The Rental Security Deposit in California

John P. Bosshardt
Lessee agrees and does hereby deposit with the Lessor the sum of . . . Dollars as security for the faithful performance of the terms of this lease, which said sum shall at all times be held as a deposit for the faithful performance of all the terms, covenants and conditions of this lease. . . .

Ideally, the rental of a dwelling unit should be conducted as an arms-length transaction with equality of bargaining power on both sides. In practice, however, the tight housing situation in many urban areas forces the prospective tenant to accede to rental conditions imposed by the landlord. With increasing frequency, landlords are demanding higher deposits on the lease or rental agreement. The deposits may have various names, but in any case the tenant must, as a precondition to the tenancy, pay the requested amount in full. Usually the rental deposit agreement contains a provision similar to that quoted above, requiring the tenant to deposit a sum of money with the landlord as “security” for the performance of the rental terms and for payment of any damage to the premises caused by the tenant and members of his family or guests. Since, for many families, apartment


2. Rental vacancy rates in all urban areas of the nation declined from 7.4 percent in 1965 to 4.8 percent in the first quarter of 1970 (1970 figures are preliminary). In the western region of the United States (including California), the rate in urban, suburban, and rural areas declined as a whole from 11.3 percent in 1965 to 5.4 percent in the first quarter of 1970. U.S. BUREAU OF THE CENSUS, DEP’T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES, table 1087, at 681 (91st ed. 1970) [hereinafter cited as STATISTICAL ABSTRACT]. There have been reports that if lending rates continue to decrease, there will be a danger of “overbuilding” of new housing units in some areas. However, as of this writing, vacancy rates in most concentrated urban areas are still too low to place the landlord and tenant in an equal bargaining position. See, e.g., San Francisco Sunday Examiner & Chronicle, Dec. 6, 1970, § C, Business Section, at 11, col. 2.

3. Thompson v. Swiryn, 95 Cal. App. 2d 619, 213 P.2d 740 (1950), classified money paid under a lease into four categories: “(1) advance payment of rent; (2) as a bonus or consideration for the execution of the lease; (3) as liquidated damages; and (4) as a deposit to secure faithful performance of the terms of the lease.” Id. at 625, 213 P.2d at 744. Discussion in this Note will focus on the fourth class, although liquidated damages clauses, insofar as they have been held invalid as penalties, are discussed in the text accompanying notes 72-77, infra. Deposits made as advance payments of the last month’s rent are not covered, unless they have been made primarily as “security,” and are applied as set-offs to the rent when the tenant has performed his obligations satisfactorily. In such case, the deposit is chiefly a rental deposit made as “security.”

4. The term “rental security deposit” will be employed in this Note to embrace
house living rather than home ownership is becoming a necessity, the laws regulating rental security deposits will affect increasingly more people in the future.

Presently, only a few states have enacted laws on the rental security deposit which outline definitively all the rights and obligations of each party. Three highly urbanized states in the Northeast—New York, New Jersey and Pennsylvania—presently have extensive statutory regulation of such deposits. Massachusetts has also recently passed legislation covering the rental deposit, although the terms of its statute are more limited in scope. These four states have recognized the increasing importance of rental security deposits in the field of landlord-tenant law and consequently have attempted to define the rights and duties of the parties involved. In California, however, judicial decisions have served only to make uncertain what these rights and duties are. With the recent enactment of California Civil Code section 1951, the state legislature has made a partial attempt to clarify the

all such security payments. In using the term "rental" security deposit, however, it should not be assumed that the deposit is made solely to secure payment of rent. It must be understood as security for all the terms of the rental agreement, including payment of rent. In those situations where it is not clear from the wording of the lease or rental agreement whether the deposit was intended primarily as "security," "the court [is] justified in considering the circumstances surrounding the making of the lease and the giving of the deposit in order to determine what meaning and effect should be given to the language." Bacciocco v. Curtis, 12 Cal. 2d 109, 115, 82 P.2d 385, 388 (1938).

5. In a speech to the Mortgage Association Convention in Miami Beach, J.M. Gross, president of the National Apartment Association, stated that apartment living is on the upswing and, of the 2.4 million housing units expected to be built in 1975, at least half will be apartments. San Francisco Chronicle, Oct. 31, 1970, at 45, col. 2.

According to the Federal Home Loan Bank of San Francisco, about 70 percent of the new building in California is expected to be apartments. San Francisco Sunday Examiner & Chronicle, Dec. 6, 1970, § C, Business Section, at 11, col. 2.


8. Stat. 1970, ch. 666, § 1, amending MASS. ANN. LAWS ch. 186, § 158 (Supp. 1970). This provision generally prescribes procedures for the retention or return of the rental security deposit by the landlord. In that respect it is similar to CAL. CIV. CODE § 1951. See note 10 infra. It also contains a proviso for the payment of 5 percent interest on deposited funds retained by the landlord in excess of 1 year.

