

Nonpayment of Taxes as Tortious Waste in Nonrecourse Mortgage Loans

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I. INTRODUCTION

The trend in recent case law has been to blur the distinction between “intentional” (or “active”) waste and “permissive” (or “passive”) waste of mortgaged property, and to hold that in addition to physical waste, “economic” waste -- i.e., the failure to pay taxes or the diversion of misapplication of rents -- may be actionable as a violation of the mortgagor’s contractual covenant in the mortgage not to commit waste or impair the value of the secured property.¹ Some courts have even found the mortgagor personally liable under a tort theory of “bad faith” waste, in those situations where the loan documents contractually exculpate the mortgagor from personal liability for any default.² Also, at least one court has held that the mortgagor’s deliberate failure to pay taxes on a nonrecourse loan from available property income would permit an action by the mortgagee, under the state’s fraudulent conveyance statute, to set aside a distribution of cash to the mortgagor’s partners as a waste of the mortgage security.³ However, the courts are not willing to expand the definition and scope of actionable waste to permit recovery by the mortgagee for failure to pay real estate taxes where the mortgagee has acquired the property by credit-bidding the full amount of the debt at a foreclosure sale.⁴

II. THE CALIFORNIA AND NEW YORK RESPONSE TO THE BORROWER’S FAILURE TO PAY TAXES

A. Punitive Damages for Waste in a Nonrecourse Loan

In *Nippon Credit Bank, Ltd. v. 1333 North California Boulevard*,⁵ the California Appellate Court upheld a jury verdict that found the defendant-mortgagor, 1333 North California Boulevard, a California limited partnership (“Partnership”) guilty of bad-faith waste for failure to pay real estate taxes while the nonrecourse mortgage loan it had obtained from Nippon Credit Bank (“Bank”) was delinquent. The Partnership borrowed \$73 million from the Bank in 1989 to refinance a \$55 million construction loan. By the end of 1994, things were not going well at the property because of the severe real estate recession (the Partnership had obtained appraisals indicating that the value of the property had decreased to \$52 million from \$13 million in 1989), and the Partnership decided not to pay the \$358,000 property tax installment due on December 12. The Partnership’s general partner, Sanford Diller (“Diller”), met with the Bank’s representatives in an attempt to negotiate a workout of the loan. However, no agreement was ever reached other than the execution of a “pre-workout” agreement, which stated that absent a “global” workout no preliminary agreements or concessions would be binding.

Diller admitted that cash flow from the property was sufficient to make the tax payment and that, on the due date of the tax payment, the Partnership had made a \$683,000 payment to a family trust that was an equity participant in the Partnership in order to reduce the trust's equity investment in the Partnership. Although denying that he deliberately avoided paying the taxes to gain leverage with the Bank in connection with a workout of the loan, Diller stated that he did not believe that the Bank was being fair in the restructuring negotiations and that he wanted the Bank to "share the pain" -- although he admitted that the Bank had no legal obligation to agree to his suggested adjustment of the scheduled variable-rate interest payments. As a result of the default, the Bank exercised its assignment of rents in February 1995 and used the rents it collected to pay the delinquent property taxes (which, with interest and penalties, totaled \$394,713) in April 1995. The trial court jury awarded this amount to the Bank as compensatory damages for bad faith waste by the Partnership, and also -- astonishingly -- awarded the Bank \$8,333,333.33 in punitive damages as the result of its finding that the Partnership's failure to pay the taxes was done with malice and intention to harm the Bank. The Partnership appealed the jury's verdict, arguing that at most there was only a breach of contract that could not be converted into a tort, and asserting that because the loan was nonrecourse that the Bank's sole remedy was to foreclose its mortgage against the property. The Partnership also argued that the impairment of the Bank's security was insubstantial and that, because the Bank had added the amount of its tax-payment advance to the mortgage indebtedness and conducted a trustee's sale to satisfy the debt, its action to separately recover the tax advance was precluded by California's one-action and anti-deficiency rules.

