511 So. 2d 1014 (Fla. Dist. Ct. App. 1987), where the escrow holder had placed the funds with a title company, which in turn embezzled the funds.


37. One can surmise that in the many realty sales in which escrows have been used there must have been at least a few instances in which an escrow simply misplaced funds, stored cash in an office later burglarized or destroyed by fire, or
For practical reasons, many potential loss allocation disputes between buyers and sellers have been avoided by the effective imposition of losses on some third party. Disputes between the buyer and seller have thus been avoided in circumstances in which the loss has been fully borne by a vandal who damaged the realty, or an escrow holder who mishandled the deposited money. Even in those instances, however, it has sometimes been necessary to determine which of the buyer or seller has the right of action against the third party and the corresponding burden of enforcing such a right.

In many instances the imposition of losses on the buyer or seller has been avoided in part or in full by some form of insurance. It is not unusual for one or both parties to secure insurance coverage for realty which is the subject of a sale agreement, and there has been a great deal of litigation involving rights in insurance proceeds. Such insurance effectively precludes disputes among the buyer and seller only when there is insurance in effect, the insurance proceeds equal the loss suffered, and proceeds are directed to the party who otherwise bears the risk of the loss.

The likelihood of there being adequate insurance in effect is reduced by the established rule that, absent specific agreement, neither party is obligated deposited funds in a risk account which then lost value. Cf. 99 Commercial St., Inc. v. Goldberg, 811 F. Supp. 900 (S.D.N.Y. 1993) (suit against broker over bad advice on investment of funds held in escrow). Other easily imaginable scenarios would involve some form of tangible property (such as jewelry, stamps, or art work) serving as part of the purchase price, entrusted to an escrow, and lost or destroyed by fire. That disputes in such circumstances have not appeared in the published reports hardly suggests that they have never arisen.

38. There are many cases involving actions by the parties against an escrow holder. See Wade v. Lake County Title Co., 86 Cal. Rptr. 182 (Cal. Ct. App. 1970) (failure to deposit a check on time, before payor’s insolvency); Mefford v. Security Title Ins. Co., 18 Cal. Rptr. 877 (Cal. Ct. App. 1962); Wagman v. Lee, 457 A.2d 401 (D.C. 1983) (holder’s mishandling of money sufficiently egregious to allow recovery of punitive damages); Katleman v. U.S. Communities, Inc., 249 N.W.2d 898 (Neb. 1977). Cf. Kirby v. Palos Verdes Escrow Co., 227 Cal. Rptr. 785 (Cal. Ct. App. 1986) (escrow liable to assignee of mortgagee for paying mortgagee rather than assignee as directed in escrow instructions). An escrow holder has a number of duties to the vendor and purchaser, the breach of any of which might expose the escrow to liability. See generally CUNNINGHAM ET AL., supra note 20, § 11.4; FRIEDMAN, supra note 20, § 1.2(d); Jacobsen, supra note 22.

39. See Arko Enter. v. Wood, 185 So. 2d 734 (Fla. Dist. Ct. App. 1966) (buyer entitled to recover damages for any trespass to the land). See generally RESTATEMENT (SECOND) OF AGENCY § 14(D) (1957) (entitlement rule also allocates right of action against wrongdoing escrow holder); Hume, supra note 20, at 250.

40. Early cases are collected in F.M. English, Annotation, Rights of Vendor and Purchaser, as Between Themselves, in Insurance Proceeds, 64 A.L.R. 2d 1402 (1959).
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to procure or maintain insurance coverage.\textsuperscript{41} It was long held that a party who voluntarily procured coverage was not obligated to share the proceeds even when the other party bore the realty loss.\textsuperscript{42} There is now a strong trend to use a constructive trust fiction to compel the recipient to apply the proceeds for the benefit of the party on whom the burden of realty loss is imposed. Ordinarily, it is the seller who has kept in force existing coverage, and the constructive trust doctrine is applied to shift the proceeds to the buyer who bears the burden of loss under the conversion rule.\textsuperscript{43}

Thus the law on risk allocation has come to be used to determine which party is entitled to proceeds from an insurance policy.\textsuperscript{44} That law can also

\textsuperscript{41} The rule is usually traced to the English case of Rayner v. Preston, 18 Ch. D. 1 (Ch. 1881). See Brewer v. Herbert, 30 Md. 301 (Md. 1869). There is at least one case suggesting a contrary rule. See Good v. Jarrard, 76 S.E. 698, 701 (S.C. 1912) (seller in possession had duty to exercise "common prudence" in caring for the property before delivering possession, including duty to insure against fire loss).

\textsuperscript{42} This rule is also usually traced to the English case of Rayner v. Preston, 18 Ch. D. 1 (Ch. 1881). See, e.g., Appleton Elec. Co. v. Rogers, 228 N.W. 505 (Wis. 1930). See generally ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 4.3(b) (1988). American cases are collected in English, supra note 40.

\textsuperscript{43} See Brady v. Welsh, 204 N.W. 235 (Iowa 1925); Standard Oil Co. v. Dye, 20 S.W.2d 946 (Mo. Ct. App. 1929); Dubin Paper Co. v. Insurance Co. of N. Am., 63 A.2d 85 (Pa. 1949) (illuminating explanation of the concept). See also Simpson, Legislative Changes II, supra note 20, at 765. The doctrine has also been applied to give a seller a beneficial interest in proceeds received by a buyer. See, e.g., Kindred v. Boalbey, 391 N.E.2d 236 (Ill. App. Ct. 1979). An interesting observation has been made that application of the trust doctrine has interfered with the movement to reform the conversion rule. See Fineberg, supra note 20, at 477-78; John C. McCoid, Allocation of Loss and Property Insurance, 39 Ind. L.J. 647, 664-74 (1964). The interaction of insurance law and practices with the development of realty loss allocation law would itself be a worthy topic of study. Examining that interaction would be especially worthwhile in light of the powerful role insurance law and practice have had in the radical reformation of risk allocation law in the sale of goods. The risk allocation provisions of the Uniform Commercial Code no longer rely on the theory of ownership, as once was true of the law as to both realty sales and sales of goods. The Code's abandonment of title as a basis for loss allocation was largely premised on the drafters' assumptions about insurance law and practices. See U.C.C. § 2-509 cmt. 3 (Supp. 1993); ROBERT A. HILLMAN ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE ¶ 503[2][b] (1985); JOHN O. HONNOLD ET AL., LAW OF SALES AND SECURED FINANCING 383-84 (6th ed. 1993); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 5-4 (3d ed. 1988).

\textsuperscript{44} The trust doctrine has been taken so far as to give a purchaser at a sheriff's sale the proceeds of insurance procured by the prior owner, for a fire loss that occurred after the sheriff's sale. See, e.g., Insurance Co. of N. Am. v. Alberstadt, 119 A.2d 83
be important when both buyer and seller have obtained insurance coverage, to
determine the relative liabilities of the insurers.45

For escrow loss, several states have adopted regulations creating bonding
requirements or state-managed security funds protecting the parties from loss
cau sed by licensed escrow holders.46

Finally, the allocation rules are not concerned with losses that arise before
a sale is initiated or after it is completed, whether the loss be the burning of
a building or the loss of money. The rules of concern here address only risks
that arise within one of the two periods of transition: the executory period for
performance of a contract for sale, and the period during which an escrow is
open.

A. Realty Risk in an Executory Contract Period

The executory contract period begins at the moment the parties enter into
an enforceable contract for the sale of the realty. It ends when the legal title
and possession have been transferred to the buyer, and all rights in the
purchase price have been transferred to the seller. Allocating realty risk
during this period is troublesome because the attributes of ownership are
necessarily in transition and split. Before the period begins, the seller is
clearly the owner in every respect. After it ends, the buyer will clearly be the
owner. Although the parties often agree that the buyer may take possession
sometime in the midst of the period, the seller retains legal title and has the
right of possession during the period. The buyer has a right to compel the
seller to complete the sale.

1275 (Pa. Super. Ct. 1990) (proration of liability of insurers is in part dependent on
impact of the conversion rule).

46. The most detailed regulatory schemes are found in Arizona and California.
1993). Other states with specific regulation of escrow holders include Hawaii,
-33 (Michie 1978); Or. Rev. Stat. §§ 696.505-.590 (1993); Utah Code Ann. §§ 7-
& Supp. 1994). Of these, only the Washington statutes appear to have been
interpreted in a reported decision. See Estate of Jordan v. Hartford Accident & Indem.
bond only for benefit of licensee, not injured depositors).
Under the doctrine of equitable conversion, this contractual right of the buyer is said to make the buyer the equitable owner of the realty and make the seller the equitable owner of the purchase price.\textsuperscript{47} Thus, the ownership of the realty is conceptualized as being split into legal and equitable components. If the sale is completed, the legal ownership will pass to the buyer to be reunited with the equitable component. If the sale fails, the equitable component will revert to the seller to be reunited with the legal component.

The length of this transition period is a matter of agreement between the parties and may vary from a few days to many years. There are actually two functionally distinct types of realty sale contracts: short-term and long-term. They differ not only as to the length of the executory period, but also in that with short-term contracts the seller ordinarily remains in possession and with long-term contracts the buyer ordinarily is given possession during the executory period. The two are used for different purposes. Long-term contracts, often called installment land contracts, are essentially used as substitutes for long-term mortgage financing.\textsuperscript{48} Short-term contracts, which some commentators label marketing contracts, are used to give the parties a staging period to arrange long-term financing, conduct a title search and obtain title insurance, and perhaps conduct a detailed inspection of the realty.\textsuperscript{49}

\textsuperscript{47} Although the doctrine leads to the conclusion that the seller becomes equitable owner of the purchase price and the buyer is merely the legal owner, there seem to be no reported cases in which that logic has been asserted as a basis for arguing that a loss of money should be imposed on the seller. The only reported cases addressing loss of money have been those in which the money was placed in escrow. In those cases, allocation of money loss has always been approached through application of the entitlement rule, with no consideration ever given to the doctrine of equitable conversion.


\textsuperscript{49} As to short-term contracts and the different functions of the two types of contracts, see \textsc{Cunningham et al.}, \textit{supra} note 20, at 650.
Although they have distinct functions, the two types of contracts have important features in common, the most important being that both present the problem of there being an executory period during which interests in the realty are split and in transition. This transitional splitting of attributes of ownership creates difficulties not only for allocating the risk of realty loss, but also a variety of other matters, especially matters affecting the rights of third parties such as successors and creditors of the buyer and seller.

B. Escrow Risk in an Open Escrow Period

An escrow is said to be opened when one or both of the parties has made a deposit of money or documents with a third party who the buyer and seller have agreed to have serve as their escrow holder. The open escrow period is closed when the holder has delivered out of escrow all monies and documents previously deposited. The length of the open escrow period, and the basis for determining when it is closed, depend on the type of escrow arrangement. Just as there are distinct types of sale contracts, there are two somewhat different types of escrow arrangements frequently associated with realty sales.

50. One of the major defects of the conversion rule is that in many instances it fails to account for the functional distinction of the two types of sale contracts. A buyer who has never been given possession of the realty, and who entered a short-term sale agreement only a few days before a fire loss is treated the same as a buyer who has been in possession for 20 years under a long-term contract. The most significant alternative minority rules make the distinction by imposing risk on the party in possession of the realty. See Uniform Vendor and Purchaser Risk Act § 1, 14 U.L.A. 471 (1990).

51. Characterizing the "ownership" interests of the parties can be important in determining the rights of third parties in a variety of ways. Upon the death of either party, the disposition of that party’s interests by will or intestacy may depend upon whether the interest is characterized as real or personal property. While the parties are alive the characterization of their interests as real or personal may affect the rights of creditors seeking to impose liens on real property. The doctrine of equitable conversion has played a major role in addressing such issues. See Simpson, Legislative Changes I, supra note 20.

52. Escrow holders are also commonly referred to as escrow agents, escrowees, depositaries, or simply as escrows.

53. Of course escrow agreements are often used for transactions not involving the sale of realty, and an escrow arrangement might be structured in a variety of ways. This Article addresses only the two types of escrow ordinarily used by a buyer and seller of realty.
The first type, which has been referred to as a "deed and money" escrow, is structured as described in the hypothetical example stated in the introduction. Such arrangements are most popular in western states. Soon after entering into a contract for the sale of the realty, or perhaps simultaneously, the buyer and seller agree upon a person to serve as escrow holder. The parties agree that the buyer will deposit with the escrow holder some portion of the purchase price, and the seller will deposit an executed deed and related documents. Jointly or separately the parties set forth instructions for the escrow holder. Ordinarily the buyer instructs the holder to release the purchase price to the seller when a valid deed has been recorded and a title insurance policy has been issued, after a title search has shown that the seller has marketable title. The seller instructs the holder to record and deliver the deed to the buyer when the purchase price has been deposited. The closing of such a deed and money escrow typically coincides with the closing of the agreement for sale, as the escrow holder’s redelivery of the deed to the buyer and the purchase price to the seller completes the obligations of each party under the sale agreement.

Such arrangements typically include provisions for the unwinding of the transaction if either party should prove unable or unwilling to follow through. For example, the holder is instructed to return the purchase price to the buyer if the seller’s title is found to be unmarketable.

54. Young, supra note 22, at 29.
55. See supra Introduction.
56. See Young, supra note 22, at 29.
57. They typically select the seller’s real estate agent, an attorney of one of the parties, a bank, a title insurance company, or an independent escrow company.
58. See generally CUNNINGHAM ET AL., supra note 20, § 11.4. Beyond these essentials, the holder might also be instructed to perform various services to complete the sale, such as payment of taxes, payment of creditors for the release of liens, and arranging of title insurance and title searches. See Oscar H. Beasley, Pitfalls in Closing, in Title Insurance in 1984, at 305, in PLI REAL ESTATE LAW & PRACTICE COURSE HANDBOOK SERIES No. 1251 (1984) (Reprinted from the PLI Course Handbook TITLE INSURANCE IN CURRENT TRANSACTIONS (1983)).
59. See Walker & Eshee, supra note 22 at 55.
60. See id. at 57.
61. One variation of such arrangements is the earnest money agreement under which the buyer simultaneously makes an offer to purchase and deposits with the seller’s real estate agent a small percentage of the purchase price. Such agreements typically provide that upon the buyer’s failure to proceed in good faith the money will not be returned to the buyer, but will be retained for the seller as liquidated damages. The deposit will be returned to the buyer only if the sale fails without fault of the buyer.
The second major type of escrow arrangement frequently used in conjunction with realty sales might best be termed a "set-aside" escrow, or a "cure" or "repair" escrow. Such arrangements are typically used to salvage the closing of a sale which otherwise would be canceled due to the discovery of a minor physical defect of the realty, or the failure of the buyer to have cleared all liens or other encumbrances on the title to the realty. The sale goes forward and the deed is delivered to the buyer and the bulk of the purchase price delivered to the seller. A portion of the price is placed in escrow, to be released to the seller after the seller, for example, repairs the leaking roof or clears the title by paying the overdue tax assessment or mortgage lien.62

For matters of risk and risk allocation the similarities of the two types probably outweigh the differences.63 They have the same basic function of facilitating the exchange of money for realty. They have two important features in common. First, depositing things of value with an escrow holder creates a risk of loss. There is a relatively minor risk that deeds or other documents deposited by a seller will be misappropriated by the escrow holder,64 and perhaps used in an attempt to wrongfully convey title to the realty to a third party.65 The greater danger is that the holder will lose,


63. The entitlement rule typically distinguishes between the two types of escrows, by imposing escrow risk on the buyer for deed and money escrows and on the seller for set-aside escrows. Given the functional similarities of the two types, making such a distinction for loss allocation purposes is probably inappropriate. See infra text accompanying notes 306-08.

64. See Frankiewicz v. Konwinski, 224 N.W. 368 (Mich. 1929), wherein the escrow holder disappeared while holding the only existing copies of the unrecorded documents by which the seller claimed title to the realty, and the seller's inability to show title prevented the seller from seeking enforcement of the sale contract.