9. It is revealing to note that these four states are located in the region which has the lowest overall dwelling unit vacancy rate in the United States. The urban areas of the Northeast had a decline in vacancy rate in rented dwellings from 5 percent in 1965 to 2.1 percent in the first quarter of 1970 (1970 figures are preliminary). This was the lowest area rate in the nation for urban regions. STATISTICAL ABSTRACT, supra note 2, table 1087.

10. CAL. CIV. CODE § 1951 provides:

"(a) Any payment or deposit of money the primary function of which is to secure
law on security deposits in California. However, while this statute does regulate the landlord's disposition of the funds upon termination of the tenancy, uncertainties in the law still remain. The principal point of confusion concerns the proper handling of the deposited money while still in the landlord's possession. This Note will analyze the various aspects of the California law on rental security deposits as it presently exists, examining the conflicting views of the pledge and trust theories by the California courts and the application of the relevant code provisions to these conflicting positions. The concluding sections will discuss the New York and New Jersey legislative solutions to the rental deposit problem. The New York law is, in many respects, the most

the performance of a rental agreement or any part of such an agreement, other than a payment or deposit, including an advance payment of rent, made to secure the execution of a rental agreement, shall be governed by the provisions of this section.

"(b) Any such payment or deposit of money shall be held by the landlord for the tenant who is party to such agreement. The claims of a tenant to such payment or deposit shall be prior to the claim of any creditor of the landlord, except a trustee in bankruptcy.

"(c) The landlord may claim of such payment or deposit only such amounts as are reasonably necessary to remedy tenant defaults in the payment of rent, to repair damages to the premises caused by the tenant, or to clean such premises upon termination of the tenancy, if the payment or deposit is made for any or all of those specific purposes. Any remaining portion of such payment or deposit shall be returned to the tenant no later than two weeks after termination of his tenancy.

"(d) Upon termination of the landlord's interest in the dwelling unit in question, whether by sale, assignment, death, appointment of receiver or otherwise, the landlord or his agent shall, within a reasonable time, do one of the following acts, either of which shall relieve him of further liability with respect to such payment or deposit:

"(1) Transfer the portion of such payment or deposit remaining after any lawful deductions made under supervision (c) to the landlord's successor in interest, and thereafter notify the tenant by registered mail of such transfer, and of the transferee's name and address.

"(2) Return the portion of such payment or deposit remaining after any lawful deductions made under subdivision (c) to the tenant.

"(e) Upon receipt of any portion of such payment or deposit under paragraph (1) of subdivision (d), the transferee shall have all of the rights and obligations of a landlord holding such payment or deposit with respect to such payment or deposit.

"(f) The bad faith retention by a landlord or transferee of a payment or deposit or any portion thereof, in violation of this section, may subject the landlord or his transferee to damages not to exceed two hundred dollars ($200), in addition to any actual damages.

"(g) This section shall become operative January 1, 1971, and shall apply only to payments or deposits made on or after such date."

See also CAL. CIV. CODE §§ 1951.2-8 (operative July 1, 1971). These new code sections, complementary to § 1951, deal specifically with rights and obligations of both landlord and tenant upon a premature termination of a lease or rental agreement.

11. CAL. COMM. CODE §§ 9101-507. CAL. CIV. CODE §§ 2215-44. The sections following CAL. CIV. CODE § 2244 would not specifically apply to the rental security deposit situation since they deal with trusts for the benefit of third persons.

extensive on the subject and may provide a model upon which similar legislation in California could be based.

California—The Current Situation

To survey the law of rental security deposits, the following six areas should be considered:  
1. the nature of the deposit,  
2. its management while in the landlord’s possession,  
3. payment of interest,  
4. disposition upon termination of the tenancy,  
5. disposition upon termination of the landlord’s interest, and  
6. penalties and forfeitures (liquidated damages).

Because the case law is confused in the first three areas, a major part of the analysis of those areas will be devoted to an explanation of the various positions which the California courts have taken and the application of the various California code sections to rental deposits. In the last three of the six areas mentioned above, the law is clear and well settled; consequently, it will be necessary only to restate the present rules and illustrate their application.

A. Nature of the Deposit

The courts in California have classified the rental security deposit into one of several categories. Boteler v. Koulouris is a principal case supporting the theory that the deposit should be treated as a pledge of money to secure the tenant’s performance of the rental terms. In Boteler, the court explained:

Clearly the whole fund [deposited as security for performance of the lease provisions] was, when first deposited, a pledge, which is defined as a deposit of personal property by way of security for the performance of another act.

The court based its conclusion on former California Civil Code section 2987, which provided that “[e]very contract by which the possession of personal property is transferred, as security only, is to be deemed a pledge.”

