Residential Security Deposit Bonds – Are They Legal in Minnesota? Are They Regulated by Minn. Stat. § 504B.178?

Introduction

Until recent times, the main methods residential landlords used to ensure themselves against their tenants' defaulting were guarantors (e.g. parents guaranteeing a lease of their college-student daughter), distress for rent (seizing the personalty of the defaulting tenant; illegal in Minnesota[1]), "security deposits", and simply leasing only to credit-worthy tenants.[2] Recently an alternative to traditional "security deposits" has been added, so-called security deposit bonds. The bonding industry is making a concerted effort to expand their use, both by marketing the product and by lobbying state and city legislatures to enact bonding-favorable laws.[3]

I've used quote marks above because, as discussed in this essay, there is some question whether security deposit bonds are a form of security deposit or are at least regulated by the security-deposit statute.

This essay reviews how the bonds work, discusses legal battles in other states over the bonds, and then analyzes whether the Minnesota security-deposit statute regulates these bonds.

Spoiler alert: Ultimately I'm not sure what the answer is. Hopefully, my essay will spur thinking. At least, it provides information that is not easily available (some bonding-related items from Ohio and Maryland, the legislative history of the Minnesota statute, and the Model Code that was the main basis for the Minnesota law.)

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[1] Minn. Stat. § 504B.101 (2020). This has been the law since 1877, 1877 Minn. Laws c 140.

[2] Wilson, James R. "Lease Security Deposits." Columbia Law Review, vol. 34, no. 3, 1934, pp. 426–472, fn. 3 (security deposits common but not universally required by commercial landlords), available at www.jstor.org/stable/1115875 . In my own experience, not that long ago many suburban Twin Cities residential landlords required very modest security deposits amounting to only 10-20% of one month's rent.

[3] E.g. see these webpages:

https://leaselock.com/blog/security-deposit-replacement-legislation/

https://www.forbes.com/sites/forbesrealestatecouncil/2020/07/15/security-deposit-legislation-sweeping-the-us--are-we-finally-solving-the-problem/?sh=54561279161e

https://www.multihousingnews.com/post/legislation-taking-aim-at-security-deposits/

https://prrac.org/pdf/alternatives-to-security-deposits.pdf

Description of traditional security deposits

The reader is no doubt familiar with traditional security deposits. The tenant pays the landlord a sum of money, often the equivalent of one-month's rent, at the beginning of the tenancy. The landlord holds onto the money, probably in a bank account, until the end of the tenancy. Then, if the tenant owes no money for unpaid rent or physical damage, the money is returned to the tenant with interest. If the tenant does owe for unpaid rent or damage, the landlord deducts that amount from the deposit.

My previous blog post[4] discussed Minnesota residential security-deposit law at length. Very briefly, these are highly regulated by Minn. Stat. § 504B.178. The landlord must pay 1% interest and must return the deposit or specifically account for deductions within three weeks of the tenancy's end; penalties for missing the deadline and for other bad-faith withholding are set out; when ownership changes, passage of the deposit from the seller to the buyer is regulated, with specific notice to the tenant required and serious consequences for noncompliance; expanded jurisdiction in conciliation court is established for the tenant who sues over the deposit; and the tenant may use the deposit to pay his last month rent when the landlord is in the final month of foreclosure or cancellation.

Description of security deposit bonds

Briefly, here is how security deposit bonds work. The tenant purchases the bond from a third-party bonding company in lieu of a traditional security deposit.[5] Appendix 1 displays several such bond agreements. The bond premium is typically 17.5% of the bond amount, which in turn is typically the same as the amount of security deposit that landlord charges, although on occasionally considerably higher.[6] If the landlord believes the tenant owes the landlord money at the end of the tenancy, the landlord does not deduct from the deposit (there is none) but rather seeks reimbursement from the bonding company, which pays the landlord and then has the right to collect the same amount from the tenant. The bonding company can dispute the landlord's claim but anecdotal reports are that it rarely does so. If the bond payment to the landlord does not cover the tenant's alleged debt, or if the landlord foregoes a bond claim, the landlord can try to collect the debt from the tenant in the usual ways (suing, hiring a collection agency, etc).

In some cases, the bonding agreement limits the tenant and the bonding company to binding arbitration or small-claims court to litigate disputes.

Typically, the bonding agreements provide the tenant with none of the rights set out in Minn. Stat. § 504B.178 -- getting details of the landlord's claim (from either the landlord or the

[4] The direct URL is https://birnberglegalwebsite.net/2021/04/11/a-detailed-discussion-of-minn-stat-%c2%a7-504b-178-and-minnesota-residential-security-deposits/

[5] Occasionally the tenant purchases a bond and also pays a security deposit but in a lower than usual amount.