65. See, e.g., Clevenger v. Moore, 259 P. 219 (Okla. 1927). The holder might wrongfully deliver the deed to the buyer who would then claim title by that deed, which presents no serious risk because the courts simply treat such a deed as invalid. There is a somewhat greater risk if the buyer quickly reconveys to a third person, who pays value in reliance on the appearance that the buyer has a valid deed. In theory the third person could record the second deed and gain the protection of the recording statutes. In a few cases courts have held for the third party, as against the original seller. Most courts, however, have treated the second conveyance as ineffective, leaving title with the original seller, and leaving the third party to seek damages from the original buyer. The escrow holder might also deliver the deed directly to a third party. Again, the courts in such cases have protected the seller by refusing to recognize the deed as valid. See 28 AM. JUR. 2D Escrow § 24 (1966); CUNNINGHAM ET AL., supra note 20, § 11.4; Blan, supra note 22, at 169.
mismanage, or simply embezzle the money on deposit,\textsuperscript{66} and it is that risk of loss of money that will be referred to here as escrow risk.

The second feature is that rights in the thing deposited are in transition and split. At the outset the seller clearly owns the deed or other such documents to be deposited. The buyer clearly owns the purchase money to be deposited. After the escrow is closed the ownership of things deposited will clearly be reversed. That clarity is absent during the escrow period. Both parties have enforceable rights with respect to the things in escrow, and neither party acting unilaterally has complete control over those things.\textsuperscript{57} Most importantly, by depositing money in escrow the buyer relinquishes some control over the money. The seller gains a measure of control and something in the nature of an ownership interest in the money on deposit.

Some authorities have characterized this splitting of interests in the same conceptual framework as is used for realty interests during the executory period: the buyer retains legal title to the money, while the seller takes equitable title.\textsuperscript{68} The legal and equitable components will only be reunited once the escrow period has ended.

\textit{C. The Functional and Temporal Relationships of Contract and Escrow, Realty Risk and Escrow Risk}

Realty sales can of course be conducted through a simple exchange of deed and money, with neither a prior contract nor an escrow. For modern sales it is, however, quite common for the parties to use both a realty sale contract and an escrow arrangement.\textsuperscript{69} Deed and money escrows have become so heavily used that in some jurisdictions, particularly western states,


\textsuperscript{67} See Walker & Eshee, supra note 22, at 50.


it is said that "use of escrows is virtually indispensable in modern real estate transactions."\(^{70}\)

In some states the combined use of long-term sale contracts and escrow arrangements is so common that a joint name has been coined: the "escrow contract."\(^{71}\) Even in those eastern states in which deed and money escrows are not popular, it is said that set-aside escrow agreements "unquestionably . . . play a significant role in accommodating the transfer of real estate."\(^{72}\) The ordinariness of combining sale contracts and escrows is reflected in statutes and regulations of some states,\(^{73}\) and in the terms of standard form contracts approved by state agencies in other jurisdictions.\(^{74}\)

When parties combine these mechanisms they bring together two sets of risks. The risk periods either overlap, as is the case with deed and money escrows, or follow very closely upon one another and still within the same overall transaction, as occurs with set-aside escrows. Whether or not either type of risk evolves into an actual loss, the risks coexist, and the relationship between the two parties is simultaneously defined by two bodies of risk allocation law.

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70. Jacobsen, supra note 22, at 326.

71. The name is noted in II BAXTER DUNAWAY, THE LAW OF DISTRESSED REAL ESTATE ch. 10 app. (1986), describing a practice popular in New Mexico, in which an installment land contract is used in conjunction with an escrow. In addition to the vendor executing and escrowing a deed, the purchaser also executes a quitclaim deed at the time of contracting, and places it with the escrow, so that upon completion of performance both deeds are released to the buyer. If the buyer defaults, both deeds are released to the seller, thus in theory saving the seller the rigors of formal forfeiture and foreclosure proceedings. The same combination (with two deeds in escrow) is apparently popular in Wyoming, as one such arrangement resulted in the dispute described in Matthew C. Bormuth, Note, The Wyoming Installment Land Contract: A Mortgage in Sheep's Clothing? or What You See Isn't What You Get, 28 LAND & WATER L. REV. 309-10 (1993) (casenote on Metropolitan Mortgage & Sec. Co. v. Belgarde, 816 P.2d 868 (Wyo. 1991)).

72. Young, supra note 22, at 57.

73. See, e.g., the Arizona regulations regarding the use of "account servicing agents" in realty sales conducted through installment land contracts. ARIZ. REV. STAT. ANN. §§ 33-741 to 749 (1990).

74. See, for example, the form provisions relating to the use of an escrow for sales conducted using the Utah Real Estate Purchase Contract (approved by the Utah State Real Estate Commission and the Office of the Utah Attorney General 1993), or the Utah Uniform Real Estate Contract (approved by the Utah State Real Estate Commission and the Office of the Utah Attorney General, January 1, 1987).
III. COMPARISON OF RULES AND RATIONALES FOR ALLOCATION OF EXECUTORY REALTY RISK AND ESCROW MONEY RISK

Realty loss allocation law is historically much older than escrow loss allocation law,\textsuperscript{75} is reflected in many more reported cases,\textsuperscript{76} has been much more thoroughly examined by commentators,\textsuperscript{77} and has been subjected to much greater efforts for reform.\textsuperscript{78} It will thus be useful to use realty loss allocation law as a baseline against which escrow loss allocation law will be examined.

Currently, the majority approach on realty loss allocation uses these factors for allocating loss: fault, express agreement, and equitable ownership.\textsuperscript{79} If one party is clearly at fault, realty loss will be imposed on that party. The parties are free to agree in advance that one will bear the risk of realty loss. If neither fault nor express agreement is found, the majority rule imposes loss on the buyer because risk is thought to necessarily accompany ownership, and the buyer is considered to become the true owner through equitable conversion.\textsuperscript{80} In a minority of jurisdictions, the equitable conversion approach is replaced by rules based on a theory that parties implicitly agree to have risk follow a combination of possession and legal title.\textsuperscript{81} Some jurisdictions have judicially adopted alternatives to the conversion rule, following a line of authority usually referred to as the "Massachusetts rule."\textsuperscript{82} Others have done so through legislative adoption of the Uniform Vendor and Purchaser Risk Act.

Accordingly, this initial foray into comparative analysis of the two areas of law will be directed to these three issues: how each body of law takes fault into account, how each takes express agreement into account; and what approaches are taken when neither fault nor express agreement is found.

A. Risk Allocation Based On Fault

For realty loss, it has often been said that loss will be allocated on the basis of fault, by imposing loss on the party who has caused the loss.\textsuperscript{83} The

\textsuperscript{75} See infra text accompanying notes 225-262.
\textsuperscript{76} See sources listed in note 17, supra.
\textsuperscript{77} See sources cited in notes 20, 22, supra.
\textsuperscript{78} See supra note 21.
\textsuperscript{79} See infra text accompanying notes 83-262.
\textsuperscript{80} See infra text accompanying notes 225-62.
\textsuperscript{81} See infra text accompanying notes 200-02.
\textsuperscript{82} See infra text accompanying notes 200-02.
\textsuperscript{83} The rule has been stated often, although most such statements are dicta. See Mackey v. Bowles, 25 S.E. 834, 836 (Ga. 1896); Marks v. Tichenor, 4 S.W. 225 (Ky. 1893).
cases demonstrate that a similar rule is equally well established for escrow loss, if fault can be found. 84

One issue common to the two areas is how the use of fault as a basis for allocation will be integrated with other bases for allocation. For realty loss, it is clear that fault will be used to override the majority conversion rule, resulting in imposition of loss on a blameworthy seller rather than on the blameless buyer. 85 In minority jurisdictions, it is equally clear that fault-based allocation will override the otherwise applicable theory of implied agreement. 86

Fault has also been taken as a basis for overriding an express agreement allocating the risk of realty loss, both in jurisdictions following the majority conversion rule, 87 and those following a minority rule. 88 For example, in DuBois v. Nye, 89 the sale agreement placed risk of realty loss on the seller. The buyer negligently caused a fire. The court imposed the loss on the blameworthy buyer, construing the risk allocation agreement not to apply to loss caused by negligent or intentional wrongdoing of a party to the sale. The court adopted a presumption against a construction that would immunize a wrongdoer, based on a "public policy [that] opposes the contracting away of liability for future negligent acts, absent a showing of clear intention to do so." 90

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84. Not much attention has been given in the literature to the role of fault in escrow loss allocation. The two 1950s student Notes on escrow loss do make passing references to the matter of fault. See Garrison, supra note 22 at 53, 54; Pederson, supra note 22, at 221.


89. 584 P.2d 823 (Utah 1978).

90. Id. at 825. New York has applied a similar rule of construction to avoid application of a clause that would have limited the extent of a seller's liability. See Horowitz, 236 N.Y.S.2d at 239 (clause limiting buyer's remedies interpreted not to apply when loss caused by seller's negligence).
For escrow loss it is clear that fault overrides the entitlement rule, which
ordinarily imposes loss on the buyer who has deposited money in escrow.91
For example, in Majors v. Butler,92 the seller contributed to the holder’s
embezzlement of money. The court imposed the loss on the seller, stating that the "reason for the [usual] rule ceases, and it should not be solely relied on,
when the act or negligence of one of the parties is the basic cause of the loss,
or is a factor without which the loss would not have happened."93

There are no reported cases addressing the question of whether fault
would be used as a basis to override an express agreement as to allocation of
escrow loss. This may be a point on which a benefit can be had from
recognition of the interrelatedness of realty loss and escrow loss problems. As
a general approach to jurisprudence, courts faced with an issue not previously
resolved in regard to escrow loss may legitimately turn to the more extensive
body of precedent developed in regard to realty loss. In particular, the
policies guiding the Dubois court in refusing to apply a loss allocation
agreement that would immunize a wrongdoer as to realty loss should be
equally applicable to an agreement purporting to immunize a wrongdoer as to
escrow loss.

A second issue common to both areas is that of setting standards. As is
most clearly true in tort law, if fault is to be used as a basis for imposing loss,
there must be standards for distinguishing cases of mere accident from cases
in which blame can be laid.94 Another lesson from tort law is that the setting
of standards is very much an act of setting policy. In that field, it has been
said that "a loss should lie where it happened to fall unless some affirmative
public good will result from shifting it."95 Imposing loss on the basis of
fault is necessarily a determination that such allocation leads to some public
good. The question is: What good is thought to be accomplished by
assigning realty loss or escrow loss on the basis of fault rather than on some
other basis? In tort law, two of the more important policies considered in
setting standards are the imposition of morality, and the creation of incentives
for loss prevention.96 For realty and escrow loss standards are needed for
determining what kinds of conduct and what degree of culpability will suffice

91. See infra text accompanying notes 263-83.
93. Id. at 997.
94. In tort law such questions would be addressed under the rubrics of proximate
cause or the defining of duties.
95. Leon Green, The Thrust of Tort Law, Part I: The Influence of Environment,
64 W. VA. L. REV. 1, 7 (1961).
96. Leon Green, The Duty Problem in Negligence Cases: II, 29 COLUM. L. REV.
255 (1929).
to override other bases for loss allocation. Those standards in turn must reflect some underlying policies.

For realty loss, there appear to be two distinct categories of conduct meriting fault-based allocation. First, there are cases in which one party has directly contributed to the occurrence of the injury. Second, there are cases in which the only wrongdoing has been the causing of a delay in the closing of the sale, with there being no immediately apparent causal relationship between the delay and the loss.

In the first category, the courts have had no hesitation allocating loss to a party who intentionally destroys or removes improvements affixed to realty being sold, and have not even found it necessary in such circumstances to explain their reasoning.97 Some courts have not hesitated in determining that loss should fall on the party whose mere negligence caused destruction. In DuBois v. Nye,98 for example, loss by fire was imposed based on jury findings that the buyer had been negligent in placing a cardboard box on an electric stove known to be defective,99 and that this negligence was the proximate cause of the fire.100 The court did not see fit to explain what policies were served by imposing loss on the basis of negligence.

In other cases allocation on the basis of negligence has proven more complicated. In a rare elaboration of standards and underlying rationale, the Pennsylvania court in Rappaport v. Savitz101 explained how a duty of care arises between buyer and seller, and what standard of care defines that duty. The parties were aware that a porch on the house being sold had a crack which was worsening.102 Although the seller remained in possession during the executory period, the buyer sought permission to enter and make repairs to prevent the crack from worsening.103 The seller refused entry, and failed to make the repairs himself.104 By the time the parties closed the sale the porch had collapsed.105 The court offered three rationales for adopting an exception to the conversion rule and imposing loss on the seller rather than the

98. 584 P.2d 823 (Utah 1978).
99. Id. at 827.
100. Id.
102. Id. at 402.
103. Id.
104. Id.
105. Id.
buyer. Two are rather shallow and conclusory: that the conversion rule was not formulated to address loss caused by culpable conduct; and that imposing loss on a buyer who had been kept from entering to make a repair would "limit unduly his equitable ownership." Of greater note, the court reasoned that the parties likely intended that the seller remaining in possession had a duty of care. The court found an implied agreement under which the seller would maintain the property for the benefit of the future owner. The court further found an implied agreement as to the standard of care: an obligation to care for the realty by "such means as might reasonably be expected would be used by a person of ordinary prudence."

For the most part, courts allocating realty loss have not openly stated the applicable standard of care to distinguish cases of blameworthy conduct from cases found to involve mere fortuitous loss. Nor have they offered rationales for adopting fault-based approaches to loss allocation. Whatever policies are thought to be served by fault-based allocation would almost certainly be better served if the policies and standards were presented openly.

The second category of realty loss cases consists of those in which one party has caused a delay in closing a sale. In one of the earlier cases, Smith v. Cansler, the seller sought specific performance after a fire. The sale was to have been closed prior to the date on which the fire occurred, and the seller had, without excuse, delayed the closing by failing to have a valid deed prepared. The court refused to apply the conversion rule to impose

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106. *Id.* at 403.
108. *Id.* at 403.
109. *Id.*
110. *Id.* (quoting 55 AM. JUR. § 390 (1970)).
111. See sources cited in note 17, *supra*.
113. The centrality of fault-based allocation in tort law suggests that courts and commentators seeking to clarify the role of fault in realty loss allocation could profitably turn to tort law for guidance. The real property doctrine of waste might also provide useful jurisprudence resources. See 3 AMERICAN LAW OF PROPERTY, *supra* note 20, § 11.32; FRIEDMAN, *supra* note 20, § 4.11, at 512-513.
114. 83 Ky. 367 (Ky. 1885), overruled on other grounds, Holland v. Stubblefield, 206 S.W. 459 (Ky. 1918).
115. *Id.* at 370.
116. *Id.* at 369.
the fire loss on the buyer through specific performance.\(^\text{117}\) It premised this refusal on findings that the seller was "guilty of laches" and that enforcement of the sale agreement subsequent to the fire "would now be oppressive."\(^\text{118}\) *Smith* seems to reflect the traditional general maxims of equity, that equitable relief otherwise available may be denied when "a party has unreasonably delayed the assertion of an equitable claim" and such relief would result in "serious loss to defendant."\(^\text{119}\) The opinion did not suggest that the delay in any way contributed to the occurrence of the fire, and did not explain how the seller's delay could in any way have caused harm to the buyer. If the deed had been prepared and delivered prior to the fire, the loss would have fallen on the buyer under any rule observed in any jurisdiction.

*Smith* may stand for nothing more than the ancient discretionary limits on equitable relief. However, it may be a reflection that even jurisdictions which follow the conversion rule are eager to find some hint of fault on which to base loss allocation, rather than relying on the troubled theory of ownership through equitable conversion.

More recently, in *Tinker v. McLellan*,\(^\text{120}\) delay was cited as the basis for refusal to enforce an express agreement allocating realty risk to the sellers.\(^\text{121}\) The agreement imposed realty risk on the sellers until transfer of legal title, although the buyers were taking possession earlier.\(^\text{122}\) The deed and purchase price were deposited in escrow, and the sale was to be closed simultaneously with the close of escrow.\(^\text{123}\) All conditions to the closing were met save one: the buyers delayed paying $87.92 in fees due the escrow holder.\(^\text{124}\) The realty was damaged by a flood two days after the date the

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\(^{117}\) *Id.* at 374-75.