In Thompson v. Swiryn the court found that a $9,000 deposit...
paid as security for a lease provision that the lessor make certain re-
pairs on the premises was in the nature of a trust:

It is defendants' argument that this provision [for return of
the deposit less damages] clearly indicates that the purposes of the
payment was merely a trust fund or deposit to be held by the lessor
or his assigns, and that his duty was to return that amount upon
the happening of the event or events indicated. As to this provi-
sion, defendants' contention is well grounded.\textsuperscript{18}

At least one case, however, \textit{Green v. Frahm},\textsuperscript{19} further confused
the matter by failing to distinguish between a bailment\textsuperscript{20} and a trust, re-
sulting in the anomalous conclusion that the deposit had characteristics
of both. In that case, the court noted that the landlord,
Frahm, being only a \textit{bailee}, held the fund \textit{in trust} . . . for the pur-
pose stated in the lease, and when the \textit{trust} ceased, the title and
right to the money reverted to the original owner. . . .\textsuperscript{21}

Although it has been suggested that California favors the pledge
theory,\textsuperscript{22} these examples serve to illustrate that the courts have come to
no unanimous conclusion about the nature of the rental security de-
posit.\textsuperscript{23} From an analysis of the cases, two general theories appear:
(1) the deposit is a pledge or bailment, with legal title to the money re-
mainin in the tenant;\textsuperscript{24} (2) the deposit is a trust fund, with the land-
lord holding legal title to the \textit{res} as trustee and the tenant/settlor re-
taining the beneficial interest.\textsuperscript{25}

Are there any legal consequences, however, because of this dis-
tinction between a trust and a pledge? First, the distinction will de-
termine the holder of the legal title. If the deposit is viewed as a pledge,
then the Commercial Code will, of course, govern.\textsuperscript{26} Although section
9202 of that code declares that its provisions apply no matter

\begin{itemize}
\item \textsuperscript{18} \textit{Id.} at 626-27, 213 P.2d at 745.
\item \textsuperscript{19} 176 Cal. 259, 168 P. 114 (1917).
\item \textsuperscript{20} Generally, the courts have made no distinction between a pledge and a bail-
ment. Thus, both terms, when applied to security deposits, should be considered syn-
\item \textsuperscript{21} 176 Cal. 259, 263, 168 P. 114, 116 (1917) (emphasis added).
\item \textsuperscript{22} Harris, \textit{A Reveille to Lessees}, 15 S. CAL. L. REV. 412, 418 (1942).
\item \textsuperscript{23} CAL. CIV. CODE § 1951(a) offers no assistance in the resolution of the con-
flicting opinions. That provision simply states, \textit{inter alia}, that a rental security deposit
is "\textit{any payment or deposit of money the primary function of which is to secure the
performance of a rental agreement . . . other than a payment or deposit . . . to
secure the execution of a rental agreement.}"
\item \textsuperscript{24} Boteler v. Koulouris, 1 Cal. App. 2d 566, 37 P.2d 136 (1934) (deposit as
pledge); Green v. Frahm, 176 Cal. 259, 168 P. 114 (1917) (semble).
\item \textsuperscript{25} Thompson v. Swiryn, 95 Cal. App. 2d 619, 213 P.2d 740 (1950); Green v.
Frahm, 176 Cal. 259, 168 P. 114 (1917) (semble). The question of title is discussed
in notes 26-30 & accompanying text infra.
\item \textsuperscript{26} CAL. COMM. CODE §§ 9101-507.
\end{itemize}
where legal title to the pledge resides, the California Legislative Coun-
Sel, commenting on this section, felt that the former California rule
should continue to apply; that is, "in the pledge situation the pledgor re-
tains title. . . ."27 With a trust, equitable title is vested in the ben-
eficiary, while legal title passes to the trustee of the res.28 Upon ful-
fillment of all the purposes of the trust, the settlor/beneficiary regains
full title.29 Thus, if the rental security deposit is considered to be a
pledge, the tenant retains legal title to the money. As a trust, how-
ever, legal title to the deposited funds rests in the landlord, and the ten-
ant retains an equitable interest in the deposit.30

It is beyond question that the rights of the parties involved will
often be affected by a determination of the holder of legal title. For
example, as Professor Scott has pointed out, a trustee who holds legal
title can transfer the trust property to a bona fide purchaser free of the
trust, but a bailee, having no legal title, ordinarily cannot.31 Likewise,
"[a] pledgee does not owe to the pledgor the fiduciary duties owing
by trustee to beneficiary."32 Moreover, when an obligation secured by
a pledge is satisfied without the return of the pledged funds by the
pledgee, he does not then become a trustee of those funds for the
pledgor. He might be called a constructive trustee, but the fiduciary
element inherent in an express trust is lacking.33 Accordingly, Pro-
fessor Scott has explained that

if the pledgor makes no attempt to compel the return of the prop-

29. Id. § 345 & comments, at 193-98.
30. It should be noted that California has extensive code provisions governing both
trusts and pledges. CAL. CIV. CODE § 2220 provides that: "A trust in relation to . . .
personal property. . . may be created for any purpose or purposes for which a contract
may be made." Thus, a contract by which money is deposited with a landlord to se-
cure performance of an act should create a valid trust relationship.

Regarding pledges, CAL. COMM. CODE § 9102(2) states: "This division applies to
security interests created by contract including pledges . . . intended as security." The
commentary to that section explains that "[t]he principal test whether a transaction
comes under this Article is: is the transaction intended to have effect as security?"
UNIFORM COMMERCIAL CODE § 9-102(2), Comment 1. Taken at face value, this would
seem to afford an equally solid basis for applying the Commercial Code sections
9101-507 to rental deposits.

