TENANTS PROJECT

De Stefano and *Caruso:*
Analysis and Commentary
by
Christopher Warnock
Tenants Project
Tenants' Project Website www.ictenantsclassaction.com

I. Introduction

De Stefano v. Apts. Downtown, 879 N.W.2d 155 (Iowa 2016) and *Caruso v. Apts. Downtown,* 14-1783 (Iowa 2016)are important landlord tenant cases, with significant rulings:

(1) delineating what landlords can deduct from security deposits, in particular making it clear that landlords cannot deduct for automatic carpet cleaning, but may deduct for carpets dirty beyond ordinary wear and tear and leaving the question of non-refundable cleaning fees open;
(2) limiting landlords' ability to shift the cost of repairs and maintenance onto tenants;
(3) preventing a landlord from unreasonably refusing permission to sublease;
(4) requiring actual knowledge as the standard for punitive damages for knowing and willful use of prohibited lease provisions;
(5) making actual dishonesty the standard for punitive damages for bad faith withholding of a security deposit;
(6) classifying statutory attorney fees in a landlord tenant action as costs for purposes of determining the $5000 jurisdictional limit of small claims.

De Stefano and *Caruso* are part of an ongoing and comprehensive campaign by the Tenants' Project to try to reform landlord tenant relations, first in Johnson County and then throughout Iowa. While litigation was an important part of this effort, the use of media, including newspapers, TV, social media and the Tenants' Project website, were also key. Ultimately, the goal was to try to change an often antagonistic relationship between landlords and tenants into one where both landlords and tenants work together and treat each other fairly and respectfully.

For the Tenants' Project the primary purpose of litigation is not winning damages, but getting clarity and guidance from the courts with regard to the legal relationship of landlords and tenants. The Tenants' Project began with class actions that challenged

commonly used standard lease provisions that appeared to violate the Iowa Uniform Residential Landlord Tenant Act ("IURLTA") codified at Iowa Code Chapter 562A. In *Staley v. Barkalow*, 834 N.W.2d 873 (Iowa Ct. App. 2013) the Court of Appeals held that under Iowa Code 562A.11 which prohibits the use of illegal lease provisions, "tenants have a right to a legal lease, a lease free from prohibited provisions…" *Staley* at 2. Thus, said the *Staley* Court, the inclusion of prohibited provisions in a lease, if the landlord included the provisions, knowingly and willfully, could give rise to punitive damages, even if the provisions were not enforced." *Staley* at 15-16.

However, as a result of the arguments raised by some landlords, both before and after *Staley*, which continued to insist on the necessity of enforcement of prohibited provisions, the Tenants' Project also filed a number of small claims cases in Johnson County District Court. In these cases, which included *De Stefano* and *Caruso*, the challenged provisions had been enforced by the landlord. In bringing these cases, the Tenants' Project and counsel for the landlords, did their best to ensure that the legal issues were fully briefed and the factual record fully developed with the hope that the cases would result in significant appellate decisions.

II. Security Deposit Deductions Must Comply with §562A.12

A. Automatic Carpet Cleaning Security Deposit Deduction

Probably the issue with the greatest practical impact for Iowa landlords and tenants was the *De Stefano* Court's ruling on automatic carpet cleaning. Many Iowa standard leases, though not the Iowa State Bar Association lease, required that tenants, at the end of the tenancy, automatically pay for professional carpet cleaning, either by a direct deduction by the landlord from the security deposit or through a lease provision that required the tenant to hire a professional carpet cleaning from an approved list or have their security deposit charged.

The *De Stefano Court* held,

> The problem with the carpet-cleaning provision is that it generates an automatic deduction from the rental deposit even when none of the conditions of section 562A.12(3) have been met. For example, suppose a tenant had Mary Poppins and her magical "Spoonful of Sugar" team restore the carpet to a pristine state at the end of the leasehold. Certainly, an additional carpet cleaning would not be necessary. Nonetheless, the charge would still apply.