The appellate court first rejected the Partnership's argument that, under California law, its failure to pay the property tax installment could not constitute an act of "bad faith waste." According to the appellate court, liability for failure to pay taxes "redresses the kind of harm the tort of waste was originally designed to remedy."⁶ The appellate court stated that, historically, "[t]he waste doctrine was developed to mediate between the competing interests of life tenants and remaindermen,"⁷ and noted that "[t]he prospect of tort liability may deter the borrower from thus behaving 'like a life tenant with very little time left to live.'"⁸ The court referred to two cases, *Cornelison v. Kornbluth*,⁹ and *Osuna v. Albertson*,¹⁰ as establishing the "bad faith waste" cause of action in California.¹¹ The appellate court further noted that the court in *Cornelison* stated "that the common law action for waste was partially codified in Civil Code section 2929, which provides that 'no person whose interest is subject to the lien of a mortgage may do any act which will substantially impair the mortgagee's security.'"¹²

The *Nippon* court stated that "milking" of the mortgaged property "has been recognized as a form of bad-faith waste within the meaning of *Cornelison*."¹³ The *Nippon* court found that the trial court had justifiably determined that the Partnership was "milking" the property, because Diller had caused the Partnership to pay his own family trust nearly twice the amount of the unpaid tax installment on the exact day that the taxes were due, and because the trust had received \$1.7 million from the Partnership while the taxes remained delinquent. The court noted that Diller's claim that he lost money on the

project was contradicted by the fact that at the time the Bank made the refinancing loan, the Partnership received \$10 million of the proceeds. Furthermore, the court noted, the property had operated successfully for a number of years and various Diller entities were paid construction and management fees. Based on these facts and the California Supreme Court's holding in *Cornelison*, the *Nippon* court held that "a trier of fact could find the missed tax payment qualified as 'milking' in this instance."¹⁴ In the *Nippon* court's view, failure to pay taxes could be justifiable only in "exigent circumstances," such as "where a choice might be made between paying the taxes and making loan payments or necessary repairs," in which event "a tax default might merely rearrange the lender's loss without increasing it."¹⁵ But in this case the court found that there were no such circumstances; i.e., the property was not in "dire straits" and generated sufficient revenue to make the required tax payment.

The appellate court further ruled that the "bad faith" standard for liability in connection with a nonrecourse loan under the *Cornelison* test had been met in this case because the lender had suffered losses that would not have occurred if the mortgage note was a recourse obligation (i.e., Diller's decision not to pay the taxes was made only because he believed that he would have no personal liability for his failure to do so). The appellate court found that the Partnership's bad faith had been conclusively established because "[b]orrowers cannot plausibly claim that the Partnership would not have paid the property taxes even if Diller and his partners had been personally liable on Bank's loan."¹⁶

The *Nippon* court noted that even though the court in *Cornelison* did not specifically mention nonpayment of taxes in its analysis of the waste claim, the plaintiff argued that "the defendant had duties apart from the contract to pay taxes on the property as well as maintain it."¹⁷ The *Nippon* court then surveyed decisions from other jurisdictions on this issue¹⁸ and, while acknowledging that there is a split of authority among the states, noted that commentators "have observed that the courts are becoming more willing to hold borrowers who fail to pay real estate property taxes liable for waste notwithstanding nonrecourse provisions of their loans."¹⁹

The Partnership argued that the trial court's ruling had impermissibly converted a contract action into a tort claim. In response, the *Nippon* court stated that the tort action codified in California Civil Code section 2929 protects lenders "from 'any act which will substantially impair' their real property security. That prohibition can properly be extended to nonpayment of real property taxes regardless of whether the omission also creates tax or contract liability."²⁰ The court ruled that total loss of the mortgagee's security is not required; rather, actionable waste will have occurred if the impairment is "substantial." The court further ruled that the impairment of the Bank's collateral was substantial even though the dollar amount of the unpaid taxes was small compared to the outstanding loan balance. According to the court, "[g]iven the duty to mitigate damages (citation omitted), the lender should not be made to wait for the tax lien to mushroom with multiple unpaid installments, and should not be penalized for promptly curing a tax default."²¹

The *Nippon* court also rejected the Partnership’s argument that the Bank had violated California’s one-action rule, finding that this argument had not been timely raised and was unsupported by the trial court record. The court ruled that, in any event, this argument would be unavailing to the Partnership because the Bank had bid in less than the full amount of its debt at the foreclosure sale, thereby creating a deficiency. The court stated that where, as in this case, the creditor’s “security has been impaired . . . he may recover damages for waste in an amount not exceeding the difference between the amount of his bid and the full amount of the outstanding indebtedness immediately prior to the foreclosure sale.”²²

Finally, the *Nippon* court addressed the Partnership’s argument that the jury’s award of punitive damages was unprecedented and unwarranted. The court first noted that the Partnership had a legal duty to pay taxes under tort law, separate from its contractual duty to pay taxes under the mortgage. The court stated that “borrowers’ right to retain funds from the Project rather than turning the money over to the Bank did not give them a license to commit waste.”²³ The court further found that, based on testimony and evidence indicating that Diller would have paid the taxes if the Bank had agreed to his requested loan concessions, and that the Partnership had the ability to pay the taxes, the jury was justified in inferring that payment of the tax was withheld solely to “punish” the Bank. The court determined that this inference by the jury was sufficient to support a finding of malice and an award of punitive damages against the Partnership. As the court succinctly stated, “Exposure to punitive damages may be as much a deterrent to bad faith waste as to any other tort.”²⁴

