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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF FRESNO - UNLIMITED JURISDICTION

TERESE CARDAMON and NICHOLAS CARDAMON, on behalf of themselves, and on behalf of all others similarly situated, Plaintiffs, vs. THE DOMINION COURTYARD VILLAS. SCOTT ELLIS ENTERPRISES, LLC, SCOTT ELLIS ENTERPRISES, L.P., BARCELONA APARTMENTS, CASA DEL RIO APARTMENTS, DARTMOUTH TOWER APARTMENTS, OXFORD PARK APARTMENTS, REEF APARTMENTS, SCOTTSMEN APARTMENTS, SCOTTSMEN TOO APARTMENTS, VILLA FARIA APARTMENTS, CEDAR SHEPHERD, LP., (added as DOES 1), SCOTT C. ELLIS, LLC (added as DOES 2) and DOES 1 through 50, inclusive Defendants.	Case No: 16CECG01918 **CLASS ACTION** **PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION FOR SUMMARY ADJUDICATION** **Date: November 3, 2021** **Time: 3:30 p.m.** **Dept: 501** **JURY TRIAL REQUESTED**

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Plaintiffs Therese and Nicholas Cardamon, on behalf of themselves and more than 3000 class members, respectfully submit this memorandum in support of their motion for summary adjudication. Class members are former tenants at one of Defendants' nine properties. This motion seeks to adjudicate two causes of action and several of Defendants' affirmative defenses, all of which turn on whether Defendants' standard procedures violate Civil Code section 1950.5.

The issues to be adjudicated and the supporting evidence are set forth in Plaintiffs' Separate Statement of Undisputed Facts, e.g., cited as "PUMF 1." This motion relies on the same undisputed facts that Defendants submitted to this Court in support of their unsuccessful motion for summary judgment. The consecutively numbered exhibits in our Statement of Evidence ("SOE") are authenticated by the accompanying Declaration of Mark Schallert and our Request for Judicial Notice ("RJN").

I. PRELIMINARY STATEMENT

The key issue to be decided by this motion is one of law, namely: does Civil Code section 1950.5 ("the Statute") permit Defendants to add an undocumented markup of between 10% and 40% onto charges that are deducted from security deposits?

"The legislature enacted [Civil Code] section 1950.5 to protect tenants, not landlords." *Granberry v. Islay Investments* (1995) 9 Cal. 4th 738, 744-45. The law allows a landlord to charge a tenant for the costs for the "repair and cleaning" of the apartment at the end of tenancy. The law was amended in 2003 to stop "the egregious acts by some landlords who have excessively overcharged tenants for cleaning and repair or fraudulently *charged tenants for work that was never performed* . . .." RJN, Ex. 2. (Unless otherwise noted, emphasis is supplied.)

The 2003 amendment sets forth, in plain and precise language, the charges that can be deducted and the proof that must be provided. If the landlord's employee does the work, it can charge a reasonable hourly rate for the time spent; if the landlord charges the tenant for work by a third-party or purchases materials, it can bill the invoice amount but "shall" give the tenant copies of the "bills, invoices, or receipts" that document the expenditure.

Not content with these rights, Defendants have, for many decades, inflated their security-deposit charges by adding a 40% markup to all the charges permitted by §1950.5. Thus, if Defendants hired an outside service to do repairs or cleaning, the invoice amount that Defendants paid was increased by another 40% and passed on to the tenant, e.g., if Defendants paid outside vendors $1000 for a significant repair (like replacing a carpet), they added $400 and charged class members $1400. So too a doorstop with an invoice price of $2.00 was charged to the tenant at $2.80. Defendants have argued that the markup reflects the "overhead" expenses associated with the work, but Defendants have never sought to document those expenses or explain why a law intended to protect tenants would silently give landlords incredible leeway to gouge tenants.

Defendants' security-deposit procedures have created a substantial revenue stream and generate hundreds of thousands of dollars in additional annual revenues. To avoid disclosing the markup to tenants, Defendants have never provided tenants with invoices to prove that charges were genuine and not exaggerated. Defendants continue to ignore the law's express requirement that landlords "shall" give tenants the "bills, invoices, and receipts" for all charges for vendors and supplies. See §1950.5(g)(2)(B)-(C).

Defendants previously moved for summary judgment. They argued that the Statute allowed them to add the surcharge because it was intended to recover their "overhead expenses" associated with doing repairs and cleaning. In denying the motion, the Superior Court, per Judge McGuire, held that a "fair reading" of the law "does support the conclusion that the landlord can only charge for the actual 'time' and 'work' performed to repair or clean if an outside vendor is not used. The statute specifically authorizes landlords to deduct actual costs; it says nothing of general overhead." Request for Judicial Notice ("RJN"), Ex. 1, p. 5.

After their motion was denied, Defendants modified their policy but did *not* bring it into legal compliance. Defendants did stop charging the 40% markup on work by their own employees, although they also significantly increased their "reasonable hourly rate" to offset any shortfall. However, Defendants still add a 10% markup to all invoices for third-party vendors and for materials. And Defendants still fail to give tenants copies of the invoices and receipts that are marked up.

Defendants' failure to properly itemize their charges means that "the right to retain all or part of the security deposit under section 1950.5, subdivision (f), has not been perfected, and [the landlord] must return the entire deposit to the tenant." *Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 745. And Defendants' bad faith refusal to obey the letter of the law entitles the class to statutory damages under 1950.5(l).

