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“SECURITY DEPOSITS” AND PAYMENTS OF RENT “IN ADVANCE” FOR RESIDENTIAL PREMISES: A NEW LEASE ON LIFE?

By M.A. SPRINGMAN*

I. INTRODUCTION

In 1968, the Ontario Law Reform Commission recommended a dramatic change in the law of landlord and tenant as it related to residential tenancies.¹ Its seminal *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies*² dealt with certain critical matters that, it was said, “require immediate legislative action.”³ The topics of particular concern to the Commission included the obligation to repair, distress, contracting out, the doctrine of frustration, mitigation of damages, termination, and security deposits. The main thrust of the Commission’s recommendations for reform was subsequently adopted by the Legislative Assembly as a new Part IV of *The Landlord and Tenant Act*, dealing exclusively with residential tenancies.⁴ And so dawned the modern — or at least a new — era of residential landlord and tenant law.

The purpose of this paper is to examine one aspect of the new order, namely, the Ontario Law Reform Commission’s proposals respecting security deposits and their subsequent implementation in the 1968-69 legislation.

Why, one may ask, is such an exercise thought to be necessary some fourteen years after the adoption of the Commission’s reasonable seemingly self-explanatory recommendations? While the effluxion of a mere decade and a half is, of course, hardly a guarantee of statutory perfection and immutability, there is a more specific explanation. The explanation has to do, at least in large part, with the implications of the decision of the County Court in *Re Veltrusy*

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¹ See Ontario Law Reform Commission, *Interim Report on Landlord and Tenant Law Applicable to Residential Tenancies* (Toronto: Queen’s Printer, 1968) (hereinafter referred to as “*Interim Report*”). See, also, *Report on Review of Part IV, The Landlord and Tenant Act* (Toronto: Queen’s Printer, 1972); and *Report on Landlord and Tenant Law* (Toronto: Queen’s Printer, 1976).

² *Supra* note 1.

³ *Id.* at 7.

⁴ See *The Landlord and Tenant Amendment Act, 1968-69*, S.O. 1968-69, c. 48.

Enterprises Ltd. and Gallant,⁵ a case that raises, directly and indirectly, certain troublesome problems created by the 1968-69 legislation and, lamentably, still with us today. At the very least, the case makes manifest the original, and continuing, absence of the proper distinction between payments of rent in advance and true security deposits for rent. But, more importantly, *Veltrusy* may well call into question the policy behind the de-legitimization of so-called security deposits for rent.

Consequently, *Veltrusy* serves as a useful vehicle for ferretting out the intricacies and mysteries of "security deposits" for rent, notwithstanding that it has become what might be called a "non-case" through abandonment of the litigation. To date, no such investigation appears to have taken place in this jurisdiction.

II. RE VELTRUSY ENTERPRISES LTD. AND GALLANT

Briefly stated, the County Court in *Re Veltrusy Enterprises Ltd. and Gallant* decided that rent for a twelve month period payable in eight equal monthly instalments was a valid advance payment of rent and not an unlawful security deposit. Was that decision a sound one, or did it violate both the letter and spirit of section 84 of *The Landlord and Tenant Act*⁶ and the Ontario Law Reform Commission recommendations that proposed the enactment of section 84?⁷ To anticipate a part of the conclusion, it is suggested that those who hold the latter view are half right: the decision — and therefore the type of residential tenancy agreement considered in *Veltrusy* — can be supported as a matter of law. However, in doing so, one may be excused for thinking that the apparent intention of the Commission and of the legislation was somehow slightly perverted. Yet, notwithstanding what for some was an unwarranted and unwelcome surprise in *Veltrusy*, the need for, and precise characteristics of, any remedial legislation respecting "security deposits" for rent is by no means self-evident.

In *Veltrusy*, the tenancy agreement — which Robson Co. Ct. J. said was "fairly typical of those entered into by landlords with university students"⁸ — provided for a term of one year, with monthly rent set at \$207.50. The "Student Plan Rent Payment" required the tenant to pay twelve months' rent in equal monthly payments of \$311.25 over the first eight months. In addition, at the execution of the agreement, the tenant was required to "deposit" with the landlord \$311.25 for the "last month's rent," in return for which the landlord was to pay interest "at the rate of 6% per annum of \$207.50." Finally, a key deposit of \$10 was payable for two keys.

The Court had no difficulty invalidating the requirement to pay for the keys. It also had little trouble coming to the conclusion that no amount above \$207.50 could be required as a deposit for the last month's rent. Both deter-

⁵(1980), 28 O.R. (2d) 349 (Co. Ct.), appeal allowed on a technical matter not related to the substantive merits of the county court judgement; see *Re Gallant and Veltrusy Enterprises Ltd.* (1981), 32 O.R. (2d) 716 (C.A.) (subsequent references are to 28 O.R. (2d)).

⁶R.S.O. 1970, c. 236. See now, R.S.O. 1980, c. 232.

⁷*Supra* note 1.

⁸*Supra* note 5, at 350.

minations were based on the language of subsections 81(d) and 84(1) of *The Landlord and Tenant Act*,⁹ which provided as follows:

81. In this Part,

(d) "security deposit" means money or any property or right paid or given by a tenant of residential premises to a landlord or his agent or to anyone on his behalf to be held by or for the account of the landlord as security for the performance of an obligation or the payment of a liability of the tenant or to be returned to the tenant upon the happening of a condition; . . .

84.(1) A landlord shall not require or receive a security deposit from a tenant under a tenancy agreement entered into or renewed on or after the 1st day of January, 1970 other than the rent for a rent period not exceeding one month, which payment shall be applied in payment of the rent for the last rent period immediately preceding the termination of the tenancy.

The more vexing issue, however, concerned the required payment of twelve months' rent over a period of eight months. The rationale given by Robson Co. Ct. J. for permitting such payment is brief and deserves to be quoted in full:¹⁰

In order to ascertain the meaning of the Legislature when referring to "security deposit" in ss. 81 and 84, it is necessary to ask "security for what?". Section 81(d) merely provides that it is "security for the payment of an obligation or the payment of a liability of the tenant or to be returned to the tenant upon the happening of a condition" and is silent as to the "obligation", "liability" or "condition" meant. However, s. 84, by providing that the security deposit "shall be applied in payment of the rent for the last rent period immediately preceding the . . . tenancy" (emphasis mine), surely means that the security is for the obligation or liability of the tenant to pay rent right up to the end of the tenancy, and is intended to secure the landlord against a tenant who steals away without paying the rent for the final period of his tenancy, and it is to be returned to the tenant upon his payment of that last month's rent.

I can see no reason why a lease cannot provide for payment of rent for one year or any other period on which the landlord and tenant agree in advance, but if, in addition to such prepaid rent, the landlord requires a security deposit of more than the amount which would be attributable to a one-month period, the landlord is contravening s. 84.

In this case, the rent is to be paid in eight equal instalments of \$311.25, and this is obviously merely prepayment of rent similar to my analogy of annual rent payable in advance. There is nothing in Part IV which prohibits it.

It is clear that the views of Robson Co. Ct. J., in part *obiter dicta*, transcend the narrow facts in *Veltrusy* and raise larger issues respecting security deposits and payments of rent in advance.

The Court of Appeal allowed the appeal,¹¹ but did so on a technical ground relating to the jurisdiction of a county court judge to hear the application. It did not touch on the substantive merits of Robson Co. Ct. J.'s decision, although this decision no longer stands. While the Court of Appeal made its order "without prejudice to the institution by any of the parties of such proceedings as may be deemed advisable," the litigation now appears to have ended. Nevertheless, the issues raised in the decision of this particular "test case" merit closer attention.