[6] E.g. see *Kopp v. Associated Estates Realty* Corp., 2010 Ohio 1690, ¶ 2 (Ohio Ct. App. 10th Dist. 2010).

bonding company), timelines for claims, penalties for bad faith, notices and related rights when ownership changes, or the right to use the bond as rent when the landlord is at the end of foreclosure or cancellation. Nor are some of the protections should the bonding company or the landlord go bankrupt[7] or caps on security deposit amounts available.[8]

In some cases, unbeknownst to the tenant, the bonding company kicks back 20% of the premium to the landlord.[9] This 20% is usually described as an "administrative fee" but that seems like a fig leaf. Essentially, it is a sales commission.

While the bond premium is supposed to be paid directly to the bonding company so that, at least in theory, the landlord is not involved in the transaction, in practice sometimes the landlord has taken one check from the tenant for rent plus bond premium and then later paid the premium to the bonding company by a separate check.[10] Typically, the landlord will work with one specific bonding company and it is through the landlord that the tenant learns of the bonds and is provided with the bond contract to sign. In Minnesota, and most other jurisdictions, the landlord has no obligation to accept bonds or to accept them from a bonding company the tenant chooses.

Typically, the tenant is given a choice of deposit or bond but HOME Line's tenant hotline has received calls from tenants who stated a bond was required and a deposit was not a choice.

While the early-entrant companies followed the model above, recently some companies follow a different model. The difference is that instead of a one-time bond premium, the tenant pays a lower premium (about $10-$20 per month) but does so every month. If he stays for a few years, he ends up paying premiums totaling more than a typical (refundable) deposit.

Renters insurance is generally a better deal for tenants than bonds

The bond differs from insurance in two important ways.

Most importantly, with true insurance the insurance company may not subrogate against its own insured. *Bigos v. Kluender*, 611 N.W.2d 816, 822 (Minn. App. 2000), *review denied* (Minn. July 25, 2000). E.g., if a tenant accidentally burns his rented house and submits the landlord's legitimate claim against him to his insurance company under his renters insurance policy, the company will pay the claim but cannot then require the renter to reimburse it. That would be subrogating against its own insured. In contrast, the security bonding company does require its client, the renter, to reimburse it for the money it pays on the landlord's claim.

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[7] Discussed in detail in my previous blog post.

[8] Listed in my previous blog post.

[9] Tenants' brief in *Kopp*, *supra* (Appendix 4) at 3; AERC's brief in *Kopp* (Appendix 5); *Converge Services* Consent Order at 6 (Appendix 2).

[10] AERC's brief in *Kopp* (Appendix 5) at 9.

Second, a true renters insurance policy also provides the renter with a free attorney to defend him against the landlord's claim for the fire damage (should an attorney be needed).

All renters insurance policies under the liability part of the policy insure the tenant against landlord's claims for damage the tenant does via fire or smoke.[11] About a quarter of Minnesota polices also cover water damage (frozen pipes bursting, bathtub left on, etc).[11] All or almost all pay for the first $500 or $1,000 of damage from any damage the tenant causes by negligence even if the cause was not fire or water.[11] Renters insurance premiums tend to be about $100-$150 per year (or much less, perhaps effectively zero, if bundled with auto insurance) and obviously protect the tenant against not only the claims just discussed but against other claims, and allow him first-party insurance for his own personalty lost to fire, floods, theft and the like.

Therefore, putting aside bond coverage for non-payment of rent, a renters insurance policy is a much better deal for the tenant. Rent default is probably the main reason security-deposit-bond agreements allow the bonding company to collect against their own client. Otherwise, the tenant would intentionally default on his last rent payment when eviction is no longer a real threat, allow the bonding company to pay the landlord, and make a profit (last rent amount minus bond premium). What I cannot determine is what would be a fair bond premium for a bond that only covered rent defaults, allowing the tenant to buy renters insurance to cover other issues.

Advantages and disadvantages to the tenant of security deposit bonds

As discussed above, unless Minn. Stat. § 504B.178 is deemed to regulate security deposit bonds, the tenant cedes many important rights in choosing a bond over a traditional deposit (or being required by the landlord to obtain a bond).

There are two advantages to the bonds. The first is not unique to lower-income tenants; the second one is.

First, if the tenant correctly believes that the landlord regularly withholds deposits unfairly & unlawfully and the tenant wants to avoid litigation (or must avoid it because, e.g., he plans to return to his home country at the end of the tenancy and suing the landlord will be impractical), he might think the bond premium is worth the money.

Second, a low-income tenant might not have the money to pay a full deposit or at least might have to forego other important needs (e.g. proper food) if he pays a full deposit. So he opts for a bond, even if he knows that at the end the bonding company might chase him for the very money he was trying to avoid paying. This is a classic sort of predatory financial scheme aimed at the poor – crappy deals which make some sense for poor persons but not for rich or middle-class persons. Indeed this advantage is the main selling point of the bonding companies. See for example https://mysuredeposit.com/whatissuredeposit (third paragraph).