The same core of undisputed facts supports the five issues to be adjudicated. Defendants' violation of the Statute is presented for adjudication pursuant to our third cause of action for declaratory relief and one of Defendants' affirmative defenses. See PUMF, Issue Nos. 1 and 2. This motion also seeks to adjudicate Defendants' statutory bad faith under subdivision (l), which is raised by two affirmative defenses in Issues 3 and 4. Finally, our Fifth Issue seeks to adjudicate our cause of action for bad faith breach of §1950.5. If Defendants' bad faith is established as a matter of law, then no triable issues will remain under that cause of action as class members will be paid the statutory damages without a need for a trial.

II. STATEMENT OF FACTS

Defendants are a group of related entities that own and operate roughly 900 apartment units in Fresno. (PUMF 1). While Defendants have violated several statutory provisions, this motion focuses on two that have been standard procedure for the entire class period: (a) the imposition of a "markup" or "administrative fee" on security-deposit charges, and (b) the failure to provide tenants with the "bills, invoices, and receipts" required by law and to disclose the charges that were added to third-party invoices.

(a) Defendants' Itemized Statements Include a Markup on Charges Deducted from Class Members' Security.

Section 1950.5 requires landlords to prove that they actually incurred the costs that are passed on to the tenants. The Statute is discussed in greater detail at pages 10-12. But for current purposes, it is important to know the following.

Within three weeks of the end of each tenancy, §1950.5(g) requires Defendants to refund the tenant's security and provide the tenant with an "itemized statement" listing any deductions.

In 2003, the subdivision (g) was amended to require the itemized accounting of all deductions by employing the following three categories of charges:

- If the landlord's employee does the work, the "itemized statement **shall** include the time spent and the reasonable hourly rate charged." §1950.5 (g)(2)(A).
- If a third party did the work, "the landlord **shall** provide the tenant a copy of the bill, invoice, or receipt supplied by the person or entity performing the work." Id. (g)(2)(B).
- "If a deduction is made for materials or supplies, the landlord **shall** provide a copy of the bill, invoice, or receipt." Id. (g)(2)(C). If material is bought "on an ongoing basis," then the charge must be supported by a vendor price list or similar document. Ibid.

For decades, up until the mid-2018, Defendants' standard policy was to add a 40% markup to all three categories of charges. (PUMF 2). Thus, if Defendants' employee did the work, the class member was charged [(hour) x (hours worked) x (.40 markup)]. Ibid. If Defendants hired a third party to do things such as cleaning, painting and carpet replacement Defendants added a 40% markup onto the invoices they paid. (PUMF 2). And materials such paint (and even door stops) were similarly inflated. See, e.g., Ex. D, E, F; Schallert Decl., ¶¶5-8.

In their own Motion for Summary Judgment, Defendants admitted that they added a 40% markup onto the "actual costs" of restoring the apartments. RJN, Exh. 5 (Def. Memo) at 2:15-20). Defendants sought to justify the markup as:

> a 40% administrative fee to reimburse Defendants for out-of-pocket costs [*sic*] such as purchasing supplies, scheduling vendors, coordinating and performing the labor related to making repairs and/or cleaning a unit after the tenant has vacated. (SSUMF, ¶ 40.) Such out-of-pocket costs [*sic*] also include the payroll taxes, workmen's compensation insurance, health insurance, supervision, administration, vacation time, sick time, non-productive time, and breaks to compensate Defendants' employees who are spending their working time engaged in making repairs and cleaning recently vacated units. (SSUMF, ¶5.) Defendants' employees also require tools necessary to make repairs, automotive expenses to purchase necessary tools and supplies, and golf carts on site for maintenance workers to travel from unit to unit to perform repair work on vacated units. (SSUMP, ¶6.)

RJN, Ex. 5 at 2:15-24.

As a rule, throughout the class period Defendants *never* disclosed the existence of the markup on work done by third parties or on materials purchased. (PUMF 5 and 6); see, Exs. D-H.[1] Thus, a Statement would simply list the line item (e. g., 'Painting, Labor and Material: $182.81') without further detail. Exhibits D-H in the Statement of Evidence are examples of the move-out statements reflecting these procedures; only the first two pages of each exhibit were provided to tenants.

Defendants' Modified Policy. Defendants modified their policy in 2018, after the Superior Court denied Defendants' motion for summary judgment. (PUMF 4). Defendants did stop charging the 40% markup on their employees' labor, although they significantly raised the "reasonable hourly rates" that were charged to recapture some or all that income. Schallert Decl., ¶13; see, e.g., SOE, Ex. G, H (examples) I and J (discovery responses). Once again, only the first two pages of the exhibit were given to the tenants.

But with a foolish obstinacy, Defendants continue to charge a 10% markup on all work done by third parties and on all materials. (PUMF 4). Thus, if Defendants pay a third party $200 to paint an apartment, the class member is charged $220; if the paint cost $50.00, then the class member is charged $55.00. Defendants' in-house documents—everything after the first two pages of the sample exhibits—show that the 10% markup is applied to all invoices from vendors and for materials. SOE, Ex. G, H. Moreover, Defendants have never disclosed the markup on vendor services or materials in any move-out statement such that no tenant knew to challenge the policy for decades.

Defendants' procedural changes are irrelevant to this motion because the legality of the markup does not depend on the amount of the surcharge. Any markup, let alone one intended to recoup overhead expenses, is illegal whether it is 10% or 40% and for the same reasons.