Boteler v. Kouloris, 1 Cal. App. 2d 566, 37 P.2d 136 (1934), applied the since-
repealed California pledge law to a rental security deposit. However, the value of that
decision as precedent for application of the Commercial Code provisions on pledges to-
day is dubious.

32. Id. § 9, at 84. Regarding the fiduciary duties which the trustee owes to the
beneficiary, see text accompanying notes 54-57 infra.
33. Id. at 85.
etry for a long period after the payment of the debt, the pledgor is barred from maintaining an action against the pledgee for return of the property, although it is well settled that under similar circumstances the beneficiary of a trust would not be precluded from maintaining a suit against the trustee.\textsuperscript{34}

Thus, a tenant who delays in bringing an action to recover his rental security deposit may be denied recovery under the pledge theory; if the trust theory were applied, the plaintiff would prevail.

B. Management of the Deposit While in the Landlord's Possession

The extent of the duties of the landlord in his control and disposition of the deposit will be determined by the characterization of that deposit. If the deposit is treated as a pledge, then the Commercial Code provisions allow such money to be mingled with the landlord's own personal assets.\textsuperscript{35} The deposited funds may even be repledged by him to secure his own obligations, provided such a transaction is "upon terms which do not impair the [tenant's] right to it."\textsuperscript{36} Thus the landlord, as pledgee, has considerable freedom to use the funds for any purpose he desires. If considered a trust, however, the deposited sum may not be mingled with other funds of the landlord.\textsuperscript{37} A landlord using the trust res for his own purposes would be required to account for all profits earned on the amounts used by him.\textsuperscript{38} Even if the landlord made no profit himself, he would be liable to the tenant for the value of the use of the money, usually assessed as simple interest.\textsuperscript{39}

\textsuperscript{34} Id. (footnotes omitted).
\textsuperscript{35} \textsc{Cal. Comm. Code} § 9207(2)(d) provides: "The secured party must keep the collateral identifiable but fungible collateral may be commingled. . . ." (emphasis added). \textsc{Black's Law Dictionary} 803 (rev. 4th ed. 1968) defines fungible items as "[t]hose things one specimen of which is as good as another. . . ." Money is commonly regarded as fungible, since it may be exchanged for an equal quantity of similar value.
\textsuperscript{36} \textsc{Cal. Comm. Code} § 9207(2)(e).
\textsuperscript{37} \textsc{Restatement (Second) of Trusts} § 179 (1959); accord, \textsc{Cal. Civ. Code} § 2236, which stipulates that "[a] trustee who wilfully . . . mingles the trust property with his own, so as to constitute himself in appearance its absolute owner, is liable for its safety in all events, and for the value of its use."
\textsuperscript{38} "A trustee may not use or deal with the trust property for his own profit, or for any other purpose unconnected with the trust, in any manner." \textsc{Cal. Civ. Code} § 2229. This provision is buttressed by \textsc{Cal. Civ. Code} § 2237, which states that "a trustee who uses or disposes of the trust property, contrary to Section 2229, may, at the option of the beneficiary, be required to account for all profits so made, or to pay the value of its use, and, if he has disposed thereof, to replace it, with its fruits, or to account for its proceeds, with interest."
\textsuperscript{39} A leading case interpreting the prohibitions of \textsc{Cal. Civ. Code} §§ 2229, 2236 & 2237 is \textit{In re Estate of Cousins}, 111 \textsc{Cal. 441}, 44 P. 182 (1896). Therein, the court applied the facts of an earlier decision, \textit{Estate of Scott}, 52 \textsc{Cal. 403} (1877). Interpreting that case, the court in \textit{Cousins} explained that the trustee "had mingled the
some cases, the courts have charged a penalty of compound interest.\(^40\)

Generally, when the trustee has commingled or used the trust funds for his own purposes, he has also of necessity failed to invest them for the benefit of the beneficiary. Thus he has breached two fiduciary duties by commingling the funds and failing to invest. Although both breaches will incur separate penalties, the courts will generally assess only a single penalty of either simple or compound interest in cases where a single act breaches both duties simultaneously.\(^41\)

At least one California case, *Ingram v. Pantages*,\(^42\) attempted to define the duties of the landlord while the deposited money was in his possession. The court, apparently favoring the pledge theory, found that title to the security deposit of $12,000 remained in the tenant.\(^43\) However, the court then concluded:

\[
\text{[N]o provision in the lease . . . provide[d] that the lessors [were] to use or acquire any benefit whatever from the $12,000 during the time it [was] on deposit with them . . . Certainly, under such an arrangement, [the lessors] would have no right to use this money or retain the earnings therefrom, until [the lessee] had forfeited his ownership thereto by failing to comply with the terms of said lease. . . .}^{44}
\]

By holding that the landlord had no right to use the deposit for his own private use, the court seemed to apply a trust theory. Yet the court had also held that the legal title to the money remained in the tenant—

[trust] funds of the estate with his own and . . . from time to time had employed them in his business, but there was no evidence of actual profits, . . . [but still] the trustee was responsible for presumed profits upon the moneys so employed, and . . . the general rule in such cases was that he should be charged with legal interest . . . ." *In re Estate of Cousins*, 111 Cal. 441, 445, 44 P. 182, 183 (1896) (emphasis added); accord, *In re McCabe's Estate*, 98 Cal. App. 2d 503, 508, 220 P.2d 614, 618 (1950).