B. Deliberate Nonpayment of Taxes as a Fraudulent Transfer

The *Nippon* court favorably cited, and discussed in detail, the Second Circuit’s holding in *Travelers Ins. Co. v. 633 Third Associates*.²⁵ This case held that the mortgagor’s failure to pay property taxes could give rise to an action for waste in connection with a nonrecourse loan. The *Nippon* court stated that “the situation here cannot be distinguished from the one in *Travelers*, where the partnership borrower was found subject to waste liability for neglecting to make a tax payment and then distributing millions of dollars to its partners.”²⁶

Travelers was a landmark decision involving a suit by The Travelers Insurance Company (“Travelers”) to set aside a \$4 million distribution from a single-asset limited-partnership borrower to the borrower’s partners as a fraudulent conveyance. The distribution was made at the time that a \$3.8 million real estate tax bill was due on a forty-one-story office building in New York City, which was the security for Travelers’ mortgage loan. The \$145 million loan was secured by a nonrecourse mortgage on the property. The legal issue was whether Traveler’s standing under New York’s fraudulent conveyance law permitted it to bring an action against the partnership borrower and the individual partners insofar as such a distribution constituted a waste of its collateral.

Travelers argued that New York law should recognize the failure to pay taxes as waste, which creates a viable substantive cause of action for a nonrecourse secured lender

against its borrower. Travelers also argued that nonpayment of the taxes, rather than causing or contributing to physical deterioration of the real estate collateral, economically impaired Travelers' collateral and constituted waste remediable by an action in equity. The Second Circuit ruled in favor of Travelers, finding that the borrower's failure to pay taxes from available property income decreased the value of Travelers' secured collateral and was similar in effect to physical injury to the collateral suffered in a traditional action for waste. The court further held that Travelers had standing to challenge the pre-receivership distribution of cash by the partnership to the borrower's individual partners under New York's fraudulent conveyance statute.²⁷

The Second Circuit stated that the doctrine of waste "corrects incentives on the part of a mortgagor who anticipates default to deplete the collateral as much as possible before defaulting."²⁸ The court described the mortgagee's interest in the property as a "contingent interest" and stated that the mortgagee is "entitled to have his mortgage security unimpaired by the acts of the mortgagor."²⁹ Although acknowledging that New York law is unclear as to whether the willful failure to pay taxes is actionable waste, the court determined that "an equitable action for waste would lie under New York law for the intentional failure to pay property taxes where there is an obligation to do so or the failure is intentional or fraudulent."³⁰ The court noted that, under this test, the failure to pay principal and interest would not impair the mortgage, whereas the failure to pay taxes would do so because of the resultant lien attaching against the property.

The Second Circuit also determined that "[t]he fact that the Receiver has been granted permission to pay taxes plus interest which accrued prior to the receivership, does not moot Travelers' claim of waste."³¹ According to the court, "[s]ince the value of the property is dependent, in part, upon the stream of income it can generate, the fact that the taxes had to be paid from rental income suggests that the distribution of the Partnership's accumulated cash assets and the Partnership's subsequent failure to pay taxes decreased the value of the property."³² However, the court dismissed Travelers' claim of waste related to conduct that occurred after the appointment of the receiver, finding that an action will only lie for waste committed while the mortgagor is in possession of the property.³³

Finally, the Second Circuit rejected the borrower's argument that its liability for the taxes should be pro-rated for the period of its possession. The court ruled that because the assessment for property taxes due for the period from January 1, 1992 to June 30, 1992 became due and payable in full on January 1, 1992 (before appointment of the receiver) and became a lien against the property on that date, the mortgage security became impaired by that entire amount and the borrower was obligated for this full amount (with credit for a partial payment by the borrower of \$426,000 of the taxes due for the applicable period).³⁴

This case is significant not only for the ruling on the substantive waste issue, but, perhaps more important, for the court's decision that a commercial lender, secured by a traditional nonrecourse loan, could maintain an equitable action against a borrower for misapplication of rental proceeds. The recent trend in case law is to permit an action for

waste against the borrower, at least under certain circumstances, even when the mortgage documents contain nonrecourse language.³⁵

III. ACTIONS FOR WASTE WHERE FULL DEBT IS BID

Notwithstanding the trend of case law in recent years to permit mortgagees to pursue contractual or tort actions against mortgagors for waste based on the nonpayment of real estate taxes from property income, the courts have consistently refused to allow such actions where the mortgagee has credit-bid the full amount of the mortgage debt at a foreclosure sale. In these situations, the courts have held that the mortgagee has made an election of remedies and has failed to demonstrate impairment of or damage to the security.