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[1] For many years, Defendants added a 40% markup on work done by their employees and did not disclose that they did so. In 2017, one complex, Dominion Courtyard Villas, began to disclose hourly rates and hours. worked. When Defendants changed procedures in 2018, they began to disclose hours worked and rate charged. See Schallert Decl., ¶15. Because this is a class action, we have not relied on this markup to establish liability.

(b) Defendants Have Never Provided Class Members with "Bills, Invoices, or Receipts" to Disclose or Document the Markup.

Regardless of the year, Defendants have admitted that they never gave class members copies of the "bills, invoices, and receipts" that show vendor charges or the cost of materials. (PUMF 5). Most recently, Defendants averred that "each tenant is given notice as part of the three-page Deposit Form that if they desire to look at any individual bills or invoices that those items will be provided for the tenant to inspect upon request." SOE, Ex. J at 5:25-6:2. In other words, the documentation is not included in the move-out statement, a fact confirmed by Defendants' principal, Scott Ellis Jr. SOE, Ex. A (Ellis Dep.).

The failure to provide "bills, invoices, or receipts" is integral to Defendants' misconduct. The invoices would allow tenants to see that they were paying between 10-40% more than the amount actually charged by a third party. Defendants' practice also means they do not provide the "bills, invoices, or receipts" that support the overhead expenses that are, in theory, being captured by the markup. Thus, even if the markup were legal, Defendants have utterly failed to document these charges as required.

(c) Defendants Have Used the Surcharge in Bad Faith to Generate Millions of Dollars in Unjust Enrichment.

Defendants employ scores of employees whose principal job is to generate as much security-deposit income as possible. RJN, Ex. 6 (Ernst Decl.). This bureaucratic billing machine creates the overhead expenses that are then, in theory, passed on to class members. The strategy is profitable since Defendants have been able to generate between $100,000-$200,000 annually in security-deposit deductions. Schallert Decl. ¶13. Revenues from the markup—as much as $40,00-$80,000 annually in the halcyon days of 40% surcharges--played a substantial role in those numbers and explain why Defendants have been reluctant to disclose its existence.

Since 2003, the Statute has clearly required landlords to provide certain information to tenants to ensure that they are not overcharged. Yet Defendants did nothing at all to change their procedures and refused to provide the required bills, invoices, and receipts. (PUMF 5). Defendants helped ensure that tenants would not know that a surcharge had even been added.

Even when the Superior Court opined that an administrative fee or markup was not permitted, Defendants continued to charge a markup on third-party invoices, just at a lower percentage. (PUMF 4). The Court's ruling did not turn on the amount of the markup, but on the addition of an unauthorized charge to the statutory guidelines.

III. PROCEDURAL HISTORY.

Complaint and Answer: In July 2016, Plaintiffs filed their First Amended Complaint ("Complaint") on behalf of all former tenants who were assessed an administrative fee on costs deducted from security deposits. The Complaint prays for statutory damages "for the monies illegally and improperly deducted from security deposits based upon an administrative charge of 40%, *or another amount.*" RJN, Ex. 3 (First Amended Complaint) at 10:10-12. Those statutory damages include liquidated damages in an amount up to twice each tenant's security. §1950.5(l).

The First Cause of Action is for unfair business practices under Business and Professions Code §§17200 et seq. RJN, Ex. 3 at ¶¶29-40. Section 17200 is the statute that is commonly used to adjudicate class actions. Plaintiffs have standing under §17200 because Defendants' withholding of security constitutes an "economic injury from unfair competition." *Kwikset Corp. v. Superior Court* (2011) 51 Cal.4th 310, 323.

This Motion seeks summary adjudication based on the Third Cause of Action for Declaratory Relief, which alleges that an "actual controversy" exists over the legality of Defendants' administrative fee or markup. RJN, Ex. 3 at ¶47(a). Plaintiffs pray for a declaratory judgment finding that Defendants "have violated the California Civil Code [§1950.5] and public policy." Id. at 9:27-10:3. Our Fourth Cause of Action is for violation of section 1950.5 and presents two issues: was the surcharge illegal and, if so, was it imposed in bad faith. If those two issues can be resolved, then §1950.5's statutory damages are self-executing.

Defendants' Answer alleged three affirmative defenses of interest here. RJN, Ex. 4 (Answer). The 14th affirmative defense alleges that Defendants' standard practice is not "*unlawful*" under section 17200. The Answer also presents the issue of the Defendants' bad faith under §1950.5(l). Thus, the 18th affirmative defense alleges that each Defendant had a "good faith and reasonable belief that [it] was in compliance with applicable law" such that no

"liquidated" or statutory damages should be awarded. And the 30th Affirmative Defense alleges that Defendants' policies were "just, fair, honest, and [taken] in good faith." RJN, Ex. 4.

Defendants' Motion for Summary Judgment. In June of 2017, Defendants filed a motion for summary judgment, which argued that the administrative fee did not violate section 1950.5. Defendants' motion was based on the same facts as ours. The Superior Court (per the Hon. Judge McGuire) denied Defendants' motion in a six-page opinion that assessed the legality of the administrative fee under §1950.5. RJN, Ex. 1.

The Court first considered "whether the administrative fee is permissible at all under section 1950.5." RJN, Ex. 1 at 3. The Court found "there is no indication that the Legislature contemplated administrative fees such as that charged by defendants." Ibid.