De Stefano at 50-1.

The *De Stefano Court* further explained,

> What a landlord cannot do, however, is impose an automatic carpet-cleaning fee and deduct such charges from a rental deposit. See

> *Chaney*, 720 N.E.2d at 944; *Albreqt*, 477 N.E.2d at 1153. Under the IURLTA, "[i]f the rental deposit or any portion of a rental deposit is withheld for the restoration of the dwelling unit," the landlord must provide notice and the tenant must have an opportunity to contest actual damages. Iowa Code § 562A.12(3). *A landlord cannot by contract extract a waiver of the notice and opportunity to contest provisions when funds are withheld from the rental deposit*. Id. § 562A.11.

De Stefano at 53.

In other words, automatic carpet cleaning provisions are illegal because they short circuit the protections of the IURLTA and charge the tenant for carpet cleaning even if the carpet is clean. This ruling explicitly prohibits a direct security deposit deduction by a landlord for automatic carpet cleaning, but the rationale applies with equal force to a provision that charges tenants' deposits if they fail to hire a professional carpet cleaner at the end of their tenancy.

B. Deduction for Carpet Dirty Beyond Ordinary Wear & Tear

The *De Stefano* Court made it clear, however, that §562A.12(3)(b), "clearly authorizes the deduction of carpet-cleaning costs from rental deposits if necessary to restore the dwelling unit to the condition at the commencement of the tenancy, beyond the ordinary wear and tear." *De Stefano* at 53. This is an important point to emphasize as some tenants and even landlords are under the mistaken impression that tenants cannot be charged for any carpet cleaning. They clearly can be, if the carpet is soiled beyond ordinary wear and tear, but the landlord must first inspect the premises, itemize the damage and follow the other requirements of §562A.12 in order to deduct from the tenant's security deposit.

II. Non Refundable Carpet Cleaning & Other Charges

A. Non Refundable Charges Cannot Be Deducted From Security Deposit

In dicta the *De Stefano* Court also stated that, "[i]t is possible that a landlord may be able to impose a nonrefundable charge on tenants for automatic carpet cleaning." *De Stefano* at 53. But Court made it clear this must be a separate charge and cannot be deducted from the security deposit as the purpose of a security deposit,

> …is to ensure the tenant faithfully executes her or his duties under the lease agreement. See Iowa Code § 562A.6 (defining a rental deposit as "a deposit of money to secure performance of a residential rental agreement"). *The rental deposit is not designed to serve as an advance payment of amounts that will always be due under the lease*.

De Stefano at 52.

The *DeStefano* Court cites several out of state cases with examples of charges that were always due under the lease and thus could not be deducted from the security deposit, including move-in, pet, redecorating and carpet cleaning fees. *De Stefano* at 52. However, the Court declined to address the legality of these fees under Iowa law and declined specifically to rule on the legality of an automatic carpet cleaning fee that was not deducted from the security deposit.

Based on the rationale it articulates in *De Stefano* and in *Caruso* and considering the requirements of the IURLTA, not only can this type of pre-paid charges and fees not be deducted from the security deposit, but they can only be imposed by a landlord under limited circumstances.

B. Non-Refundable Charges Cannot Be Used to Shift Cost of Landlord's Statutory Duties

First, as the Supreme Court held in both *De Stefano* and *Caruso v. Apts Downtown*, "...a landlord cannot shift the financial costs of repairs necessary to comply with its duty of fitness and habitability under Iowa Code section 562A.15 to the tenant." *Caruso* at 12; citing *De Stefano* at 49. Under §562A.14, " [a]t the commencement of the term, the landlord shall deliver possession of the premises to the tenant in compliance with the rental agreement and section 562A.15." Iowa Code §562A.15 requires that the landlord comply with applicable building and housing codes and keep the premises in, "fit and habitable condition" Iowa Code §562A.15(1)(a)&(b).