\(^{118}\) *Id.*

\(^{119}\) *McCIntock*, supra note 20, at 71. *Smith* is a rare example of those principles being used to thwart the conversion rule. The English case which is usually said to be the source of the conversion rule involved very similar facts. In *Paine v. Meller*, 31 Eng. Rep. 1088 (Ch. 1801) the seller's failure to clear the title caused a delay in closing, and a fire occurred during that period of delay. The court rejected the buyer's plea for equitable discretion and granted the seller's request for specific performance of the sale agreement at full price. *Paine* is addressed further infra notes 240-51.

American courts have generally followed *Paine* rather than *Smith* by refusing to take into account the hardship imposed on an innocent buyer through application of the conversion rule. An early and much-cited example is *Brewer v. Herbert*, 30 Md. 301, 312 (Md. 1869).\(^\text{120}\) *Id.* at 312.

\(^{121}\) *Id.* at 467.

\(^{122}\) *Id.* at 466.

\(^{123}\) *Id.*

\(^{124}\) *Id.*

https://scholarship.law.missouri.edu/mlr/vol59/iss2/2
buyers were to have paid the fees, the buyers' institutional financing was withdrawn due to the destruction, and the sale was never closed.\textsuperscript{125} The court held that absent the buyers' delay in paying the fees, the escrow would have been closed, and the risk would have shifted by agreement prior to the flood.\textsuperscript{126} The court imposed the loss on the buyers by holding that the buyers were estopped from claiming that legal title had not passed, and thus estopped from enforcing the clause.\textsuperscript{127} Here again, it was not suggested that the delay had any impact on the occurrence of the loss.

The lesson of \textit{Tinker} seems to be that a party cannot claim the benefit of the nonoccurrence of an event that would have caused risk to shift if the critical event was unreasonably delayed by that party, regardless of the lack of causal connection between the delay and the loss. Or, the case might simply be an example of the courts being eager to find some hint of fault on which to base realty loss allocation.\textsuperscript{128} \textit{Tinker} also provides some guidance on the question of what sort of delaying conduct is to be considered unreasonable. The buyers clearly knew of their obligation to pay the escrow fees because it was stated in the written escrow instructions which they had signed.\textsuperscript{129} Nevertheless they questioned that obligation when the holder requested payment.\textsuperscript{130} They later orally promised the sellers that they would make the payment, and then failed to do so, without excuse.\textsuperscript{131} Although there was no indication of corrupt intent on the part of the buyers, the court held that the buyers' promise had induced the sellers not to pay the fees, which the seller could have done to cause the closing to occur earlier.\textsuperscript{132} Thus, the buyers had delayed the closing by their own failure to pay the fees, and by inducing the sellers not to pay the fees.\textsuperscript{133}

For escrow loss, the cases in which fault has been given a determinative role share some similarities to the treatment of fault in realty loss cases and

\textsuperscript{125} \textit{Id.} at 465-66.
\textsuperscript{126} \textit{Id.} at 467.
\textsuperscript{127} \textit{Id.} The opinion does not clearly indicate whether loss was then imposed on the buyers on the theory that legal title had passed so that risk shifted by the agreement, or on the theory that the agreement was simply stricken. With the agreement stricken, risk would have been governed by California's version of the Uniform Vendor and Purchaser Risk Act, under which risk would have passed to the buyers when they took possession. \textit{Id.} at 466.
\textsuperscript{128} Or, perhaps \textit{Tinker} reflects a moral decision that loss should be borne by a party who has behaved badly, rather than one who has not behaved badly, despite the lack of a causal connection between the bad behavior and the loss.
\textsuperscript{129} \textit{Tinker}, 331 P.2d at 466.
\textsuperscript{130} \textit{Id.}
\textsuperscript{131} \textit{Id.}
\textsuperscript{132} \textit{Id.} at 467.
\textsuperscript{133} \textit{Id.}
may be viewed in three categories. First, there are cases in which one party has caused a delay in closing of escrow, thus extending the risk period. Second, there are cases in which one party has committed some act, other than mere delay, that enabled the holder to lose or embezzle the money. Third, there are cases in which one party has had a closer relationship with the wrongdoing holder, and might be blamed for putting the holder in a position to cause the loss.

The notion that one party's action in causing a delay in the close of escrow might play a role in loss allocation seems to have first been mentioned in Foster v. Elswick. The loss resulted from failure of the bank in which escrowed funds were deposited. The escrow period was quite lengthy because the seller was having difficulty clearing the realty title. The court stated that "[o]f course, if the money had been lost on account of an unreasonable delay on the part of [the seller] in perfecting her title, the loss should have been charged to her." The court found the seller's delay was not unreasonable, and applied the entitlement rule to impose the loss on the buyer.

The same principle led to a different result in Majors v. Butler. The seller delayed the clearing of the title, causing the funds to remain in escrow for a lengthy period during which the escrow holder became insolvent. While the entitlement rule would have put the loss on the buyer, the Majors court imposed it on the seller. The court found that the seller's failure to speedily perform the obligation to clear the title was "responsibly negligent."

In Jones v. Lally, the sellers extended the escrow risk period by failing to make a timely demand for the money held in escrow. They had a right to take payment from the escrow holder in cash or a cashier's check.

134.  4 S.W.2d 946 (Ark. 1928).
135.  Id. at 946.
136.  Id.
137.  Id. at 947.
138.  Id.
140.  Id. at 997-98.
141.  Id. It was this situation which led to the statement that the "reason for the [entitlement] rule ceases, and it should not be solely relied on, when the act or negligence of one of the parties is the basic cause of the loss, or is a factor without which the loss would not have happened."  Id. at 997.
142.  511 So. 2d 1014 (Fla. Dist. Ct. App. 1987), review denied, 519 So. 2d 987 (Fla. 1986).
143.  Id. at 1016.
at the closing.\textsuperscript{144} They accepted an ordinary check and failed to endorse it properly when they presented it to the bank for payment.\textsuperscript{145} They later tried again, this time properly endorsing the check.\textsuperscript{146} By then the escrow holder had ordered payment on the check stopped and had embezzled the funds in the account. Finding that the buyer was blameless, and that the sellers' actions had given the holder "an opportunity to stop payment\textsuperscript{147} the court imposed the loss on the sellers based on a principle that "[w]here one of two innocent parties must suffer a loss as the result of the default of another, the loss shall fall on the party who is best able to avert the loss and is the least innocent."\textsuperscript{148}

There are two important concepts in the quoted language. The first is that loss should be imposed on the party "best able to avert the loss."\textsuperscript{149} That quick reference opens the door to a greater understanding of why courts have chosen to override other considerations to find fault and impose loss on the basis of fault. In the current terminology of economic analysis of law, imposing loss on the party whose conduct contributes to realty or escrow loss is an economically efficient means of encouraging loss avoidance. That rationale for fault-based allocation has not been articulated in other escrow loss cases, or in the realty loss cases\textsuperscript{150} although it does explain the results rather nicely.

The second Jones concept is that of the "least innocent" of two parties.\textsuperscript{151} The phrase captures the task of courts seeking to use fault as a rational basis to choose between the parties in cases like Foster, Majors and Jones. Both parties are innocent of any wrongdoing in the embezzlement or insolvency of the escrow holder. However, use of an escrow does involve risk, extending the escrow period increases the risk, and one party's role in extending the period does make that party at least slightly more culpable, or "less innocent" than the other.

Jones' articulation of the concept might help shed light on the realty loss cases in which loss has been allocated to the party who caused delay. The escrow loss cases are very different from the realty loss cases in that for

\textsuperscript{144} Id. at 1015.
\textsuperscript{145} Id. at 1015-16.
\textsuperscript{146} Id. at 1016.
\textsuperscript{147} Id.
\textsuperscript{148} Id.
\textsuperscript{149} Id.
\textsuperscript{150} The basic concepts of loss prevention and economic efficiency were addressed in Professor Williston's 1895 critique of the conversion rule, although of course he could not then call upon the terminology now made popular by followers of the "law and economics" school of legal analysis. See Williston, supra note 20.
\textsuperscript{151} Jones, 511 So.2d at 1016.
escrow loss, delay clearly has at least some causal connection to loss, while delay seems not even to be a but-for cause of realty loss. Nevertheless, the realty loss delay cases such as Smith and Tinker might be a reflection of the same force at work in the escrow cases: a search for some basis on which to treat one party as less innocent than the other.

The second category of fault-based escrow loss cases are those with one party having contributed to a loss through conduct other than delay. In Crum v. Los Angeles,\textsuperscript{152} money in escrow was lost by failure of the bank serving as escrow holder.\textsuperscript{153} The buyer, a municipality, deposited a warrant with the escrow/bank, with instructions that the bank not endorse and present the warrant for payment by the municipality's treasurer until the close of escrow.\textsuperscript{154} The bank violated those instructions by prematurely presenting the warrant for payment, and the buyer's treasurer paid the warrant.\textsuperscript{155} Shortly after the bank received the payment in cash, it failed. The court, reasoning that the buyer could have prevented the holder's violation of instructions by refusing to cash the prematurely presented warrant, imposed the loss on the buyer.\textsuperscript{156} The buyer's conduct "created a situation which made it possible for the later loss to occur."\textsuperscript{157} The court applied to this a general principle "that where one of two innocent persons must suffer by the act of a third, he by whose negligence it happened, must be the sufferer."\textsuperscript{158}

The third category of cases are those in which one party might be said to have a closer relationship with the wrongdoing escrow holder. It is typical for a seller's realtor to serve as escrow holder,\textsuperscript{159} or for an attorney of one

\textsuperscript{152} 294 P. 430 (Cal. Ct. App. 1930).
\textsuperscript{153} Id. at 431.
\textsuperscript{154} Id.
\textsuperscript{155} Id.
\textsuperscript{156} Under the circumstances it was not clear how loss would have been allocated under the entitlement rule. There were some indications that the rule would be inapplicable because the arrangement was not truly an escrow. The court made no finding on that point, choosing instead to take up the fault-based rule as the basis for decision. Id. at 432.
\textsuperscript{157} Id. (citing a California statute to that effect). The court was apparently unperturbed about simultaneously referring to the buyer as innocent and yet negligent. The unwieldy combination was repeated by a commentator who cited Crum in urging adoption of a rule to the effect that "where the loss must fall upon one of two innocent parties, it will be placed upon the one who caused the loss." Pederson, \textit{supra} note 22, at 229-230. The \textit{Jones} terminology of "least innocent" seems to more accurately capture the sentiment.
\textsuperscript{158} Id. The standard form earnest money sales contracts ordinarily provide for the buyer's earnest money deposit to be taken in escrow by the seller's real estate agent.
party to so serve. These common situations lead to one party having a preexisting and therefore closer relationship with the holder, and some of the few commentators on escrow loss law have argued that this should be a basis for loss allocation.

The argument has been openly accepted in only one case, Paul v. Kennedy, which did not concern a sale of realty. The seller had engaged a business broker to sell a trucking business. The broker played an extensive part in the transaction: finding the buyer, accepting the buyer’s offer on behalf of the seller, drafting the sale agreement, and serving as escrow of the purchase price pending official transfer of the necessary business permits. He also absconded with the money. The entitlement rule would have imposed the loss on the buyer, as the status of the escrow conditions was such that the buyer had retained "legal title" of the money. The court shifted the loss to the seller, in part on the basis of "a just and well-established maxim that 'where one of two innocent persons must suffer from the wrongful act of a third, the loss should be borne by him who put the wrongdoer in a position of trust and confidence, and thus enabled him to perpetrate the wrong.'"

Other courts have rejected that basis for allocating escrow loss. In Pagan v. Spencer, the court refused to allocate loss on the basis of the escrow having been the seller’s real estate agent, when in all other respects it was "agreed that both parties are innocent so far as the loss of the money is concerned."

160. In some regions it is "exceedingly common" for one party’s attorney to serve as escrow holder. Nelson & Whitman, supra note 22, at 162 n.2.

161. See, e.g., Pederson, supra note 22, at 230.


163. Id. at 160.

164. Id. at 159.

165. Id.

166. Id. at 160 (quoting Franklin Fire Ins. Co. v. Bradford, 50 A. 286, 286 (Pa. 1901)). In Rykaczewski v. Kerry Homes, Inc., 161 A.2d 924 (Pa. 1960), the Paul reasoning was applied to allocate loss of funds in a realty sale. However, there the court found the holder’s ties to the seller to be so strong and one-sided that it was not viewed as a true escrow. Id. at 925. The principle espoused in both Paul and Rykaczewski is further elaborated in a dissenting opinion in Borough of West Mifflin v. O’Toole, 275 A.2d 384, 385 (Pa. Super. Ct. 1971) (Montgomery, J., dissenting).


168. Id. at 324. See also Van Dyke v. Lauer, 100 N.W.2d 335, 337 (Wis. 1960) ("The determining factor is not that [the escrow] was originally the agent of the vendors at the time the escrow arrangement was entered into, but rather who had title to the $3,000 at the time the escrow holder absconded with it.").
In Cradock v. Cooper, it was the seller's attorney who served as escrow and absconded with the money. The trial court's decision in Cradock is noteworthy. That court did take the seller's relationship with the attorney/escrow holder into account. More importantly, it decided that both parties should share the loss and it did so on the theory that they were equally at fault in allowing the holder to abscond with the money. However, the appellate court refused to consider the seller's relationship with the attorney/escrow as a factor, because it was unwilling to entertain the notion that a licensed attorney's "wrongdoing in either a moral or a legal sense can be imputed" to a party. Instead, the appellate court reverted to the entitlement rule imposing the entire loss on one party.

The overturned decision of the Cradock trial court appears to be the only example of a court deciding to make the parties share an escrow loss. Most courts have imposed the entire escrow loss on one party. The same is true of realty loss cases, under both the majority conversion rule and the alternative minority rules. The Cradock trial court holding may still be useful as

170. Id. at 257.
171. Id.
172. Id. at 257.
173. Id. The same argument was made again to the Florida court in Jones v. Lally, 511 So. 2d 1014, 1016 (Fla. Dist. Ct. App. 1987), although the court apparently ignored the argument and relied solely on the seller's more directly culpable conduct as a basis to override the traditional rule and impose the loss on the seller. The holding is examined in FRIEDMAN, supra note 20, § 1.2(d).
174. Cradock, 123 So. 2d at 258. In Zaremba v. Konopka, 228 A.2d 91 (N.J. Super. Ct. Ch. Div. 1967), the buyer who had deposited money argued that its loss by embezzlement should fall on the seller because the escrow holder was the seller's real estate sale agent. However, the court found that any fault attributable to the seller because of this preexisting relationship was offset by fault attributable to the buyer. The buyer had given the holder a fully negotiable cashier's check. The court described that act as putting the holder in a position from which the holder could easily abscond with the deposit. With the causal responsibilities balanced, the court reverted to the ownership theory of the entitlement rule. It imposed the loss on the buyer who had made the deposit in escrow because the loss had occurred before ownership of the deposit had shifted to the seller. Id. at 95.
175. The realty loss cases do evince something in the nature of a loss-sharing remedy when a loss is covered by insurance. Under the constructive trust doctrine, the party who has paid for insurance coverage and does not bear the risk is compelled to share insurance proceeds with the uninsured risk-bearing party. See supra notes 40-45 and accompanying text. Also, when both parties have procured insurance coverage there is some precedent requiring their insurers to share the loss through proration, based on the theory that the parties were in a sense co-owners. See, e.g., Mutual Benefit Ins. Co. v. Goschenhoppen Mut. Ins. Co., 572 A.2d 1275 (Pa. Super. Ct.
precedent for the concept of loss-sharing, despite the appellate court's reversal. The appellate court did not expressly find that loss-sharing was unacceptable; it merely found that under the circumstances it was inappropriate to base loss allocation on fault, thus removing the grounds used by the trial court to divide the loss.176

Commentators have argued that loss-sharing should be a remedy available in cases of escrow loss when the parties are equally at fault, and even when they are equally without fault.177 The reporter of the Restatement (Second) of Agency has taken that position.178 Loss-sharing might also be an appropriate means of allocating realty loss when the parties each bear some blame for allowing the loss to occur, and perhaps when they are equally blameless. The quote from the escrow loss case Jones v. Lally suggests that a primary rationale for imposing loss on the basis of fault is encouragement of efficient loss avoidance.179 That policy would be well served by imposing loss on both parties when both are at fault, as to either realty loss or escrow loss.