> A fair reading of the two subdivisions does support the conclusion that the landlord can only charge for the actual 'time' and 'work' performed to repair or clean if an outside vendor is not used. The statute specifically authorizes landlords to deduct actual costs; it says nothing of general overhead.

Id. at p. 5. The Order rejected Defendants' contention that "overhead expenses" constituted recoverable out-of-pocket expenses: "The court does not believe that one would ordinarily consider general overhead to constitute an out-of-pocket expense associated with a repair or cleaning expense." Id. at p. 4. The Court cast doubt on whether a landlord could ever properly itemize the markup finding that it "would seem to be very difficult, if not impossible" to itemize the 40% administrative fee as required by statute. Ibid.

IV. THE COURT MAY SUMMARILY ADJUDICATE THE ISSUES PRESENTED.

Code of Civil Procedure section 437c(f)(1) authorizes this Court to grant summary adjudication of "one or more causes of action within an action, one or more affirmative defenses." As to causes of action, Plaintiffs' Third Cause of Action for declaratory relief is an appropriate vehicle for resolving the legality of the markup/administrative fee. "Viewed in the light of the gradual expansion of actions to which summary proceedings were made applicable [], it is apparent that section 437c was intended to include declaratory relief actions in a proper case." *Walker v. Munro* (1960) 178 Cal.App.2d 67, 70 (statutory citations omitted); *1300 N. Curson Investors, LLC v. Drumea* (2014) 225 Cal.App.4th 325, 336 (granting summary

adjudication of declaratory relief claim based on obligations of an apartment manager upon termination of services).

Defendants' affirmative defenses also present both the important legal issues. First, the 14th affirmative defense contends that Defendants' business practice was not "unlawful" under Business and Professions Code §17200. RJN, Ex. 4 (Answer). Second, both the 18th and 30th affirmative defenses present the issue of whether Defendants acted in good faith, which would cut off Plaintiffs' right to liquidated, statutory damages. Id. "If a party contends the affirmative defense has no merit, it can and should seek summary adjudication of the affirmative defense itself." *Paramount Petroleum Corp. v. Superior Court* (2014) 227 Cal.App.4th 226, 240 fn. 18; accord, *Kendall-Jackson Winery v. Superior Court* (1999) 76 Cal.App.4th 970, 977-78. ("Summary adjudication of an affirmative defense is properly granted when there is no triable issue of material fact as to the defense, and the moving party is entitled to judgment on the defense as a matter of law.")

Given that there are no disputed facts, the applicability of section Civil Code 1950.5 to our facts is a matter for the Court. The Statute either permits undisclosed markups or it does not. "Stated in another way, when the facts are clear and undisputed, it is a question of law for the court to determine the legal consequences of such facts." *Banville v. Schmidt* (1974) 37 Cal.App.3d 92, 106; accord, *Moulton v. Workers' Compensation Appeals Board* (2000) 84 Cal.App.4th 837, 842. The legality of the markup is a question of statutory interpretation, which means the issue is for the Court, not the jury. See Evid. Code § 310 (a) ("All questions of law (including but not limited to questions concerning the construction of statutes and other writings, the admissibility of evidence, and other rules of evidence) are to be decided by the court .") [2] So to, the Defendants' bad faith turns on the meaning of that statutory term in subdivision (l).

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[2] "'When the material facts are undisputed, the trial court can resolve the matter as a question of law in conformity with summary judgment principles.'" *Sharon v. Porter* (2019) 41 Cal.App.5th 1, 7.

V. ARGUMENT.

(a) Civil Code §1950.5 Seeks to End Security-Deposit Abuses by Strictly Limiting a Landlord's Permissible Charges.

The predecessor to Section 1950.5 was enacted to address "the egregious acts by some landlords who have excessively overcharged tenants for cleaning and repair . . ." RJN, Ex. 2. Our Supreme Court noted that the law was needed because "'the security deposit in actuality has evolved into a bonus to be kept by the landlord upon termination of the lease agreement regardless of the damages actually sustained by the landlord.'" *Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 745–46.The "Legislature enacted section 1950.5 to protect tenants, not landlords." *Id.* at 761. For our purposes, three subsections are especially important.

First, subdivision (b) begins by defining "security" to mean, inter alia, a deposit or payment "that is imposed as an advance payment of rent, used or to be used for any purpose, including, but not limited to, any of the following:

"(2) *The repair of damages* to the premises, exclusive of ordinary wear and tear, caused by the tenant or by a guest or licensee of the tenant.

"(3) *The cleaning of the premises* upon termination of the tenancy necessary to return the unit to the same level of cleanliness it was in at the inception of the tenancy. . . ." [3]

Second, subdivision (e) then uses this definition to limit the charges that can be made against the security: "The landlord may claim of the security ***only*** those amounts as are reasonably necessary for the *purposes specified* in subdivision (b)."[4] Here, the "purposes specified" are charges for "repair and cleaning" authorized by subdivisions (b)(2) and (3).

Third, subdivision 1950.5(g)(1) requires a landlord (within 21 days of the end of the tenancy) to give the tenant "a copy of an itemized statement indicating the basis for, and the amount of, any security received and the disposition of the security, and shall return any

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[3] The first and fourth permissible deductions are for unpaid rent and for "future defaults" by tenants, respectively.