40. In *Bemmerly v. Woodward*, 124 Cal. 568, 57 P. 561 (1899), the court found that the trustee "mingled the funds with his own, and even, under the findings, must therefore was properly charged with compound interest." *Id.* at 573, 57 P. at 563.

Since there appears to be no substantial difference between the trustees' misuse of funds in either *Bemmerly* or *Cousins*, the question whether simple or compound interest will be charged to the trustee might be answered by turning to Cal. Civ. Code § 2262. Although that section is located in the chapter relating specifically to trusts for the benefit of third persons—and rental deposits would certainly not fall within that category—it might provide a helpful explanation. Under that section, a mere negligent failure to invest results in an assessment of simple interest to the trustee, while an intentional or wilful failure draws a penalty of compound interest. Therefore, the courts' determination of which rate of interest to charge apparently turns on whether the failure by the trustee to invest was negligent or wilful.

41. See discussion of penalties for failure to invest in text accompanying notes 56-57 infra.

42. 86 Cal. App. 41, 260 P. 395 (1927).

43. *Id.* at 44, 260 P. at 396.

44. *Id.*
a pledge concept.\textsuperscript{45} Thus, although the words of the excerpt above appear to be clear, when interpreted in the light of prior statements in the opinion, they reveal that the court fell victim to the same legal confusion regarding trusts and pledges which has characterized the holdings of the other cases.

In summary, then, if the rental security deposit is viewed as a pledge, the landlord may, under the current Commercial Code provisions, commingle it in any way he desires, provided that the tenant’s interest in its restoration is not jeopardized.\textsuperscript{46} The landlord is liable to the tenant only for actual earnings received from such use.\textsuperscript{47} If the Civil Code sections on trusts are applied, however, the funds must be kept separate and identifiable.\textsuperscript{48} If the money is commingled or used in any way for the landlord’s benefit, he will be held accountable for the profits earned, or the value of its use, reckoned at least at simple interest.\textsuperscript{49}

Although a penalty of simple, or even compound,\textsuperscript{50} interest for use of the funds is not a powerful deterrent to the landlord if the deposit is a small sum held for a relatively short period, such interest could become substantial if the deposit exceeds a month’s rent and the tenancy lasts for several years, with the interest accumulating. The landlords most affected would be those with large income-producing properties, for they would be required to pay interest on a great number of individual deposits. Equally substantial would be the sums involved in a commercial leasehold, as the deposit often amounts to thousands of dollars and the duration of the tenancy runs for decades.

C. Payment of Interest

No California court has passed on the question whether interest should be paid to the tenant on the money which the landlord holds as security. Several cases imply that interest need not be paid unless there is a specific prior agreement between the parties.\textsuperscript{51} Nor do California Commercial Code provisions applicable to pledges (secured transactions) specifically require that the landlord, as pledgee, make the deposit productive for the tenant/pledgor. It is a fair inference that the

\textsuperscript{45} See note 43 & accompanying text supra.
\textsuperscript{46} See notes 35-36 & accompanying text supra.
\textsuperscript{47} See notes 52-53 & accompanying text infra.
\textsuperscript{48} See note 37 & accompanying text supra.
\textsuperscript{49} See notes 38-39 & accompanying text supra.
\textsuperscript{50} See note 40 & accompanying text supra.
pledgee need not pay interest to the pledgor on the money held as security. Under Commercial Code section 9207(2)(c), however, if the pledgor does receive profits on the deposited funds, such earnings either must be applied in reduction of the secured obligation or remitted to the pledgee. In other words, the landlord must pay any interest he may earn on the funds to the tenant.

A trustee, on the other hand, has the duty to invest trust money to make it productive for the beneficiary. If the rental deposit is treated as a trust, then the character of the landlord's duties as trustee is substantially different from those as pledgee. Under the trust theory, the landlord not only has the negative obligation to refrain from commingling and using the trust res for his own purposes, but he also has the affirmative duty to invest it for the benefit of the tenant. This penalty for failure to invest is identical to that imposed for using the funds for the landlord's own benefit: the value of the use of such funds, generally computed at simple or compound interest.

D. Disposition upon Termination of the Tenancy

In this and the following two areas, the California law on the rental security deposit is more definite. Thompson v. Swiryn stated the rule in California governing the disposition of the deposit upon the normal termination of a tenancy:

[W]hen the sum is deposited merely as security for the performance of the covenants by the lessee, without a penalty or forfeiture clause . . . the lessor may look to the fund for damages proved and the lessee may recover the balance.