For example, in *Beneficial Homeowner's Services Corp. v. Breuer*,³⁶ the New York court held that the mortgagee, which had foreclosed upon the mortgage and was barred by the mortgagor's bankruptcy discharge from obtaining a deficiency judgement, was prohibited from pursuing an action in waste against the mortgagor for diminution in the value of the property. The court noted that the mortgagee would normally be permitted to sue in waste for damages resulting in diminution in the value of the collateral.³⁷ However, the court held that once the mortgagee had purchased the property at the foreclosure sale the mortgage debt was extinguished, and the mortgagee had no claim for damage to the collateral alleged to have occurred during the period between the mortgagor's bankruptcy discharge and the mortgagee's commencement of the foreclosure action. The mortgagee would, the court said, be treated as any other purchaser buying property in "as is" condition. The court also noted that the mortgagee had failed to exercise its rights under the mortgage to prevent damage to the property.³⁸

IV. CASES HOLDING THAT FAILURE TO PAY TAXES IS NOT WASTE

In contrast to *Nippon* and *Travelers*, several courts have held that, under the particular facts presented, the failure to pay property taxes did not constitute actionable waste. These cases can, for the most part, be distinguished from *Nippon* and *Travelers* because they involve situations where there is no allegation of fraud or deliberate misconduct, and no proof of the borrower's intent to "milk" the property. For example, in *Bank of America Illinois v. 203 N. LaSalle N. LaSalle Street Partnership*,³⁹ the bankruptcy court acknowledged that "[c]ourts have found that nonpayment of taxes constitute[s] waste where such payment is continuous and resulted in repayment of such taxes by the principal creditor," but held that that in this case there was no continuous practice of nonpayment of real estate taxes by the debtor and no indication of a general course of conduct prejudicial to creditors; the court further found that neither the mortgagee or the property were injured in any way by the delay in payment.

In *FGH Realty Credit Corp. v. Bonati*,⁴⁰ the New York appellate court held that although banks, as holders of escrowed funds designated for the payment of real estate taxes, could be held liable for breach of fiduciary duty for failure to pay the taxes, a non-escrow holding mortgagor who fails to pay real estate taxes does not thereby commit fraud within the nonrecourse provision in the mortgage. The court distinguished

Travelers, finding that there was no evidence of fraud in this case that would support a claim of waste of the property.⁴¹

V. NONRECOURSE CARVEOUT FOR FAILURE TO PAY TAXES

In an attempt to prevent the mortgagor from diverting property income to pay its equity holders in a nonrecourse loan, most commercial mortgage loan documents now contain a “carveout” stating that certain actions of the mortgagor, including the failure to apply rents to the maintenance of the property and servicing of the debt and the failure to pay real estate taxes when due, constitute actionable waste of the mortgage security notwithstanding the nonrecourse nature of the mortgagor’s liability.⁴²

Although the insertion of such contractual carveouts in the loan documents may have no direct bearing on a subsequent claim for tortious waste of the property based on nonpayment of taxes (as opposed to an action for breach of contract), the reason that mortgage lenders resort to tort theories in nonrecourse loans (where no contractual remedy may be available) is to force payment of the taxes that otherwise would have been paid from the property’s revenue. The mortgagee’s goal is generally not to “punish” the mortgagor, or risk aggravating courts of equity where the mortgagor has not engaged in any “bad acts.” A recourse carveout for nonpayment of taxes has a powerful prophylactic effect -- rarely is there litigation involving a mortgagor’s failure to pay taxes where the mortgage makes the mortgagor personally liable for such nonpayment -- and will, along with such cases as *Nippon* and *Travelers*, undoubtedly have a “chilling” effect on mortgagors who may contemplate willfully failing to pay property taxes in order to divert funds to equity holders or attempt to obtain leverage to force a loan workout.