In sum, it is appropriate to draw upon both realty loss cases and escrow loss cases in assessing the role that fault plays in loss allocation in realty sales transactions. Taken together, the cases support the following general propositions. The buyer and seller in a sale transaction making use of an escrow have mutual duties of care toward each other. Those duties might be said to be based on an implied-in-fact agreement because the parties are bound by contract, or might be said to arise as a matter of law because of the nature of the relationship. The duties encompass the two major things of value brought to the relationship: the realty and the money deposited in escrow.

The standard of care accompanying those duties can be said to be that of a reasonably prudent person under the circumstances, akin to simple negligence in the law of torts. The standard might also be described as "less innocence," indicating that although both parties are nearly blameless, one party is at least slightly more culpable than the other. Setting the standard of care in this context, as in tort law, should be based on a determination of what policies are being served and how they might best be served. One policy clearly of importance is the encouragement of loss prevention. That policy is well served by imposing loss on the party who could most easily have avoided a loss.

176. Cradock, 123 So. 2d at 257.
178. RESTATEMENT (SECOND) OF AGENCY § 14(D) reporter's notes, app. vol. 3 (1958).
179. See *supra* text accompanying notes 142-50.
Realty or escrow loss that is causally linked to one party's breach of the applicable standard will be imposed on that party, regardless of how loss would otherwise be allocated through operation of the entitlement rule for escrow loss, or the conversion rule or an alternative rule for realty loss. An express agreement as to loss allocation will be construed not to immunize a party against liability for loss caused by that party's conduct, if the conduct rises at least to the level of simple negligence, and such a construction is reasonably possible.

In some circumstances in which one party is less innocent than the other, loss may be imposed on that basis despite the lack of a clear causal connection between the loss and the less than innocent conduct. That phenomenon may merely reflect the desire of courts to avoid reliance on the rather arbitrary theories underlying the entitlement and conversion rules.\(^{180}\)

When both parties bear some fault in causing a loss, it may be appropriate to impose the loss on both, rather than imposing the entire loss on one party. It has been suggested that division of a loss would also be appropriate when both parties are equally blameless.

**B. Risk Allocation Through Agreement**

For realty loss, it is an accepted rule that an express agreement allocating risk among the parties will be enforced although it leads to a result different from that dictated by the majority rule of equitable conversion.\(^{181}\) In most cases involving an express risk allocation agreement the only matter of dispute is determining how broadly the agreement sweeps. There are essentially two types of agreements addressed in the realty loss cases: those that clearly encompass casualty losses, such as fire, and those that impose on one party an obligation to maintain the premises in a certain condition and which might be construed to encompass casualty losses. Cases addressing the second type of agreement are particularly useful because they invite consideration of the underlying policies.

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180. It may also reflect a moral judgment.

181. The point is apparently seen as so obvious that it is usually stated by courts only in dicta. See, e.g., Bleckley v. Langston, 143 S.E.2d 671 (Ga. Ct. App. 1965). The point is also made by treatises without citation to supporting authority. See, e.g., 77 AM. JUR. 2D Vendor and Purchaser § 356 (1975). Some of the cases are collected in Koenders, supra note 17, at 257-67. However, courts will construe realty risk allocation agreements so as not to immunize one party from loss brought about by that party's own negligence. See supra text accompanying notes 87-90. See also DuBois v. Nye, 584 P.2d 823 (Utah 1978). Cf. Tinker v. McLellan, 331 P.2d 464 (Cal. Dist. Ct. App. 1958) (party who caused delay not allowed to take advantage of risk allocation agreement).
Even agreements that clearly encompass casualty losses can be subject to dispute, as is seen in New York's *Pellegrino v. Giuliani.*\(^{182}\) The premises were damaged by a windstorm.\(^{183}\) The sale agreement provided that the seller bore the risk of "loss or damage by fire."\(^{184}\) The court construed the agreement not to cover the wind damage, and imposed the loss on the buyer under the conversion rule,\(^{185}\) without explaining what motivated such a narrow construction.\(^{186}\)

The *Pellegrino* problem can obviously be avoided by drafting a risk allocation agreement more broadly. Competent counsel could certainly do so,\(^{187}\) and broad provisions are included in many of the form contracts that are widely available for unrepresented buyers and sellers.\(^{188}\) For example, an officially approved form used in one jurisdiction provides that "All risk of loss or damage to the Property shall be borne by Seller until closing."\(^{189}\) Even such broadly phrased forms might be subject to dispute. The above-quoted provision clearly applies to loss by physical injuries, but might be construed not to apply to loss by condemnation or zoning changes.\(^{190}\)

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183. *Id.* at 258.
184. *Id.*
186. One can only wonder whether the court reasoned that the parties in fact had not intended the clause to apply to loss other than by fire, or reasoned that the policy driving the conversion rule was too important to be overridden by an ambiguous agreement.
187. See *Friedman,* *supra* note 20, at 509-11 (suggesting language for counsel to insert in agreements).
188. There are, however, no form contracts that are standardized for use throughout the United States. Gaffney, *supra* note 20, at 1143 n.50.
189. Utah Real Estate Purchase Contract (approved by the Utah State Real Estate Commission and the Office of the Utah Attorney General, June 1993). That form is used for short-term sales. For long-term installment contracts, the officially approved form provides that "All risk of loss and destruction of the Property shall be borne by Seller until the agreed date of possession." Utah Uniform Real Estate Contract (approved by the Utah State Real Estate Commission and the Office of the Utah Attorney General, January 1, 1987).
190. Narrow construction of such a clause would result in a confusing and probably unintended differential treatment of types of loss in cases in which the agreed upon allocation differs from the otherwise applicable rule. In Utah, loss by condemnation is clearly governed by the conversion rule, putting loss on the buyer, while under the form contract loss by fire would fall on the seller. See *Jelco,* Inc v. Third Judicial Dist. Ct., 511 P.2d 739 (Utah 1973). Widespread distribution of such forms may also be giving the public a false impression of the applicable law. One reading the Utah forms might assume they reflect the otherwise applicable rule for
Courts have frequently been asked to consider contract provisions obligating a seller to deliver the realty in a specified condition, or to maintain and repair the improvements prior to closure. Courts have usually been willing to read such provisions broadly enough to shift to the seller the risk of loss by casualty such as fire and storm damage for which neither party can be said to bear blame.\textsuperscript{191} The few cases in which courts have not been willing to adopt such broad constructions have involved language clearly not susceptible to encompassing casualty loss.\textsuperscript{192} This penchant for broadly construing repair clauses to serve as risk allocation agreements may reflect the same motivation observed in the realty and escrow loss cases in which allocation was based on fault. Courts appear to be anxious to avoid relying on the conversion and entitlement rules, and eager to turn to the more rational grounds of fault or agreement.

The New Jersey case of \textit{Coolidge & Sickler, Inc. v. Regn}\textsuperscript{193} provides a useful explanation of the policies to be considered in construing provisions affecting realty loss allocation. The seller had agreed to deliver the premises in good condition.\textsuperscript{194} The seller then evicted the prior tenants in order to complete the sale, and those tenants severely vandalized the premises upon leaving.\textsuperscript{195} Absent an express agreement, the loss would likely have fallen on the buyer.\textsuperscript{196} In construing the impact of the provision for delivery in good condition, the court took the important step of explaining that it was

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realty loss allocation. However, Utah clearly follows the conversion rule. \textit{See id.}; Utah State Medical Ass'n v. Utah State Employees Credit Union, 655 P.2d 643 (Utah 1982). The form contracts may be partially responsible for a phenomenon observed by this author in the course of conducting research for this Article. A number of faculty colleagues, law students, lawyers in general practice, and lay persons were surprised when informed that Utah follows the conversion rule. A similar situation may exist in Florida, where the conversion rule is also followed, and where officially approved form contracts state that risk is on the seller. \textit{See Gaffney, supra} note 20, at 1144-45.

\textsuperscript{191} \textit{See} Goddard v. Bebout, 40 Ind. 114, 115 (Ind. 1872) (seller's obligation to deliver "in as good a condition" as at time of contracting); Rhomberg v. Zapf, 208 N.W. 276, 276 (Iowa 1925) (seller's covenant to deliver "in as good a condition" as at date of contract); Bishop Ryan High Sch. v. Lindberg, 370 N.W.2d 726, 729 (N.D. 1985) (purchaser had only covenanted to purchase "in its present condition").

\textsuperscript{192} \textit{See}, e.g., Marks v. Tichenor, 4 S.W. 225 (Ky. 1887).

\textsuperscript{193} 80 A.2d 554 (N.J. 1951).

\textsuperscript{194} \textit{Id.} at 556.

\textsuperscript{195} \textit{Id.} at 555-56.

\textsuperscript{196} Had the court not allocated the loss to the seller as a matter of contract interpretation, it might have done so on a fault theory because of the seller's role in allowing the prior tenants the opportunity to cause the damage.
engaging in ordinary contract interpretation.\textsuperscript{197} Perhaps that is too obvious to merit attention. Unfortunately, it is a point overlooked by many courts that ignore the contractual nature of the relationship between buyer and seller and instead focus on defining that relationship only as a matter of property law, with loss allocation based solely on a determination of which party owned the realty at the time of loss.

As seen by the \textit{Regn} court, the entire arrangement was one of contract, and the primary objective of the court was to ascertain the intentions of the parties.\textsuperscript{198} In doing so it consulted not only the language used, but also "the situation of the parties, the attendant circumstances, and the objects they were striving to obtain."\textsuperscript{199}

The lesson of \textit{Regn} is taken even further in those jurisdictions that have rejected the conversion rule, with its emphasis on ownership, in favor of minority rules that emphasize the contractual nature of the parties' relationship. A judicially developed doctrine often referred to as the Massachusetts rule treats loss allocation as a matter of implied agreement.\textsuperscript{200} That approach has been codified in the Uniform Vendor and Purchaser Risk Act.\textsuperscript{201} The Act operates by inserting in realty sales contracts an implied agreement that risk of realty loss remains with the seller until either possession or legal title is transferred to the buyer, whichever occurs first. Of course, the agreement implied by law under the minority rules can be overridden by an express contrary agreement.\textsuperscript{202}

For escrow loss, there has been strikingly little attention paid to allocation by agreement. The matter has been raised in only one reported case, and there the contract clause referred to was found inapplicable.\textsuperscript{203} Commentators have neither noted the lack of attention to allocation by agreement, nor argued for greater attention.

A major reason for there being so little attention to the possibility of allocation by agreement may be found in the widely used standard form

\begin{itemize}
\item \textsuperscript{197} \textit{Id.} at 557.
\item \textsuperscript{198} \textit{Id.}
\item \textsuperscript{199} \textit{Id.} at 557 (quoting Mantell v. International Plastic Harmonica Corp., 55 A.2d 250, 255 (N.J. 1947)).
\item \textsuperscript{200} The doctrine was largely developed in a series of Massachusetts cases culminating in Libman v. Levenson, 128 N.E. 13 (Mass. 1920).
\item \textsuperscript{201} \textit{Uniform Vendor and Purchaser Risk Act}, 14 U.L.A. 469 (1990).
\item \textsuperscript{202} The Uniform Act applies "unless the contract expressly provides otherwise." \textit{Uniform Vendor and Purchaser Risk Act} § 1, 14 U.L.A. 471 (1990). See, e.g., World Exhibit Corp. v. City Bank Farmers Trust Co., 59 N.Y.S.2d 648 (1945), aff'd, 68 N.E.2d 876 (N.Y. Sup. Ct. 1945) (contractual assumption of risk of fire by seller applied although Act would otherwise impose risk on buyer who had taken possession).
\item \textsuperscript{203} \textit{See infra} text accompanying notes 208-13.
\end{itemize}
escrow agreements. While the form contracts used widely for basic realty sale agreements typically include provisions allocating realty loss, the forms used for escrow arrangements make no reference to escrow loss. Even combined forms constituting both an agreement for sale and an agreement on the use of an escrow, and expressly providing for allocation of realty loss, say nothing of escrow loss.

Why are parties to escrow agreements not expressly allocating the risks arising from their transactions? Perhaps the primary reason is that escrow agreement forms are often supplied by the person serving as escrow holder. That practice is reflected in the contents of the forms, which appear to have been drafted for the protection of escrow holders rather than to meet the needs of the parties. It is hardly surprising that an escrow holder would not supply parties with a form calling the parties' attention to the possibility of the holder embezzling or losing their money or valuable documents.

For realty loss, the cases have addressed three issues: whether an express risk allocation agreement would be enforced; how broadly or narrowly courts would construe risk allocation language; and what policies would be called upon in answering the first two questions. For escrow loss, the enforceability and construction questions have been considered only in New York's Asher v. Herman, and there has been no judicial explanation of policy.

204. Consider, for example, the Friedman treatise. While suggesting form language to address a variety of concerns, the treatise offers no language on allocation of escrow loss despite the author's recognition of the risk of such loss. See Friedman, supra note 20, § 1.2(d).

205. See, e.g., Am. JUR. Legal Forms 2D Escrow §§ 100:14-18 (1991). Accompanying those forms is a checklist of matters to be considered in drafting an escrow agreement. The list makes no reference to escrow loss. Id. § 100:13. See also the standard form contract appended to Alan E. Linder, Negotiating and Drafting Single Family House Contracts, in Residential Real Estate Contracts and Closings, PLI Real Estate Law and Practice Course Handbook No. 392 (1993).

206. The forms typically include provisions by which the parties purportedly agree to hold the escrow holder harmless from any liability. See, e.g., Am. JUR. Legal Forms 2D Escrow §§ 100:14, 63 (1991). Some provisions are less bold, purporting only to excuse the holder from liability for simple negligence, thus probably more accurately reflecting the likelihood that a court would refuse to enforce a provision purporting to immunize a holder for willful or grossly negligent conduct. The form in use in New York is an example. See Linder, supra note 205, at Appendix.

207. Professional organizations and government agencies might consider drafting and distributing form agreements with escrow risk allocation clauses, just as they have included realty risk clauses in form sale contracts.

The buyer in Asher had deposited funds in escrow with the seller's attorney.\textsuperscript{209} The holder then embezzled the money before the seller was in a position to give legal title to the realty, which was to have been the trigger for the money to be released to the seller.\textsuperscript{210} A clause in the sale agreement stated that if the seller were unable to convey a marketable title, the seller could cancel the contract and its "sole liability [would] be to refund to the purchaser the amount paid on account of the purchase price."\textsuperscript{211} The buyer argued that by this language the seller had expressly agreed to refund the money deposited in escrow, and had thus become a "guarantor of the escrow agent."\textsuperscript{212} The court rejected the argument, finding that the clause was a "stock clause" in sale agreements, meant to apply only as to funds received by the seller, and thus of no force because under the entitlement rule the seller had "obtained nothing" from the buyer.\textsuperscript{213}

Although the Asher court found that there was not an express agreement as to escrow loss allocation, the court's careful consideration of the buyer's argument does at least raise the prospect of enforcement of an express loss allocation agreement. It remains to be seen what language and circumstances will be found sufficient to show that one party has assented to bear the risk of escrow loss. Language in the form contract now popular in New York should prove much more amenable to the construction urged by the buyer in Asher. It provides that upon cancellation of the contract, "other than as a result of Purchaser's default . . . Seller shall promptly refund or cause the Escrowee to refund the Downpayment to Purchaser."\textsuperscript{214} Other provisions often found in escrow agreements might be read to serve as risk allocation provisions. Escrow agreements sometimes make express provision as to which party is entitled to the benefit of investment interest accruing on money deposited in escrow,\textsuperscript{215} and courts have held that ordinarily the right to take such a benefit is held by the same party who bears the burden of risk of loss.\textsuperscript{216}

The nearly complete lack of attention given to agreement as a basis for allocating escrow loss makes it particularly useful to turn to the related area of realty loss allocation for some guidance. The realty loss cases provide

\textsuperscript{209} Id. at 933.
\textsuperscript{210} Id. at 933-34.
\textsuperscript{211} Id. at 936.
\textsuperscript{212} Id.
\textsuperscript{213} Id.
\textsuperscript{214} This might be interpreted to make the seller a guarantor of the escrow holder.
\textsuperscript{215} See Friedman, supra note 20, at 17.
support for the following propositions, which should be applicable for both types of loss. Courts will enforce express agreements that contradict the otherwise applicable rules for loss allocation, although they will construe such agreements not to protect a party who bears blame for the loss. Courts will broadly construe language which can within reason be interpreted to serve as an agreement for risk allocation, so as to avoid having to turn to the otherwise applicable entitlement and conversion rules.

