

On the Civil Side/Security Deposit Squabbles

Once, when my son was seven and went to summer camp, I asked the camp counselor how he was doing. She said that he was doing fine, except that he had threatened to sue her for breach of contract when she changed her mind about whether he could dig up a (very large) rock he found. That wasn't the first—or last—time I struggled to explain to my son that suing people is not the simple speedy solution to problems that he imagined. Small claims magistrates tell me that successful plaintiffs sometimes expect to recover the amount awarded from the defendant at the end of the trial. Certainly, many a plaintiff has been dismayed to learn that the trial is often merely the first of several steps necessary to collect money damages.

Landlords are entitled to collect a security deposit in order to avoid the need to file a lawsuit for reimbursement for certain specific damages caused by a tenant's breach. GS Ch. 42, Art. 6, the Tenant Security Deposit Act, regulates this practice in residential tenancies in an attempt to prevent certain unfair and deceptive acts historically associated with security deposits. In this post, I'll explain the basics of the law and address a few of the most common questions asked about its application.

Major Provisions

– Deposits must be placed in a trust account in a NC bank or similar institution (with insurance company bond alternative)

– LL must notify tenant of bank/insurance company name & address within 30 days of lease beginning.

– Maximum amount is equivalent of:

two weeks rent for week-to-week tenancy

1 ½ months rent for month-to-month tenancy

two months rent for terms greater than month-to-month

– LL may use security deposit for only eight breaches enumerated in statute.

- Nonpayment of rent and costs for utilities
- Property damage, exceeding that caused by normal wear and tear, including damage to smoke and carbon monoxide alarms.
- Costs due to early termination (other than that authorized by law, or due to uninhabitable conditions and/or constructive eviction)
- Unpaid bills resulting in lien against rental property
- Costs of re-renting made necessary by tenant's breach
- Costs of removing and storing property after summary ejectment action
- Court costs
- Late fees and administrative fees as authorized by GS 42-46.

- LL must account for deductions and return balance of deposit to tenant within 30 days of lease termination. If LL is unable to determine extent of damages due within 30 days, LL is allowed to make interim accounting within 30 days and final accounting and return of balance within 60 days.
- In the event tenant's address is unknown, LL must retain balance due tenant for at least six months.
- If the LL transfers the property during the tenancy, the LL must either (1) transfer deposit, minus lawful deductions, to new owner and notify tenant of this, or (2) return deposit, minus lawful deposits, to tenant.
- The law applies to individuals and businesses "engaged in the business of renting or managing" residential rental property (other than single rooms).

Remedies for Violation

The Tenant Security Deposit Act has been discussed in few appellate cases, and that discussion has been brief, with the exception of *Neil v. Kuester Real Estate Services, Inc.*, 237 NC App 132 (2014). *Neil* is a lengthy opinion containing a detailed analysis of GS 42-55, which provides:

If the landlord or the landlord's successor in interest fails to account for and refund the balance of the tenant's security deposit as required by this Article, the tenant may institute a civil action to require the accounting of and the recovery of the balance of the deposit. The willful failure of a landlord to comply with the deposit, bond, or notice requirements of this Article shall void the landlord's right to retain any portion of the tenant's security deposit as otherwise permitted under G.S. 42-51. In addition to other remedies at law and equity, the tenant may recover damages resulting from noncompliance by the landlord; and upon a finding by the court that the party against whom judgment is rendered was in willful noncompliance with this Article, such willful noncompliance is against the public policy of this State and the court may award attorney's fees to be taxed as part of the costs of court.

Neil arose in an odd context, as an appeal from a Superior Court ruling refusing to certify the case brought by tenant/plaintiffs as a class action lawsuit. The dispositive issue was whether damages would need to be separately determined for each member of the class. The facts complained of by the tenants in *Neil* was that the landlord consistently deducted costs of cleaning (carpets, bathrooms, appliances), painting, and stove drip pans from security deposits, as well as a \$40 "administrative fee" established in the lease for violation of any of approximately 40 listed health, safety, and maintenance regulations. The tenants' argument was that the consistent use of unauthorized deductions resulted in the landlord's forfeiture of the entire security deposit, thus eliminating the need for individual determination of damages.

The *Neil* Court rejected this argument, finding instead that the statute actually establishes four separate possible remedies, depending on the precise violation. These remedies are:

1. The Appropriate Refund Remedy: applies when a landlord fails to account for and refund the balance owed: tenant is entitled to accounting and refund of balance minus proper deductions
2. The Full Refund Remedy: applies when a landlord willfully violates GS 42-50 (the provision requiring deposit in a trust account or obtaining insurance bond, with notice to tenant); tenant is entitled to full refund, despite landlord's otherwise legitimate claims for deductions, as penalty for deliberate violation of this provision.
3. The Damages Remedy: applies when tenant has suffered actual damages from landlord's failure to comply with the Act.
4. The Attorney's Fees Remedy: applies when a landlord's noncompliance with the Act is willful.

Practical Questions

Magistrates often ask whether and how they should take a security deposit into account when determining money damages in a summary ejectment action. I suggest that they ignore the existence of the security deposit unless it is an identified issue in the lawsuit. The nature of summary ejectment actions often means that consideration of how the security deposit should be allocated is premature. Granting a tenant's request to credit amount already held by the landlord as a security deposit toward the money judgment of the court unfairly deprives the landlord of the opportunity to use the deposit for permissible deductions discovered or incurred after judgment is entered.

A second area of confusion involves the relationship between authorized deductions from the security deposit and additional money damages that might be claimed by the landlord. Remember that these two areas overlap but are not co-extensive. For example, it seems clear (at least to me) that the \$40 fee for rules violations is not an authorized deduction from the security deposit. It may, however, be an enforceable damage claim based on the tenant's agreement to that lease provision. (Or, it may be an unenforceable liquidated damages clause due to its nature as a penalty, but that's another blog post!)

A final note, just for the record: I'm skeptical about the other deductions in *Neil* as well. While routine maintenance cleaning is often claimed as a deduction from security deposits, none of the statutory deductions seem to cover such a charge. This issue was not before the *Neil* Court, and the Court did not directly address it.