THE LAW REFORM COMMISSION
OF WESTERN AUSTRALIA

Project No 41

Tenancy Bonds

REPORT

JANUARY 1975

The Law Reform Commission of Western Australia was established by the *Law Reform Commission Act 1972.*

The Commissioners are -

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Mr. B.W. Rowland
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To: THE HON. N. McNEILL M.L.C.
MINISTER FOR JUSTICE

TERMS OF REFERENCE

1. The Commission was asked to inquire into the law and practice relating to bonds between landlord and tenant.

THE WORKING PAPER

2. The Commission issued a working paper on this project on 28 June 1974, copies of which were sent to those persons listed on page 2 of the paper and to members of the public who answered the Commission's notice in the press inviting comments. A copy of the working paper is attached as Appendix I to this report.

3. A list of those who commented on the working paper is contained in Appendix II. All comments have been taken into account even though not specifically referred to.

LAW AND PRACTICE IN WESTERN AUSTRALIA

4. It is common in this State for a landlord to require a tenant to pay to the landlord or his agent a sum of money known as a tenancy bond, security deposit or indemnity bond, prior to or at the time of the commencement of the tenancy. The amount of the bond is usually between two and four times the weekly rental (see paragraph 3 of the working paper). The bond money is held by the landlord or his agent as security for the due performance by the tenant of his obligations under the tenancy agreement. Upon the termination of the tenancy the money is repayable to the tenant. The capacity in which the landlord or his agent holds the bond money and the legal consequences thereof are discussed in the working paper at paragraph 7.

5. There are no statutory provisions controlling the use of tenancy bonds in this where a tenancy bond is required, the situation is by the terms of the agreement between the landlord and tenant.

6. Loss or partial loss of the bond money depends on the terms of the tenancy agreement. In most cases the amount of the bond is credited against the actual damage suffered by the landlord as a result of the tenant's default. The forfeiture of the bond money may be total or partial depending on the extent of the damage suffered (see *N.L.S. Pty. Ltd. v. Hughes* (1966) 120 C.L.R. 583).

In some cases the amount of the tenancy bond may be a genuine pre-estimate of damage forfeitable in full upon default (*Rayner v. Lyster* (1865) 4 Sup. Ct. Rep. 366, N.S.W.). In other cases, the tenancy bond may be in the form of a penalty, that is, a sum unrelated to any reasonable estimate of damages and intended to be forfeitable upon default (see *Hughes v. Fresh Pack Fruit and Vegetable Market Pty. Ltd. and Levis* [1965] W.A.R. 199 and *Hughes v. N. L. S. Pty. Ltd.* [1966] W.A.R. 100). In the case of penalties, the courts will only permit recovery of actual damage suffered.

TENANCY BOND DISPUTES IN WESTERN AUSTRALIA

Number of disputes

7. The Commission made enquiries to determine the prevalence of tenancy bond disputes in Western Australia. For this purpose it contacted seventeen companies and firms engaged in property management in Western Australia. Information on the prevalence of disputes was also received from the Consumer Protection Bureau, the Land Agents Supervisory Committee of Western Australia, the Citizens Advice Bureau of W.A. (Inc.) and other bodies.

The overall conclusion is that many disputes have occurred; for example the Consumer Protection Bureau in the eight months between July 1973 and February 1974 dealt with 92 landlord and tenant disputes, 80% of which related to tenancy bonds.

A report on the information obtained on tenancy bond disputes in Western Australia is to be found in the working paper, Appendix I.

Types of dispute

8. From the information gathered, the matters most frequently in dispute appear to be -

(a) whether the premises were left in a clean condition and in good repair;

(b) whether the lawns and gardens were properly tended and the grounds left free from rubbish;

(c) whether any lack of repair existed before the commencement of the tenancy or whether it was caused by the tenant;

(d) whether any lack of repair exceeded fair wear and tear, and whether the tenant was liable for damages caused by fair wear and tear;

(e) whether the rent was in arrears and whether the tenant was liable for rent in lieu of notice terminating the tenancy;

(f) whether the amount charged to the tenant for telephone rent, or calls or for excess water, gas or electricity consumed was reasonable, particularly in cases where there was no separate meter to the leased premises;

(g) whether any chattels which cannot be located at the end of the term were included in the tenancy.

THE LAW IN OTHER JURISDICTIONS

In Australia

9. There is at present very little statutory control over tenancy bonds in any Australian jurisdiction (see paragraphs 13 and 14 of the working paper).