[11] The details are available in another of my blog posts, https://birnberglegalwebsite.net/2020/03/20/renters-insurance-helps-a-residential-tenant-when-he-accidentally-burns-his-apartment-but-not-when-he-accidentally-floods-his-apartment-full-coverage-should-be-mandated-by-statute/

Advantages and disadvantages to the landlord of security deposit bonds

For the most part a bond is a much better deal than a traditional deposit for the landlord. Perhaps he gets a 20% kickback. Even if not, he is relieved of paying interest on a deposit; he is relieved of all the notice, accounting and mailing requirements of Minn. Stat. § 504B.178; the penalties in Minn. Stat. § 504B.178 don't apply; and if he sells the place, he doesn't have to obey the transfer rules of Minn. Stat. § 504B.178.

Having to make a claim against the bonding company and waiting to get paid is a downside. With a deposit, the landlord simply makes an accounting note in his ledger and scoops up the deposit to "pay" his claim. If the bonding company is unscrupulous, the landlord might never get paid or have difficulties collecting. Anecdotal evidence suggests this is not a significant problem, especially since the bonding companies' marketing strategy seems to depend on the landlords as their salesmen. Unhappy salesmen don't sell.

For an unscrupulous landlord, a traditional deposit might be a better deal. There is a small subset of landlords that simply don't return deposits or routinely deduct unfairly and consider this one of their profit centers.[12] Successfully keeping a deposit is more profitable than keeping 20% of a bond premium.

Legal and legislative attacks against security deposit bonds

Given the concerns above, what types of attacks have tenant advocates asserted? They fall into two categories – "nondisclosure" and "direct".

In the former, the gravamen of the attack is that the bonding companies and landlords did not disclose how the bonds worked or provided false descriptions.

In the latter, the gravamen of the attack is that the bonding companies or the landlords or both violated the state's security deposit statute, making them liable for the bond amount, for the premiums, or for other penalties in the statute.

Very few of the legal attacks have led to reported case outcomes. Both in California[13] and in Oregon[14], apparently there were direct attacks that led to some sort of settlement. Several jurisdictions have enacted legislation regulating such bonds.

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[12] Sometimes the AG or an enterprising Legal Aid attorney will go after these landlords so the scheme is not always profitable. See e.g. *Love v. Amsler*, 441 N.W.2d 555 (Minn.Ct.App.1989) (success by Legal Aid); *State by Ellison v. Meldahl*, Henn. Cty. Dist. Ct. File No. 27-CV-19-16424 (on-going case by the Minnesota Attorney General; docket available on MNCIS, https://pa.courts.state.mn.us/default.aspx)

[13] Indirectly discussed in this case *Park Plaza II, Ltd. V. American Bankers Ins. Co.*, No. G048916 (Cal. Ct. App. Fourth District, Division Three, October 31, 2014).

[14] https://www.oregonlive.com/front-porch/2012/01/renters_lawsuit_challenges_bon.html

The Maryland Attorney General brought a nondisclosure-type case that led to a final settlement favorable to the tenants. There is one reported direct-type of reported case, an Ohio case which the tenants lost. They are discussed below.

Maryland nondisclosure case

The Maryland Attorney General ("AG") filed an administrative complaint against the SureDeposit bonding company, *Consumer Protection Division Office of the Attorney General of Maryland v. Converge Services Group, L.L.C. T/A SureDeposit et al*, CPD Case No. 03-021, OHA No. OAG-CPD 02-03-45426. See *Converge Servs. Grp., LLC v. Curran*, 383 Md. 462, 860 A.2d 871 (Md. Ct. App. 2004). After a lot of battles over the reach of the AG's office, the Attorney General essentially won those battles in the appellate court case (383 Md. 462). Then the parties settled the dispute.

I have been unable to obtain a copy of the administrative complaint but the assistant AG who handled the case provided me with a copy of the settlement Consent Order (Appendix 2). He was unable to locate the original complaint. [15] Paragraph 6 of the Consent Order lays out the allegations of the complaint, to wit that SureDeposit failed to disclose:

> [a] All material terms of the bonds.
>
> [b] The tenant remained liable to SureDeposit for damages paid to landlord.
>
> [c] The tenant forewent her rights, including
>
> > [i] inspection of their unit at the beginning and at the end of their lease;
> >
> > [ii] prompt written notice by landlord of damages and actual costs incurred;
> >
> > [iii] the right to seek a penalty of up to three times the amount of the deposit plus attorney fees for landlord's noncompliance with the Maryland security deposit statute.
>
> [d] The landlord got a 20% kickback of the premium.
>
> [e] The landlords could claim more against the bond than they could deduct from deposit.
>
> [f] SureDeposit pays landlords without the landlords having to honor the tenants' rights under the Maryland Real Property Article (security deposit statute etc.) and without having to submit evidence to support their claims

and also that SureDeposit gave tenants no notice or chance to contest damage claims by their landlords.

[15] Both are public records but short of going to Annapolis, MD it might be hard to get a copy of the complaint.

Under the settlement, the AG got essentially everything it was asking for with one important exception. SureDeposit agreed to stop selling the bonds in Maryland. It agreed to undo any negative credit reporting of tenants it had done. Tenants whose tenancies had ended received a 40% refund of the premiums they paid (incomplete relief for them). Tenants with active tenancies and uncooperative landlords got back their premiums; if their landlords cooperated, tenants with active tenancies had their premium was returned to the landlord (the 80%) and the landlord then combined that with the 20% kickback and made that into the tenant's normal security deposit. SureDeposit also paid the AG $12,000 as a penalty plus $15,000 as reimbursement for its investigative costs (basically more penalty).