VI. CONCLUSION

Recent case law suggests that the failure to pay taxes (and the diversion or misapplication of rents) may be actionable as “bad faith” waste under a tort theory of liability, even if the loan is nonrecourse. The mortgagee may be entitled, at least in certain jurisdictions, to an action for recovery of amounts actually diverted or misapplied by the mortgagor by claiming that a fraudulent conveyance or transfer has occurred under state fraudulent transfer (or federal bankruptcy) law, or that the mortgagor has committed an actionable tort, regardless of the nonrecourse language in the loan documents. However, as noted above, the theories utilized successfully by the mortgagees in *Nippon* and *Travelers*, have not been universally adopted by other courts, at least where there is no evidence of fraud or intentional violation of the loan documents. Also, the courts are not likely to permit the mortgagee to pursue an action for waste where it has credit-bid the amount of the outstanding debt at a foreclosure sale and taken title to the property. Finally, it is not at all clear that other courts will follow the groundbreaking precedent set by the court in *Nippon*, and permit a mortgagee to recover punitive damages against a mortgagor where “bad faith malice” can be demonstrated to the court’s (or jury’s) satisfaction.

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Endnotes

¹ In *Prudential Ins. Co. v. Spencer's Kenosha Bowl, Inc.*, 404 N.W. 2d 109, 113 (Wis. App. 1987) [hereinafter *Prudential*], the court stated that "the modern definition of waste is broad enough to include both active and passive waste." The court also stated that "[p]assive or permissive waste results from negligence or omission to that which would prevent injury " and that "[a]ctive or voluntary waste requires an affirmative act which results in the destruction or alteration of property." *Id.* at 112. See also Gregory M. Stein, *The Scope of the Borrower's Liability in a Nonrecourse Real Estate Loan*, 55 WASH. & LEE L. REV. 1207, 1210 (1998) [hereinafter *Stein*].

² This was the result in *Nippon Credit Bank, Ltd. v. 1333 North California Boulevard*, 86 Cal. App. 4th 486, (2001) [hereinafter *Nippon*], and *Travelers Ins. Co. v. 633 Third Associates*, 14 F.3d 114 (2nd Cir. 1994) [hereinafter *Travelers*]. In each of these cases, a single-asset limited partnership made a cash distribution to its partners while real estate taxes due on the mortgaged property remained unpaid. The court in each case ruled that the mortgagor's failure to pay the taxes constituted actionable "bad faith" waste of the collateral, which created an equitable remedy entitling each mortgagee to recover the distribution payments -- even though each of the mortgage loans was nonrecourse. Each mortgagee successfully argued that the mortgagor's distribution of cash to its partners while real estate taxes were unpaid substantially impaired the mortgage security and entitled it to recover the amount of the tax advance -- and, in the *Nippon* case, also to receive a significant punitive-damages award.

³ See *Travelers*, *supra* note 2, at 126.

⁴ See *infra* note 38 and accompanying text.

⁵ *Supra* note 2.

⁶ *Id.* at 496.

⁷ *Id.* at 497.

⁸ *Id.* (quoting *Stein*, *supra* note 1 at 1241 n. 87).

⁹ 15 Cal.3d 590 (1975) [hereinafter *Cornelison*].

¹⁰ 134 Cal. App. 3d 71 (1982) [hereinafter *Osuna*].

¹¹ The court in *Cornelison* held that the policy behind California's anti-deficiency legislation bars post-foreclosure waste actions unless the plaintiff proves "bad faith" waste based on "reckless, intentional or malicious despoliation of property." *Cornelison*, *supra* note 9, at 590-92. The court in *Osuna*, *supra* note 10, permitted an action for waste for nonpayment of taxes in connection with a tax foreclosure.

¹² *Nippon*, *supra* note 2 at 494 (quoting *Cornelison*, *supra* note 9, at 597).

¹³ *Id.* at 497.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.* The court noted that nonrecourse borrowers have a "special responsibility" to protect property that they have pledged as sole security for the debt, and stated that "there are circumstances where a nonrecourse borrower should be liable for waste, including failure to pay real property taxes (quoting *Stein*, *supra* note 1, at 1245). *Id.* at 496.

¹⁷ *Id.* at 494-95.