[4] The remainder of section (e) reads: "The landlord may not assert a claim against the tenant or the security for damages to the premises or any defective conditions that preexisted the tenancy, for ordinary wear and tear or the effects thereof, whether the wear and tear preexisted the tenancy or occurred during the tenancy, or for the cumulative effects of ordinary wear and tear occurring during any one or more tenancies." §1950.5(e).

remaining portion of the security to the tenant." Without a proper itemized statement, the landlord's "right to retain all or part of the security deposit under section 1950.5, subdivision (f), has not been perfected, and he must return the entire deposit to the tenant." *Granberry v. Islay Investments,* supra, 9 Cal.4th at 745.

The Statute was amended in 2003 to add subdivisions (g)(2)(A)-(C), which give specific directions on how to itemize charges.[5] The bill's sponsor, Senator Torklakson, explained the need to ensure that landlords actually did the work and paid the invoices charged to tenants.

> I introduced SB90 to address the egregious acts by some landlords who have excessively overcharged tenants for cleaning and repairs or fraudulently charged tenants for work that was never performed, the costs of which have ultimately denied tenants their security deposits. . . . [¶] SB90, among other things, mandates that landlords provide tenants with copies of bills, invoices, receipts, vendor price lists, or other vendor documents for materials purchased and labor expended for rental units. The intent of SB 90 is to provide tenants with documentation to demonstrate that the *total charges deducted from their security deposit by the landlord does not exceed the reasonable out-of-pocket costs of the landlord* for those items and/or services."

RJN, Ex. 2.

As a result, subdivision (g)(2) was added to give detailed directions to landlords on how to itemize any deduction for the "repair and cleaning" of the apartment:

> (g)(2) Along with the itemized statement, the landlord **shall** also include copies of documents showing charges incurred and deducted by the landlord ***to repair or clean*** the premises, as follows:
> (A) If the landlord or landlord's employee did the work, the itemized statement shall reasonably describe the work performed. The itemized statement shall include the time spent and the reasonable hourly rate charged.
> (B) If the landlord or landlord's employee did not do the work, the landlord shall provide the tenant a copy of the bill, invoice, or receipt supplied by the person or entity performing the work. . . .
> (C) If a deduction is made for materials or supplies, the landlord shall provide a copy of the bill, invoice, or receipt. If a particular material or supply item is

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[5] The former law required the landlord to provide an itemized statement but gave no guidance as to how the statement should calculate charges. RJN, Ex. 8 (prior statute).

> purchased by the landlord on an ongoing basis, the landlord may document the cost of the item by providing a copy of a bill, invoice, receipt, vendor price list, or other vendor document . . ..

(b) Defendants Administrative Fee Violates Section 1950.5.

Plaintiffs contend that any markup is illegal under 1950.5, but if such a charge were permitted, it would have to be disclosed with the requisite documentation and would have to be reasonably related to the tenant's default.

1. Section 1950.5 Does Not Permit a Markup of Any Kind.

The dispositive legal question in this case is whether §1950.5 permits a landlord to impose an administrative fee or markup. "Where a statute is theoretically capable of more than one construction, we choose that which most comports with the intent of the Legislature. Words must be construed in context, and statutes must be harmonized, both internally and with each other, to the extent possible." *California Mfrs. Assn. v. Public Utilities Com* (1979) 24 Cal.3d 836, 844.

> One ferrets out the legislative purpose of a statute by considering its objective, the evils which it is designed to prevent, the character and context of the legislation in which the particular words appear, the public policy enunciated and vindicated, the social history which attends it, and the effect of the particular language on the entire statutory scheme.

Santa Barbara County Taxpayers Assn. v. County of Santa Barbara (1987) 194 Cal.App.3d 674, 680.

The Statute's subdivisions identify and limit the costs that can be charged against a security deposit. Subdivision (e) provides that a landlord can ***only*** claim the amounts needed "for the purposes specified in subdivision (b)," here the "repair and cleaning" costs permitted by subdivisions (b)(2) and (3).[6]

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[6] The specific statutory provisions for outside-contractor charges and employee charges limit the range of other permissible charges. In *Kraus v. Trinity Mgmt. Servs., Inc.* (2000) 23 Cal. 4th 116, 141, 999 P.2d 718, the Court applied the doctrine of ejusdem generis to hold that §1950.5's broader statutory language ("reasonably necessary" charges) is "'restricted to those things that are similar to those which are enumerated specifically,'" i.e., out-of-pocket charges as exemplified by hourly-rate charges for employees and invoices/receipts for third parties.

The Statute's centerpiece is its requirement for an "itemized statement" and refund within 21 days. Subdivision (g)(2) requires that "the landlord shall also include copies of documents showing charges incurred and deducted by the landlord to ***repair or clean*** the premises as follows." Subdivisions (g)(2)(A)-(C) give detailed directions on how the landlord is to itemize his employees' time, the work by third party vendors, and materials. There is no provision for markups or administrative fees. To the contrary, the provisions require landlords to *prove they actually did the repairs for the amounts charged* as reflected in the "bills, invoices, and receipts" documenting work by a vendor [(g)(2)(B)] and the price of materials [(g)(2)(C)].