⁹ R.S.O. 1970, c. 236, as am. by S.O. 1972, c. 123, s. 1, and S.O. 1975 (2nd Sess.), c. 13, s. 2. See, now, the identical provisions in the *Landlord and Tenant Act*, R.S.O. 1980, c. 232, ss. 81(d) and 84(1).

¹⁰ *Supra* note 5, at 351-52.

¹¹ *Re Gallant and Veltrusy Enterprises Ltd.*, *supra* note 5.

III. THE ROOTS OF THE PROBLEM

It has been noted that the genesis of section 84 of the *Landlord and Tenant Act* was the Ontario Law Reform Commission's 1968 *Interim Report*.¹² In that Report — indeed, in the Commission's three Reports on landlord and tenant law — attention was focused mainly on security deposits for damage to the rented premises. However, the *Interim Report* did consider prepayments of rent; it recommended, *inter alia*, that “[l]andlords should be permitted . . . to request payment of the last month's rent in advance. . . .”¹³

The problem raised by *Veltrusy* arises from the unhappy juxtaposition of two different concepts in the Commission's original recommendations and in the subsequent implementing legislation. The Commission's proposal in the *Interim Report* would have allowed payment of rent “in advance” only for the last month. However, it appears that this term was rather ambiguously used, or at least used in only one of two possible ways. At first blush, it might appear that the Commission intended to preclude (except for the last month) what is the most common method of rent payment for residential premises, that is, rent payable at the commencement of each month for that month. The term “in advance” — for example, payment on January 1 for the month of January — is frequently used in contradistinction to the term “in arrears”, that is, payment on January 31 for the month of January.¹⁴

It is hardly likely that, with respect to tenancy agreements providing, for example, for monthly or weekly rent payments, the Commission sought to prohibit advance payments at the commencement of each month or week.¹⁵ While not at all clear from the *Interim Report*, the Commission appeared to view rent payable for January as due on January 1 and, therefore, not payable “in advance.” Consequently, the term “in advance” was likely used to refer to payment prior to the date on which the rent would ordinarily be due under

¹² *Supra* note 1.

¹³ *Interim Report*, *supra* note 1, at 28. The remaining portion of the recommendation appears in the text accompanying note 18, *infra*.

¹⁴ It bears emphasizing here that, at common law, rent was payable in arrears and any different requirement, where permissible, must be as a result of a clear agreement to that effect. See Rhodes, *Williams' The Canadian Law of Landlord and Tenant* (4th ed. Toronto: Carswell, 1973), at 182. With respect to the validity of payment of rent in advance, see, also, *id.* at 769-70.

¹⁵ The legitimacy of paying each month's or each week's rent at the commencement of the month or week has seldom been questioned. It is rare for the issue even to be mentioned. One of the few references to the practice appears in The Law Commission, *Codification of the Law of Landlord and Tenant: Report on Obligations of Landlords and Tenants*, Law Com. No. 67, (London: H.M.S.O., 1975) at 19, para. 69:

Unless the terms of a tenancy provide for payment of rent in advance, it is normally payable in arrear. However, it is usual to provide for payment of rent in advance in short tenancies. This system is reasonable and is generally accepted without comment. The code should confirm the principle, and make a statutory exception in the case of a periodic tenancy from quarter to quarter or any shorter period. Rent for these short tenancies would be payable in advance at the commencement of each period. These statutory provisions to pay the rent in advance or in arrear would be variable.

With respect to the general rule in the United States, namely, that rent is payable in arrears, see 52 C.J.S. §511. However, again, the parties may provide for payment of rent in advance.

the terms of the tenancy agreement — for example, payment on November 1 for any month other than November.¹⁶

The immediately preceding interpretation of what the Commission meant by the term “in advance” seems reasonable, having regard to the usual practice with respect to residential tenancies. However, it is not entirely without difficulty.¹⁷

Let us ignore the problem raised by the payment of the first month’s rent before the start of the term.¹⁸ In addition, let us assume that the Commission did not wish to preclude payment at the commencement of, for example, each monthly rental period, but sought only to prohibit payments before that time of any more than the last month’s rent. Accordingly, the Commission’s recommendation, at least as described to this point, would appear to preclude, for example, the type of prepayment of rent that gave rise to *Veltrusy*. However, the *Interim Report* went on to propose that payment of the last month’s rent in advance “should be treated as security for the payment of rent only.”¹⁹

One suspects that the Commission really intended to emphasize the last two words quoted above. That is to say, the Commission wished to make it clear that the money paid would not be a *damage* deposit, but would be applied to “rent only.” The term security deposit is indeed aptly used in relation to damages, for the money so paid — that is, as “security” — would clearly become the landlord’s property only if and when the tenant breached his obligation by damaging the rented premises. But the Commission unfortunately used the term “security” in reference to the deposit for rent as well.

The resulting legislation²⁰ combined the concept of payment of rent “in advance” and the concept of a security deposit for rent. Subsection 84(1) — to a great degree reflecting the legacy of damage deposits — defines what is permissible and what is not permissible in terms of a lawful and unlawful security

¹⁶ See Rhodes, *supra* note 13, at 181 *et seq.*, where a distinction appears to be made between payment “in advance” (but when actually said to be due), and “prepayment”. At 184, the following statement is made: “Payment of rent *before it is due* is not fulfilment of the obligation imposed by the covenant to pay rent, but is in fact an advance to the landlord, with an agreement that *as and when rent becomes due* the amount advanced will be applied for that purpose” (emphasis added). See also, *Cavell v. Canada Dry Ginger Ale, Ltd.*, [1945] O.W.N. 799 (Co. Ct.) at 800: “Rent paid in advance must be clearly distinguished from rent prepaid . . . Rent paid to the landlord before it is due is paid at the tenant’s risk in case of a change of ownership.”

¹⁷ For example, how would one deal with the not uncommon situation in which a prospective tenant pays rent for both the first month and the last month on, say, December 8, when the tenancy agreement is executed, for a term commencing January 1? Would not the payment of the first month’s rent be a payment “in advance” (that is, in advance of the date when rent would normally be due for the first month) and, therefore, violative of the Commission’s proposal in the *Interim Report* and of section 84(1), both of which restrict payment in advance to the last month’s rent alone? But, surely, this normal type of prepayment was not to be rendered unlawful. Indeed, its legality appears never to have been questioned.

¹⁸ See *id.*

¹⁹ *Interim Report*, *supra* note 1, at 28.

²⁰ *Supra* note 4.

deposit. So, too, do the unproclaimed provisions of the *Residential Tenancies Act*.²¹

In view of the language used by Robson Co. Ct. J. to distinguish the advance payments required in *Veltrusy* from a security deposit, and in view of the wider implications of *Veltrusy*, it is necessary to examine the distinction in more detail.

IV. PREPAYMENTS OF RENT

There is an important conceptual and practical difference between a security deposit for rent and payment of rent in advance. Indeed, prepayments may take several forms and be designed for several purposes. In this connection, reference may be made mainly to the American experience, since there is virtually no Canadian jurisprudence on point. In the American context, various types of prepayment have been characterized and described in a leading case as follows:²²

There are several types of cases involving payments of this kind — not different lines of authority adopting divergent rules on the legal principle involved, but different groups of cases dependent upon the special facts. Within these groups the rules of law are settled and our authorities are in complete harmony. First, because of more frequent occurrence, come the cases involving an absolute payment in advance of the rent for the last few months of the term. When paid under such circumstances, the lessor is entitled to retain the fund on default of the lessee Second, where the payment is made by way of a deposit as security for the performance of the covenants of the lease. Cases within this group should be again divided into two classes — where the lease provides that the sum shall be forfeited to the lessor in the event of breach by the lessee, and, where the sum is treated as a

²¹ R.S.O. 1980, c. 452. The relevant provisions provide as follows:

1.(1) In this Act,

“rent deposit” means a security deposit that section 9 does not prohibit a landlord from requiring or receiving;

“security deposit” means money or any property or right paid or given by a tenant to a landlord or his agent or to anyone on his behalf to be held by for the account of the landlord as security for the performance of an obligation or the payment of a liability of the tenant or to be returned to the tenant upon the happening of a condition; . . .