¹⁸ Several Illinois federal and state court decisions have held that a mortgagor's failure to pay real estate taxes can constitute actionable waste. See, e.g. *Capital Bankers Life Ins. Co. v. Amalgamated Trust & Sav. Bank*, 1993 WL 594103, at *5 (Bankr., N.D. Ill., May 6, 1993), *aff'd* 16 F.3d 1225 (7th Cir. 1994) (tabled opinion) (finding that under Illinois law failure to pay real estate taxes is an act of waste and awarding summary judgment on mortgagee's recourse liability action against owners of property); *North American Security Life Ins. Co. v. Harris Trust & Sav. Bank*, 859 F.Supp. 1163, 1165-66 (N.D. Ill. 1994) (holding that "waste" under Illinois law includes nonpayment of real estate taxes by mortgagor); *Hausman v. Hausman*, 596 N.E. 2d 216, 220 (Ill. App. 1992) ("failure to pay real estate taxes on a life estate by the life tenant may give rise to a cause of action in waste"); *Pasulka v. Koob*, 524 N.E.2d 1227, 1239 (Ill. App. 1988) ("[w]aste occurs when someone who lawfully has possession of real estate destroys it, misuses it,

alters it or neglects it so that the interest of persons having a subsequent right to possession is prejudiced in some way or there is a diminution in the value of the land wasted”).

¹⁹ *Nippon*, *supra* note 2, at 495 (citing *Stein*, *supra* note 1, at 1210).

²⁰ *Id.* at 499.

²¹ *Id.* at 501. The *Nippon* court noted that “[t]he Restatement Third of Property, Mortgages, section 4.6, subdivision (a), page 262, lists as a form of waste, along with physical alteration or neglect of mortgaged property, a mortgagor’s failure to pay property taxes secured by a lien with priority over the mortgage.” *Id.* at 496. The RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES (1997) [hereinafter *Restatement*] provides, at § 4.6(a)(3), that waste occurs when the mortgagor “fails to pay before delinquency property taxes or governmental assessments secured by a lien having priority over the mortgage.” Section 4.6(b)(1) provides that foreclosure is a proper remedy for the mortgagor’s commission of waste only “if the waste has impaired the mortgagee’s security.” Comment b. to § 4.6 states that “[w]aste encompasses default on senior tax and assessment liens. The mortgagee has a reasonable and legitimate expectation that the mortgagor will not place a governmental entity in a position to destroy the mortgage.” Comment d. to § 4.6 states that when a mortgagee has a contractual right to the rents from the secured real estate and a default has occurred under the loan documents, “the mortgagor or any other person who intercepts the rents and fails to deliver them to the mortgagee has committed waste. This principle may assume great importance in a case in which the mortgagor is not personally liable on the debt, for such a person may still be liable for waste.” The *Restatement* comments suggest that waste occurs only when the nonpayment of real estate taxes results (or could result) in the imposition of a lien that primes the mortgage. However, courts that have decided this issue generally base their holdings on whether the failure to pay taxes constitutes waste or impairment of the collateral -- especially where the mortgagor’s fraudulent intent has been established and it has diverted property income available for payment of the taxes and distributed it to the mortgagor’s equity holders -- as opposed to focusing exclusively on whether a default on a senior tax lien has occurred or may occur. *See, e.g., McNeese v. Hutchinson*, 724 So.2d 451 (Miss. App. 1998) (rejecting *Restatement* test and holding that mortgagee claiming waste must demonstrate that fair market value of property has declined from date of mortgage conveyance as result of actions of mortgagor); *Band Realty Co. v. North Brewster, Inc.*, 59 A.D. 2d 770, 771 (N.Y. App. Div. 2d Dep’t 1977) [hereinafter *Band Realty*] (“[t]he foundation of an action for waste by a mortgagee is the impairment of the security of the mortgagee with knowledge of the [mortgage] lien (citation omitted)”). *See also* David A. Leipziger, *The Mortgagee’s Remedies for Waste*, 64 CAL. L. REV. 1086 (1976); Jeffrey S. Bay, Comment, *Remedies for Waste in Missouri*, 47 MO. L. REV. 288 (1982); *Stein*, *supra* note 1 at 1269, 1275-77; Dale A. Whitman, *Mortgage Drafting: Lessons From The Restatement of Mortgages*, 33 REAL PROP. PROB. & TR. J. 415, 433-34 (1998) (noting that the *Restatement* provides that “waste” includes the mortgagor’s “material failure to comply with mortgage covenants respecting the property’s ‘physical care, maintenance, construction, demolition, or insurance’ ”).

²² *Id.* at 500.

²³ *Id.* at 501.

²⁴ *Id.* at 503.

²⁵ *Supra* note 2.

²⁶ *Nippon*, *supra* note 2, at 497.

²⁷ *See* John C. Murray, *Pre-Petition Distribution of Cash by a Mortgagor: A Fraudulent Transfer?*, 44 REAL PROPERTY NEWSLETTER 4 (Illinois State Bar Association, Section on Real Estate Law, June 1999).

²⁸ *Travelers*, *supra* note 2, at 120.

²⁹ *Id.*

³⁰ *Id.* at 123. In an apparent contradiction, the court then stated that both elements must be present.