The important exception was that if Maryland enacted a statute allowing security deposit bonds SureDeposit could prospectively sell such bonds as allowed by the statute. As indicated in a press release by the AG (Appendix 3), the legislature was doing exactly that, no doubt one reason SureDeposit agreed to settle. In the new legislation, bonds are allowed but are significantly regulated, providing the same sort of rights the AG had alleged SureDeposit had not honored pre-settlement. The statute is Md. Code § 8-203, with the new law being the part headed "Surety bonds".

Ohio direct case

Facts[16]

The Ohio case is *Kopp v. Associated Estates Realty* Corp., 2010 Ohio 1690 (Ohio Ct. App. 10th Dist. 2010) . The tenants, Kyle and Melanie Kopp, were given a choice of paying an $840 deposit or buying a $2500 bond from SureDeposit for a premium of $437.50. They bought the bond. SureDeposit kicked back 20% of that, $87.50, to Associated Estates Realty Corp ("AERC").[17]

At the end of their tenancy, they did not receive the itemized list of damages required by Ohio R.C. 5321.16(B).[18]

The tenants' claim that the bond premium was a deposit was rejected.

The Kopps argued that as a result their landlord, AERC, owed them the "deposit" (apparently the bond premium) plus the penalties under Ohio R.C. 5321.16(C).

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[16] The facts are gleaned primarily from ¶¶ 2-12 of the appellate decision and to a lesser extent from the parties' briefs to that court.

[17] AERC claimed the 20% was for "administrative and accounting services". AERC's brief (Appendix 5) at 9-10. However, as the Kopps argued, Tenants' brief (Appendix 4) at 8, that strikes me as a canard.

[18] AERC claimed the Kopps did receive an itemized-damage list. AERC brief (Appendix 5) at 12, fn. 5. However, since the case was decided against the Kopps by summary judgment, the facts must be construed in favor of the Kopps, and they alleged they did not receive such a list.

The court rejected this argument. It first quoted the definition of "security deposit" in the Ohio Landlord Tenant Act:

> (E) "Security deposit" means any deposit of money or property to secure performance by the tenant under a rental agreement.

Ohio R.C. 5321.01(E). Then it quoted section 5321.16(B) which read:

> (B) Upon termination of the rental agreement any property or money held by the landlord as a security deposit may be applied to the payment of past due rent and to the payment of the amount of damages that the landlord has suffered by reason of the tenant's noncompliance with section 5321.05 of the Revised Code or the rental agreement. Any deduction from the security deposit shall be itemized and identified by the landlord in a written notice delivered to the tenant together with the amount due, within thirty days after termination of the rental agreement and delivery of possession. The tenant shall provide the landlord in writing with a forwarding address or new address to which the written notice and amount due from the landlord may be sent. If the tenant fails to provide the landlord with the forwarding or new address as required, the tenant shall not be entitled to damages or attorneys fees under division (C) of this section. [emphasis added]

In somewhat cursory fashion, the court concluded that since AERC was not paid the $437.50, "there was no sum of money held by the landlord". 2010 Ohio 1690, ¶ 13. Therefore, section 5321.16(B) did not apply. *Id*.

As to the 20% kickback, the court's entire reasoning was as follows:

> It is not disputed that BIC pays appellee an administrative fee calculated as 20 percent of the total premiums of all bonds purchased by appellee's tenants nationwide. However, it is equally undisputed that appellee does not "retain" any portion of what tenants submit to BIC. Rather, the payment of the administration fee is a transaction separate and apart from the bond premium paid by appellants to BIC and in no way reflects a type of deposit. [quote marks in original]

Id. at ¶ 14. Noteworthy is that neither the word "retain" nor other tenses of the word (e.g. "retained") are in the Ohio Landlord Tenant Act. The proper question is whether the landlord, AERC, "held" the 20%, the $87.50. Essentially the court bought the argument that the trip the $87.50 took – as part of the original $437.50 paid to AERC by the Kopps and then back (in a sense) to AERC as part of a larger payment kickback payment for several bonds[19] – rendered it not a deposit payment. At worst, this is circular reasoning. At best it strikes me as elevating form over substance.

What the court did not discuss was whether the $87.50, even if "held by the landlord", was a "deposit of money or property to secure performance by the tenant" under the definition in

[19] AERC's brief (Appendix 5) at 10.

section 5321.01. AERC's brief (Appendix 5) (pages 10-11) raised this issue, which seems to me to be important, probably crucially important. The direct security was the bond, not the premium.

The Kopps' brief (Appendix 4) did discuss this issue on page 7. It argued as follows. Suppose AERC had the Kopps pay a "non-refundable security fee" of $437.50 and then used the $437.50, or 80% of that, to buy $2500 in insurance from SureDeposit. I.e., the actual transaction might have been different in form but it was the same in substance as this "non-refundable security fee", and such fees are rendered refundable by the Ohio Landlord Tenant Act.