9.(1) A landlord shall not require or receive a security deposit from a tenant other than,

(a) in the case of a weekly tenancy, the rent for a period not exceeding one week; or
(b) in the case of a tenancy other than a weekly tenancy, the rent for a period not exceeding one month,

which shall be applied only in payment of the rent for the period immediately preceding the termination of the tenancy.

(2) Subject to subsection (3), a rent deposit may be required only at the commencement of the tenancy.

(3) Where there has been a lawful rent increase, a landlord may require the tenant to pay, as an addition to the rent deposit, the amount necessary to increase the deposit to a sum not exceeding the new rent for the period to which the deposit is applicable.

²² *A-1 Garage v. Lange Investment Co.*, 44 P.2d 681 at 682 (Calif. Dist. Ct., 1935).

trust fund to which the lessor may look for relief upon proof of damages arising from the breach. Where a forfeiture is provided for and the deposit treated as liquidated damages, the clause has been uniformly held invalid in this state under section 1670 of the Civil Code On the other hand, where the sum is deposited merely as security for the performance of the covenants by the lessee, without a penalty or forfeiture clause, the payment is valid to that extent and the lessee is not entitled to a return of the fund upon a breach of the lease, but the lessor may look to the fund for damages proved

Another group of cases of increasing number is where the lease calls for the flat payment of a sum as a bonus, or "consideration" for the execution of the lease. Such clauses have been uniformly held valid in this state and the lessee has been denied recovery when the lease has been cancelled through his default²³

The characterization of the tenant's payment depends on the intention of the parties, having regard to the terms of the tenancy agreement and all the other circumstances of the case.

Clearly, then, a security deposit, properly so called, is a payment of money that is held only as "security" for the performance of an obligation — in the instant case, to pay rent. In fact, the notion that the money is to be held "as security" is made explicit in subsection 81(d) of the *Landlord and Tenant Act* and subsection 1(1)(o) of the *Residential Tenancies Act*, where "security deposit" is defined. Technically, in a tenancy for one year, with rent payable monthly "in advance," the tenant would have to pay the last month's rent in the same manner that he paid every previous month. Any "security deposit" taken for the last month's rent — permissible under the *Landlord and Tenant Act* and the *Residential Tenancies Act* — could be used only as security, that is, only if the tenant did not in fact pay the last month's rent.²⁴ However, where a landlord requires a tenant to pay the last month's rent in ad-

²³ The issue whether a deposit, to be forfeited upon the tenant's bankruptcy, was a penalty, liquidated damages, or a condition precedent to entering into the lease for a store was considered in *Re Abraham* (1925), 59 O.L.R. 164 (Reg. in Bank.), reversed (1926), 59 O.L.R. 168, [1926] 1 D.L.R. 939 (H.C. Div.), app. dis. (1926), 59 O.L.R. 173, [1926] 3 D.L.R. 971 (App. Div.).

Other cases that have decided that a security deposit and prepayment of rent are property of the landlord and cannot be recovered by a trustee upon the tenant's bankruptcy include: *Re Champion Machine and Tool Co. Ltd.* (1971), 15 C.B.R. (N.S.) 136 (S.C.O. Reg. in Bank.); *Re Flomen & Lussier Inc.* (1952), 33 C.B.R. 1 (Que. Sup. Ct. in Bank.); *In re Yaffy Systems Inc.* (1952), 32 C.B.R. 202 (Que. Sup. Ct. in Bank.); and *In re Bradley; Ex parte Dixon* (1921), 21 O.W.N. 216, 2 C.B.R. 147 (Reg. in Bank.). See also, Houlden, *Annotation* (1952), 32 C.B.R. 204, where the author states that the same holds true for money paid as liquidated damages. The issue concerning whether the payment by the tenant is in respect of liquidated damages or is a penalty is considered in Goodman, *Prepayment Clauses in Leases in Quebec and Ontario: Treatment in Bankruptcy* (1953), 33 C.B.R. 8 at 9.

In the cases cited above, it was also held that the trustee was entitled to set off the amount of the payment forfeited to the landlord against the latter's claim for, for example, accelerated rent, or rent otherwise in arrears, and occupation rent.

²⁴ See Lamont, *Residential Tenancies* (3d ed. Toronto: Carswell, 1978) at 26, where it is stated that, "[i]f the rent has already been paid for [the last] month, the security deposit should be repaid by the landlord" See also, Clover, *Interest on Security Deposits — Benefit or Burden to Tenant?* (1978), 26 U.C.L.A. L. Rev. 396 at 396; Note, *Security Deposits in Residential Leases* (1973), 8 Val. L. Rev. 63 at 63; Wilson, *Lease Security Deposits* (1934), 34 Colum. L. Rev. 426 at 431; and McQuarrie, *The Residential Tenant's Security Deposit — A Protected Interest Worth Litigating* (1977), 8 St. Mary's L.J. 829 at 829-30.

vance, and not by way of a security deposit, the landlord clearly must use that advance payment as rent for the last month.²⁵

The difference is sometimes reflected in the manner in which the landlord must hold a true security deposit. In the United States, some statutes characterize the landlord as a trustee holding for the benefit of tenants, and most prohibit the commingling of security deposit funds with the landlord's other funds.²⁶ Presumably, this characterization and prohibition arise from the fact that technically the money does not belong beneficially to the landlord: it will have to be returned to the tenant if the tenant performs his obligations respecting the payment of rent. But where the money paid is simply rent in advance, and not held as security, there is generally no need to impose any such requirements on the landlord, since the money "becomes the absolute property of the landlord upon receipt."²⁷ With respect to the distinction between

²⁵ See *Regina v. Benetos* (1978), 6 B.C.L.R. 353 (C.A.) at 356, where Farris C. J.B.C. stated in respect of the payment of one half of one month's rent, to be applied to the last month's rent:

It was not given as a security. Indeed, it is described as "a rent payment." There is nothing in the agreement that requires the sum to be "held or enforced" by the landlord. Once the landlord received the sum, it became his to do with as he wished. It was simply a payment in advance of \$225 of the rent that the tenant was bound to pay ultimately for the final month.

The *Benetos* case will be considered in Part V, *infra*.

See also, Law Reform Commission of British Columbia, *Report on Landlord and Tenant Relationships: Residential Tenancies* (Victoria: Queen's Printer, 1973), at 80, quoting from *Contemporary Landlord and Tenant Law* (1973), 4 Vand. 689, 693-94, where, after noting four types of payment — the last of which was "a deposit to secure payment of rent or fulfillment of all lease covenants" — it was said:

Only the last of these four is properly described as a security deposit, although modern statutes often treat alike advance payments of rent and security deposits. Consideration for granting a lease seldom causes problems unless an inartfully drawn lease agreement fails to articulate clearly the intentions of the parties. Liquidated damages clauses frequently are subject to challenges as penalties which are disfavoured and unenforceable.

The use to which a "security deposit" may be put was described in this way:

Disposition of the security deposit — The landlord may retain the security deposit until the tenant renders the performance secured by the deposit, unless the landlord wrongfully evicts the tenant or misuses the deposit. The money paid as security constitutes a fund upon which the landlord may draw to compensate himself for a tenant's breach of covenants covered by the security. The tenant is entitled to the timely return of the deposit subject only to the rightful claims of the landlord consistent with the lease provisions.