The recent enactment of California Civil Code section 1951 has adopted and amplified the general holding of the Thompson case. Subsection (c) of the new law provides:

The landlord may claim of such payment or deposit only such amounts as are reasonably necessary to remedy tenant defaults in the payment of rent, to repair damages to the premises caused by the tenant, or to clean such premises upon termination of the ten-

55. See note 37 & accompanying text supra.
56. See note 54 & accompanying text supra.
57. See notes 39-40 supra.
59. Id. at 626, 213 P.2d at 744. Of course, the amount considered sufficient to cover damages suffered by the landlord is a question of fact. Collins v. Jones, 131 Cal. App. 747, 22 P.2d 39 (1933).
RENTAL SECURITY DEPOSIT

ancy, if the payment or deposit is made for any or all of those specific purposes. Any remaining portion of such payment or deposit shall be returned to the tenant no later than two weeks after termination of his tenancy.

It is interesting to note that section 1951 does not indicate whether any amounts may be deducted for damages other than those resulting from physical deterioration, rent deficiencies or cleaning charges. It seems reasonable to assume that the landlord could suffer damages for violations of other provisions of the rental agreement. For example, leases often contain a clause which provides that the deposit is paid to secure, in addition to the other stipulations mentioned, the "faithful performance . . . of all the conditions of [the] lease. . . ."60 Another lease provision common in many urban areas declares that "[t]he lessee agrees not to use the premises in any manner that will increase the existing rate of fire insurance on the building."61 Does the former clause give to the landlord the right to apply the deposit toward any damages resulting from a breach of the latter provision? That is, since the tenant has agreed to perform faithfully all the conditions thereof, it may be argued that he should be held liable for any performance which would increase the fire insurance rate on the premises. But does section 1951 preclude the landlord from employing such a remedy? Is the language of the Thompson decision62—that the landlord may look to the deposit for "damages proved"63—to be construed liberally to permit the landlord to deduct damages for a tenant's breach of any of the lease provisions? Or does the express wording of section 1951 limit the holding in that case, excluding deductions for any damages not expressly provided for in the statute (physical damage, rent deficiency or cleaning fees)?

Section 1951 also provides procedures for protection of the tenant's interest in the deposit. If the landlord retains the deposit in bad faith, the tenant may recover any actual damages, and exemplary damages of not more than 200 dollars.64 Additionally, when the tenancy has been terminated, the funds remaining after damages have been deducted must be returned to the tenant within 2 weeks.65

The courts have not yet decided whether the provisions of section 1951 may be expressly waived by mutual agreement of the parties. The statute itself does not indicate if a waiver would be void as contrary to public policy. The history of Civil Code sections 1941 and 1942 may

60. SAN FRANCISCO REAL ESTATE BOARD, SHORT FORM LEASE § 18.
61. Id. § 15.
63. Id. at 626, 213 P.2d at 744.
64. CAL. CIV. CODE § 1951(f).
65. Id. § 1951(c).
provide a helpful analogy. These two sections impose a duty on the landlord to keep the rental unit in repair, and allow the tenant to withhold a portion of the rent if he is forced to make the repairs himself. Most modern leases contain a stipulation for express waiver of the tenant’s rights under those sections; this waiver, which had been upheld by the courts, was the subject of criticism, both within the legal profession and by the tenants affected by it. Consequently, last year the legislature responded by declaring waivers of these two sections “void as contrary to public policy with respect to any condition which renders the premises untenantable.” There is no reason to assume that a similar waiver will not be inserted into future leases with regard to tenant rights under section 1951 as well. Will the courts permit such waivers, similar to those allowed under sections 1941 and 1942 prior to the new statute? And will the legislature wait nearly a hundred years (the time between the enactment of sections 1941-42 and the legislative prohibition of their waiver) to declare possible waivers of section 1951 void? It is hoped that either the courts or legislature will delineate more carefully the protection which section 1951 affords to all parties involved.

E. Disposition upon Termination of the Landlord’s Interest

This question is now specifically covered by Civil Code section 1951, which affords the landlord or his representative two options upon termination of the landlord’s interest in the deposit. The termination may occur by sale, assignment, death, appointment of a receiver or other transfer. Whenever the landlord’s interest ends, he or his agent must do one of the following:

(1) Transfer the portion of such payment or deposit remaining after any lawful deduction [for damages] to the landlord’s successor in interest, and thereafter notify the tenant by registered mail of such transfer, and of the transferee’s name and address.

68. CAL. CIV. CODE § 1942.1. The lessor may not retaliate against the lessee “because of the exercise by the lessee of his rights.” CAL. CIV. CODE § 1942.5(a). If the tenant is not in default, the lessor may not “cause the lessee to quit involuntarily, increase the rent, or decrease any services, within 60 days” after the tenant has attempted to assert his rights granted under Civil Code sections 1941 and 1942. CAL. CIV. CODE § 1942.5(a)(1).
(2) Return the portion of such payment or deposit remaining after any lawful deductions [for damages] to the tenant.\textsuperscript{70}

If the funds on deposit are transferred in accordance with the above provisions, the transferee has the same rights and obligations respecting such deposit as the original landlord possessed.\textsuperscript{71}