³¹ *Id.* at 123 n.9.

³² *Id.*

³³ For a discussion of the factors that courts consider in determining whether to appoint a receiver for mortgaged property when waste of the collateral is alleged, *see* Wade R. Habeeb, Annotation, *What Constitutes Waste Justifying Appointment of Receiver of Mortgaged Property*, 55 A.L.R. 3d 1041, *supp.* §3 (2000).

³⁴ In his dissent, Judge Mishler argued that the receiver had inappropriately used the rents collected from January 1, 1992 to June 30, 1992 to pay the taxes due July 1, 1992 for the period from July 1, 1992 to December 31, 1992. Therefore, in Judge Mishler’s opinion, the measure of damages should have been

reduced to the extent that rental income was actually generated from the property and available to pay the taxes due for the period from January 1, 1992 to June 30, 1992.

³⁵ See also *FDIC v. Prince George Corp.*, 58 F.3d 1041, 1046 (4th Cir. 1995) (holding that filing bankruptcy petition, resisting foreclosure action, or any other act, omission, or representation of borrower that reduces or impairs lender's rights in mortgaged property could negate effect of nonrecourse provision in loan documents); *Jaffee-Spindler Co. v. Genesco, Inc.*, 747 F.2d 253, 256 (4th Cir. 1984) (ruling that because waste is a tort, mortgagee's suit for waste was not barred by mortgage provision stating that mortgagor shall not be liable to the mortgagee "on the indebtedness secured hereby or upon any of the other terms, covenants or conditions of this instrument"); *Micuda v. McDonald (In re Evergreen Ventures)*, 147 B.R. 751, 755-56 (Bankr. D. Ariz. 1992) (ruling that mortgagee was permitted to recover monetary damages against mortgagor for permissive waste, based on mortgagor's inept management of property and failure to maintain property in safe and reasonable condition); *Lanier v. Spring Cypress Investments.*, No. 01-93-00414-CV, 1995 Tex. App. LEXIS 1934 (Tex. Ct. App. 1995) (ruling that, where nonrecourse promissory note provided for recourse liability for failure to pay real estate taxes and assessments on mortgaged property, borrower remained personally liable for unpaid taxes even after full-price foreclosure sale); *United States v. Haddon Haciendas Co.*, 541 F.2d 777, 785 (9th Cir. 1976) (holding that waste is a tort and stating that California's one-form-of-action rule "does not prohibit actions for damages for something other than enforcement of the debt"); *Prudential*, *supra* note 1, at 318-20 (finding that "waste is a species of tort" and ruling that mortgagee could assert waste claim against non-assuming grantee of mortgagor; and noting that "[m]odern Wisconsin law does not distinguish between passive and active waste").

³⁶ 174 Misc. 2d 288 (N.Y. Sup. Ct. 1997).

³⁷ The court stated that an action for waste "is grounded in tort and is generally not considered an action either of foreclosure or upon the loan indebtedness" *Id.* at 289 (citing *Syracuse Sav. Bank v. Onondaga Silk Co.*, 171 Misc. 993 (N.Y. Sup. Ct. 1939)). The court noted that another New York case, *Odell v. Buck*, 5 A.D. 732 (N.Y. App. Div. 3d Dep't 1957), held that because the referee's deed had been delivered to the purchaser after a foreclosure sale of the mortgaged property, the purchaser was barred from pursuing for a claim for damages against the mortgagor's assignees as the result of their removal of heating and plumbing fixtures.