²⁶ The relationship created between the landlord and tenant by the giving of a security deposit has also been characterized as that of debtor and creditor or pledgor and pledgee. See Wilson, *supra* note 23, at 457 *et seq.*, and Note, *supra* note 23, at 68 *et seq.*

See also, Waters, *Law of Trusts in Canada* (Toronto: Carswell, 1974) at 65: "And if a trustee wrongfully mixes trust assets with his own funds, the trust property remains beyond the creditors' reach until it is no longer 'identifiable.'" And further (*id.*): "A trustee must keep the assets of the trust distinct."

²⁷ Clover, *supra* note 23, at 414n. 92. One commentator has said that "if landlords are permitted to have the unrestricted use of the tenants' money, then the funds are no longer used for their original purpose — as security": Bosshardt, *The Rental Security Deposit in California* (1971), 22 Hastings L.J. 1373 at 1389. See also, the language of Farris C.J.B.C. in *Regina v. Benetos*, in the passage quoted *supra* note 24, and the High Court Division decision (affirmed on appeal) in *Re Abraham*, *supra* note 22, at (1926), 59 O.L.R. 172-73 (although it was said that the rent, while payable "in advance", was really "a condition precedent to entering into the lease").

security deposits and payments of rent in advance, based on the circumstances under which a landlord may retain the money, one Court has stated as follows:²⁸

If the \$700 was intended to be a mere deposit by way of security to insure the faithful performance of appellant's covenants, then upon the forfeiture of the lease, which occurred when appellant failed to pay the accrued rent within the time fixed by the three days' statutory notice, the latter would be entitled to a return of the sum so deposited by him, less the amount of the rent then due and unpaid If, however . . . it was intended to be an advance payment for and on account of the last three months' installments of rent — then and in that case no part of the \$700 can be recovered by appellant

Notwithstanding the statutory definition in Ontario of security deposit as the receipt of money "as security" for the payment of rent, it bears mentioning that both section 84 of the *Landlord and Tenant Act*²⁹ and subsection 9(1) of the *Residential Tenancies Act*³⁰ provide that the security deposit permissible under these statutes "shall be applied" in payment of the last rental period. The statutory requirement is mandatory, and there is no reference to a default in payment on the part of the tenant as a precondition to the stipulated application of the deposit. If one were to read these provisions apart from the definition of security deposit, it would appear that the landlord is legally obligated to use the "security deposit" as rent for the last rental period — that is, as an advance rental payment and not as "security".³¹ Indeed, the intention appears to have been that the money would and should be directly used as the rent for the last rental period. Moreover, the general practice of Ontario

²⁸ *Wetzler v. Patterson*, 238 P. 1077 at 1078 (Calif. Dist. C.A., 1925). See also, *Zaconick v. McKee*, 310 F.2d 12 (U.S.C.A., 5th Cir., 1962); *Bacciocco v. Curtis*, 82 P.2d 385 at 387 (Calif. S.C., 1938); *Lochner v. Martin*, 147 A.2d 749 at 752 (Md. C.A., 1959); and *Paul v. Kanter*, 172 So.2d 26 at 28 (Fla. Dist. C.A., 1965). In *Householder v. Black*, 62 So.2d 50 (Fla. S.C., 1952), the Court accepted the principle that the general rule is that, in the absence of a contrary provision in the lease, rent paid in advance cannot be recovered by a tenant on termination, unless the termination was wrongful against the tenant, whereas a security deposit could be recovered, less amounts covering damage caused by the tenant.

²⁹ R.S.O. 1980, c. 232.

³⁰ R.S.O. 1980, c. 452.

³¹ See Rhodes, *supra* note 13, at 173, where it is said that the "deposit in an amount not exceeding one month's rent . . . must be applied towards the last month's rent" pursuant to s. 84(1). See also, Law Reform Commission of British Columbia, *supra* note 24, at 89 (footnote deleted):

Under section 37(1) [of the *Landlord and Tenant Act*, R.S.B.C. 1960, c. 207, as am.], existing rent deposits "shall be applied in payment of the rent for the last period under the tenancy agreement." It is therefore the practice where a rent deposit has been taken that, when a tenancy is lawfully terminated, no further money changes hands. This is a convenience to both landlord and tenant and is a practice which we would like to preserve to the extent possible.

On the other hand, see Klippert, *Residential Tenancies in British Columbia* (Toronto: Carswell, 1976) at 137, where the author considered British Columbia provisions (reproduced *infra*) permitting a maximum of one half of one month's rent as a security deposit:

The sections governing security deposits . . . do not oblige a tenant, upon the expiration or termination of the tenancy, to pay the last month's rent in full. For example, a tenant whose last month's rent is \$200 may elect to submit a cheque for \$100 and give his landlord authority to retain the \$100 security deposit as partial payment of the last month's rent. Obviously, such a practice would emasculate the protection a security deposit [for damages] is intended to accord a landlord.

landlords is to use the money as rent for the last month of the term. Yet, whatever the intention of the draftsman or the practice of landlords, it should be emphasized that the legislation expressly characterizes the relevant payment as a security deposit to secure rent in respect of the future occupation of the premises.

While any mandatory requirement to apply money paid as a security deposit to the last month's rent is, therefore, a contradiction in terms, it is not uncommon for leases to mix — in fact, to confuse — security deposits and payments of rent in advance. It has been said that “[l]eases . . . frequently provide for repayment [of a “security deposit”] by applying it as rent for so many of the last rental periods of the lease as it will cover. . . .”³² One rationale given for this practice is that, as the term progresses to the end, the landlord has less need of the money as “security,” at least in respect of damages.³³ This practice, however, has been criticized. One commentator has said that “[t]he security deposit thus becomes self-defeating: lessees simply skip the last month's rent and allow the lessor to keep the entire deposit as that month's rent.”³⁴ Of course, presumably this criticism is valid only where the security deposit is in respect of the performance of covenants in addition to the covenant to pay rent; where the security deposit can apply only to rent — ostensibly the position in Ontario — its use as rent rather than true “security” is of less practical importance.

V. PREPAYMENTS OF RENT IN OTHER CANADIAN JURISDICTIONS

For the most part, the relevant legislation in Canadian jurisdictions other than Ontario deals with a prepayment of rent in terms of its use as security. For example, the Alberta *Landlord and Tenant Act*³⁵ uses the term “security deposit” and defines it in almost exactly the same way as does the Ontario Act.³⁶ In Manitoba, the definition of “security deposit” in *The Landlord and Tenant Act*³⁷ refers to its use “as security for the payment of rent in arrears.” Clearly, the tenant must first be in default before the landlord is entitled to apply the deposit to the rent then owing. In New Brunswick, subsection 8(2) of *The Residential Tenancies Act*³⁸ states, *inter alia*, that a “security deposit” is “to provide security against the tenant's failure to pay rent”

In other provinces, the requirement to use the money “as security” is not made express in the applicable security deposit legislation, although the

³² Wilson, *supra* note 23, at 445.

³³ *Id.*

³⁴ Note, *supra* note 23, at 83-84. See Klippert, *supra* note 28. But see, *supra* note 20.

In *Kobold v. Allen* (1922), 66 D.L.R. 566, [1922] 1 W.W.R. 1186 (Man. K.B.), where a “guarantee” was given in respect of a lease of a theatre, it was held that the landlord could either appropriate the sum paid in whole or in part to defaults from time to time in the payment of rent, or refuse to do so, at the landlord's option. Notwithstanding the guarantee, the landlord could sue for the rent in default.

³⁵ R.S.A. 1980, c. L-6.

³⁶ *Id.* at s. 1(g).

³⁷ R.S.M. 1970, c. L70, as am. by S.M. 1970, c. 106, s. 1, adding a new s. 2(e) to the Act.