That seems to me to be the tenants' strongest argument that the full $437.50 is actually a security deposit. However, there is a real-world problem with the argument. AERC would be unable to unilaterally purchase the same product at the same price. As discussed above, the bond was not insurance. Part of the bond deal was that SureDeposit had the right to collect against the tenants dollar-for-dollar what they paid to AERC. Without the tenants' agreement, AERC could not have purchased equivalent "insurance". Likely, had AERC tried to buy actual insurance against both the Kopps' defaulting on their duties to maintain the premises and to pay rent, the premium would have been higher, probably closer to $840 (one month of rent).

The tenants' claim that the bond deal was unconscionable was also rejected.

The Kopps also argued that the entire bonding scheme was unconscionable. Tenants' brief (Appendix 4) at 9-10. They made two points. First, the deal was so one-sided as to be one that no informed tenant would make. Second, AERC hid all the facts from the Kopps, much as the Maryland AG claimed SureDeposit hid facts from Maryland tenants. Indeed, the Kopps' brief cited the Maryland litigation. *Id*. at 11-12.

The court did not deal with the second argument. It rejected the first one on the grounds that unconscionability only applies when the consumer has no good choice. Since the Kopps had a choice of a traditional $840 deposit, the doctrine of unconscionability did not apply. 2010 Ohio 1690, ¶ 17.

Obviously, this leaves open the question of whether an Ohio lease that required a SureDeposit bond would be unconscionable.

Summary and comment about the named parties

With somewhat cursory reasoning, the Ohio court held [1] the bond premium was not a "security deposit"; and [2] since the tenants had a choice of either buying a bond or paying a typical security deposit equal to a month's rent, that choice was not unconscionable.

Noteworthy is that the Kopps only sued their landlord and not the bonding company. It remains an open question in Ohio whether the bonding company would have a duty to treat either the bond premium or the entire bond amount as a security deposit under Chapter 5321 of the Ohio Revised Code.

Analysis of Minn. Stat. § 504B.178

Assume a Minnesota landlord and a bonding company work together to sell a security deposit bond to a residential tenant and do so with full disclosure, so that the type of concerns about trickery raised in the Maryland litigation are not present. Assume further that the tenant is given a real choice between a traditional security deposit and a bond in the same amount. Is that bond regulated by Minn. Stat. § 504B.178?

The plain language of Minn. Stat. § 504B.178

The reach of section 504B.178 is largely set out in its first two subdivisions, which read:

> Subdivision 1. **Applicability**. Any deposit of money, the function of which is to secure the performance of a residential rental agreement or any part of such an agreement, other than a deposit which is exclusively an advance payment of rent, shall be governed by the provisions of this section.
>
> Subd. 2 **Interest**. Any deposit of money shall not be considered received in a fiduciary capacity within the meaning of section 82.55, subdivision 26, but shall be held by the landlord for the tenant who is party to the agreement and shall bear simple noncompounded interest [calculated as follows] ….

Subdivision 1 has three prongs. The payment must be [i] a deposit; [ii] of money; and [iii] secure the performance of a residential rental agreement.

Clearly the bonding arrangement – the premium, the bond, or both – is designed to secure the performance of the tenant's lease ("residential rental agreement"), so prong #iii is met.

As discussed in my previous blog, "money" means "lawful money of the United States" and extends to items that are denominated and spent/doled out as such. *Rathbun v. W.T. Grant Co.*, 300 Minn. 223, 219 N.W.2d 641 (1974) (coupons denominated in dollars but only good for buying items at the W.T. Grant department stores are "money"). The bond premiums obviously are money as they are paid by dollar-denominated checks. The bond itself, if paid, is paid in dollars. Until it is claimed, it is not actually dollars but a pledge to pay dollars, similar to the landlord's pledge to return the tenant's traditional deposit if the tenant leaves debt free, so that two should qualify as "money." Thus prong #ii is met.

The word "deposit" is not defined in Minn. Stat. Chapters 504B or 645 (the construction-of-statutes chapter). The one Minnesota case discussing possible definitions is *State v. Keehn*, 554 N.W.2d 405 (Minn. App. 1996). The court had to determine if certain restitution claims by a crime victim which she called "deposits" were expenditures (valid claims) or refundable (not valid claims) and it wrote as follows:

> The district court's restitution order, tracking the language of C.K.'s affidavit, lists her relocation expenses as deposits rather than payments or expenses. But neither the affidavit nor the order indicates whether the deposits may be refunded. The term "deposit" has multiple meanings. Most common is the definition supporting the notion

> that a deposit is refundable. A security deposit on a new apartment, for example, is normally returned at the end of the tenancy. Refundable deposits like the security deposit are not losses for which restitution is appropriate….
>
> But a deposit can also be a "partial or initial payment of a cost or debt." *The American Heritage Dictionary of the English Language* 502 (3d ed. 1992). In other words, "deposit" does not necessarily imply "refund." We cannot determine on this record whether the expenses labeled "deposits" were down payments or refundable collateral.