F. Penalties and Forfeitures

When the rental security deposit is to be totally forfeited as liquidated damages, without regard to actual damages suffered, the California courts have generally found such a provision to be void as a penalty clause.\textsuperscript{72} As the court stated in \textit{Redmon v. Graham,}\textsuperscript{73}

[a] deposit was made as security for the performance of the covenants of the lease, the sum to be retained . . . by the lessor as liquidated damages in the event of breach by the lessee. It is settled in this state that such a provision in a lease is a penalty within the meaning of section 1670 of the Civil Code, and is void.\textsuperscript{74}

In \textit{Webster v. Garrette}\textsuperscript{75} it was held that such an agreement was presumed void unless the landlord could prove that the damages would be impractical or extremely difficult to ascertain.\textsuperscript{76} The opinion further stated that when parties to a lease agree to a fixed sum to be paid for any one of several breaches of varying importance, an inference arises that a penalty, not liquidated damages, was intended.\textsuperscript{77}

The Future of the California Law

This Note has attempted to survey the existing California law on rental security deposits, the conflicts within that law and their legal consequences, and recent developments which have settled several areas within the field. It is evident that California must clarify its law on rental

\textsuperscript{70} \textsc{Cal. Civ. Code} § 1951(d).
\textsuperscript{71} \textit{Id.} § 1951(e).
\textsuperscript{72} \textit{E.g.}, \textit{Redmon v. Graham}, 211 Cal. 491, 493-4, 295 P. 1031, 1032 (1931); \textit{Ace Realty Co. v. Friedman}, 106 Cal. App. 2d 805, 813, 236 P.2d 174, 179 (1951); \textit{Webster v. Garrette}, 10 Cal. App. 2d 610, 615, 52 P.2d 550, 552 (1935). \textsc{Cal. Civ. Code} § 1670 provides: "Every contract by which the amount of damages to be paid . . . for a breach of an obligation, is determined in anticipation thereof, is to that extent void. . . ." This is modified by \textsc{Cal. Civ. Code} § 1671, wherein exceptions are granted when, "from the nature of the case, it would be impractical or extremely difficult to fix the actual damage."
\textsuperscript{73} 211 Cal. 491, 295 P. 1031 (1931).
\textsuperscript{74} \textit{Id.} at 493-94, 295 P. at 1032.
\textsuperscript{75} 10 Cal. App. 2d 610, 52 P.2d 550 (1935).
\textsuperscript{76} \textit{Id.} at 615, 52 P.2d at 552.
\textsuperscript{77} \textit{Id.} For general coverage of the California law regarding penalties and forfeitures, see \textsc{Smith, Contractual Controls of Damages in Commercial Transactions, 12 Hastings L.J. 122 (1960).}
security deposits in those areas not covered by consistent case holdings or Civil Code section 1951.

Section 1951 may, of course, be supplemented with a gradual accretion of case law to elucidate those areas where uniformity is lacking. But since the courts have failed to provide positive and consistent guidance in the past, there can be no assurance that guidelines will be developed in the future. Even if such clarification is forthcoming, it may be years until an adequate number of rulings have been produced to cover all areas now in conflict. Two more expedient alternatives should therefore be considered: (1) authoritative selection by the California Supreme Court of either the pledge or trust theory, with the full application of the respective code sections covering each; or (2) passage of additional code provisions to expand those areas of the rental security deposit law which are presently inadequate.

A. Choosing the Pledge or Trust Theory

As first alternative, the supreme court could define the deposit as either a pledge or trust. The relevant provisions of either the Commercial Code or Civil Code could then be used to regulate security deposits. The pledge theory would be more advantageous as far as the landlord is concerned, since that characterization of the deposit would afford him extensive latitude to use the pledged money for his own needs. If, on the other hand, the trust theory were adopted, the landlord would be restricted to use the deposit, if at all, solely for the benefit of the tenant, and would have to discharge all other fiduciary duties owed by a trustee. The tenant would be benefited by such legislative action, as the landlord would no longer be able to use the tenant's money at his own unfettered discretion. Additionally, the tenant would collect some earnings on the money which the landlord held as security.

Those areas not specifically governed by either of the codes might be covered by later court decisions, but at least the basic law would be settled. When combined with Civil Code section 1951, either selection would make it possible to determine more precisely the rights and duties of both the landlord and tenant.

It would be more desirable, however, for the legislature to enact a specific and comprehensive statute to clarify those areas presently in disaccord. Such legislation would add certainty and stability to the law.
of landlord-tenant. California might adopt code provisions similar to the New York General Obligations Law section 7-103, which generally covers those aspects of the field of rental deposits wherein California law is now inadequate.

B. Positive Legislative Action—the New York and New Jersey Experiences

Prior to enactment of New York's rental security deposit statute in 1935, that state's decisions had held that the deposit created a relationship of debtor-creditor between the landlord and tenant, unless the rental agreement manifested a clear intent to the contrary. Section 7-103 completely altered the law. That statute treats the security deposit as a trust res; hence, the landlord is strictly proscribed from commingling the deposit with his own funds. In fact, New York courts have held that a bad faith commingling amounts to a conversion, entitling the tenant to the immediate return of the full rental deposit. The law also renders void any attempted waiver of its provisions.