³⁸ S.N.B. 1975, c. R-10.2.

absence of this specific requirement would appear to make no real difference. For example, in Nova Scotia, subsection 9(1) of the *Residential Tenancies Act*³⁹ provides that, “[w]here a landlord obtains from a tenant any sum of money or other value that is in addition to the rent payable in respect of the residential premises the sum of money or value shall be deemed to be a ‘security deposit’.” It may be thought that this provision would render a “security deposit” inapplicable to arrears of rent. Indeed, subsection 9(3), in its original form, provided only that, “[s]ubject to subsection (6), a security deposit or the proceeds thereof shall be held in trust by the landlord and may be applied to expenses incurred in respect of *damage to the residential premises* that is the responsibility of the tenant.”⁴⁰ In 1975, however, the words “to outstanding rent or” were added after the word “applied” in subsection 9(3).⁴¹ Consequently, the security deposit may now be used by a landlord as security to be applied where the tenant has breached his obligation to pay rent.

A provision almost identical to subsection 9(1) of the Nova Scotia Act, and a provision very similar to former subsection 9(3) of that Act, appear in *The Landlord and Tenant (Residential Tenancies) Act, 1973* of Newfoundland.⁴² However, since the Newfoundland Act has not been amended to include the application of a security deposit to a rent default, but, rather, is express in its restriction of the deposit to “damage to the residential premises,” it may be that the Act does not deal at all with — and, therefore, does not prohibit — security deposits for rent.

One noteworthy feature of both the Nova Scotia and Newfoundland provisions is the fact that they provide for the security deposit to be held in trust by the landlord. As will be recalled, the requirement to hold a payment in trust is characteristic of a true security deposit, as opposed to a mere payment of rent in advance.⁴³

The requirement of a landlord to hold a security deposit “as trustee for the tenant” also appears in subsection 96(1) of the Prince Edward Island *Landlord and Tenant Act*.⁴⁴ Indeed, a 1981 amendment to that Act went further, requiring that “[s]ecurity deposits provided under subsection (1) shall be maintained by the landlord in an account designated as a trust account . . . and shall be kept separate and apart from moneys belonging to the landlord.”⁴⁵ Again, the requirement of segregation is also characteristic of true security deposits.⁴⁶

Reference should now be made to legislation that does not mention security deposits for rent. Subsection 2(k) of the Saskatchewan *Residential Tenancies Act*⁴⁷ defines security deposit to mean, *inter alia*, “consideration, other than rent” to be held as security. To put the scope of section 2(k) beyond all uncertainty, section 38 provides for the following prohibition:

³⁹ S.N.S. 1970, c. 13.

⁴⁰ Emphasis added.

⁴¹ S.N.S. 1975, c. 64, s. 5(1).

⁴² S.N. 1973, No. 54, s. 18(1) and (3).

⁴³ See, *supra* note 24, and accompanying text.

⁴⁴ R.S.P.E.I. 1974, c. L-7.

⁴⁵ S.P.E.I. 1981, c. 19, s. 1(2), adding s. 96(1.1) to the Act.

⁴⁶ See text accompanying note 24, *supra*.

⁴⁷ R.S.S. 1978, c. R-22.

38. No landlord shall demand, receive or collect from a tenant of residential premises or from any person on behalf of a tenant an amount of money to be used by the landlord to pay rent to become due in the future.

While, at first blush, the section appears to preclude all types of prepayment, including security deposits for rent and advance payments of rent, the language of the section raises certain questions. For example, what does the phrase "become due" mean? In *Veltrusy*, the rent payable for each of the first eight months of the twelve month tenancy clearly could be said to be "due" at the beginning of each month. But, equally clearly, part of that rent included rent that would otherwise be payable, or "become due," in the future, that is, at the beginning of each of the last four months. However, this type of analysis would seem to render inoperative a provision like section 38: a landlord could simply provide in the lease that any rent earmarked in respect of future occupation of the premises is now due and owing. Presumably, the intention of the draftsman was to restrict some type of prepayment of rent or, more likely, to prohibit all types of prepayment; it is hardly credible to assume that a landlord could circumvent at least the spirit of the prohibition by stipulating that such prepayments are "due" immediately.⁴⁸

As in the case of Saskatchewan, legislation in Quebec does not mention security deposits for rent. Article 1665.2 of the Quebec *Civil Code* provides as follows:

1665.2 The lessor can only exact in advance payment of rent for one term or, if such term exceeds one month, the payment of one month's rent.

He cannot exact an amount of money other than the rent, in the form of a deposit or otherwise.

If the phrase "in advance" is used narrowly, in contradistinction to a security deposit — and, in this connection, note the use of the term "deposit" in the second paragraph — then the Quebec provision would seem to preclude the type of advance rental payments made in *Veltrusy*. Indeed, even if the above phrase is broadly defined to include any kind of prepayment, whatever its legal characterization, then presumably *Veltrusy* would have been decided differently in Quebec. Moreover, the provision would appear to prohibit a payment made on the execution of the lease for rent applicable to both the first and last month's rent (assuming that execution of the lease and commencement of the term were not coincidental).

Before considering the legislation in British Columbia, it bears mentioning that the above commentary on provincial landlord and tenant legislation does not purport to represent a full discussion of the ambit of the relevant prepayment provisions. For example, in some cases, the legislation has expressly restricted prepayments to an amount no greater than the equivalent of one month's rent,⁴⁹ or, unlike the Ontario Act, has imposed no limitation concerning the month to which the prepayment may be applied.⁵⁰ Consequently,

⁴⁸ However, it should be emphasized that many persons are of the opinion that Robson, Co. Ct. J.'s, decision in *Veltrusy* does just that — namely, that it violates the clear spirit and intent of s. 84(1) of the Ontario *Landlord and Tenant Act*.

⁴⁹ *Landlord and Tenant Act*, R.S.A. 1980, c. L-6, s. 37.

⁵⁰ *Id.* See also, *The Landlord and Tenant Act*, R.S.M. 1970, c. L70, as amended by S.M. 1970, c. 106, s. 3, adding, *inter alia*, s. 84(1) to the Act. However, as indicated above, the restriction in Ontario to the last month's rent is, in practice, honoured essentially in the breach.

certain kinds of prepayment of rent that may be valid in one Canadian jurisdiction may be invalid in another.

It should also be noted that where prepayment of rent by way of a security deposit is permitted,⁵¹ the legislation requires the landlord to pay interest on the sum deposited.⁵² This requirement to pay interest, as well as, for example, the requirement to hold the money in trust and to avoid commingling, are often said to be characteristics of true security deposits, rather than mere advance payments of rent.

The final legislation to which reference will be made is the British Columbia *Residential Tenancy Act*.⁵³ For the purpose of this discussion, the most relevant provisions read as follows:

1. In this Act,

“security deposit” means money or property advanced or deposited, or a right given, by or on behalf of a tenant or prospective tenant, to be held or enforced by or on behalf of a landlord

- (a) to secure the performance by a tenant or prospective tenant of an obligation under this Act or a tenancy agreement or in respect of residential premises;
- (b) to secure payment by a tenant or prospective tenant of a liability or probable liability to a landlord; or
- (c) to be returned to a tenant or prospective tenant, or in respect of which a tenant or prospective tenant is to be released, on the happening of an event,

and includes, without restricting the foregoing,

- (d) a negotiable instrument made negotiable more than 30 days after the date it is given;
- (e) a prepayment of rent for other than the first month of a tenancy agreement;
- (f) a deposit in respect of damage or rent for which a tenant is, or may be made to be, responsible;
- (g) an agreement entitling a right to be enforced if a tenant terminates a tenancy agreement or goes out of possession of residential premises other than in accordance with this Act or a tenancy agreement;
- (h) a fee or deposit that is not refundable; and
- (i) a requirement to pay a rental payment that is substantially greater than other rental payments required under a tenancy agreement;⁵⁴

31.-(1) A landlord shall not

- (a) impose a requirement that a security deposit be given except at the time the tenancy agreement is entered into; or
- (b) require or receive a security deposit in an amount exceeding the equivalent of 1/2 of one month's rent payable under the tenancy agreement, unless the rentalsman orders that it is proper in the circumstances that a greater amount be paid as a security deposit.