Therefore, the landlord is required at the beginning of the tenancy to provide the tenant with carpets that are clean enough to be fit and habitable. The landlord cannot require a tenant to pay a non-refundable charge or fee for carpet cleaning necessary to bring the carpet in a unit up to a fit and habitable state. If the carpets are fit and habitable and the tenant wishes additional cleaning above and beyond merely clean carpets, they can negotiate with the landlord for the cost of additional cleaning. Similarly, with regard to a move-in or other charges, this charge must not be for costs necessary to comply with the landlord's statutory duties, including the duty to provide a unit that complies with §562A.15 at the beginning of the tenancy.

C. Non-Refundable Charges Must Benefit the Tenant Charged

Secondly, who gets the benefit of the cleaning, remodeling and other charges is also extremely important. Iowa Code §562A.15(2) regulates landlord charges for repairs, maintenance tasks, alterations and remodeling for tenants in single family homes and §562A.15(3) regulates these charges for multi-unit buildings. Section 562A.15(2) requires that any agreement for tenants in a single family house with regard to repairs, maintenance tasks, alterations and remodeling be in writing and be entered into in good faith. Section 562A.15(3) requires that for tenants in multi-unit buildings that any agreement for repairs, maintenance tasks, alterations and remodeling be set forth in a separate agreement, made in good faith and supported by adequate consideration and in

addition, this separate agreement cannot be a condition to an obligation or performance of a rental agreement. Iowa Code §562A.15(3)(a) & (4).

Tenants in a multi-unit building cannot be charged for repairs, maintenance, alterations or remodeling unless they are the ones who get the benefit, otherwise there is a failure of consideration, i.e. the benefit is to the landlord or other tenants and the detriment (the cost) is to the tenant. See *Doggett v. Heritage Concepts, Inc*., 298 N.W.2d 310, 311 (Iowa 1980) If, for example, the landlord wishes to charge a non-refundable fee and provide professional carpet cleaning in a multi-unit building, they must do so at the beginning of the tenancy so the tenant who is paying for the carpet cleaning gets the benefit. The consideration for the charge cannot be entering into the lease itself because §562A.15(4) specifically requires that the separate repair, maintenance, alteration and remodeling agreement not be conditioned on the existence or compliance with the rental agreement.

With regard to tenants in single family homes, the Tenants' Project would argue that a pre-paid charge that does not benefit the tenant, e.g, charging the outgoing tenant to clean the carpet for the incoming tenant, is either in bad faith under §562A.15(2) or unconscionable under §562A.7. The landlord is simply using their superior knowledge and bargaining power to force the tenant to pay for a service for which they receive no benefit.

IV. Can Landlords Shift the Responsibility for Repairs and Their Costs to Tenants?

A key issue in both *De Stefano* and *Caruso* was the extent to which landlords could shift the responsibility to make repairs to tenants and how far landlords could go in requiring tenants to pay for the costs of repairs.

A. Can the Warranty of Habitability Be Waived?

A major change in modern landlord tenant relations was the introduction of the implied warranty of habitability to residential leases. This required that the landlord ensure that the premises are safe, sanitary and fit for habitation and complied with applicable housing laws. See *Meese v. Fox*, 200 N.W.2d 791, 796 (Iowa 1972) and Iowa Code §562A.15 (landlord's responsibilities for repair and maintenance). In *De Stefano* the landlord argued that under §562A.15(2) that it could contractually waive the warranty of habitability and require the tenant to be responsible for making all repairs and maintenance including those required for safety and habitability. While the *De Stefano* Court was clearly unsympathetic to allowing waiver of the warranty of habitability, see *De Stefano* at 30-47, it declined to rule on this issue.