All states and territories, with the exception of Queensland and Western Australia have rent control legislation (see paragraph 12 of the working paper). The scope of these statutes is confined to certain classes of residential premises. Each statute prohibits the payment of any bonus, premium or other sum of money (other than rent) to the landlord, with the exception that in some cases such payments may be made with the consent of a rent fixing authority. It

is not clear whether these statutes have the effect of prohibiting the payment of bond money for premises to which the legislation applies.

10. Disputes over tenancy bonds requiring litigation follow the usual civil procedure of the jurisdiction. The recent trend has been to devise simplified and less costly procedures for small claims, such as tenancy bond disputes.

In the Australian Capital Territory, the *Small Claims Ordinance 1974* allows litigants in the Court of Petty Sessions to bring their proceedings under the Ordinance for claims (apparently including tenancy bond disputes) up to $1,000. The proceedings are simple and informal, the usual rules of evidence do not apply and costs are substantially reduced.

In Queensland, legislation establishing small claims tribunals has been passed to enable disputes between traders in goods and services and consumers, where the amount involved does not exceed $450, to be dealt with informally and cheaply (see Queensland *Small Claims Tribunals Act 1973*). The Act was amended in 1974 to give specific recognition to a tenant's claim for repayment of his bond money being a "small claim" as defined by the Act.

Similar legislation to the original Queensland Act exists in Victoria (see the Victorian *Small Claims Tribunals Act 1973*) and in New South Wales (see the *Consumer Claims Tribunals Act 1974*), but in each case the Tribunals have no specific power to deal with tenancy bond disputes.

Elsewhere

11. The Commission has studied the position in New Zealand, England, South Africa, Eire, most provinces of Canada and some states of the United States of America. The results of that study have been set out in detail in Appendix IV of the working paper.

THE MAJOR RECOMMENDATIONS OF THE COMMISSION

12. In paragraph 19 of the working paper the Commission outlined the major criticisms that have been made of the current law and practice with respect to tenancy bonds. In most

cases the main difficulty arises because the tenant is in the position of a party trying to recover money which is held by the other party to the dispute.

The Commission considers that these problems could be overcome if an effective, inexpensive and speedy means of dealing with bond money disputes were available.

13. In paragraph 30 of the working paper the Commission considered the establishment of a Small Claims Tribunal the jurisdiction of which should include disputes between landlords and tenants over tenancy bonds. It was suggested that such a tribunal may be able to deal with disputes faster, with less regard to legal technicalities and at less cost to the parties. In so doing it may encourage landlords and tenants with valid claims to seek relief through it, thus providing a means of solving many tenancy bond disputes.

14. Since the issue of the Commission's working paper, the *Small Claims Tribunals Act 1974* has been enacted in Western Australia. This legislation provides for Small Claims Tribunals to deal with claims by consumers arising out of disputes with suppliers of goods and services where the claim is for less than $500 or such other sum as may be prescribed. It was also designed to permit a claim by a tenant for repayment of tenancy bond money to be dealt with by the Tribunals.

The object of the legislation is to provide a cheap and speedy method of settling small claims of consumers and tenants by the use of informal proceedings. The legislation provides for such claims to be heard by a referee with legal qualifications. The proceedings are not governed by the normal rules of evidence. Negotiation and compromise may be involved in the proceedings and the referee may act as a conciliator as well as an arbitrator. Both parties to the claim are required to present their case personally, and only in exceptional circumstances would an agent with legal qualifications be allowed to represent a party (s.32(3)). The referee may, if he considers the claim involves complex points of law which would warrant the claim being determined by another court, decline to deal with it (s.17(3)). A decision by a Small Claims Tribunal is final and binding on the parties, and no appeal lies (s.18). Costs are not allowable (s.35).

15. A tenancy bond claim is a "small claim" within the meaning of that definition in s.4(1) of the Act. Section 16 of the Act specifically vests the Small Claims Tribunals with

jurisdiction to deal with any such small claim. However, there does not appear to be any machinery for a tenant to refer his claim to the Tribunal since only consumers are referred to in s.24 of the Act (which deals with the practice as to claims) and the definition of "consumer" does not include a tenant.

While s.36 enables a Tribunal to control its own procedures, it would be desirable to amend the Act so as to clarify the procedure by which a tenant may have his claim dealt with by a Tribunal, or alternatively to amend the definition of "consumer" to include a tenant.