⁵¹ See discussion accompanying note 44, *supra*, with respect to the legislation in Saskatchewan.

⁵² A partial exception or variation is to be found in New Brunswick where the security deposit is administered by the rentalsman, who must place the money “in one or more interest bearing accounts” in a bank or trust company: see *The Residential Tenancies Act*, S.N.B. 1975, c. R-10.2, s. 8(15).

⁵³ R.S.B.C. 1979, c. 365, as am. by S.B.C. 1980, c. 48.

⁵⁴ See Lamont, *supra* note 23, at 26, referring to the law in Ontario:

A device by landlords to avoid the strictures applicable to security deposits for rent might be to simply require a larger sum of money for the first month's rent and thereafter a lesser regular sum each month. There seems to be no legal requirement that the rent has to be the same amount each month.

See also, Law Reform Commission of British Columbia, *supra* note 24, at 87.

Immediately prior to the 1980 amendment of clause (e) of the definition of "security deposit,"⁵⁵ it was provided that the term included "an advance payment of more than one month's rent." In other words, an advance payment of only one month's rent was not a security deposit under the Act and, accordingly, was exempt from the strictures pertaining to such deposits. Under the new provision, only the prepayment of the *first* month's rent is outside the ambit of section 31. Beyond such prepayment, a landlord may only take up to one half of one month's rent as a rent prepayment.

As noted earlier in respect of the meaning to be given to the term "in advance," it must be assumed that the common method of paying rent for residential premises — rent payable monthly or weekly at the commencement of each month or week — was not intended to be interfered with by the draftsman. Rather, the provision would appear to legitimize payment of the first month's rent prior to the commencement of the term. Assuming that this interpretation is correct, it is not unlikely that the *Veltrusy* case, where rent was payable on a monthly basis, would have been decided differently under the British Columbia Act. Even if the prepayment of the first month's rent would be valid, prepayment of the rent for any subsequent month would be invalid. Consequently, a landlord could not demand a payment in the first eight months that would comprehend the last four months as well. Moreover, where rent for a yearly tenancy is expressly stated to be payable monthly, it is arguable that the landlord could not demand one lump sum for the whole year.

However, what if the tenancy agreement provided for a term, for example, of one year, with rent not payable monthly but due and payable at the commencement of the term? That is, could the landlord claim that such payment is not "prepayment" at all, since it is actually all due at the beginning?

Of course, taken to this extreme, it would appear that the notion of "prepayment" of rent could be rendered meaningless. If the landlord merely has to define the rental period in its broadest terms and then state that the rent is due and payable at the commencement of the rental period in order to take it out of the realm of a "prepayment," then, arguably, the British Columbia legislation would prohibit nothing: a rent payment stated to be "due" would, by definition, never be a prepayment of rent.

If the statutory restrictions are to be given any real meaning, they must be taken to legitimize only one type of advance payment — other than the common one of payment on the first day of each week or month — that is, an advance payment, usually at the execution of the agreement, of the first month's rent. If this view is correct, then the legislation would seem to preclude, for example, tenancies from quarter to quarter and yearly tenancies where rent is payable in full at the beginning of the year. Such a departure from the present law and practice is, however, hardly self-evident. The British Columbia legislation, while more comprehensive than its Ontario counterpart, remains somewhat ambiguous, since it fails to distinguish the different ways in which payments "in advance" or "prepayments" may be interpreted.

The ambit of an earlier version of the British Columbia legislation was considered in *Regina v. Benetos*,⁵⁶ a decision cited and distinguished by Rob-

⁵⁵ S.B.C. 1980, c. 48, s. 1(d).

⁵⁶ *Supra* note 25.

son Co. Ct. J. in *Veltrusy*. The essential difference between the legislation considered in *Benetos* and the present British Columbia legislation is that, in place of what is now clause (e) of the definition of security deposit, reproduced above, the earlier clause provided that “an advance of more than 1/2 of 1 month’s rent” was a security deposit. In other words, a landlord could require an advance of one half of one month’s rent, to be applied to any portion of the tenancy.

In *Benetos*, the tenancy agreement — which provided for a month-to-month tenancy — acknowledged receipt from the tenants of \$675, “of which \$450.00 is a deposit to apply on the first month’s rent, \$225 as a rent payment to be applied on account of the rent for the final month of the above term” The agreement was executed, and the \$675 paid, on May 7, 1976, and the term was to commence June 1, 1976.

The sole issue revolved around the question whether the \$225 was a security deposit. It is not entirely clear why the issue was not framed in terms of the entire \$675, since, arguably, such a payment on May 7, prior to the first day of the term (June 1), was “an advance of more than 1/2 of 1 month’s rent” within the then existing clause (e). Again, the legitimacy of paying the first month’s rent in advance of the commencement of the term went unquestioned.

Farris C.J.B.C. with whom Robertson J.A. concurred, was of the view that the \$225 was not a security deposit. In the first place, reasoning in a manner akin to that of Robson Co. Ct. J. in *Veltrusy*, he stated that the money “was not given as a security” in case the tenant should default;⁵⁷ rather, it was to be the primary source of rent when due. Therefore, it did not fall within the first and more general part of the definition of security deposit. In the second place, he stated that, “[a]s it is not an advance payment of more than one-half of a month’s rent, it is not caught by the second part of the definition section.”⁵⁸

Bull J.A. dissented. He agreed with the lower court judge that the \$225, while not within the meaning of clause (e) of the definition — not being in excess of one half of one month’s rent — did come within the more general words defining security deposit. Unlike Farris C.J.B.C., Bull J.A. did not find that an advance payment falling within the general portion of the definition, but outside clause (e), would make that clause meaningless or redundant. Moreover, since the tenancy was a monthly one, Bull J.A. was of the view that “there could be no specific ‘final month’ of the tenancy known at the time of the payment on 7th May 1976, and hence there was no particular month upon which the payment was to be, or could be, applied.”⁵⁹ The tenant could pay rent for some month in the future and then abandon the premises. In this case, the last month of the tenancy would have been fully paid and, therefore, the \$225 held by the appellant would have to be returned or, alternatively, retained not as rent for the final month but on account of the obligation of the tenant to pay a month’s rent in lieu of notice. In other words, the sum would function as a true security deposit.

⁵⁷ *Id.* at 356.

⁵⁸ *Id.*

⁵⁹ *Id.* at 360-61.

Bull J.A. concluded, then, that the \$225 was in fact a security deposit, although he also decided that it was not prohibited under the then existing British Columbia legislation, since it was not in excess of one half of one month's rent. To repeat, the majority of the Court believed that the sum was not a security deposit at all.

In *Veltrusy*, Robson Co. Ct. J. distinguished the *Benetos* case as follows:⁶⁰

The report does not indicate whether there is a section [in the British Columbia legislation] similar to s. 84 of the Ontario statute. It was held that the payment agreed upon did not constitute a security deposit for 'damage or rent' but was an advance payment of part of the rent for the final month of the term, and since it was for not more than one half of the final month's rent it was not caught in the second part of the definition section.

In view of the difference in the definition, and more particularly in view of the fact that the Ontario statute does not refer to damage but clearly by s. 84, provides for the deposit being security for the last month's rent, *R. v. Benetos* does not, in my view, apply here.

