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Nonrefundable tenant security deposits: Kraus v Trinity Mgmt., 2000

Roger Bernhardt
Golden Gate University School of Law, rbernhardt@ggu.edu

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Kraus v Trinity Mgmt. Servs., Inc. (2000) 23 C4th 116, 96 CR2d 485

Defendants (Trinity) own, lease, and manage residential properties in San Francisco. Trinity requires tenants to (1) pay a $100 nonrefundable "tenant initiation expense reimbursement" (TIER) fee for pre-lease administrative services; (2) pay liquidated damages equal to one month's rent plus all unpaid rent for the balance of the lease term if a unit is vacated before the end of the lease term; and (3) surrender the security deposit as an offset against the liquidated damages. Six former tenants, on behalf of themselves and other present and former tenants, sued Trinity, seeking declaratory relief, restitution, and civil penalties. Among other causes, plaintiffs alleged that (1) the TIER fees violated CC §1950.5's ban on nonrefundable security deposits, and (2) Trinity's assessment of the TIER fees, and the liquidated damages and rent on early termination, constituted an unfair business practice prohibited by the Unfair Competition Law (UCL) (Bus & P C §§17200–17208). The trial court agreed and enjoined Trinity from (1) assessing TIER fees or any other nonrefundable charges as a condition of tenancy, (2) collecting security deposits for the purpose of charging them against liquidated damages, and (3) including liquidated damages provisions in its leases. Further, the court ordered Trinity to (1) repay the $100 TIER fee to each tenant who paid the fee and "who may, with due diligence, be found"; and (2) disgorge the otherwise undisbursed TIER fees and the security deposit/liquidated damage funds (in total, almost $1 million) into a fluid recovery fund to provide "financial assistance for the advancement of legal rights and interests of residential tenants" in San Francisco.

On appeal, Trinity argued that, without class action certification, the disgorgement order violated due process because Trinity would still be subject to potential suits from nonjoined class members. The court of appeal rejected that argument and affirmed, holding that a "fluid recovery fund in a representative UCL action [is] a permissible exercise of the broad equitable power granted to the trial court by [Bus & P C] section 17203." 23 C4th at 125.

The supreme court reversed, finding that restitution is the only monetary remedy expressly authorized by Bus & P C §17203. Restitution is defined as the "return [of] money obtained through an unfair business practice to those persons in interest from whom the property was taken. . . ." 23 C4th at 126. Noting that the legislature has authorized the fluid recovery remedy only for certified class actions, the court held that ordering disgorgement into a fluid recovery fund is not within the court's inherent equitable power and is improper in a representative UCL action. Accordingly, "disgorgement of sums collected to secure liquidated damages may be enforced only to the extent that it compels restitution to those former tenants who timely appear to collect restitution." 23 C4th at 138.

The court also held that fees such as Trinity's TIER fees do not constitute a nonrefundable security deposit in violation of CC §1950.5 because that section applies only to charges intended to secure the landlord against future tenant defaults. "A fee imposed at the outset of the tenancy

to reimburse the landlord for expenses incurred for such purposes as providing application forms, listing, interviewing, screening the applicant, for checking credit references, and for similar purposes is not a security governed by [CC §1950.5].” 23 C4th at 141.

▶ ***THE EDITOR’S TAKE:*** At last there is a definitive answer to the question of what kind of nonrefundable front end charges CC §1950.5 permits and prohibits residential landlords from imposing on their tenants. The answer may be entirely illogical, but at least it is definitive, which is far more important anyway.

The answer is illogical because it has to be illogical, given the self contradiction expressly written into the code section by way of defining security as “any payment” used for “any purpose”—which by definition has to include rent—while at the same time providing that no landlord could make it “nonrefundable”—which rent always is. The intrinsic absurdity of the section is best revealed by comparing the first and second districts’ treatment of it, with both courts agreeing that it “teeter[ed] on the brink of unintelligibility,” and also reaching diametrically different interpretations of it. *Granberry v Islay Invs.* (1984) 161 CA3d 382, 388, 207 CR 652; *People ex rel Smith v Parkmerced Co.* (1988) 198 CA3d 683, 688, 244 CR 22 (concurring opinion of King, J). The missing logic has now been supplied by the supreme court, giving the statute a meaning that works, even if it is not at all what it says.

The court’s interpretation is that money paid in advance is a security deposit within the scope of the statute only if it is “imposed to secure the landlord against future tenant defaults,” even though the section itself says “used for any purpose, including but not limited to . . .” such defaults. That means that, despite the legislature’s expansive universality, the statute permits a landlord to structure transactions that fall outside of its scope.

Not only does the court’s opinion permit a nonrefundable front end payment to be retained (*i.e.*, be made nonrefundable), it also shows landlords how to do it. By upholding the TIER fee Trinity Management imposed on its tenants, the court has effectively told other residential landlords that if they label their fee the same way, they can keep the money. Thus, front end payments identified as “tenant initiation expense reimbursements” can be retained, whereas they might have to be refunded if called something else. Any residential landlord would be foolish not to immediately so recaption its form.

This issue of hidden security deposits has many similarities to the history of hidden mortgages. Initially, our courts held that a deed of trust did not look like a mortgage and was therefore not subject to conventional mortgage rules. That induced the lending industry to make the deed of trust the universal lending instrument and to entirely abandon their old mortgage forms. In the landlord-tenant field, we will probably soon witness both “true” refundable security deposit charges and also nonrefundable “nonsecurity” charges.

Based on the legislature’s past record, we should probably all hope that it doesn’t make another attempt to deal with the problem itself. It was its 1977 revision from “primary function” to “any purpose” in the predecessor to CC §1950.5 which created this problem in the first place. Furthermore, the legislature’s 1996 addition of CC §1950.6 declaring that “application screening fees” are not security, but limiting them to $30, only created more confusion as to how to

classify nonscreening fees of over $30. The *Kraus* decision appears—by not talking about it—to eliminate the need to limit TIERs to "actual out-of-pocket costs" (as §1950.6 does), perhaps meaning that, if landlords and tenants can agree in arms'-length transactions on the amount of these charges, they will then be upheld.

Now we have to wait to see how rent control ordinances can change these results. —*Roger Bernhardt*