As the explanation in Coolidge & Sickler, Inc. v. Regn reveals, the parties to a sale agreement using an escrow are engaged in a relationship that arises through contract. Allocating losses between those parties should be done in light of the contractual nature of their relationship. The primary objective should be to ascertain and implement their intentions through ordinary contract interpretation principles. That proposition has been made especially clear for realty loss in jurisdictions that have reformed their law on realty loss allocation by adopting the Uniform Vendor and Purchaser Risk Act or another minority rule based on a theory of implied agreement. Those jurisdictions should be at the forefront in recognizing that escrow loss ought also to be approached through contract principles.

C. Risk Allocation Based On Status In the Absence of Fault Or Agreement: Ownership and Agency, the Separate Histories and Common Failings of the Conversion and Entitlement Rules

When neither fault nor express agreement are readily available as bases for allocation of realty or escrow loss, the majority rule for realty loss and the unchallenged rule for escrow loss both resort to status. The conversion rule for realty loss imposes the entire loss on one party, chooses between the two parties on the theory that loss must fall on the owner of the realty, and relies upon the doctrine of equitable conversion to determine ownership. In most circumstances the doctrine dictates that the buyer as owner of an equitable interest is the true owner during the executory risk period. The

217. See supra text accompanying notes 87-90.
218. 80 A.2d 554 (N.J. 1951).
219. The importance of contract-based analysis for problems associated with the use of escrows is also demonstrated in the cases in which one or both of the principal parties brings suit against an escrow holder. Courts in such cases have made clear that the relationship existing among the parties and the holder, and thus the duties owed by the holder, are largely defined by the terms of the escrow agreement. In other words, the relationships are governed by contract. See Jacobsen, supra note 22, at 325-26.
220. See infra text accompanying notes 251-62, 265-81.
221. See infra text accompanying notes 251-62.
entitlement rule for escrow loss also imposes the entire loss on one party, and chooses between the two parties on a theory that loss must fall on the owner of the money.\textsuperscript{222} However, it does not accept the concept of equitable conversion, and instead concludes that the true owner of an escrow deposit is the party owning legal title.\textsuperscript{223} For a typical deed and money escrow the buyer is treated as the legal owner of money held in escrow.\textsuperscript{224}

The doctrinal inconsistency prompts a question and an observation. The question is: How could it come to pass that two opposing definitions of ownership are used to resolve loss allocation problems that are functionally related? The observation is: If one body of law can define ownership in one way, and the other can define it in a directly contradictory manner, the notion of exclusive ownership is arbitrary, and using the status of exclusive ownership as a basis for loss allocation is untenable.

This final section of the article answers the question by briefly examining the separate histories of the conversion and entitlement rules. It also follows up on the observation by demonstrating that using ownership, \textit{i.e.}, status, as a basis for loss allocation in either area is unworkable, and that reliance on notions of exclusive ownership has created significant practical difficulties in each area of law.

1. Historical roots of the conversion and entitlement rules

The conversion rule for realty loss was developed long before the entitlement rule for escrow loss. American cases and commentators usually trace the conversion rule only so far as the 1801 English chancery case of \textit{Paine v. Meller}.\textsuperscript{225} In truth the roots extend much farther. \textit{Paine} merely added the third component of the rule, defining the buyer as the true owner. The first two components were in place at least as early as the 13th century, when it was held that realty loss must fall on one party only, and that the party to bear the loss would be selected as a matter of status, of ownership.\textsuperscript{226} In that era, however, it was thought that the seller, rather than the buyer, was the true owner.\textsuperscript{227}

\textsuperscript{222} See infra text accompanying notes 265-81.
\textsuperscript{223} See infra text accompanying notes 265-81.
\textsuperscript{224} The entitlement rule is sometimes said to be based on an alternative theory of agency, which typically leads to the same result as the legal title theory. See infra text accompanying notes 265-81.
\textsuperscript{225} 31 Eng. Rep. 1088 (Ch. 1801).
\textsuperscript{226} See HENRY BRACTON, \textit{DE LEGIBUS} ch. XXVII, 493 (Travers Twiss ed., 1878).
\textsuperscript{227} Id.
Bracton stated the medieval rule. If a house promised to be sold burns before the sale is completed, he said, the loss must fall on the seller "because in truth, he who has not delivered a thing to the purchaser, is still himself the lord of it." The law remained as Bracton described it up through the 18th century. By then the courts of equity had developed the doctrine of equitable conversion by contract, and in Paine Chancellor Eldon applied the doctrine to reverse the centuries old rule by treating the buyer as the true owner burdened with the risk of realty loss.

It is usually said that the doctrine arose from two features of equity practice: the maxim that "Equity regards as done that which ought to be done" and equity's willingness to grant the extraordinary remedy of specific performance of an executory contract for the sale of realty. It is also said that the doctrine was first developed to resolve problems arising from the death of a buyer or seller while a contract remained executory. The divergent treatment of real and personal property in English law made it necessary to determine whether a decedent's interest had the character of real property or that of personalty. Equity resolved that need. Upon the death of a buyer, the buyer's interest under the sale contract would be characterized as real property in equity, to pass to heirs rather than next of kin, or to devisees rather than legatees. Those successors could

228. Id.
229. Id. Bracton stated the same rule for loss of personal property, illustrated with an example of the death of an ox promised for sale. Id. Bracton's description of the medieval law was reiterated by Glanville. See Ranulp Glanville, Laws and Customs of the Kingdom of England bk. X, ch. XIV, 216 (J. Beames trans. 1900).
230. See Stent v. Balis, 24 Eng. Rep. 705, 706 (Ch. 1724) ("If I should buy an house, and before such time as by the articles I am to pay for the same, the house be burnt down by casualty of fire, I shall not in equity be bound to pay for the house.").
232. McClintock, supra note 20, at 105.
233. See id.
234. See, e.g., Hume, supra note 20, at 239; Simpson, Legislative Changes I, supra note 20, at 561.
235. That divergent treatment in turn came about as a result of the historically split jurisdiction in the English courts, with the devolution of real property having been ruled by the courts of law, and the passage of personal effects having been governed in the ecclesiastical courts. See Munroe Smith, Elements of Law, in Arthur T. Vanderbilt, Studying Law 249-256, 320 (1945).
236. See Leake, supra note 20, at 309.
then complete the sale transaction and acquire the legal title to the realty.\(^{237}\)

Upon the death of a seller, the seller’s rights under the contract would pass as personalty.\(^{238}\)

In time the resolution of such problems came to be stated as the doctrine of conversion.

A contract of sale of which a court of equity would decree specific performance further operates in equity as a conversion, according to the terms of the contract, of the land into money on the part of the vendor, and of the amount of purchase money into the land on the part of the purchaser.\(^{239}\)

By the time of *Paine v. Meller*,\(^{240}\) the doctrine had been applied to a wide variety of problems involving real property, including rights of dower for a spouse of a decedent buyer or seller, and rights of creditors of either party.\(^{241}\) Chancellor Eldon described that state of the law in *Paine*.

\[ \text{If the party by the contract has become in equity the owner of the premises, they are his to all intents and purposes. They are vendible as his, chargeable as his, capable of being incumbered as his; they may be devised as his, they may be assets, and they would descend to his heir.} \] \(^{242}\)

Eldon then extended the logic of the doctrine to allocate realty loss.\(^{243}\) The buyer and seller had entered into a short-term contract for the sale of some houses.\(^{244}\) No escrow was used.\(^{245}\) Before the full purchase price was paid, and before the buyer had either actual possession or the right to take possession, the houses burned.\(^{246}\) The seller sought specific performance.\(^{247}\) There was some question as to whether the seller’s title was sufficiently free of encumbrance, and Chancellor Eldon directed that further

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\(^{237}\) *Id.*

\(^{238}\) *Id.* at 306.

\(^{239}\) *Id.* at 306. For an example of the American use of the conversion theory in addressing problems relating to disposition of property upon death of a party to an executory contract, see Seymour v. Freer, 75 U.S. 202 (1868).

\(^{240}\) 31 Eng. Rep. 1088 (Ch. 1801).

\(^{241}\) *Id.* at 1089.

\(^{242}\) *Id.*

\(^{243}\) *Id.*

\(^{244}\) *Id.* at 1088.

\(^{245}\) Or at least the opinion makes no mention of the use of an escrow. *See id.*

\(^{246}\) *Id.*

\(^{247}\) *Id.*
fact-finding be done on that issue. He went on to indicate that should it be found that the legal title was of sufficient quality, the buyer would be required to follow through with the promise to buy at full price notwithstanding the destruction. He reasoned that this burden of risk necessarily accompanied the many other attributes of true ownership which came to rest with a buyer under the conversion doctrine.

Eldon also supported his decision by referring to the buyer's right to demand specific performance from the seller. "If [the market price of the land alone had gone up] and that house was burnt, it would be impossible to say to the purchaser, willing to take the land without the house . . . that he should not have it."

As it has since been developed, this application of the doctrine of conversion may be stated as follows.

(i) A seller's refusal to follow through with a promise to sell a specific plot of land could not be adequately remedied by common law damages because of the uniqueness of realty,
(ii) therefore equity would grant to a buyer specific performance of such a promise,
(iii) under equity's rule of mutuality of remedy, a contract specifically enforceable by one party would be made specifically enforceable by the other party, so a seller could demand specific performance of a buyer,
(iv) specific performance would result in a seller taking the purchase price and a buyer taking possession and a deed for legal title of the realty.

248. Id. at 1090.
249. Id. at 1089.
250. Id.
251. Id. With that reference Eldon alluded to what some have seen as the true purpose of development of the conversion doctrine: protecting the rights of buyers. Law courts gave little protection to buyers, because remedies at law were reserved for the exalted of society, the legal owners of land. Equity enhanced buyers' rights by treating the contract right as an interest in realty. With the status of landowner, a buyer could have remedies against third party trespassers, as well as remedies against the seller. As was said in Good v. Jarrard, 76 S.E. 698, 701 (S.C. 1912), "The principle that the vendee becomes the equitable owner of real property while the contract is still executory was established for the purpose of enabling him to resort to a court of equity for the protection of his rights. . . ."
252. McCLINTOCK, supra note 20, § 44.
253. Id.
254. Id. at § 60.
255. Id. at § 106.
(v) the specific remedy would become available to either party as soon as the contract was enforceable,256

(vi) following the maxim that what ought to be done would be regarded as having been done, equity would proceed on a fiction, as if the purchase price and land had in substance been exchanged, and all that remained was to complete the formal exchange.257

In that way equity reasoned that the buyer could be treated as the true owner of the realty and the seller could be treated as the true owner of the purchase price as of the time the contract became enforceable.258

For allocation of realty loss, the rule that grew from Paine was that once a sale contract was formed, "[a]ny subsequent deterioration or improvement of the property prima facie accrues to the purchaser as owner; as a loss by fire, according to the maxim 'damnum ex casu sentit dominus'."259 The rule described by Bracton had been turned completely around.260

256. Id.
257. Id.
258. See 3 AMERICAN LAW OF PROPERTY, supra note 20, § 11.22; McClintock, supra note 20, § 106; 2 John N. Pomeroy, A TREATISE ON EQUITY JURISPRUDENCE § 368 (S. Symons ed., 5th ed. 1941); Hermann, supra note 20, at 10-12; Simpson, Legislative Changes II, supra note 20, at 113.
259. Leake, supra note 20, at 303.
260. A similar development seems to have occurred in the law regarding risk of loss in the sale of goods. Bracton had said of medieval law that loss by the death of an ox prior to delivery of possession fell on the seller as owner. In Tarling v. Baxter, 108 Eng. Rep. 484 (K.B. 1827), the court adopted a rule functionally equivalent to the doctrine of equitable conversion of realty. The contract was for the sale of a stack of hay. After the agreement was made, but before the buyer made payment and took possession, the hay burned while still stacked in the seller's field. The loss was imposed on the buyer. Id. at 485. The reasons for this change of law are described in Honnold et al., supra note 43, at 383-84.
American states adopted the doctrine of conversion by contract for many uses, some of which continue today, and a majority applied it as did Paine for allocating risk of realty loss.

Turning to escrow loss, the first reported American case allocating escrow loss came nearly a century after Paine, although escrows were known in England and this country much earlier. None of the American cases has referred to English authority for escrow loss allocation.

Treatises and cases usually trace the entitlement rule for escrow loss to two California cases reported in 1924 and 1925. Oddly enough, the two

261. See, e.g., Moose v. Moose, 608 S.W.2d 3 (Ark. 1980) (trust which could be terminated by trustee’s sale of property was terminated when the sale contract was formed, as interests were then converted); In re Baker’s Estate, 78 N.W.2d 863, 867 (Iowa 1956) (conversion severs joint tenancy of sellers); Canenefax v. Clement, 818 P.2d 546 (Utah 1991) (seller’s interest converted to personalty and thus not subject to attachment of judgment lien where lien statute encompasses only realty); In re Estate of Willson, 499 P.2d 1298 (Utah 1972) (seller’s interest converted to personalty so that seller’s widow not entitled to dower tax exemption applicable only to realty).

A more recent and still controversial use of conversion doctrine is in protecting buyers against enforcement of forfeiture clauses in long-term installment sale contracts. Initially courts readily enforced such clauses, which allowed a seller to declare forfeiture of a buyer’s rights upon default on an installment payment, even after a buyer had made payments for many years. More recently, by using conversion theory to characterize a buyer’s interest as realty, some courts have reasoned that a contract buyer is in much the same position as a mortgagor. Courts have thus extended to buyers protection analogous to the equity of redemption that protects mortgagors from harsh foreclosure. See, e.g., Sebastian v. Floyd, 585 S.W.2d 381 (Ky. 1979). Other courts refuse to treat an installment land contract as analogous to a mortgage, and continue to strictly enforce forfeiture clauses. See, e.g., Smith v. MRCC Partnership, 792 S.W.2d 301, 305 (Ark. 1990). Forfeiture clauses, and the role of conversion theory, are considered in Eric T. Freyfogle, Vagueness and the Rule of Law: Reconsidering Installment Land Contract Forfeitures, 1988 DUKE L.J. 609, 631-33; John R. Lewis & John R. Reeves, How the Doctrine of Equitable Conversion Affects Land Sale Forfeitures, 3 REAL EST. L.J. 249 (1974). Rose has made interesting observations about the competing forces guiding the evolution of the law on enforcement of forfeiture clauses. See Carol M. Rose, Crystals and Mud in Property Law, 40 STAN. L. REV. 577, 585-86 (1988).