However, it bears repeating that, in both *Veltrusy* and *Benetos*, it was in fact determined that the payment in question was not for the purpose of providing the landlord with "security." In both cases, a distinction was made between a true security deposit and an advance payment of rent.

Whatever one thinks of the two viewpoints expressed in *Benetos*, it is not difficult to justify the practical results of the majority's decision. As indicated earlier, it is common for an Ontario residential tenant to be required to pay the first month's rent at the time the tenancy agreement is entered into (normally prior to the first day of the term). Moreover, he will usually be required to pay a further sum as a so-called "security deposit" for the last month's rent.⁶¹ Again, this requirement is generally not seen as unjustifiable. *Benetos* would legitimize an analogous situation (only analogous because rent for the *whole* of the last month could not be required) under the then extant British Columbia legislation.

VI. THE NEED FOR REFORM

While it is clear that students are often singled out for different treatment by many landlords,⁶² the issues raised in *Veltrusy* go beyond the narrow confines of student leases, and include all types of payment in advance. Admittedly, few persons or classes of persons are required to pay (for few are able to pay) more than the last month, and frequently the first month, in advance. However, it must be borne in mind that, for example, quarterly tenancies do in fact exist, where payment is made at the beginning of each quarter. In some instances, too, yearly tenancies provide for a full year in advance, or one payment at the

⁶⁰ *Supra* note 5, at 352.

⁶¹ See the decision of the Appellate Division in *Re Abraham*, *supra* note 22. See also, *Re Champion Machine and Tool Co. Ltd.*, *supra* note 22, at 137.

⁶² In *Veltrusy*, Robson Co. Ct. J. noted that "this is a test case, there being a large number of 'student leases' which are drawn" in the manner in issue: see *supra* note 5, at 353.

outset and another at the end of six months.⁶³ Unless the sum so paid in advance constitutes "security" for the landlord, arguably it is valid. Moreover, few complaints have arisen in respect of these types of arrangement; certainly the Ontario Law Reform Commission did not note any fulminations in its 1968 *Interim Report*.⁶⁴

Legitimate questions may be asked as to whether remedial legislation ought to be adopted. If, for example, payment in advance of any more than the last month's or first month's rent is prohibited, who will suffer? Will landlords simply raise their rents (within, of course, the statutory limits) to make up what they perceive to be their anticipated losses when a certain proportion of defaulting students or other tenants leave after eight months? Will they offer eight month leases at a gross rental equal to what they might otherwise ask for a twelve month lease? Will they refuse to rent to students? Will they take their rental units out of the rental market? Will landlords be prejudiced more by any remedial legislation than any benefits provided to tenants? Will remedial legislation unjustifiably interfere with quarterly, half yearly, or yearly tenancies in respect of which there has been no plea for reform?

Let us assume that some type of remedial legislation is favoured. What form should it take? Several reform issues are examined below, ranging generally from what is expected to be the least controversial to the most controversial.

First, should legislation universally require payment "in arrears" and, therefore, preclude all types of payment of rent "in advance," broadly defined to mean payment at any time prior to the end of a rental period, and therefore including, for example, payment of each month's or each week's rent at the commencement of that month or week? It is presumed that no such blanket

⁶³ However, it must be said that, according to the Urban Development Institute and the Multiple Dwelling Standards Association, it is relatively rare for residential tenancies to be quarterly, half yearly, or yearly. Presumably, such tenancies are more likely to arise in the case of non-professional landlords and landlords of houses, duplexes, or triplexes.

⁶⁴ For the most part one is left, then, with student leases. But even here, the complaints are apparently not excessive. For example, the staff at the University of Toronto student housing service are unable to cite more than a few examples of cases in which landlords sought to require more than the last month's rent in advance. Nor have there been any complaints to the housing service from students in this regard. A similar response was obtained from York University.

However, the absence of any complaints may mask, at least to some degree, what may be, or may become, a real problem. The University of Toronto housing service staff have been advising landlords that they may exact no more than the last month's rent in advance. But if *Veltrusy* were good law, or even if the County Court decision were to become notorious, perhaps further attempts to require several months' payment in advance will be made (although the housing service at the University of Toronto stated that many landlords are beginning to offer eight month leases to students).

Moreover, there is no little justification for many of the complaints by landlords. Without attempting to tar all students with the same brush, it is clear that many landlords do suffer from students abandoning rented premises at the end of the school year. Their reaction is to protect themselves by means of advance payments of rent. The students involved in the *Veltrusy* litigation could have been placed in a worse position: for example, they could have been required to pay half yearly. Cold comfort, perhaps; but not irrelevant.

prohibition is necessary or desirable. For example, a landlord should continue to be permitted to require a tenant to pay rent for each month at the commencement of that month. It is not likely that this practice gives rise to any difficulties or injustice.

Second, should a landlord be permitted to require a tenant to pay the *first* month's rent prior to the commencement of the term (ordinarily, at the execution of the tenancy agreement)? Again, this is a common practice and does not seem to be unjustifiable. It should be noted that some jurisdictions permit security deposits to be exacted only at the time the agreement is executed.⁶⁵

In this connection, reference should be made to subsection 9(2) of the Ontario *Residential Tenancies Act*,⁶⁶ which provides as follows: "Subject to subsection (3) [dealing with the situation where there has been a "lawful rent increase"], a rent deposit may be required only at the commencement of the tenancy." The language is clearly inapt and, therefore, should be clarified, for such deposits are not normally exacted "at the commencement" (that is, on the first day) of a tenancy; rather, they are usually paid when the tenancy agreement is executed.

Third, should a landlord be permitted to require a tenant to pay the *last* month's rent prior to the commencement of the term (again, ordinarily, at the execution of the tenancy agreement)? At present, this type of prepayment is lawful in Ontario: either the last month's rent is a "security deposit," and permitted under section 84(1) of the *Landlord and Tenant Act*,⁶⁷ or it is an advance payment, not by way of security, and therefore not prohibited by the statute.

Fourth, leaving aside the issues concerning the prepayment of the first or last month's rent, or both, should it be unlawful for a landlord to require a tenant to pay rent "in advance" in any other case? Having regard to *Veltrusy*, does the existence of "student leases" warrant legislative intervention in this manner, bearing in mind the arguments of landlords and the possible consequences in the marketplace of remedial action? It appears that, in order to correct *Veltrusy* and eliminate, as much as possible, discrimination against students, without creating new sources of discrimination, it may well be necessary to intervene in other areas where, arguably, there can be no legitimate cause for concern. More specifically, it may be necessary to prohibit quarterly, half yearly, and yearly rent payments in order to rectify the situation in *Veltrusy*, for to countenance exceptions to a general prohibitory provision for such payments would seem to give students scant relief.

Fifth, in view of the fact that the real problem made manifest in *Veltrusy* and addressed in this Note appears to have been inaccurately perceived in the past, should legislation in Ontario expressly prohibit all security deposits, properly so called? A prohibition of this kind would still leave it open for a landlord to demand an "advance" rental payment. For example, a prepayment of the last month's rent would continue to be permissible, but the sum so paid would have to be applied directly to the rent payable for the last month,

⁶⁵ See, e.g., s. 31(1)(a) of the British Columbia *Residential Tenancy Act*, R.S.B.C. 1979, c. 365 as am. by S.B.C. 1980, c. 48, reproduced above.

⁶⁶ R.S.O. 1980, c. 452.

⁶⁷ R.S.O. 1980, c. 232.

whenever it should occur; it could not be held solely as security. This type of prepayment of the last month's rent is common and reasonable, notwithstanding its legal characterization in the legislation as a security deposit. As far as the landlord is concerned, it is not really necessary to protect himself in respect of a default in the payment of rent by demanding "security" as such.