Id. at 407-408 (emphasis added).

Definitions in dictionaries available in 1973[20] follow those in *Keehn.* Black's Law Dictionary (4th ed. 1951) page 526 defines "deposit" as

> money lodged with a person as earnest or security for the performance of some contract to be forfeited if the depositor fails in his undertaking. It may be deemed to be part payment, and to that extent may constitute the purchaser the actual owner of the estate.

The *American Heritage Dictionary of the English Language* (1st ed. 1969) has the same definition as the 1992 edition.

According to the bonding agreement the bond premium does not meet the first definition since the agreement says the bond premium is nonrefundable. The bond itself is not refundable to the tenant.

Of course, this leads to a circular-reasoning problem. Minn. Stat. § 504B.178 is non waivable, so perhaps the parties cannot make the bond premium nonrefundable by agreement.

The premium does not meet the second definition since it is full payment for the bond. The bond might meet the second definition when the bond does not fully cover the damage a tenant does.

Thus it is unclear if either the bond premium or the bond itself are "deposits". Based only on subdivision 1 it is not clear-cut if prong #i is met.

Other parts of Minn. Stat. § 504B.178 indicate that neither the bond premium nor the bond are "security deposits". Subdivision 2 says the "deposit … shall be held by the landlord for the tenant". Assuming no kickback, the premium and the bond are both held by the bonding company, suggesting they were never "deposits" under prong #i. Also, subdivision 3 requires the landlord to "return the deposit to the tenant" absent tenant debts. If the landlord never touched the premium, he cannot "return" the deposit.

When the landlord takes a 20% kickback, then that 20% amount more readily fits within the definition of "security deposit" in Minn. Stat. § 504B.178. The 20% money is deposited one way

[20] As discussed below, the language of Minn. Stat. § 504B.178, subd. 1, has not changed since the original statute was enacted in 1973. Therefore, definitions in dictionaries available in 1973 are relevant. Black's 4th edition was published in 1951; the 5th edition was published in 1983.

or another with the landlord, who in turn can readily return the 20% money, with interest, to the tenant at the end of the tenancy

The indication from subdivisions 2 and 3 that the bond premiums and bonds– at least those not in hands of the landlord -- are not "security deposits" probably arises from the fact that when the statute was enacted in 1973 no one even thought about security deposit bonds. Historically, both security deposits and security deposit bonds were governed by the common law of contracts. By enacting Minn. Stat. § 504B.178, the legislature was abrogating common law. One canon of statutory construction states that if "statutory enactment is to abrogate common law, the abrogation must be by express wording or necessary implication". *Wirig v. Kinney Shoe Corp.*, 461 N.W.2d 374, 377-378 (Minn.1990).[21] Based on this canon a court would lean toward ruling that Minn. Stat. § 504B.178 does not regulate security deposit bonds.

In summary, the language of Minn. Stat. § 504B.178 indicates that it does not cover security bonds or their premiums, at least as to the money not kicked back to the landlord, but the language is not definitive.

Comparison to *Kopp*

As discussed above, I think the analysis in *Kopp v. Associated Estates Realty Corp* was cursory. However, its holding that the Ohio security-deposit law did not govern bonds is clear. The language of Minn. Stat. § 504B.178 is very similar to the language of the Ohio statute. If a Minnesota court were to follow *Kopp*, it would very likely rule against the tenant, at least if the tenant were only suing her landlord.

The legislative history of Minn. Stat. § 504B.178

Perhaps the legislative history of Minn. Stat. § 504B.178 sheds light on its meaning.

Except for the changes to the interest rate over time, the language of first two subdivisions of section 504B.178 is unchanged since the original statute was enacted in 1973. Compare Minn. Stat. § 504.20 (1973) and Minn. Stat. § 504B.178 (2020).[22] I am unaware of any post-1973 legislative effort to modify the first two subdivisions of Minn. Stat. § 504.20 (1973). Thus, only the 1973 legislative history matters for the bonds-as-deposits issue.

Records at the Gale library

In 2002 Adam van Alstyne, a very sharp law-school-student intern at HOME Line, complied a comprehensive collection of the paper records of the Minnesota legislature's files at the Gale

[21] Of course there is a countervailing canon -- remedial statutes should be given a liberal construction when they are ambiguous. *S.M. Hentges & Sons, Inc. v. Mensing*, 777 N.W.2d 228,232 (Minn. 2010) .

[22] Recodifications changed Minn. Stat. § 504.20 (1973) into Minn. Stat. § 504B.178 (2020) and Minn. Stat. § 82.17, subd. 7 (1973) into Minn. Stat. § 82.55, subd. 26 (2020).

Library of the Minnesota History Museum related to the 1973 law, Appendix 7 (large file, 44,740 KB). By that time, the library had long since discarded its audio tapes of 1973 committee meetings and floor debates.