262. See, e.g., Brewer v. Herbert, 30 Md. 301 (Md. 1869).

263. It appears that the first reported case was Lipman v. Noblit, 45 A. 377 (Pa. 1900).

264. See WILLIAM BLACKSTONE, COMMENTARIES ON THE LAW 307 (Bernard C. Gavit ed., 1941) (describing the functions of an escrow in realty sales).

separate cases arose from the misdeeds of one escrow holder.\textsuperscript{266} H.B. Eshleman was handling a large number of escrows in the early weeks of 1921 when he "disappeared ... leaving a large shortage in his accounts."\textsuperscript{267} One set of his unfortunate clients went to the California Supreme Court in 1924, in Shreeves \textit{v. Pearson}.\textsuperscript{268} The seller had engaged Eshleman as a realtor to list a home for sale.\textsuperscript{269} The parties then arranged to have Eshleman serve as escrow holder for a deed and money escrow, with money deposited by the buyer.\textsuperscript{270} Eshleman disappeared before a title guaranty had been provided, which was the condition precedent to the seller's right to call for the money in escrow.\textsuperscript{271}

To determine which party had to suffer the loss, the court framed the question as one of agency, asking whether "Eshleman, at the time of his defalcation, [was] the agent of the seller and not of the buyers."\textsuperscript{272} The fact that the title guaranty had not yet been provided, so that the seller had no right to call upon Eshleman to turn over the money, led the court to conclude that at the time he disappeared Eshleman "still occupied his original position as the agent of the purchasers in respect to ... the purchase price [in] his hands."\textsuperscript{273}

The second set of unfortunates resolved their dispute a few months later through \textit{Hildebrand v. Beck}.\textsuperscript{274} Again, Eshleman's disappearance had come before the needed title guaranty was provided, and again the court imposed the loss on the buyer who had deposited the money.\textsuperscript{275} However, the court made no reference to \textit{Shreeves} or the agency theory used there. Instead, the court reasoned that because the seller at the time had no right to call for the money, the money was being held "in trust for the vendee," the vendor had

\begin{enumerate}
\item 266. Odder still, the California court made no mention of the relationship between the two cases.
\item 267. Shreeves \textit{v. Pearson}, 230 P. 448, 450 (Cal. 1924). Mr. Eshleman might also take some credit for prompting California's later enactment of what is probably the most comprehensive statutory scheme for regulating independent escrow holders and providing financial security for their clients. \textit{See CAL. FIN. CODE §§ 17000-17700} (West 1989 & Supp. 1994).
\item 268. 230 P. 448 (Cal. 1924).
\item 269. \textit{Id.} at 448.
\item 270. \textit{Id.} at 448-49.
\item 271. \textit{Id.} at 449-50.
\item 272. \textit{Id.} at 451.
\item 273. \textit{Id.} at 453.
\item 274. 236 P. 301 (Cal. 1925).
\item 275. \textit{Id.} at 303.
\end{enumerate}
no claim to it," and "it follows that the money embezzled was the money of the vendee.\textsuperscript{276}

The court had thus adopted two theories to reach the same result, both based on what can be broadly characterized as issues of status. One focused on the status of the relationship of the holder with each of the parties: agency, or no agency. The other focused on the status of the relationship of each party with the money in escrow: ownership or no ownership. For both theories the test was whether or not the conditions of the escrow agreement had been satisfied so that the right to receive the money had shifted to the seller, or remained with the buyer. The two theories lead to one rule, that loss falls on the party entitled to the money at the time of the loss.

That rule has now been accepted in every reported opinion in which escrow loss has been addressed.\textsuperscript{277} Some states use the agency terminology of \textit{Shreeves} to describe the rule.\textsuperscript{278} Most turn to the ownership terminology of \textit{Hildebrand},\textsuperscript{279} perhaps because \textit{Hildebrand} was made the subject of an A.L.R. annotation\textsuperscript{280} and is often said to be the leading case on escrow loss allocation.\textsuperscript{281} More recent California cases combine the two theories.\textsuperscript{282} Treatises seem to favor the ownership theory, and that is the position of the Restatement (Second) of Agency, which states: "If the escrow holder loses or disposes of an escrow, the one having the legal title to it at the time has the risk of loss..."\textsuperscript{283}

In neither \textit{Shreeves} nor \textit{Hildebrand} did the California court offer any explanation of underlying rationale, other than the conclusory statements noted

\textsuperscript{276} Id.
\textsuperscript{277} See sources cited in notes 11, 18 supra.
\textsuperscript{278} See, e.g., Lechner v. Halling, 216 P.2d 179, 183 (Wash. 1950) ("[W]hen an escrow agent absconds with money he is holding in his capacity as depositary, the loss must fall upon the person as whose agent he is holding the money at the time.").
\textsuperscript{279} See, e.g., Foster v. Elswick, 4 S.W.2d 946, 946 (Ark. 1928) (allocation based on whether funds in escrow "belong to" buyer or seller); Cradock v. Cooper, 123 So. 2d 256, 258 (Fla. Dist. Ct. App. 1960) (loss falls on the party with "legal title to the subject matter of the escrow").
\textsuperscript{281} See, e.g., 19 AM. JUR. \textit{Escrows} § 11 (1939); 30 C.J.S. \textit{Escrows} § 9 (1967).
\textsuperscript{283} \textit{RESTATEMENT (SECOND) OF AGENCY} § 14(D) cmt. a (1958).
above. Other states fell in line, adopting the rule without critical analysis, and without offering anything but conclusory explanation for their actions. Only one court on one occasion has offered any explanation for either theory on which the rule is based. In the 1950 case of Majors v. Butler the intermediate California appeals court provided this brief explanation for the agency theory: the "general rule is based upon the doctrine that a principal, although not himself at fault, is bound by the acts of his agent."

The courts developing the entitlement rule not only failed to examine critically the rule on its own merits. They also failed to observe that by using the status of legal ownership as a basis for escrow loss allocation, they were adopting a definition of ownership conflicting with the equitable ownership definition that the majority of jurisdictions use for realty loss.

284. The Washington history is instructive. The rule was developed there in a series of three cases. In the first, the court stated only that the parties had agreed upon the rule to be applied. Lieb v. Webster, 190 P.2d 701, 702 (Wash. 1948). In the second, the parties again agreed on the rule, and the court applied it without explanation. Angell v. Ingram, 213 P.2d 944, 945 (Wash. 1950). In the third, the court treated the rule as established, characterizing the prior cases as having "laid down" the rule. Lechner v. Halling, 216 P.2d 179, 183 (Wash. 1950).


286. Id. at 997. Courts have not called upon other principles of escrow law to support the entitlement rule, as they might do. The usual effect of the conversion rule is to impose realty loss on buyers. In Paine, Chancellor Eldon justified that burdening of buyers by referring to the many benefits given buyers through the doctrine of equitable conversion, including the remedy of specific performance to take advantage of a rising market. Paine v. Meller, 31 Eng. Rep. 1088, 1089 (Ch. 1801). The usual effect of the escrow entitlement rule is to impose loss on the buyer who has deposited money. There is some authority by which the imposition of escrow loss on the depositor could be justified as consonant with allocation of benefits to the depositor. See, e.g., Alexander v. Quality Leather Goods Corp., 269 N.Y.S. 499, 502 (N.Y. Sup. Ct. 1934) (depositor of shares retains shareholder rights during escrow period); Clark v. Campbell, 65 P. 496 (Utah 1901) (dividend declared while shares were in escrow goes to depositor). Those holdings have in turn served as the bases for broad dictum stating that "the incidents of ownership remain in the person depositing the property into escrow until the conditions of the escrow agreement are fulfilled." Press v. Marvalan Indus., Inc., 422 F. Supp. 346, 349 (1976). See TTS, Inc. v. Citibank, N.A., 158 B.R. 583, 586 (Bankr. D. Del. 1993); In re Bernard J. Rosenshein, 136 B.R. 368, 372 (Bankr. S.D.N.Y. 1992). In re Cobham Enter., 72 B.R. 779, 781 (Bankr. S.D.N.Y. 1987); Young, supra note 22, at 31.

287. The contradiction may not have been clear in California at the time of Shreeves and Hildebrand, because the realty loss law was unsettled, with some authority for the conversion rule and some for a minority rule not relying on equitable title. See Kelly v. Smith, 24 P.2d 471 (Cal. 1933) (surveying cases). California later adopted the Uniform Vendor and Purchaser Risk Act, abandoning reliance on
It appears that on only one reported occasion has a court considered both rules and there the circumstances were such that the conversion rule was not put to use. In Frankiewicz v. Konwinski, the seller of a farm deposited his title documents in escrow in accord with a sale agreement, and the escrow holder then disappeared with the documents. At about the same time, the buildings on the farm burned down. The loss of the documents was critical because the seller’s purported ownership of the farm was based on such convoluted circumstances that he could not prove good title without those documents.

The seller sought to force the buyers to complete the transaction, despite the fire damage. He urged application of the conversion rule. The ownership as a theoretical basis for realty loss allocation. CAL. CIV. CODE § 1662 (West 1985). The contradiction would be much more clear in those states that have settled upon the conversion rule for realty loss. Of that majority, at least four have also had occasion to address allocation of escrow loss and have adopted the entitlement rule. They are Florida, Maryland, New Jersey, and Pennsylvania. See supra note 12 and accompanying text. The New Jersey case addressing escrow loss is especially troubling. It suggests that a buyer/depositor is not only legal owner of funds deposited in escrow, but also is equitable owner. See Zaremba v. Konopka, 228 A.2d 91, 95 (N.J. Super. Ct. Ch. Div. 1967). However, New Jersey follows the conversion rule for realty loss, based on the theory that the buyer is equitable owner of the realty and the seller is equitable owner of the purchase price. See Gallichio v. Jarzla, 86 A.2d 820, 822 (N.J. Super. Ct. Ch. Div. 1952).


289. The case actually involved an exchange of a farm for an urban home, rather than a sale, id. at 369, so the case is not truly typical of either the cases treating realty loss or those treating escrow loss in the context of a realty sale. However, because the realty loss affected only the farm, Frankiewicz, who brought the farm to the exchange, will here be referred to as the realty seller. The Konwinski, who brought the urban home to the exchange, will be referred to here as the buyers of the farm. The court’s treatment of the realty loss allocation issue seems to fit with this classification of the parties’ roles.

290. Id. at 369-370.

291. Id.

292. Id. at 370. Frankiewicz claimed to have been purchasing the farm from the Bobbs, who in turn had been purchasing it under a contract with the record owner, Harris. Other than oral evidence, Frankiewicz’s only proof of his interest in the farm consisted of the documents he had placed in escrow: the original land contract between the Bobbs and Harris, and the assignment of that contract to him. He had no other copies of those documents. After the fire, the Bobbs’ interest in the farm was extinguished in favor of Harris, and he obtained a quitclaim deed from the Bobbs and a judgment for possession. Harris knew nothing of the alleged assignment of the Bobbs’ interest to Frankiewicz. Id.

293. Id. at 369.
court recognized the conversion rule295 but refused to apply it to grant specific performance because without the critical documents the seller was unable to carry out his side of the bargain, to convey legal title.296 The seller contended that he had actually conveyed legal title before the fire by depositing the documents in escrow, from which they were later to be delivered to the buyer.297 The court rejected that argument by calling upon the entitlement rule.298 It held that at the time the documents were lost, the escrow holder was still acting as the seller's "agent with respect to his papers" so that the seller had to "bear the consequence of the default or failure of his agent."299 The court made no other observations about the interplay of the entitlement rule and the conversion rule.

Aside from that brief and unrevealing convergence of the two bodies of law, the rules for escrow loss and those for realty loss have been developed in separate lines of authority, without recognition of their functional relationship.300

2. The common failings of the theories of ownership and agency

The conversion and entitlement rules use contradictory definitions of ownership for allocating two types of risk that occur within the same overall transaction between the same parties. The conversion rule defines the buyer as the risk-bearing owner of the realty and the seller as the owner of the purchase price, while the entitlement rule defines the buyer as the risk-bearing owner of the money in escrow and the seller as the owner of the realty title documents in escrow until the time for closing.

This inconsistency is disturbing. The inconsistency would be less bothersome if the authors of the rules had shown some practical advantage of each rule that outweighed the attractions of consistency. They have not. The

294. Id. at 370.
296. Frankiewicz, 224 N.W. at 370.
297. Id.
298. Id.
299. Id. The court cited California's Hildebrand case as support for the entitlement rule, although it was apparently using the agency theory of Shreeves, rather than the legal title theory of Hildebrand. Id.
300. In Tinker v. McLellan, 331 P.2d 464, 467 (Cal. Dist. Ct. App. 1958), in the course of considering a realty loss allocation problem, the court did refer to the Shreeves and Hildebrand line of cases, but did so for a point of escrow law other than the entitlement rule for escrow loss allocation.
disturbance might be easily eliminated by changing one rule to be consistent with the other. The entitlement rule might be reversed, perhaps by applying the theory of equitable conversion to escrow agreements. By recognizing that an escrow agreement gives an enforceable claim for the money deposited by the buyer, courts could treat the seller as the equitable owner of the money, with risk attending that ownership.

On the other hand, the rule for realty loss could be revised to impose risk on the owner of legal title. That was apparently the rule followed in England prior to the turn taken in Paine in 1801. There is a great deal of literature addressing, and in most instances, castigating the rule of Paine. Much of the criticism focuses on the unfairness of imposing risk on a buyer when the seller who has legal title and usually has possession of the realty is "more nearly the owner." That concern would be eliminated by a return to the legal title rule of the middle ages. At least one American state followed that older rule for a time, so that ownership was defined consistently, by legal title, for both realty loss and escrow loss.

Changing either the entitlement rule or the conversion rule would cure the inconsistency. There is, however, a deeper problem that is revealed by the inconsistency. It is a problem that might have been more readily confronted if the two bodies of loss allocation law had been integrated. If ownership is the best basis for allocating risk, how is it that two bodies of law can lead to diametrically opposed definitions of ownership within one transaction? The contradiction highlights the failure of the theories on which the rules are based. It is possible for the two lines of authority to reach different conclusions as to ownership because in truth the attributes of ownership are

301. See e.g., CUNNINGHAM ET AL., supra note 20, at 736 & nn.2-3.
302. Fineberg, supra note 20, at 461. The sentiment is well presented by Dobbs. Imposition of realty risk by equitable conversion is a "good example of the trouble that comes when a moral principle is carried to the limit of its logic, rather than to the limit of its morality." DAN B. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 40-41 (1973).
303. Washington for many years refused to apply the general doctrine of equitable conversion. Because the courts did not view a buyer as having an equitable ownership interest, they did not apply the conversion rule for realty loss. The history is described well by Hume, supra note 20, at 233-34. Washington has long followed the entitlement rule for escrow loss. See, e.g., Lechner v. Halling, 216 P.2d 179, 183 (Wash. 1950).

States which have judicially adopted the Massachusetts approach to realty loss also refer to legal title. However, that approach uses legal title not to define ownership, but rather as an indication of how the parties intended to allocate risk of loss. The same is true of the Uniform Vendor and Purchaser Risk Act. Both of those minority rules have switched from a focus on determining the status of ownership to a focus on determining the intentions of the parties, from property to contract.
not found in one party. Neither party can honestly be said to be the owner. Both the conversion rule and the entitlement rule impose loss through theories of ownership only by ignoring the fundamental characteristics of the problems they seek to address. They each rely on a concept of sole ownership, when by definition the attributes of ownership are divided and in transition during the periods for which the rules are meant to serve.

Professor Hume observed that fundamental flaw in the law regarding realty loss. "[I]t is quite impossible to decide which party . . . has 'real property,' because the usual incidents associated with ownership are divided between the parties . . . ."\textsuperscript{304} The notion of unilateral ownership as a theory for allocation reflects an "all-or-nothing solution[] to problems that are not all-or-nothing problems."\textsuperscript{305}

It is similarly implausible to apply a notion of unilateral ownership for money deposited in escrow. The usual result of the entitlement rule as applied to deed and money escrows is to impose loss on the buyer who has deposited money, on the theory that the depositor has retained ownership until the escrow closes. However, the defining characteristic of an escrow arrangement is that the depositor must "part with 'dominion and control' over the deposited funds."\textsuperscript{306} In fact, the depositing buyer retains only a limited right to demand return of the money if the sale fails. Both parties expect the sale to proceed and the money to pass to the seller. As one critic has observed, reasoning that the buyer is the sole owner works only through a sort of negative logic syllogism: the buyer owned the money prior to depositing it, full ownership does not pass to the seller until the escrow conditions are met, therefore the buyer must still be the owner.\textsuperscript{307}

The usual result of the rule as applied to set-aside escrows is to impose loss on the seller.\textsuperscript{308} It is equally untenable to treat the seller as sole owner.

\textsuperscript{304} Hume, \textit{supra} note 20, at 236.

\textsuperscript{305} \textit{Id.} at 242. Hume's criticism was directed both at the equitable conversion rule, and at the former Washington rule by which the seller as holder of legal title was treated as true owner for purposes of allocation of realty loss. Most critics have focused on the concept of ownership as defined through equitable conversion. One labels equitable conversion a "talisman, employed to decide cases for which it has no practical relevance at all" and observes that "[t]he decisions often seem adamant in their unwillingness to discuss the underlying policy issues; equitable conversion almost becomes a substitute for thinking about the real questions in the case." \textsc{Cunningham et al.}, \textit{supra} note 20, at 736. \textit{See also} Lee, \textit{supra} note 20, at 373 (equitable conversion "frequently obscures more than it reveals").