³⁸ The mortgagee had claimed that the mortgagor committed "affirmative and passive" acts of waste (i.e., diminution in the value of the property) by damaging the property (a residence) and rendering it uninhabitable. See also *Allstate Fin. Corp v Zimmerman*, 272 F.2d 323, 325-326 (5th Cir. 1950) (holding that under Florida law, mortgagee that purchased property at foreclosure sale for full amount of debt could not maintain separate action for damages to mortgaged premises that occurred during time mortgage was in effect); *Sloss-Sheffield Steel & Iron Co. v. Wilkes*, 165 So. 764, 767 (Ala. 1936) ("The mortgagee may pursue any course he pleases to collect the debt, whether it be a suit for a personal judgement against the debtor, or for damages against one who has wrongfully converted the mortgaged property, or otherwise destroyed his rights in it, or for a foreclosure. And he may do them all at the same time. But when he once collects his debt, by any one of those proceedings, or by a voluntary payment of it, he cannot pursue any other remedy. They are all but means to accomplish one purpose, and when that is accomplished, all the remedies, not used in so doing, are terminated"); *Cornelison*, *supra* note 9, at 606-07 (ruling that defendant, as non-assuming grantee of deed of trust, had not established impairment of its security because it had acquired property at foreclosure sale by making full credit bid); *Band Realty*, *supra* note 21, at 725 (holding that because mortgagee had already recovered entire amount of mortgage debt as result of foreclosure sale, and had not requested deficiency judgement, no impairment of its security existed and thus no recovery for waste would be allowed); *Monte Enters., Inc. v. Kavanaugh*, 303 S.E. 2d 194, 195-96 (N.C. Civ. App. 1983) (holding that even though plaintiff-mortgagee alleged that defendants committed wasteful acts which damaged property and diminished its value while foreclosure action was proceeding, it could not maintain an action for tortious damage where it bid full amount of debt at foreclosure sale); *In re Morris*, 204 B.R. 783, 785 (Bankr. N.D. Ala. 1996) ("satisfaction of the mortgage debt terminated any right of action the mortgagee may have had against the debtor, or any other party for that matter, for injuries caused to the mortgaged property prior to foreclosure"); *Nippon*, *supra* note 2, at 500 (stating that California law "provides for a tort action for bad faith waste following a nonjudicial foreclosure sale unless the foreclosure results, by full credit bid or otherwise, in full satisfaction of the secured debt").

³⁹ 195 B.R. 692, 703 (N.D. Ill. 1996).

⁴⁰ 226 A.D. 2d 188-89 (N.Y. App. Div. 1st Dep't 1996).

⁴¹ See also *EOR Fifty Nine of New York Inc. v. Baco Dev. Corp.*, 254 A.D. 79,80 (N.Y. App. Div. 1st Dep't 1998) (holding that, following foreclosure by mortgagee, residential tenant who had not received notice of assignment-of-rents clause in original mortgage was not liable for waste based on his alleged failure to pay real estate taxes on property; and distinguishing *Travelers*, *supra* note 2, on basis that mortgagee had "failed to demonstrate that [the tenant] was liable for those taxes, much less that he fraudulently or intentionally failed to pay them"); *Acorn Properties, Inc. v. East 7th Realty Associates*, 238 A.D. 2d 279, 280 (N.Y. App. Div. 1st Dep't 1997 (holding that mortgagee's claim that mortgagor's mismanagement of secured property constituted waste, in violation of condition of nonrecourse mortgage, had not been timely raised and that claim of fraud lacked merit); *Chetek State Bank v. Barberg*, 489 N.W. 2d 385, 387 (Wis. Ct. App. 1992) (finding that concept of waste sufficient to justify appointment of receiver is different from concept of waste that results in tort liability, and holding that mortgagor's failure to pay real estate taxes, without more, is not per se unreasonable conduct giving rise to tort liability; court rejected mortgagee's argument that tort claim was sufficiently independent to authorize money judgment against individual partners of mortgagor, notwithstanding that loan was nonrecourse); *Camden Trust Co. v. Handle*, 26 A.2d 865, 872 (N.J. Eq. 1942) (denying claim of waste based on failure to pay real estate taxes); *Krone v. Goff*, 53 Cal. App. 3d 191, 195 (1975) ("None of the cases even suggest that the traditional and legal meaning of waste, as that word is used in a mortgage or trust deed, embrace the failure to pay taxes"); *In re Mills*, 841 F.2d 902, 905 (9th Cir. 1988) (ruling that borrower was not liable for nonpayment of taxes where it had not "milked" property); *Farm Mortg. Loan Co. v. Pettet*, 200 N.W. 497, 500 (N.D. 1924) ("it was never considered by the legislature . . . that failure to pay taxes is 'one of the actions or omissions usually named in the books as instances of waste' (citation omitted)"); cf. *Osuna*, *supra* note 10, at 78 ("Other authorities in California and elsewhere are in conflict, some holding that failure to pay real estate taxes constitutes waste, and others holding that failure to pay taxes does not constitute waste"); *Nippon*, *supra* note 2, at 497 ("[t]here may be exigent circumstances which would justify a failure to pay real estate taxes; for example, where a choice must be made between paying the taxes and making loan payments or necessary repairs, a tax default might merely rearrange the lender's loss without increasing it").

⁴² With respect to a nonrecourse mortgage, Comment i. to § 4.6 of the *Restatement*, *supra* note 21, takes no position as to whether a nonrecourse clause in the mortgage precludes liability for waste and suggests that the parties are free to bargain on the issue and that it is a matter of construction of the nonrecourse language.