Having set forth detailed directions to ensure the tenants pays the actual costs, it is inconceivable that the legislature also intended to give landlords discretion to impose a markup of their choosing. The legislature did not trust landlords with any discretion since they had historically abused security deposits. The Superior Court previously agreed with Plaintiffs' contentions about the effects of §1950.5(g)(2)(A) and (B): "A fair reading of the two subdivisions does support the conclusion that the landlord can only charge for the actual 'time' and 'work' performed to repair or clean if an outside vendor is not used." RJN, Ex. 1 at 5.

Faced with this record, Defendants have argued that their markup is intended to recoup their overhead expenses and that "overhead expenses are out-of-pocket expenses" permitted by the Statute. RJN, Ex. 5 at 2:15-24. This attenuated reasoning is so out of line with accepted terminology that it cannot be advanced in good faith.

As the Court previously observed: "The court does not believe that one would ordinarily consider general overhead to constitute an out-of-pocket expense associated with a repair or cleaning expense." RJN, Ex. 1 (Order) at p. 4.[7] The 2003 amendment added (g)(2) (A)-(C), which specify what charges constitute an out-of-pocket expense. The subdivisions permit charges for true out-of-pocket expense as reflected in the bills, invoices, and receipts paid "out of the landlord's pocket" and passed on to the tenant. And subdivision (g)(2)(A) allows a landlord

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[7] Wikipedia defines overhead as being distinctly different from the costs of labor and materials: "In business, **overhead** or **overhead expense** refers to an ongoing expense of operating a business. [¶] . . . Overhead expenses are all costs on the income statement *except for direct labor, direct materials, and direct expenses*."

to bill for its employees' work by converting it to an out-of-pocket measure by using the [(hours worked) x (reasonable hourly rate)] formula. The Statute simply does not envision or permit an additional charge to be added to legitimate, direct expenditures.

Given the legislature's intention to end abusive billing practices by requiring full disclosure of all charges, it is not plausible that the statute would silently give landlords the right to inflate charges, let alone give a windfall to a large management company with large bureaucracies and correspondingly high overhead.[8]

2. Defendants Failed to Provide the "Bills, Invoices, and Receipts" to Support the Markup on Charges for Vendors and Materials.

Defendants have always refused to comply with the clear rules for passing on charges for third-party vendors and materials. Every class member was assessed a markup of between 10% and 40% on these types of charges, and in every instance, Defendants failed to provide tenants with copies of the "bills, invoices, and receipts" required by §§1950.5(g)(2)(A)-(C). (PUMF 5).

The purpose of the Statute is to "demonstrate that the total charges deducted from their security deposit by the landlord does not exceed the reasonable out-of-pocket costs" (RJN, Ex. 2). It accomplishes this goal requiring Defendants to provide tenants with the bills, invoices, and receipts that document the amounts paid to third parties, a true out-of-pocket expense. Subdivision (g)(2)(B) provides that "the landlord shall provide the tenant a copy of the bill, invoice, or receipt supplied by the [third-party vendor]." And Subdivision (g)(2)(C) reads: "If a deduction is made for materials or supplies, the landlord *shall* provide a copy of the bill, invoice, or receipt." These legal requirements are as clear as statutory language can be and are clearly intended to prevent landlords from passing on fictitious or exaggerated bills for outside services.

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[8] This accords with the rule that the various parts of a statutory enactment must be harmonized. "'If possible, significance should be given to every word, phrase, sentence and part of an act in pursuance of the legislative purpose.' .... Moreover, the various parts of a statutory enactment must be harmonized by considering the particular clause or section in the context of the statutory framework as a whole." *People ex rel. Smith v. Parkmerced Co.* (1988) 198 Cal. App. 3d 683, 691, (construing section 1950.5 as to nonrefundable deposits) (abrogated by *Kraus v. Trinity Mgmt. Servs., Inc.* (2000) 23 Cal. 4th 116, 999 P.2d 718.

The move-out statements given to tenants have never included copies of the invoices, either for services by third parties such as cleaners and carpet installers or for purchases of materials like door stops and paint. (PUMF 5). Not only have Defendants consistently refused to provide the invoices for charges that would be marked up, but they also made no attempt to provide bills, invoices, or receipts to support the overhead charges that were in theory captured by the markup. Ibid. As the Court noted when denying Defendants' motion for summary judgment, it "would seem to be very difficult, if not impossible" to itemize the 40% administrative fee as required by statute. RJN, Ex. 1 at p. 5. This inability to itemize just underscores that the markups were not envisioned by the Statute.

Having received thoughtful guidance from the Superior Court, Defendants did nothing to correct this shortcoming. Defendants' new policy applies the 10% surcharge to invoices for contractors and materials, items covered by (g)(2)(B)and (C), and Defendants continue to withhold the "bills, invoices, and receipts" required by the Statute. (PUMF 4 and 5).

3. A Surcharge Intended to Cover Overhead Is NOT Reasonably Necessary to Remedy Resident Default.

"[A] security fee paid by a tenant to a landlord is an amount intended to offset expenses incurred by the landlord as a result of tenant conduct during the tenancy." *Kraus v. Trinity Management Services Inc.* (2000) 23 Cal. 4th 116, 140 (emphasis added) (superseded by statute on other grounds). Defendants lease form thus provides that the landlord "may withhold from security only such amounts as are reasonably necessary to remedy resident default." RJN, Ex. 2, ¶3. Moreover, subdivision (g) states that the "landlord may claim of the security only those amounts as are *reasonably necessary* for the purposes specified in subdivision (b)." That subdivision in turn identifies situations where a tenant has breached a rental obligation. See, §1950(b)(2) (landlord may deduct for repairing damages "caused by the tenant").