New York has also made adequate provision for payments of interest on the funds. When the deposit is “for rental of property containing six or more family dwelling units,” the landlord must deposit the tenant's money in an interest-bearing bank account in order to make the trust productive for the tenant. Exemption is made for the benefit of small-scale landlords who own apartments with less than six units, but even they are under a duty to pay the tenant any earned interest if the

85. N.Y. GEN. OBLIGATIONS LAW § 7-103-1 (McKinney Supp. 1971) provides in part: “Whenever money shall be deposited or advanced on a contract or license agreement for the use or rental of real property as security for performance of the contract or agreement or to be applied to payments upon such contract or agreement when due, such money, with interest accruing thereon, if any, until repaid or so applied, shall continue to be the money of the person making such deposit or advance and shall be held in trust by the person with whom such deposit or advance shall be made and shall not be mingled with the personal moneys or become an asset of the person receiving the same, but may be disposed of as provided in section 7-105 of this chapter.”
86. Id.
89. Id. § 7-103-2-a. Allowance is made for deduction of “a sum equivalent to one per cent per annum upon the security money so deposited, which shall be in lieu of all other administrative and custodial expenses.” Id. § 7-103-2.
deposit is placed in an interest-bearing account. The law also stipulates that if a small-scale landlord chooses to deposit the funds in such an account, the name and address of the bank, and a statement of the amount of money on deposit must be given to the tenant. Thus, the New York law appears to cover adequately those areas about which the California law is presently unclear.

It may also be enlightening to consider briefly the situation in New Jersey prior to that state's recent adoption of a statute patterned after the New York law. New Jersey had, before the new law, no code provisions regulating rental security deposits, but its case law had clearly indicated a trend toward the pledge theory. Furthermore, effective in 1963, that state adopted the Uniform Commercial Code provisions on secured transactions as California has done. Certainly, then, the New Jersey courts could simply have placed the rental security deposit within the coverage of the pertinent U.C.C. sections. However, the legislature preferred to enact the independent statute dealing solely with security deposits, thus manifesting its belief either that the U.C.C. provisions were inadequate, or that rental deposits were important enough for a separate body of law. Thus, similar action by the California Legislature would not be without precedent.

Conclusion

The foregoing recommendations would have a substantial impact only on those landlords with large residential or commercial holdings who would be deprived of a free source of capital under the trust theory and who would be required to pay interest on the money which they hold. It should be apparent that the small landowner would only be marginally affected by imposing a trust on the security deposit. Nor would the average tenant be benefited, except to the

90. Id. § 7-103-2.
91. Id.
92. Id. § 7-105 covers disposition of the rental security deposit upon termination of the landlord's interest and is similar in effect to CAL. CIV. CODE § 1951(d). See notes 70-71 & accompanying text supra. Unlike the California provision, however, the New York section makes it a misdemeanor for failure to comply with its instructions. N.Y. GEN. OBLIGATIONS LAW § 7-105-3 (McKinney Supp. 1971).
96. Since there are presently no effective restraints on the landlord in his handling of the deposit, theoretically he is provided with an interest-free source of capital. The quantity of money he could thereby accumulate would be limited only by the size of his property holdings and the amount of security exacted from each tenant.
extent that the imposition of a trust on his money would provide some measure of additional safety. Nevertheless, if landlords are permitted to have the unrestricted use of the tenants' money, then the funds are no longer used for their original purpose—as security. Furthermore, the landlord is provided with interest-free working capital.

To protect the tenant—the weaker of the two parties—the trust alternative should be adopted because the tenant's interest in the security deposit will be made more secure by imposing a trust on the funds. Of the two methods for implementing the trust theory, the second—modelling a California statute after the New York General Obligations Law section 7-103—would provide greater detail and clarity than the simple application of the general trust provisions of the California code. It is likely that trust law would not always be dispositive of the many problems that arise out of the landlord-tenant relationship; the courts would then have only the prior case law—patently confusing and inadequate—on which to rely.

The New York statute attempts to define the rights and obligations of each party to the rental agreement while the security deposit is in the landlord's possession. That state's provisions do not regulate the disposition of the deposited funds after termination of the tenancy, an area which is now fully clarified by California Civil Code section 1951. Clearly if California could combine section 1951 with new legislation similar to New York's, all areas within the field of rental security deposits would be adequately covered. Both landlord and tenant would then be provided with a clear and detailed set of guidelines upon which to base their actions when entering into any type of rental agreement.

Some form of legislative action is required to clarify the inconsistent case law on rental security deposits. In the past, the courts failed to make this increasingly important aspect of the law either coherent or just. Although the enactment of Civil Code section 1951 has brought some clarification to the law, other areas of the field still lie neglected. Unless some remedy is forthcoming, neither the landlord nor the tenant will ever be fully aware of his rights and duties, and the present uncertainties—resolved most often against the weaker of the bargaining parties—will be perpetuated.

John P. Bosshardt*

* Member, Second Year Class