16. Section 39 of the Act prohibits a consumer from contracting out of the right to refer a small claim to the Tribunal. The purpose of this section is to prevent the consumer from being deprived of his right of recourse to the Tribunal as a consequence of a contract made from a basis of unequal bargaining power. Assuming the Act is amended as suggested in paragraph 15 above, to ensure a tenant's right to have a tenancy bond claim dealt with by the Tribunal, the Commission believes that a tenant should have the same protection as is granted to a consumer under s.39 of the Act.

17. In paragraph 30 of the working paper the Commission tentatively suggested that the jurisdiction of the proposed Tribunal should include disputes between landlords and tenants over tenancy bonds and that either party should have recourse to the Tribunal.

In view of the policy of the new legislation (see s.4(1)(d) of the Act) to restrict access to the Tribunal in tenancy bond disputes to the tenant, and having regard to the infrequent occasions when a landlord would need recourse to the Tribunal, the Commission recommends that the Act is not amended in this respect.

18. Provided the Act is amended as suggested in paragraphs 15 and 16 above, the Commission recommends that any additional specific legislation on tenancy bonds be deferred until the success of the Small Claims Tribunals' activities has been measured.

DISCUSSION OF OTHER QUESTIONS RAISED IN THE WORKING PAPER

19. In paragraph 42 of the working paper, the Commission invited comment on a number of questions concerning tenancy bonds. In the light of the basic recommendation, as set out in

paragraph 18 above, the Commission does not think it appropriate to express a final view on these questions at this stage. The Commission does however, in paragraphs 20 to 29 below, consider the comments received.

(a) *Prohibition of tenancy bonds*

20. In paragraph 42(A) of the working paper the question was asked whether the use of tenancy bonds should be prohibited by legislation. It was noted that prospective tenants already face a considerable financial burden at the commencement of a tenancy, such as advance rent, lease preparation costs, stamp duty, State Electricity Commission deposit, telephone connection fee/rent and letting fees. It was further suggested that bonds in most cases served little purpose because of the tenants' practice of not paying rent towards the end of the tenancy.

All the commentators on the working paper were against the proposition. It was generally agreed that tenancy bonds were a proper method of protecting landlords against loss or damage due to the tenant's default.

The Commission is in agreement with the commentators and does not favour the prohibition of bonds.

(b) *The amount of the bond*

21. In paragraph 42(B)(i) of the working paper the question was asked whether there should be a statutory maximum or minimum on the amount of a bond. Particular consideration was given to the imposition of a maximum which would prevent landlords insisting upon tenancy bonds of a large amount.

The commentators were equally divided on the merits of the proposal. The majority of those in favour of a statutory maximum agreed that it should be the equivalent of two to four weeks rent. Those against statutory limits argued that the amount of the bond was a matter for mutual agreement between landlord and tenant.

The Commission believes that the only justification for interference with the parties' freedom to contract is where one party to an agreement takes an unfair advantage of his position. At present the Commission has been unable to find any evidence of the landlords making unfair demands on tenants as to the size of the tenancy bonds.

In view of the current practice in Western Australia as to the size of tenancy bonds (see Appendix I of the working paper, page 26), the Commission is presently of the view that no statutory limit should be set for the amount of a tenancy bond.

(c) *Bond holder - capacity of bond holder*

22. In paragraph 42(B)(ii) of the working paper the question was asked who should hold the tenancy bond money and in what capacity should it be held. In paragraph 22 of the working paper a number of alternatives were suggested. These were -

(a) the landlord or his agent to hold the money on account of the landlord;

(b) the landlord or his agent to hold the money as trustee for the tenant, in a separate trust account;

(c) the agent to hold the money as a stakeholder;

(d) the landlord or his agent to pay the money over to an independent holder, being a "rentalsman";

(e) the landlord or his agent to pay the money over to a government department or statutory authority, as an independent holder.

There were widely differing views amongst the commentators as to who should hold the bond money. The majority of real estate agents who commented believed the money should be held by the landlord or his agent, on account of the landlord. The Institute of Legal Executives, the Law Society of W.A., and the Citizens Advice Bureau were amongst those who maintained the landlord or his agent should hold the bond money as trustee for the tenant, in a separate trust account. The proposal that a government department or authority should hold the money

was supported by the Housing Study Group. The Council of Social Services of W.A. was the only commentator to favour a "rentalsman" holding the bond.