The surcharge cannot satisfy this basic requirement because the markup is intended to recoup overhead charges. But overhead at Defendants' nine properties has no relationship, let alone a reasonable one, to the tenant's failure to leave the apartment in the same condition as when it was rented. Defendants' declarations have described a large bureaucracy of managers,

handymen, and accountants; it is this bureaucracy, rather than a tenant's conduct, that drive Defendants' overhead expenses. RJN, Ex. 6 (Ernst Decl.).

By definition, overhead expenses are ongoing and not directly attributable to a tenant's breach of lease obligation. As commonly used, overhead means "those costs required to run a business, but which cannot be directly attributed to any specific business activity, product, or service." Bragg, Steven, CPA (.accountingtools.com); accord, *Investopedia* ("Overhead refers to the ongoing business expenses not directly attributed to creating a product or service.")

(c) Defendants Bad Faith is Manifest.

Security-deposit claims tends to be for relatively small amounts of money, at least when compared to the many millions in revenues generated at Defendants' properties. When a landlord acts in bad faith, however, the court is authorized to award substantial statutory (liquidated) damages. Section 1950.5(l) reads:

> (l) The bad faith claim or retention by a landlord or the landlord's successors in interest of the security or any portion thereof in violation of this section, or the bad faith demand of replacement security in violation of subdivision (j), may subject the landlord or the landlord's successors in interest to statutory damages of up to twice the amount of the security, in addition to actual damages. *The court may award damages for bad faith whenever the facts warrant that award,* regardless of whether the injured party has specifically requested relief. In an action under this section, the landlord or the landlord's successors in interest shall have the burden of proof as to the reasonableness of the amounts claimed or the authority pursuant to this section to demand additional security deposits.

A common meaning for "good faith" is "honesty in fact" with bad faith its converse. See *Hersch v. Citizens Savings Loan Assn* (1983) 146 Cal.App.3d 1002, 1011 ("Bad faith , if one is mindful of the definitions contained in the Uniform Commercial Code, would have to be described as "[dis]honesty in fact in the conduct or transaction concerned.") Bad faith does NOT "connote the absence or presence of positive misconduct of a malicious or immoral nature — considerations which, as we shall indicate below, are more properly concerned in the determination of liability for punitive damages." *Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 922 fn. 5 (bad faith insurance claims). Relying on Black's Law Dictionary, the Ninth Circuit has defined "bad faith" as follows:

> The government persuasively contends that bad faith is a concept with a well-settled meaning in the law. The broader definition includes "neglect or refusal to fulfill some duty or some contractual obligation, not prompted by an honest mistake as to one's rights or duties, but by some interested or sinister motive." *Black's Law Dictionary* 127 (5th ed. 1979).

U.S. v. Louisiana-Pacific Corp. (9th Cir. 1992) 967 F.2d 1372, 1380

Defendants' bad faith is manifest. Defendants are sophisticated landlords with ample resources to ensure legal compliance. The 2003 amendments adding subdivisions (g)(2)(A)-(C) are clearly written and easy to understand, and yet Defendants made no attempt to comply with the statute until this lawsuit was filed. Defendants employ scores of employees to make sure that no charges are overlooked and could certainly afford competent advice if they were unable read the Statute. Defendants have been using the surcharge for as long as Mr. Ellis can remember, and for the decade preceding the class period (2003-2013), Defendants just ignored the mandate that they disclose [(hours worked) x (hourly rate)].

Throughout, Defendants had the ability to provide class members with itemized summaries of all charges. The sample statements, from before and after the change in policy, all have the backup documentation that Defendants did not disclose. See SOE, Exs. D-F (old) G, H (new procedure). But Defendants did not disclose the markup in any fashion, and they did not produce the invoices form which the markup could be deduced, precisely so they could continue to make money while breaking the rules. See SOE, Ex. A, at 82:19 -22; SOE, Exs. D-F.

For decades, the markup has provided a perverse incentive to Defendants to aggressively bill every possible charge. Defendants have created a substantial income stream that generates up to $200,000 annually with the surcharge making a substantial contribution to those sums over the years. Schallert Decl., ¶13.

Even after the Court's ruling found no basis for an administrative fee, Defendants continued to apply the markup on vendor services and materials. When Defendants appeared to rescind the markup on employee charges, they just goosed their hourly rates from a rate of $17 per hour to a high of $41 per hour for clerical work and $21 for odd jobs. Ex. G & H at p. 2. In other words, Defendants have never, in good faith, sought to comply with the law's mandate. Statutory damages under subdivision (l) are the only way to ensure compliance.

IV. THE RECORD SUPPORTS ADJUDICATION OF THREE AFFIRMATIVE DEFENSES AND TWO CAUSES OF ACTION.

Our Separate Statement of Undisputed Material Facts identifies five issues to be adjudicated. These issues in turn depend on two conclusions of law arising from the undisputed facts. The first conclusion is that Defendants violated section 1950.5 by adding a markup or administrative fee to otherwise legitimate charges; the second is that these procedures constituted bad faith under subdivision (l).

As to the legality of section 1950.5, our First Issue seeks summary adjudication of our Third Cause of Action's prayer for a declaration of law that "by adding an administrative fee to their security-deposit charges Defendants have violated the California Civil Code section 1950.5 and public policy." Our Second Issue seeks to adjudicate Defendants' 14th Affirmative Defense, which alleges that Defendants' standard practice is not "*unlawful*" under Business and Professions Code §17200. If the markup violates §1950.5, then this affirmative defense is without merit. The same facts support both issues.