The Gale Library also maintains records donated by some former state legislators. Among these are the files of former State Senator Robert Tennessen, who was the chief author of 1973 SF 965, the bill that became 1973 Minn. Laws c 561, Minn. Stat. § 504.20 (1973). Tennessen's files include two documents of interest; these are displayed in Appendix 8. The chief author of the companion House bill, former State Representative Tom Berg, has not donated his files. When I recently asked him if he still had any relevant files he said he did not.

The legislature's own files don't shed light on the bonds-as-deposits issue. The committee minutes say nothing about the issue. With one exception the final law's first two subdivisions are the same as the original (identical) House and Senate bills (1973 HF 1034 and 1973 SF 965). The exception was the addition of the first clause in subdivision 2. As discussed in my previous blog, this change was aimed at avoiding a conflict with another chapter related to the interest rate; it had nothing to do with the bonds-as-deposits issue.

1973 HF 1034, 1973 SF 965 (and thus the enacted law 1973 Minn. Laws c 561/Minn. Stat. § 504.20 [1973]) repealed and replaced the prior law, Minn. Stat. § 504.19 (1971). Other security-deposit bills were introduced. They were not repeal-and-replace bills; instead they amended Minn. Stat. § 504.19 in various ways. However, as Appendix 7 shows, none of them advanced once Tennessen and Berg introduced their comprehensive legislation. Moreover, none of those other bills modified any language in Minn. Stat. § 504.19 related to the bonds-as-deposits issue.

Senator Tennessen's files do include a summary of the bill prepared by University of Minnesota law professor (later Dean) Robert Stein. It's unclear if this summary was used in committee testimony. Regardless, Stein's summary says nothing about subdivision 1 and as to subdivision 2 only states the interest rate as 5% per year non-compounded.

In summary, the legislature's and legislator's files at the Gale Library shed little light on the bonds-as-deposits issue.

Discussions with the chief authors

I corresponded with the two chief authors. Neither recalled the bonds-as-deposits issue coming up and nor recalled thinking about it at the time. The nature of their replies suggested that this could mean it came up and they don't recall what was said or that it didn't come up, although probably the latter. I've spoken to both fairly recently and the problem is not their brains going downhill – far from it – but just that it was 48 years ago.

Tom Berg did write me, "As for the source [of 1973 HF 1034], this bill came from my friends at Legal Aid. I remember Paul Marino and my law school classmate Bernie Becker. They did the basic drafting and may have worked with someone in the Revisor of Statutes office. I heavily relied on their expertise and good political judgement." Both Mr. Marino and Mr. Becker have since died so I could not talk to them.

The probable source of the 1973 bills is a Model Code; implications from that code

The language of 1973 HF 1034/1973 SF 965 bears a striking resemblance to a 1950 California law, Cal. Stats. 1970, c. 1317, p. 2453, § 1, which is quoted in its entirety in *Bauman* v. *Islay Investments*, 30 Cal. App.3d 752, 761 (Cal. Ct. App. Feb. 22, 1973). Other state statutes also resemble the California statute, but I don't think any of them were enacted before the 1973 Minnesota law.

As *Bauman* states, the California law, and by implication the Minnesota law, were copied, at least in part, from the *Model Residential Landlord-Tenant Code, Tentative Draft* (American Bar Foundation 1969) ("Model Code").[23] I have copied the part related to security deposits plus associated definitions in Appendix 9.[24]

Reading the Model Code and the Minnesota law, one can see that the Minnesota law was copied in large part from the Model Code.[25] The drafters disagreed with the Model Code's no-interest rule, the rule regarding prepayment of last month rent, and the criminal-law penalty for noncompliance, but otherwise the laws were similar, especially the parts that became the first two subdivisions of Minn. Stat. § 504.20 (1973).

This is especially true of the first sentence in each law. Compare:

> [1973 MINNESOTA LAW, SUBDIVISION 1] Any deposit of money, the function of which is to secure the performance of a residential rental agreement or any part of such an agreement, other than a deposit which is exclusively an advance payment of rent, shall be governed by the provisions of this section. [emphasis added]

to

> [MODEL CODE, SECTION 2-401(1)] Any advance or deposit of money, regardless of its denomination, the function of which is to secure the performance of a [residential][26]

[23] The "Tentative Draft" part of the title refers to the authors' intent that it be viewed as a "basis for discussion and not as a proposal ready for adoption". *Id*. at 1. There was no second draft.

[24] The entire Model Code is available at some law libraries but it is copyrighted so I hesitate to reprint all of it. I do have a copy in my home.

[25] A more widely adopted uniform law, the Uniform Residential Landlord Tenant Act ("URLTA"), was not a model for the Minnesota law. The security-deposit provision of the URLTA and the Minnesota law are very different.

[26] The Model Code did not use the word "residential" in section 4-201(1) because its definition of "rental agreement" in section 1-207 was limited to leasing dwelling units. For ease of reading, I've inserted "residential" above.

> rental agreement or any part thereof, shall be governed by the provisions of this section. [emphasis added]

As stated above, the Minnesota drafters made a policy choice to exclude prepaid rent from the statute's reach and apparently also disliked payment in foreign currency. Otherwise, the provisions are the same.