23. The Commission supports the view that it would be unwise to require a department, statutory authority or "rentalsman" to hold the bond. The practical difficulties associated with such a move might well be extensive. It was pointed out by one commentator that the administrative costs involved would hardly be warranted and central control would probably lend to delays in the disbursement of the bond. While it was suggested that interest earned on the bond money might help to pay the administrative costs involved, such a scheme could be costly and is, in the Commission's view, unwarranted.

24. The current practice is for the tenant to pay the bond money to the landlord or his agent to be held by either of those parties. The capacity in which the landlord or agent holds the bond money depends on the circumstances of each case, and in particular the wording of the written tenancy agreement on the payment of bond money. It may be that a creditor/debtor relationship results or the landlord holds the money as trustee for the tenant or the agent holds the money as stakeholder.

If the landlord holds the bond money as a debtor of the tenant, in the event of the landlord's bankruptcy the bond money forms part of his estate and is distributable. If the landlord holds the bond as trustee for the tenant the sum is isolated from his estate and is not distributable on bankruptcy. However, the Commission has found no evidence of tenants suffering a loss as a result of a landlord's bankruptcy.

If the landlord holds the bond as trustee and the money is lost without fault of the landlord, he is not answerable for the loss. He would however be answerable if the bond money was held as a debt, The Commission has found no evidence of problems arising in this area and is of the view that the parties should be left at liberty to agree to the capacity under which the bond money is held.

(d) *Payment of interest*

25. Whether or not interest on bond money is payable depends on the capacity in which the landlord or his agent holds the money, and the terms of the agreement. If the landlord

holds the bond money as trustee for the tenant it might be argued that, as a matter of strict law, he should place the money in an appropriate interest earning investment. If, however, the landlord holds as a debtor, no interest is payable to the tenant, unless the agreement specifically provides. The Commission understands that in the majority of tenancy arrangements in Western Australia, no interest payments are made by the landlord.

26. In paragraph 42(B)(iii) of the working paper, questions were raised as to whether statutory provision should be made for the payment of interest on the bond money. Such a requirement could be enforced upon the landlord irrespective of whether he holds bond money as a trustee or as a debtor.

While many commentators were in favour of interest being paid to tenants, the Commission considers that, having regard to the relatively small amounts of bond money involved (which frequently would not exceed $100), the short terms of many tenancies, and the administrative costs, the imposition of a statutory obligation on the landlord to pay interest on the bond money to the tenant is not warranted. The Commission is of the view that this should be left to the agreement of the parties.

(e) *Application of bond money*

27. In paragraph 42(B)(iv) of the working paper, the question was asked as to what matters, if any, should the application of bond money be restricted.

The majority of commentators were in favour of the bond money being applied in the three categories outlined in paragraph 24(b) of the working paper. These were -

(a) wilful or negligent damage to the premises, including lack of cleanliness, caused by the tenant or such persons as the tenant is responsible for, with the exception of fair wear and tear;

(b) arrears of rent;

(c) outstanding charges for electricity, gas, rates, taxes and excess water for which the tenant is liable.

28. Statutory regulation of the matters to which the bond money can be applied appears to the Commission to be unnecessary. The Commission considers that it is desirable in all cases for the landlord and tenant to enter into an agreement, preferably in writing, and that the terms of the agreement should determine both parties' liabilities and the circumstances under which the bond money can be applied.

(f) *Duties of the landlord - at the termination of the tenancy*

29. Questions were raised in the working paper (at paragraph 28) concerning duties of the landlord or his agent at the termination of the tenancy such as giving details of damage and reasons for proposed deductions from the bond money.

A majority of commentators favoured the landlord notifying the tenant of his right to repayment of the bond money and the furnishing of full details of proposed deductions.

Many commentators also considered that the landlord be required to commence action before retaining the bond money without the tenant's consent. In view of the procedural provisions of the *Small Claims Tribunals Act* (on the assumption that the amendments suggested in paragraphs 15 and 16 above are enacted) the Commission considers that the tenant would be adequately protected and no further regulation is required.

SUMMARY OF RECOMMENDATIONS

30. The Commission recommends that -

(a) the *Small Claims Tribunals Act 1974* be amended to -

(i) clarify the procedure by which a tenant may bring a tenancy bond claim before a Small Claims Tribunal;

(see paragraph 15 above)

(ii) expressly prohibit a tenant from contracting out of his right of access to a Small Claims Tribunal;

(see paragraph 16 above)

(b) no further legislation on tenancy bonds is required at this stage.

(see paragraph 18 above)

E.G. Freeman CHAIRMAN

B.W. Rowland MEMBER

R.W. Harding MEMBER

17 January 1975