As to Defendants' bad faith under subdivision (l), two affirmative defenses present that and the related issue of Plaintiffs' entitlement to statutory, liquidated damages under subdivision (l). Issue Three seeks to adjudicate the 18th Affirmative Defense, which alleges that each Defendant had a "good faith and reasonable belief that [it] was in compliance with applicable law" such that no "liquidated" or statutory damages should be awarded. Issue Four addresses the 30th Affirmative Defense alleges that Defendants' policies were "just, fair, honest, and [taken] in good faith."

Finally, resolving the issues of illegality and bad faith would permit adjudication of our Fifth Issue and thereby resolve the litigation. Our Fourth Cause of Action alleges the bad faith violation of section 1950.5(l) and seeks the statutory damages that can be awarded by the Court on a finding of bad faith. Our Fifth Issue therefore seeks to adjudicate the Fourth Cause of Action for breach of 1950.5 and to require the imposition of statutory damages under subdivision (l). Subdivision (l) expressly grants the Court the power to apply statutory damages up to twice the amount of the security deposits.

Moreover, if Defendants did not comply with the Statute, then they are required to refund the security deposit in its entirety to each class member. As our Supreme Court ruled:

> If, within the specified period, the landlord has not provided the tenant with a written accounting of the portion of the security deposit he plans to retain, the right to retain all or part of the security deposit under section 1950.5 subdivision (f), has not been perfected, and he must return the entire deposit to the tenant.

Granberry v. Islay Investments (1995) 9 Cal.4th 738, 745.

The Court has noted that any right to set-off could be barred by the landlord's bad faith. *Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 750 ("Because defendants have raised their claims through the equitable defense of setoff, the trial court must also determine whether defendants' claims are barred by any of the generally applicable equitable affirmative defenses, including laches, unclean hands, and estoppel.") Here, the Court can find as a matter of law that Defendants' unclean hands as regards the imposition of the markups is a separate basis for barring any set off by Defendants. Moreover, the *Granberry* decision implies that Defendants' bad faith could, per the statute, bar all such setoffs.

> "Second, defendants contend that because the Legislature provided a remedy only for *bad faith* retention of a security deposit, we can infer it did not intend to impose a penalty for *good faith* retention. They conclude that landlords like themselves that have retained security deposits in good faith should not be penalized by being barred from raising setoff. This argument is persuasive."

Granberry v. Islay Investments (1995) 9 Cal.4th 738, 747.[9]

Subdivision (l) grants the Court authority to impose statutory damages *sua sponte* up to twice the amount of each tenant's security deposit. The Fifth Issue therefore presents a path for resolving this class action after nearly five years without the need to resolve hundreds or thousands of disputed issues arising from individual members' refund. The egregious nature of Defendants' misconduct recommends this as the fairest and most efficient resolution of this

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[9] In *Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 74, the Court considered "whether a landlord who in good faith fails to comply with the requirements of this statute may nevertheless recover damages for unpaid rent, repairs, and cleaning in a subsequent judicial proceeding." *Granberry* was a class action where defendants had charged an extra $100 rent at the beginning of tenancies. It took two separate appeals to finally resolve whether the $100 was a security or not so that the defendants clearly had a good faith belief that they were not violating the statute.

litigation. All the requested rulings fall squarely within the Court's discretionary power under the summary adjudication statute but also under subdivision (l), which gives the Court an important role to play.

Respectfully submitted,

Dated: August 19, 2021.

LAW OFFICE OF MARK SCHALLERT

By: _____

Mark Schallert, Counsel for Plaintiffs TERESE CARDAMON and NICHOLAS CARDAMON

PROOF OF SERVICE
(Code Civ. Proc., §§1013, subd. a, and 2015.5)

I declare that I am a citizen of the United States of America and a resident of the County of Fresno, California. I am over the age of 18 years and not a party to this action; my business address is 1233 West Shaw Avenue, Suite 106, Fresno, California 93711.

On August 20, 2021, I caused to be served the attached **PLAINTIFFS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION FOR SUMMARY ADJUDICATION,** on each of the interested parties in said cause as indicated below:

(XXXX) **(BY PERSONAL SERVICE)** I caused a copy of said pleadings to be hand-delivered to the interested parties at:

Howard A. Sagaser, Esq.
Sagaser, Watkins & Wieland PC
5260 N. Palm Avenue, Suite 400
Fresno, California 93704

(XXXX) **(BY ELECTRONIC MAIL)** I caused a copy of said pleadings to be sent via electronic mail to the parties listed below: Howard A. Sagaser at has@sw2law.com

(XXXX) **(BY REGULAR MAIL)** I caused a copy of said pleadings to be placed in a United States mail depository. I am readily familiar with my office's practice of collection and processing correspondence for mailing. It is deposited with the U.S. Postal Service on the same day in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after the date of deposit for mailing.

TYLER H. LESTER
TYLER H. LESTER, ATTORNEY AT LAW
2350 West Shaw Avenue, Suite 128
Fresno, California 93711

I declare that I am employed in the office of a member of the bar of this court at whose direction the service was made.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on August 20, 2021, at Fresno, California.

Audrey Moreno
Audrey Moreno