Moreover, true security deposits for any obligation or liability other than the payment of rent have already been abolished in this jurisdiction. Prepayment of money as security in respect of these other obligations or liabilities was indeed meaningful: for example, a landlord would look to the damage security deposit for compensation if the tenant caused damage to the rented premises. But the real focus of attention now (indeed, the sole focus of attention) is on the legitimacy of certain kinds of prepayment of rent, concerning which a true security deposit is far less critical. As noted above, landlords simply apply the so-called security deposits directly to the rent payable for the last month.

In short, with respect to payment of the last month's rent, and having regard only to existing practice, it is misleading to continue to speak in terms of security deposits. The legislation is designed essentially (albeit, in part, unsuccessfully) to deal with payment of rent in advance, and the parties to a tenancy agreement now regard the payment in this way.

Notwithstanding the similarity, at least as a practical matter, between true security deposits and payments of rent in advance, and despite the almost universal belief that the sum paid as a security deposit for the last month's rent is to be applied directly to such rent, there does remain a clear legal difference between the two types of payment. And the difference may become important where the issue of title to the money is in issue (as upon the landlord's bankruptcy).⁶⁸ If the sum is a true security deposit and held in trust for the tenant,⁶⁹ legal title to the money will be quite different than where absolute ownership is vested in the landlord immediately upon payment. For example, under section 47(a) of the *Bankruptcy Act*,⁷⁰ it is provided that "[t]he property of a bankrupt divisible among his creditors shall not comprise . . . (a) property held by the bankrupt in trust for any other person . . ."⁷¹ Nor are execution creditors able to seize and sell property held in trust by an execution debtor or by his estate upon his death.⁷²

It may well be that we have been too zealous in our concern to rid Ontario of security deposits. What, indeed, would be the purpose in prohibiting true security deposits for the last month's rent? Would any evil befall landlords or tenants if both security deposits and prepayments of rent were permissible, at least for the last month's rent? Again, it bears emphasizing that the central

⁶⁸ See, *supra* note 25, and accompanying text.

⁶⁹ See, *supra* note 22, and accompanying text.

⁷⁰ R.S.C. 1970, c. B-3.

⁷¹ With respect to the issue whether the property held in trust must be traceable and capable of being identified, see, for example, *Ogilvie Flour Mills v. Canadian Credit Men's Trust Assoc.*, [1925] 4 D.L.R. 969, 7 C.B.R. 31 (Sask. C.A.); *Re Standard Imports Ltd.*; *Ex parte Can. Express Co.* (1922), 68 D.L.R. 396, 2 C.B.R. 206 (Que. Sup. Ct. in Bank.); *Re C.A. MacDonald & Co. Ltd.* (1958), 17 D.L.R. (2d) 416, 37 C.B.R. 119 (Alta. S.C. in Bank.); *Re Algo Sunderland Ltd.* (1962), 3 C.B.R. (N.S.) 245 (S.C.O. in Bank.); and *Re Hartney Co. (1959) Ltd. and Freed* (1962), 4 C.B.R. (N.S.) 71 (Que. Sup. Ct. in Bank.). See also, the observations of Waters, *supra* note 25.

⁷² See, generally, Waters, *supra* note 25, at 64-65.

concern of the Ontario Law Reform Commission and the legislative draftsman in 1968 was to preclude *damage* deposits and to restrict rent deposits to the last month's rent.

Perhaps an entirely new approach is called for; an approach combining more satisfactorily than the present legislation some of the features of true security deposits and advance payments of rent. For example, one might envisage the validity of a prepayment of the equivalent of one month's rent, to be applied directly to the last month of the term. Such a prepayment would be deemed by statute to be held in trust by the landlord for the tenant. Careful consideration could be given to a requirement to keep the prepayment in a separate account, to preclude (or attempt to preclude) commingling to the prejudice of the tenant. However, in this latter connection, it must be recognized that a significant number of landlords would not in fact keep the prepayment separate and apart from other funds, and that some administrative inconvenience to landlords might well be caused (although this ought not to be exaggerated). On balance, the characterization of a prepayment as money held in trust for the tenant would not seem to be an unsatisfactory or unworkable compromise. It would at least provide some additional protection for tenants without unduly upsetting the ordinary commercial expectations of residential landlords.

VII. CONCLUSION

It is apparent that the precise legal characterization of money paid for the right to occupy rented premises depends, at least in part, on the draftsman's ingenuity — or lack of sophistication. By means of imaginative drafting, what looks very much like an illegal security deposit may be converted into a respectable prepayment of rent.⁷³

To the extent that residential landlords apply the money directly to the last month's rent rather than hold the money as security lest the tenant default (and the former practice is the usual one⁷⁴) the attempt to determine whether a particular payment is properly described as a true security deposit or merely a payment of rent in advance may well seem to lead to artificial distinctions and rather arid arguments. As a practical matter, in most cases there seems to be no real functional distinction between the two types of payment for either the tenant or the landlord.

The fundamental purposes of both security deposits and payments in advance are clear and simple: they are designed to ensure payment of the rent and avoid the necessity of a long, expensive, and often fruitless lawsuit for arrears of rent. In this sense, then, both kinds of payment provide what may loosely

⁷³ See Wilson, *supra* note 23, at 441 (footnote reference deleted):

[I]t may be provided that the initial payment including the security shall be paid immediately, with the remainder of the rent to be paid at a set sum per month thereafter until the entire amount reserved is paid, leaving a few months during the latter part of the term when no rent will be payable. This latter method . . . would seem more likely to pass the scrutiny of a court without being denounced as an attempt to cover up a security payment under the guise of an advance rental.

⁷⁴ Moreover, it would appear that the draftsman of s. 84 of the *Landlord and Tenant Act*, R.S.O. 1980, c. 232, envisaged precisely this application of the sum so paid, although, as we have seen, this putative intent is reflected only obliquely and unsatisfactorily in the legislation.

be called security to a landlord; and both kinds of payments demand the same initial financial outlay by a tenant.

Whatever the Ontario Law Reform Commission had in mind in 1968 in respect of "advance" rental payments, the implementing legislation effected an unhappy marriage between true security deposits and mere advance payments of rent. As indicated, it is not at all helpful — indeed, it is misleading and confusing — to characterize the real issue as one involving the merits and demerits of various kinds of security deposit.

But the issue is not simply one involving a need for conceptual clarification (although obviously one ought not to eschew the pursuit of that goal for its own sake). We have seen that the rights of landlords, tenants, and, for example, their creditors, may be vitally affected by the legal characterization of rent paid in advance. *Veltrusy* itself bears witness to a problem in the existing law, for it is certainly not self-evident to many people that the spirit of the Ontario Law Reform Commission's proposals and of the implementing legislation is reflected in that decision.

However, the necessity for clarification or an antipathy towards *Veltrusy* does not necessarily or automatically make us wiser as to what direction, if any, a statutory amendment ought to take. Leaving aside "student leases," is there any real need for substantive reform? Are there abuses arising from subsection 84(1) that could be corrected by clearer language? Should the common practice of prepaying the first month's rent prior to the commencement of the tenancy be given express acknowledgement in the legislation, or should we continue to turn a blind eye to this violation of subsection 84(1)? Should true security deposits, whether or not restricted to the last month's rent, be expressly reintroduced into Ontario, perhaps as much for tenants as for landlords? Indeed, as has been suggested, should legislation go even further: should all prepayments of rent be deemed to be held in trust by landlords for tenants, and perhaps even held in a separate account? Or, despite their apparent utility, have true security deposits, or at least certain of their features, simply become anathema, pariahs in the world of landlord and tenant, accursed relics of an *ancien régime*?