\textsuperscript{306} Young, \textit{supra} note 22, at 29 (quoting West Fed. Sav. & Loan Ass'n v. Interstate Inv., Inc., 205 N.W.2d 361, 363 (Wis. 1973)).

\textsuperscript{307} \textit{See} Garrison, \textit{supra} note 22, at 47.

in those circumstances, because the primary function of the escrow arrangement is to prevent the seller from gaining dominion and control of the money during the escrow period.

The fallacy of the notion of sole ownership has recently been recognized by courts faced with two other problems relating to deposits held in escrow: allocation of interest accruing on deposited funds and characterization of ownership for purposes of bankruptcy.

The most frequently cited case addressing allocation of interest accrued on escrowed funds is New York's Lischak v. Kotzer. Both buyer and seller claimed the right to take interest accrued on funds that the buyer had deposited in escrow, and they had made no provision as to interest in their sale contract and escrow agreement. New York had previously fallen in line with the Hildebrand line of cases and adopted the entitlement rule for escrow loss allocation. The Lischak court reasoned simply that the right to take accrued interest, like the risk of loss by embezzlement, was an aspect of ownership, and necessarily fell to the same party who would be characterized as the owner for purposes of risk allocation.

A more thoughtful and honest approach to interest allocation and ownership is found in New Jersey's Jacobs v. Great Pacific Century Corp. An escrow was not used, however, the arrangement had characteristics similar to those of an escrow. The buyer had delivered funds directly to the seller as a down payment on realty. The seller had deposited the money in a special segregated "trust" bank account pending the closing of the sale, as the parties had agreed. The agreement had no provision as to the right to interest accruing on the deposit. It did, however, incorporate the terms of a statute providing that down payments in such trust accounts "shall continue to be the money of the person making such purchase ... until actually employed in connection with the consummation of the transaction."

(seller bears loss of nonrefundable earnest money deposit).

310. Id. at 997.
312. Lischak, 408 N.Y.S.2d at 998, citing Asher, 267 N.Y.S.2d at 936. Accord Terry v. Castleton Farm, 618 S.W.2d 583, 585 (Ky. Ct. App. 1981) (Lischak cited to support holding that interest on escrowed money is "considered to have the same ownership as the principal by which it is produced").
314. Id. at 1024.
315. Id.
316. Id. at 1023.
317. Id. at 1024 (quoting N.J. STAT. ANN. 49:3-40 (West 1970) (repealed 1985)).
When both parties claimed the accrued interest, the trial court found for
the buyer on the theory that the incorporated language made the buyer "the
owner of the deposit for all purposes" and the right to interest was an attribute
of ownership. 318

The appeals court rejected that reasoning. Instead, the court held that
"neither a seller nor a purchaser 'owns' [such a trust] deposit to the exclusion
of the other during the period." 319 It found the statutory language was
intended only to prevent the seller from commingling the deposit with
personal funds, and to prevent the down payment from being treated as an
asset of the seller should the seller become insolvent, not to determine such
matters as the right to interest income. Having rejected the notion that either
party could be considered the sole owner of the funds for all purposes, the
court went on to address the real issue: ascertaining the parties' "unexpressed
intention" as to which should have the right to interest income. 320

The court engaged in ordinary contract interpretation by examining the
words, subject matter, and circumstances of the agreement, finding an implied
agreement that the buyer had the right to interest generated while the funds
were held in the trust account. 321 Although New Jersey, like New York, had
previously adopted the entitlement rule and underlying ownership theory for
escrow loss allocation, 322 the more recent Jacobs reasoning shows a recogni-
tion of the shallowness of the notion that either buyer or seller can honestly
be considered sole owner of funds deposited in escrow.

The second area in which the sole ownership notion has been questioned
is that of determining the scope of a bankruptcy estate. In the 1993
bankruptcy case of TTS, Inc. v. Citibank, N.A., 323 the debtor had deposited
funds in escrow long before entering bankruptcy, and the court had to
determine whether the funds were part of the bankruptcy estate. 324 The
essential issue was whether the depositor owned the money in escrow. New
York law governed the question. 325 The conditions for release of the money
had not been fulfilled. 326 The court recognized New York’s view that legal

318. Id.
319. Id.
320. Id.
321. Id. at 1024-26.
323. 158 B.R. 583 (Bankr. D. Del. 1993). The escrow account was established
between an employer and employee, with funds to be released to the employee as part
of a retirement package, so long as the employee adhered to a promise not to compete
after leaving the employer.
324. Id. at 585.
325. Id. at 586.
326. Id. at 587.
title to a thing deposited in escrow remains with the depositor during an escrow period. However, it went on to demonstrate that the other party also has a recognizable interest. It did so by applying reasoning similar to that which had two centuries earlier led to the development of the conversion rule in Paine v. Meller.

The court reasoned that the escrow agreement worked something in the nature of an equitable conversion. "The deposit of property placed in escrow 'creates in the grantee . . . an equitable interest in the property. . . ."

By labelling the other party's rights as an equitable interest in the funds, the court was able to get past the fallacy that sole ownership lay with the depositor as legal owner. It also noted that the depositor could have a substantial beneficial interest, beyond mere legal title, which could also be characterized as an equitable interest. The court then examined the extent of each party's substantive interest in the account, scrutinizing the terms of the escrow agreement, as well as the surrounding circumstances. The most important conditions of the escrow had been fulfilled, although a few minor requirements were yet to be completed. The court found that the depositor's interest was far outweighed by the other party's interest, and refused to take the money into the depositor's bankruptcy estate.

The court used the labels of legal and equitable title to recognize that both parties had ownership interests, but then went beyond the labels to make an honest assessment of the relative rights of the parties. In less one-sided circumstances, a court's recognition of the co-existence of interests should lead to a determination that ownership of funds in escrow is substantially balanced as between the buyer and seller in a realty sale, whether or not a court makes use of the legal and equitable title labels.

327. Id. at 586.
328. 31 Eng. Rep. 1088 (Ch. 1801).
331. Id. at 586-88.
332. Id. at 587.
333. It might be argued that the TTS, Inc. reasoning is applicable only to bankruptcy proceedings. However, the court indicated that its task was to apply state law to determine what interests the parties had prior to and without regard to the filing for bankruptcy. TTS, Inc., 158 B.R. at 586.
334. A student Note some four decades earlier suggested that an honest weighing of interests of buyer and seller could be accomplished by using the legal and equitable title notions. The author went on to urge that once co-ownership is recognized, escrow loss should be divided accordingly, rather than imposed entirely on one party. See
The entitlement rule for escrow loss also relies on another theory of status: that loss falls upon the party for whom the escrow holder was serving as agent at the time of the loss.335 Of course that theory depends on the notion that an escrow holder is the agent of one party only, rather than being the servant of both. The theory is as fundamentally flawed as the theory of sole ownership.

By definition, an escrow holder is bound to serve both buyer and seller, and within the confines of the escrow instructions owes fiduciary duties to both.336 Once the buyer has deposited funds in escrow, the holder cannot return the funds at the buyer's request, without the express agreement of the seller, except in accord with instructions given by the parties when the escrow was opened.337 Even in Shreves v. Pearson,338 the seminal case adopting the agency theory, the California court recognized the well established general rule of escrow law that an escrow holder is "prior to the performance of the conditions of the escrow, the agent of both parties thereto."339 The court then proceeded to hold that when the infamous Mr. Eshleman disappeared with the money, prior to the performance of the conditions of the escrow, he was acting "as the agent of the purchasers in respect to . . . the purchase price . . . [in] his hands. . . . "340 The court did not explain how it jumped from recognizing the dual agency to a determination that for purposes of loss allocation the agency relationship connected only the holder and the depositor.

One court has explicitly refused to make that leap. In Zaremba v. Konopka,341 the New Jersey court referred to the "firmly established" holding that an "escrowee acts as agent for both parties" and in that light stated that the agency theory was "of no help" in allocating the escrow loss as between the buyer and seller.342

The fallacy of the unilateral agency theory is being recognized by courts addressing other problems connected with the use of escrows. In the 1993

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Pederson, supra note 22, at 233.
335. See supra text accompanying notes 265-86.
337. See 28 AM. JUR. 2d Escrow § 17 (1966).
338. 230 P. 448 (Cal. 1924).
339. Id. at 451.
340. Id.
342. Id. at 94. While the New Jersey court's treatment of the agency theory was refreshingly accurate, it then turned to the equally deficient ownership theory, imposing the escrow loss on the buyer after ruling that the buyer owned the deposited money at the time the escrow holder absconded with it. Id. at 95.
case of 99 Commercial Street, Inc. v. Goldberg, a federal court applying New York law has given a refreshingly honest review of both the sole ownership theory and the unilateral agency theory as to escrows. A lender and borrower established an escrow account. The parties had agreed to have the money invested while it was in escrow. The escrow holder signed an arbitration agreement encompassing any claims that might be made against the broker who handled the investment. When the account lost value, the borrower brought a securities fraud suit against the broker, and the broker sought to compel the borrower to arbitrate the claim.

It was necessary to determine whether the borrower was bound by the escrow holder’s signing of the arbitration agreement. The borrower and broker rested their competing arguments on the ownership and agency theories underlying the entitlement rule for loss allocation. The borrower argued that at the time the holder signed the arbitration agreement the money was still owned by the lender who had deposited it, and the holder was acting as agent of the lender with respect to the money. The broker argued that the conditions of the escrow were such that the ownership of the money and the holder’s agency tie had shifted to the borrower by the time of the signing.

The court recognized the two theories, but refused to make the logical extension of applying them to the problem at hand. As to the ownership theory, the court clarified that

once funds . . . are deposited with the escrow agent, the [depositor] loses control over the [funds], and the [intended recipient] does not obtain title until the condition is satisfied. [So that in] a very real sense, ownership is held in stasis, the [funds] available [to neither party], awaiting disposition by the agent in accordance with the terms of the agreement.

Accordingly, the court held that "[b]oth parties to an escrow agreement own the escrow account for purposes of acts that an escrow agent undertakes

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344. The escrow account was established in conjunction with the mortgaging of one piece of realty and intended purchase of another. The law firm serving as escrow holder was instructed that the money deposited by the lender be released to the borrower upon fulfillment of certain conditions. Id. at 903.
345. Id.
346. Id.
347. Id. at 902.
348. Id. at 905.
349. Id.
350. Id. at 906.
in accordance with the terms of the escrow agreement.\textsuperscript{351} On the theory of agency, the court explained that an "escrow agent is, in effect, agent to both parties . . . and holds the [funds] for both parties. Accordingly the escrow agent acts for both parties and, by definition, on behalf of both parties [with respect to funds]."\textsuperscript{352}

With this clear view of the nature of the escrow arrangement, the court held the borrower bound by the holder's signing of the arbitration agreement.\textsuperscript{353} It so held not because the escrow conditions had been satisfied, but because both parties owned the account and both had relationships with the holder throughout the escrow period.\textsuperscript{354}

3. Complications of application resulting from reliance on the ownership and agency theories

It might be argued that the faults of the conversion and entitlement rules are outweighed by their fulfillment of the need for bright-line rules. In actuality, their reliance on the untenable theories of sole ownership and unilateral agency leads to significant difficulties in application, substantially reducing their functioning as bright lines. Both rules require precise determinations as to the points at which losses occur, and the points at which ownership or agency are said to shift from one party to another.

For realty loss, the point in time at which loss occurs is usually not particularly difficult to determine. The point at which ownership is said to shift can be more troublesome. It is usually said that conversion occurs when a sale contract is formed. More precisely, the theory of conversion comes into play only when there is a contract that is specifically enforceable. The cases are in some disarray as to how the conversion rule is affected by the existence of various conditions within a contract that might affect specific enforcement during an executory period. For many years the Washington courts essentially nullified the conversion rule as to installment land contracts containing forfeiture clauses.\textsuperscript{355} Such clauses typically provide that a buyer's contract rights may be forfeited upon failure to timely pay each installment.\textsuperscript{356} Washington held that with a buyer's rights being subject to forfeiture, a buyer could not be treated as owner until the final installment had been paid, so that

\textsuperscript{351} Id. at 905 (emphasis in original).
\textsuperscript{352} Id. at 906.
\textsuperscript{353} Id.
\textsuperscript{354} The court had also determined that the signing of an arbitration agreement binding the escrow parties was within the scope of authority of the escrow holder as their joint agent with respect to the funds. Id.
\textsuperscript{355} The Washington history is described in Hume, supra note 20.
\textsuperscript{356} See id. at 236 n.12.
the conversion rule could not be applied until then. In that view, equitable title did not vest until the buyer had an unconditional right to demand conveyance by deed.\textsuperscript{357}

The Illinois cases long presented conflicting views as to when equitable conversion was thought to occur.\textsuperscript{358} Some cases stated that a buyer does not acquire equitable title until the buyer has performed all obligations that precede a seller's obligation to convey legal title.\textsuperscript{359} Others held that conversion occurs at the formation of a sale agreement.\textsuperscript{360}

One of the more troublesome issues has been a seller's obligation to have marketable title. In general a seller is obligated to have marketable title by the time set for closing of a sale, and is not obligated to have title in marketable status during the executory period.\textsuperscript{361} In fact, one of the functions of the executory and escrow periods is to permit a seller to take steps necessary to obtain marketable title. If a seller has not yet made marketable title at the time a realty loss occurs, the seller would not be in a position to demand specific performance of the buyer at that moment, although the seller would likely be able to clear title by the time a dispute over the loss could be brought to court. Some courts have said that a seller's failure to have marketable title as of the time of loss defeats the conversion rule.\textsuperscript{362}

Some commentators have urged that the sharpness of the conversion rule be dulled by application of traditional equitable factors.\textsuperscript{363} That approach was taken in some older cases, such as \textit{Smith v. Cansler},\textsuperscript{364} in which the court's refusal to compel specific performance of the buyer after a fire was in part based on the court's unwillingness to use its powers to impose such a heavy burden on an innocent buyer. In more recent cases, the notion of conducting a wide-ranging equitable analysis of all facts and circumstances, and possibly refusing specific performance, has been stated only in dissenting

\textsuperscript{357} \textit{Id.} at 235.

\textsuperscript{358} The Illinois history is examined in \textit{Pusateri}, \textit{supra} note 20, at 469-75, and \textit{Hermann}, \textit{supra} note 20, at 14-22. Illinois later adopted the Uniform Vendor and Purchaser Risk Act, replacing the conversion rule. 765 IL COMP. STAT. ANN. 65/1-65/3 (Smith-Hurd 1993).

\textsuperscript{359} \textit{See} \textit{Hermann}, \textit{supra} note 20, at 14-22; \textit{Pusateri}, \textit{supra} note 20, at 469-75.

\textsuperscript{360} \textit{See} \textit{Hermann}, \textit{supra} note 20, at 14-22; \textit{Pusateri}, \textit{supra} note 20, at 469-75.

\textsuperscript{361} \textit{See} \textit{CUNNINGHAM ET AL.}, \textit{supra} note 20 at 730.


\textsuperscript{363} \textit{See}, e.g., \textit{Stone}, \textit{supra} note 20, at 386.

\textsuperscript{364} 83 Ky. 367 (1885) (overruled on other grounds, \textit{Holland v. Stubblefield}, 206 S.W. 459 (Ky. 1918)).
opinions. Nevertheless, commentators continue to urge courts to treat specific performance in the context of realty loss as a discretionary remedy, not a right. Injecting discretion into the remedial process would likely render uncertain the applicability of the conversion rule that is based on the availability of specific performance.

All such varying interpretations of the conversion rule take away from the security of a bright line by which the parties might plan their activities when entering into a contract, and which might preclude litigation after the fact of a loss.

For escrow loss, application of the entitlement rule is made difficult by the need to precisely determine the point in time at which loss has occurred as well as the need to determine whether and when ownership and agency status have shifted from buyer to seller. Ascertaining the time of loss has proven to be difficult in situations in which an escrow was serving as escrow in several transactions concurrently, had deposited escrowed funds from several transactions into one general escrow account, and had embezzled monies from that account over a period of time through numerous withdrawals. If, in any of the escrow transactions, the shift of ownership and agency had occurred during the period in which the embezzlement was occurring, the parties to that transaction have been put to disputing whether the embezzlement of the funds for their transaction took place before or after the shift.


