Late-Fee Confusion In Calif. Residential Leases

Law360, New York (October 09, 2013, 5:06 PM ET) -- As anyone who has ever surfed the Internet knows, there is a great deal of conflicting information and advice to be found on just about every topic under the sun. One such issue, which has been the subject of increasing interest and debate in online legal forums over the last several years, is whether or not the standard provision for late fees in a residential lease is enforceable in California.

Some consumer advocate groups maintain that any late fees charged are void because they constitute impermissible liquidated damages. Others argue that late fees are usurious to the extent that they exceed the maximum legal rate of interest. Still others claim that such fees are permissible because landlords are entitled to recoup administrative costs associated with the collection of late rent.

The reason for these varied and conflicting perspectives appears to be the fact that California case law is itself unclear as to what charges are reasonable for a landlord to assess.

There are no specific statutes that directly establish limits for late-payment fees. However, California Civil Code Section 1951.5 makes it clear[1] that a lease of real property is subject to Civil Code Section 1671’s limitation on “liquidated damages” (i.e., a predetermined amount of damages designated in a contract as compensation for a specific breach).

Civil Code Section 1671 establishes the applicable analytical framework for determining whether or not certain kinds of liquidated-damages provisions are valid.

Unlike commercial leases, where the late fee is valid unless it is unreasonable,[2] 1671(d) provides that a liquidated-damages provision in a residential lease is void unless: (1) it is agreed to in the lease; and (2) “from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.”[3]

Predictably, it is this latter condition that has created confusion. It is often argued by tenant advocacy groups that, with respect to a lease’s obligation to pay rent (and indeed, any obligation to pay money), it is not difficult at all to calculate the actual damage: per Civil Code Section 3302, the only damage that the landlord can claim is interest at the legal rate.[4]
Indeed, as the California Supreme Court held almost a century ago in Knight v. Marks, “[w]here the lease has not expired and a forfeiture and restitution is not sought, the measure of damage for a breach of the covenant to pay the rent fixed by the lease is the amount of the rent unpaid and no more.

It could not be difficult or impracticable to fix the damages in such a case. It was a breach of an obligation to pay money only and the damages was ‘the amount due by the terms of the obligation, with interest thereon.’”[5]

Viewed from this perspective, charging a 6-percent late fee (which is common) for being one-day late with the rent amounts to an annual percentage rate in excess of 2,000 percent, which is obviously usurious. Accordingly, the most the landlord would be able to charge a tenant for being late on, say, a $1,000 rent payment would be 27 cents per day.

Although the Knight opinion has never been overturned, this reasoning was expressly rejected in the much more recent case of Orozco v. Casimiro,[6] which is frequently cited for both the proposition that such late fees are valid and the argument that they are void.

The tenant argued that the late fee was punitive in nature and not a “good-faith estimate of the damages likely to be suffered by [Orozco] ... and that therefore, the late fee, which bore no rational relationship to any actual damages ... was 'void and unenforceable.'”

Although the appellate court ultimately found in favor of the tenant, it specifically stated: “Appellant [tenant] argues that, notwithstanding such language [in Section 1671], late-fee provisions in a residential lease are never valid, since the landlord is only entitled to interest on the late-paid rent as damages, which is easily ascertainable as a matter of law. Appellant's legal premise, however, is simply wrong. A landlord is not limited to interest as damages as a consequence of the late payment of money. He is also entitled to 'administrative costs reasonably related to collecting and accounting for' late payments.”

The Orozco court reiterated that, per Civil Code Section 1671, a liquidated damages provision in a residential lease is normally void, except where the parties specifically agree and when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

The court then stated that once the landlord shows that it was impracticable or extremely difficult to fix actual damages, the amount the parties agreed upon is presumed to represent the amount of damage suffered by the breach.

Therefore, because the lessor plaintiff in Orozco neither pleaded nor proved that damages were impracticable or extremely difficult to fix, he was not entitled to the presumption that a late fee represented actual damages; under these circumstances, the late fee was void.
The holding in Orozco has been misinterpreted as a bar against the recovery of late fees in residential leases; however, its holding is narrower, based on the fact that the landlord failed to meet his evidentiary burden of demonstrating that the administrative damages he sought to recover were sufficiently difficult to fix. Different facts could lead to different results in other cases, particularly if there were evidence concerning the difficulty of determining actual damages.

Accordingly, a landlord is not limited to interest as damages as a remedy for the late payment of rent. He or she may also collect “administrative costs reasonably related to collecting and accounting for late payments.”

This begs the question of which administrative costs — and how much — are “reasonable.” Unfortunately, there is a dearth of case law on this point. Generally, a late fee that is so high that it amounts to a penalty is not going to be enforceable.[7]

The residential lease agreement published by the California Association of Realtors contains the following language in paragraph 8, concerning late fees:

Tenant acknowledges that either late payment of rent or issuance of a [nonsufficient fund] check may cause landlord to incur costs and expenses, the exact amount of which are extremely difficult and impractical to determine. These costs may include, but are not limited to, processing, enforcement and accounting expenses, and late charges imposed on landlord. ... Landlord and tenant agree that these charges represent a fair and reasonable estimate of the costs landlord may incur by reason of tenant's late or NSF payment.

The ubiquitous CAR form lease agreement contains language that is generally considered sufficient to meet the requirements of Civil Code Section 1671(d), provided that the late fee itself is not unreasonably high.

If a landlord uses a residential lease that does not contain a similar provision, any late-fee provision will probably be found to be unenforceable. Residential landlords who want legally enforceable late-fee provisions should evaluate their leases accordingly.

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[2] Commercial leases are instead covered by Civil Code Section 1671(b), which provides that “a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.”
[3] See Civ. Code § 1671(d) (“a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.”).

[4] See Civ. Code § 3302 (“The detriment caused by the breach of an obligation to pay money only, is deemed to be the amount due by the terms of the obligation, with interest thereon.”). See also Cal. CONST., art. XV, § 1 (establishing the legal rate of interest).

[5] Knight v. Marks, 183 Cal. 354, 357 (1920) (citing Civ. Code § 3302). See also Ridgley v. Topa Thrift & Loan Assn., 17 Cal. 4th 970 (1998) (liquidated damages clause generally unreasonable and unenforceable under section 1671(b) if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach). The Ridgley court held that if the sum taken from lender was designed to exceed the damages suffered by lender, the provision for additional fees was an invalid attempt to impose a penalty inasmuch as its purpose was to compel prompt payment through threat of charges bearing no relationship to actual loss.


[7] This is the position expressed by the California Department of Consumer Affairs’ Legal Affairs Division. See: http://www.dca.ca.gov/publications/landlordbook/catenant.pdf