Typically when model codes are adopted by the legislature, the comments by the model-code drafters are given some credence. It is even possible that the testifiers to the 1973 committees discussed the comments. The relevant comment is the very first sentence under "COMMENT", to wit,

> The first sentence of [Model Code Section 2-401,] subdivision (1) defines "security deposit" in terms of its intended security function.

The comment is hardly definitive but it does suggest a broad reach of "security deposit", possibly broad enough to encompass security deposit bonds.

A more attenuated argument can be made on the basis of two other parts of the Model Code. Since they are not part of the code that the Minnesota legislature copied, their import is less than the comment just quoted. Nonetheless, I call attention to the following two provisions in the Model Code:

> Section 1-104. Applicability of the Act
>
> This Act shall regulate and determine all legal rights, remedies, and obligations of the parties and beneficiaries of any rental agreement for a dwelling unit within this State, wherever executed. Any agreement, whether written or oral, shall be unenforceable insofar as the agreement or any provision thereof conflicts with any provision of this Act and is not expressly authorized herein. Such unenforceability shall not affect other provisions of the agreement which can be given effect without such void provisions.

and

> Section 1-207. Rental Agreement
>
> Rental Agreement means and includes all agreements, written or oral, which establish or modify the terms, conditions, rule, regulations, or any other provisions concerning the use and occupancy of a dwelling unit.

The definition of "Rental Agreement" is broad enough to cover the bonding agreement, especially since it is almost always incorporated into the lease. Thus the Model Code's security-deposit provision would draw security deposit bonds within its reach. Combined with Section 1-104, the nonrefundability of the bond premium is called into question under the Model Code. This is a doubly attenuated argument since it involves assuming that the Minnesota law should be interpreted the way the drafters wanted the Model Code to be interpreted plus assuming that

this interpretation should include parts of the code that (sections 1-104 and 1-207) that were not copied into Minnesota law. Nevertheless, it is food for thought.[27]

> *Bauman* v. *Islay Investments*, 30 Cal. App.3d 752, 761 (Cal. Ct. App. Feb. 22, 1973).

"Laws uniform with those of other states shall be interpreted and construed to effect their general purpose to make uniform the laws of those states which enact them." Minn. Stat. § 645.22. Also, "when a court of last resort has construed the language of a law, the legislature in subsequent laws on the same subject matter intends the same construction to be placed upon such language." Minn. Stat. § 645.17(4). Therefore, the construction by the *Bauman* court – albeit not by the California Supreme Court but of a uniform law – should be given respect by Minnesota courts. Furthermore, since *Bauman* was decided before 1973 HF 1034 and 1973 SF 965 were introduced in March 1973, that construction can be imputed to the 1973 Minnesota law.

The *Bauman* court held that a "nonrefundable" "cleaning fee" which the tenants paid prior to occupancy was nevertheless refundable as a security deposit under the statute. By analogy, albeit not an exact analogy, the "nonrefundable" bond premium paid by a Minnesota tenant would be refundable as a security deposit under Minn. Stat. § 504B.178. Thus *Bauman* lends a bit of support to a broad reach of the definition of "security deposit" in Minn. Stat. § 504B.178.

> Summary of legislative history

In summary, the legislative history of Minn. Stat. § 504B.178 is not definitive but provides a bit of ammunition for tenants arguing that it governs security deposit bonds.

Conclusion

Minn. Stat. § 504B.178 was enacted in 1973 to deal with the main collateral landlords used then, security deposits. Unsurprisingly it was not drafted in a way that readily deals with a recent invention, the security deposit bond. My guess is that if a tenant whose landlord and bonding company had fully disclosed the pros and cons of buying a security deposit bond still bought the bond were to challenge its nonrefundability in court, she would lose her case. If the landlord took a kickback of the bond premium, the tenant's chances would improve.

However, I don't think either side could be sure of the outcome. If nothing else, the discussion and citations above will give legal researchers a head start when representing clients in security-deposit-bond disputes.

[27] One of the two main authors of the Model Code (Julian Levi) is dead but recently I had a chance to speak to the other main author, Philip Hablutzel. He pointed out the import of sections 1-104 and 1-207 to me. He recalled testifying about the Model Code to the California legislature but does not recall discussing the bonds-as-deposits issue there or otherwise (until I telephoned him).

This field is rife with low-income tenants being taken advantage of by the bonding companies. At a minimum tenants buying such bonds should be protected by the sort of disclosure and procedural protections found in Md. Code § 8-203. The protections should include a cap on the bond so that neither the bond nor the accumulated bond premiums exceed the traditional deposit that tenant would have paid otherwise.

A natural solution is legislation of exactly this kind. The Minnesota legislature can regulate a new field – a common task of legislatures – while protecting consumers who have little bargaining power. Of course, tenant advocates and bonding companies might be motivated to take their shots in court under current law before lobbying for legislation (and especially before joining together reach a compromise on proposed legislation.)