366. See, e.g., Gaffney, supra note 20, at 1142.

367. The need for a bright-line rule in this context is perhaps not very pressing, because the parties are free to expressly allocate loss within their sale agreement. To the extent it is important to have a clear rule known to the parties in advance, the conversion rule probably fails anyway. As stated supra note 190, this author has found that most lay persons, law students, and even lawyers are surprised to learn of the effect of the conversion rule. The authors of the Cunningham treatise report similar results from their informal surveys of law students. See CUNNINGHAM ET AL., supra note 20, at 741 n.27.

368. Given that the monies of each of several escrow transactions are practically untraceable once they have been mingled, the courts have rather blithely resolved such disputes by narrowly focussing on the one transaction at bar, determining whether at the time in question there were sufficient funds in the general account to satisfy the escrow holder's obligations to one set of parties, while ignoring the fact that there was clearly insufficient money in the account to satisfy all of the holder's obligations to all sets of parties. See, e.g., Lechner v. Halling, 216 P.2d 179, 184 (Wash. 1950) (although apparent that holder's obligations "as a whole, were considerably greater than the amount on deposit ... she had sufficient money ... to have paid ... Mrs. Lechner ... "). Cf. Majors v. Butler, 221 P.2d 994, 996 (Cal. Ct. App. 1950) (evidence unclear as to whether funds of one of many escrow transactions were
Determining whether ownership and agency have shifted has often proven to require painstaking analysis of the escrow agreements and the events that have transpired relevant to the conditions imposed in the agreements. For deed and money escrows, the seller’s right to call for the purchase price held in escrow is ordinarily dependent on the seller’s having delivered into escrow a deed.\(^{369}\) When that general understanding holds true, then entitlement to the money in escrow is determined by reference to the transfer of legal title to the reality.\(^{370}\) However, in some instances, the escrow instructions provide that the money is not to be released to the buyer until the deed is received and a title insurance policy is issued, so that a loss occurring after the deed is deposited but before the insurance is issued falls on the buyer.\(^{371}\)

Applying the rule is made more complex by inclusion of liquidated damages provisions, which often appear in earnest money sales agreements. In *Van Dyke v. Lauer*,\(^ {372}\) the buyer had deposited $3,000 with the seller’s realty agent as part of an offer to purchase reality.\(^ {373}\) The form contract provided that if the seller were to accept the offer, the money would be held in escrow by the realtor and the money would be credited as part of the purchase price if the sale were to be completed.\(^ {374}\) If the sale were to fail because of the buyer’s unexcused default, the money would be treated as liquidated damages, to be forfeited to the seller.\(^ {375}\) The buyer would have a right to demand return of the money only if the sale were to fail because of traceable or had been depleted by insolvency).

\(^{369}\) In some instances, it is not clear that the seller’s right to call for the escrowed money depends upon the seller’s deposit of a deed. For example, in *Zaremba v. Konopka*, 228 A.2d 91 (N.J. Super. Ct. Ch. Div. 1967), the agreement apparently imposed only one condition precedent to the release to the seller of the down payment deposited by the buyer. It was conditioned on the buyer’s success in obtaining suitable institutional financing for the balance of the purchase price. The loss occasioned by the escrow holder’s embezzlement of the down payment was imposed on the buyer, as owner, because the financing contingency had not been fulfilled at the time of the loss. The buyer, unaware of the embezzlement, later attempted to waive the contingency and called for the seller to complete the sale, but the court found that waiver irrelevant because it occurred subsequent to the embezzlement. *Id.* at 95.

\(^{370}\) *See, e.g.*, Lechner v. Halling, 216 P.2d 179 (Wash. 1950) (risk of loss of money shifted to seller when deed to reality was delivered by escrow holder to buyer); Pagan v. Spencer, 232 P.2d 323, 325 (Cal. 1951) (transfer of title to money depended on transfer of title to reality, which had not occurred).

\(^{371}\) *See, e.g.*, Angell v. Ingram, 213 P.2d 944 (Wash. 1950).

\(^{372}\) 100 N.W.2d 335 (Wis. 1960).

\(^{373}\) *Id.* at 336.

\(^{374}\) *Id.*

\(^{375}\) *Id.* at 336-37.
an unexcused default of the seller, such as failure to provide marketable title.\footnote{376}{Id. at 338.}

Given this provision for forfeiture, the \textit{Van Dyke} court found that the title to the earnest money deposit had vested in the seller at the moment the seller accepted the offer, "subject to be divested by a condition subsequent" if the seller later defaulted.\footnote{377}{Id.} Because the escrow holder had embezzled the funds after the seller accepted the offer, and the seller was not then in default, the money embezzled was that of the seller,\footnote{378}{Id.} although the title to the realty had not yet been transferred.\footnote{379}{Id.}

A similar principle has been applied for set-aside escrow arrangements. In \textit{Cradock v. Cooper},\footnote{380}{Id. at 338.} in closing the sale the parties had set aside money in escrow to ensure clearance of a tax lien.\footnote{381}{Id.} The agreement provided that the money would either be paid to the seller if the seller cleared the lien, or would be used by the escrow holder to clear the lien, with any surplus to be paid to the seller.\footnote{382}{Id.} No provision was made for any of the money to be returned to the buyer.\footnote{383}{Id.} The court imposed the loss on the seller, reasoning that the buyer had relinquished all rights in the money.\footnote{384}{Id.}

The most recently reported escrow loss case took a similar approach, again demonstrating the difficulties brought on by reliance on the untenable theories of sole ownership and agency. In the 1993 case of \textit{Stuart v. Clarke},\footnote{385}{Id. at 256-57.} the parties met to close the sale, at which time the seller informed the buyers of an unresolved encumbrance on the realty title.\footnote{386}{Id.} Rather than

\begin{itemize}
\item \footnote{376}{Id. at 338.}
\item \footnote{377}{Id.}
\item The only authority cited by the \textit{Van Dyke} court was an Illinois case which had upheld a seller's right to keep an earnest money deposit as liquidated damages upon the buyer's default. \textit{Id.} at 338 (citing Summers v. Hedenberg, 115 N.E. 566 (III. App. Ct. 1916)). In so holding, the Illinois court had stated that "the earnest money was [the seller's] money from the moment it was paid over [in escrow] as part of the purchase money, and so remained unless there was a defect in the title which was neither cured nor excused." Summers v. Hedenberg, 198 Ill. App. 460, 466 (III. App. Ct. 1916).
\item \footnote{379}{\textit{Van Dyke}, 100 N.W.2d at 336.}
\item \footnote{380}{123 So. 2d 256 (Fla. Dist. Ct. App. 1960).}
\item \footnote{381}{\textit{Id.} at 256-57.}
\item \footnote{382}{\textit{Id.}}
\item \footnote{383}{\textit{Id.} at 258.}
\item \footnote{384}{See also Lipman v. Noblit, 45 A. 377, 378 (Pa. 1900) (after sale otherwise closed, part of money was placed in escrow to be released to seller upon seller's clearing of a mortgage lien, so that buyer had relinquished all rights to the money).}
\item \footnote{385}{619 A.2d 1199 (D.C. 1993).}
\item \footnote{386}{\textit{Id.} at 1199.}
\end{itemize}
delay the closing they agreed on a set-aside escrow.\textsuperscript{387} The realty deed and most of the purchase price were exchanged.\textsuperscript{388} A $13,500 portion of the purchase price was placed in escrow, to be released to the seller upon proof that the title encumbrance had been cleared.\textsuperscript{389} The agreement did not specify what was to happen to the money if the seller failed to clear the title.\textsuperscript{390} The court inferred two possibilities: that the money would be used to pay for clearing the title, or would be returned to the buyers as compensation for the cloud on the title.\textsuperscript{391} The holder absconded with the money before the seller cleared his title.\textsuperscript{392}

The court, in a two to one decision, applied the entitlement rule\textsuperscript{393} and held that the loss fell on the seller.\textsuperscript{394} The dissent reasoned that because the seller had not fulfilled the condition of clearing the realty title, he was not entitled to call for the escrowed money, and therefore had never gained title to the money.\textsuperscript{395} On that logic, ownership necessarily remained with the depositor/buyers.\textsuperscript{396}

The majority agreed that would be the result for what it termed a "normal escrow situation," by which it meant a typical deed and money escrow.\textsuperscript{397} The majority found this set-aside arrangement was not a "normal" escrow, because the realty deed had been delivered to the buyers before the escrow was opened.\textsuperscript{398} Given that situation, the majority reasoned that ownership of the escrowed money must have passed to the seller when the realty title passed to the buyers, because "[t]he buyers cannot logically be the owners of both the purchased property and the portion of the money in escrow."\textsuperscript{399}

\textsuperscript{387} Id.
\textsuperscript{388} Id. at 1200.
\textsuperscript{389} Id. at 1199-1200.
\textsuperscript{390} Id. at 1201.
\textsuperscript{391} Id.
\textsuperscript{392} Id. at 1200.
\textsuperscript{393} The majority recited both the agency and the ownership theories for the entitlement rule. Id. at 1200. The dissent wrote only of the ownership theory. Id. at 1202. The District had previously stated the entitlement rule in two opinions. See Ferguson v. Caspar, 359 A.2d 17, 22 (D.C. 1976); Lawyers Title Ins. Corp. v. Edmar Constr. Co., 294 A.2d 865, 867 (D.C. 1972).
\textsuperscript{394} Stuart, 619 A.2d at 1201.
\textsuperscript{395} Id. at 1203 (Terry, J., dissenting).
\textsuperscript{396} Id.
\textsuperscript{397} Stuart, 619 A.2d at 1200.
\textsuperscript{398} Id.
\textsuperscript{399} Id. The court repeated the reasoning in a later passage: "It simply does not make sense to say the buyers had title to the escrowed funds while recognizing that the buyers also had title to the real property." Id. at 1201. The author obviously was referring only to legal titles to both the realty and the money, not equitable titles, and
The dispute among the members of the panel can be reduced to their disagreement on the function of the seller's obligation to clear the realty title. The dissent saw it as a condition precedent to the seller's right to call for the money. The majority saw it as a "condition subsequent entitling him to release of the escrowed funds" of which he was already owner.

The inability of the members of the Stuart court to agree on the question of which party was entitled to the money demonstrates the difficulties inherent in applying a test of status to a situation in which ownership is necessarily divided and the escrow holder serves both parties simultaneously. The outcome can be manipulated by the simple expedient of characterizing a contingency as either a condition precedent or a condition subsequent. The entitlement rule established at the beginning of this century has not succeeded as a bright line eliminating the need for costly litigation as recently as 1993.

IV. CONCLUSION

It is often said that the core of the American dream is home ownership. Realty sale contracts and escrows are increasingly joined as related components of the overall purchase and sale transactions by which that dream is made real. With each component there arise risks of loss, and those risks must be allocated between buyer and seller. The law by which those risks are presently allocated has been developed without recognition of the functional interrelatedness of sales contracts and escrows, and the risks associated with each.

This Article begins the process of bringing to light what has long been obscured. The Article has surveyed the cases in each area, and compared

was not considering the combined effect of the conversion rule and entitlement rule, which taken together do treat a buyer as true owner of both the realty and money deposited in a deed and money escrow.

400. Id. at 1203.

401. Id. at 1200. The majority viewed this situation as analogous to the circumstances of Cradock. However, it failed to note that in Cradock the buyer had relinquished all rights to return of the money, whereas in Stuart the court inferred an agreement that the money would be returned to the buyer unless the seller succeeded in clearing the encumbrance.

The Stuart majority also supported its holding by reference to the "less innocent" fault-based rule. The use of an escrow had only become necessary because the seller had failed to clear the title before the closing, despite knowing about the problem well in advance. On that basis the majority reasoned that the "case also falls within the familiar equity principle . . . that "where one of two innocent parties must suffer a loss the loss should be borne by the one whose act permitted the loss to occur."" Id. at 1201 n.2. The dissent found the seller to have been no more at fault than the buyers. Id. at 1204 (Terry, J., dissenting).
them on three points: the role of fault, the role of express agreement, and the role of ownership and agency status.

As to fault, it has been shown that within each body of law provision clearly is made for allocating loss on the basis of culpability. When one party bears a sufficient degree of fault regarding either realty loss or escrow loss, the loss will be imposed on that party. Allocation of loss on the basis of fault is the stuff of tort law. The issues now being addressed and yet to be addressed in matters of realty and escrow loss are similar to those faced in the field of tort law. Standards must be set to distinguish fault from fortiuty. Setting those standards, determining what conduct merits blame, and determining what constitutes causation, are in turn decisions which cannot be made well without some understanding of the policies sought to be served. As in tort law, there are indications here that loss allocation on the basis of fault serves at least two significant policies: economically efficient loss prevention and imposition of moral norms.

The policy of loss prevention is reflected in the statement of Jones v. Lally that escrow loss should fall on the party best able to avoid loss.\textsuperscript{402} That policy and the morality policy are represented in the decisions imposing either escrow or realty loss on the "less innocent" of the parties.

The reporter of a Restatement suggests that escrow loss should be imposed on both parties rather than entirely on one when both parties are equally at fault, or even when they are equally without fault. Although that course has not yet been taken by the courts, neither has it been rejected. It may also be a viable approach for allocation of realty loss in appropriate circumstances. Loss sharing might better serve the policy of loss prevention as to both types of loss by giving both buyer and seller incentives to guard against loss.

As to express agreement, it is clear that contract provisions allocating realty loss are being widely used, and that they will be enforced, except when their enforcement would immunize a blameworthy party. Loss allocation agreements require interpretation. That sort of interpretation is the stuff of contract law. Courts faced with ambiguous loss allocation language should be guided by the principles developed in contract law, which in turn should bring into play the policies thought important in the field of contract law.

Critics of the conversion rule have succeeded in developing strong minority trend rules that define realty loss allocation as a problem of contract law in all cases, with agreement to be implied when there is no express agreement. Those rules emphasize the nature of the relationship between buyer and seller as based in contract rather than property law.

\textsuperscript{402} 511 So. 2d 1014, 1016 (Fla. Dist. Ct. App.), review denied, 519 So. 2d 987 (Fla. 1987).

https://scholarship.law.missouri.edu/mlr/vol59/iss2/2
For escrow loss, the role of contract has not been well developed. Escrow loss allocation agreements are not widely used. It seems likely that such agreements would be enforced, however, that has not been demonstrated. The paucity of authority on escrow loss makes it particularly important to recognize the tie between reality loss and escrow loss. The authority on the role of contract law for reality loss can be called upon for guideposts in the development of a role for contract law with regard to escrow loss.

As to status, the separate histories of the conversion and entitlement rules have been examined in this Article. That historical analysis demonstrates that the two rules were not developed through open rational policy-based jurisprudence. Instead of policy they rely on conclusory labels. The conversion rule for reality loss depends on a theory that only one party is the true owner of reality during an executory period. The entitlement rule for escrow loss depends on two parallel theories, ownership and agency, and also posits that only one party is the true owner of escrowed money, or the sole principal for the escrow agent during an open escrow period. The two rules use contradictory definitions of true ownership. When combined, the two rules do what the Stuart v. Clarke court recently recognized was logically impossible, treating a buyer as owner "of both the purchased property and the portion of the money in escrow."403

That inconsistency is troubling in its own right. It also reveals a deeper problem: the theories of sole ownership and unilateral agency are fundamentally flawed. A basic characteristic of both executory sales agreements and escrow arrangements is that they cause ownership to be divided and in transition, and an escrow holder serves both parties, not one only.

The two rules have also failed to serve as bright lines which might eliminate costly litigation. In summary form they might appear attractively simple and straightforward. In practice, both have proven difficult to apply. Those difficulties are inherent in the theories underlying the rules. The weaknesses of the foundations have rendered the rules untenable.

This initial comparative analysis of the two bodies of loss allocation law has brought to light the common theoretical and practical failings of the status-based rules. As the search for sounder rules progresses, the relationship of reality loss and escrow loss ought not continue to be overlooked.

403. Stuart, 619 A.2d at 1200.