B. Landlords May Not Do Repairs and Shift the Cost to Tenants

Instead the *De Stefano* Court held that, "Section 562A.15(2) permits tenants to agree to make certain repairs, but it does not authorize the landlord to make repairs and then shift the costs to the tenants." *De Stefano* at 48. In addition, "...a landlord cannot

shift the financial costs of repairs necessary to comply with its duty of fitness and habitability under Iowa Code section 562A.15 to the tenant." *Caruso* at 12; citing *De Stefano* at 49. Therefore, as a general rule any repairs made by the landlord must also be paid for by the landlord. A landlord can only charge a tenant for repairs made by the landlord if the tenant violates their statutory obligations under §562A.17, for example, deliberately causing damage to the premises, and either (1) during or after the tenancy the landlord complies with the requirements of §562A.28 or (2) if the landlord wishes to deduct the cost of repairs from the security deposit they comply with §562A.12.

V. Landlord Cannot Unreasonably Withhold Consent to Sublease

The *De Stefano* Court held that if a lease permits subleasing, even if does not explicitly require that the landlord act reasonably that there is an implied standard of reasonableness and thus a landlord may not unreasonably withhold consent to sublease. *De Stefano* at 50-1. Note that even if the lease had stated that the landlord had "sole discretion" or "absolute discretion" to consent to subleasing that the landlord must "…exercise that discretion in a reasonable manner on the basis of fair dealing and good faith." *Midwest Management v. Stephens*, 291 N.W.2d 896, 912 (Iowa 1980) citing *City of Bowling Green v. Knight*, 216 Ky. 838, 840-41, 288 S.W. 741, 742 (1926); *Richard Bruce & Co. Inc. v. J. Simpson & Co., Inc*., 40 Misc.2d 501, 504, 243 N.Y.S.2d 503, 506 (1963) ("absolute discretion" interpreted to require reasonable discretion based on fair dealing and good faith).

VI. Punitive Damages for Knowing & Willful Use of Prohibited Provisions Requires Actual Knowledge on the Part of the Landlord

Under 562A.11(2), if a landlord willfully uses a rental agreement containing provisions known by the landlord to be prohibited the tenant may recover up to three months' rent as punitive damages. The *Caruso* court ruled that the tenant must show that the landlord had actual knowledge that the provisions were prohibited. *Caruso* at 13. Knowledge can be established thorough direct or circumstantial evidence, but circumstantial evidence must be sufficient both to infer the person's mental state and conclude a reasonable person simply could not have known otherwise. Thus, actual knowledge can be established by circumstantial evidence only in rare cases. *Caruso* at 13. However, now that the Supreme Court has ruled on the issues presented in *De Stefano* and *Caruso*, while this precedent is not enough by itself to prove knowledge, the existence of the precedent should be considered by the finder of fact. *Caruso* at 15.

VII. Punitive Damages for Bad Faith Withholding of a Security Deposit Requires Actual Dishonesty on the Part of the Landlord

Under 562A.12(7) the bad faith withholding of a security deposit by a landlord currently subjects the landlord to punitive damages of up to two months rent. The *De Stefano* Court held that bad faith requires dishonesty in fact. *De Stefano* at 57-8. The landlord's intention must be dishonest and a mere mistake or conflicting evidence on a

disputed question of fact do not establish bad faith. *De Stefano* at 58. The burden of proving bad faith rests with the tenant and may be established by substantial circumstantial evidence as well as by substantial direct evidence. *De Stefano* at 58.

VIII. The $5000 Jurisdictional Limit of Small Claims Does not Include Attorney Fees Under IURLTA

Under Iowa Code §631.1 the small claims division of the district court has subject matter jurisdiction over cases where the amount in controversy is $5000 or less, exclusive of interest and costs. The *De Stefano* Court held that statutory attorney fees under Iowa Code §562A.12(8) are classified as costs and thus not included in the amount in controversy for small claims cases. *De Stefano* at 12-30.

Christopher Warnock
Iowa Tenants Project
Website:
www.ictenantsclassaction.com