Golden Gate University Law Review

Volume 7 | Issue 2 Article 5

January 1977

The Doctrine of Waste and California's Anti-Deficiency Statutes

Henry E. O'Neill

THE DOCTRINE OF WASTE AND CALIFORNIA ANTI-DEFICIENCY STATUTES

In the recent decision in *Cornelison v. Kornbluth*,[1] the California Supreme Court examined the conflicting policies of the common law doctrine of waste and the California anti-deficiency statutes. This Note will present a brief overview of the two areas, analyze the *Cornelison* decision and evaluate the more recent decision of *United States v. Haddon Haciendas Co.*,[2] in which the Ninth Circuit Court of Appeals declined to follow the analysis of the *Cornelison* court.

I. OVERVIEW

A. THE DOCTRINE OF WASTE: PROTECTION OF THE MORTGAGEE

The action for waste finds its roots in the twelfth century common law.[3] The early English statutes of Marlbridge[4] and Gloucester[5] supplied the model for many American statutes pro-

1. 15 Cal. 3d 590, 542 P.2d 981, 125 Cal. Rptr. 557 (1975).
2. 541 F.2d 777 (9th Cir. 1976).
3. 5 R. POWELL & P. ROHAN, THE LAW OF REAL PROPERTY ¶ 637, at 7-11 (rev. ed. 1977) [hereinafter cited as POWELL & ROHAN].
4. 1267, 52 Hen. III, c. 23, § 2. The text of the statute reads:
> Also fermors, during their term, shall not make waste, sale nor exile of house, woods, and men, nor of anything belonging to the tenements that they have to ferm, without special license had by writing of covenant, making mention that they may do it; which thing, if they do, and thereof be convict, they shall yield full damage, and shall be punished by amerciament grievously.
5. 1278, 6 Edw. I, c. 5. The text of the statute reads:
> It is provided also that a man from henceforth shall have a writ of waste in the Chancery against him that holdeth by law of England, or otherwise for term of life, or for term of years, or a woman in dower; and he which shall be attained of waste shall lose the thing that he hath wasted, and moreover shall recompense thrice so much as the waste shall be taxed at.

hibiting waste,[6] including New York Field Code section 1622[7] upon which the California statute[8] is based. Waste is a tort committed against the property or estate of another. It has been variously defined, but it essentially constitutes "conduct (acts of commission and of omission) on the part of the person in posession of land which is actionable at the behest of, and for the protection of the reasonable expectations of, another owner of an interest in the same land."[9]

With respect to the relationship between mortgagees and mortgagors,[10] a cause of action for waste protects the mortgagee's interest in the preservation of the value of the property securing the mortgagor's obligation.[11] California recognized the right of a mortgagee to sue in tort for waste in 1864, in *Robinson v. Russell*,[12]

---

6. *See* 5 POWELL & ROHAN, *supra* note 3, ¶ 640, at 23.

7. N.Y. CIV. CODE § 1622 (1865).

8. CAL. CIV. CODE § 2929 (West 1974). The California section, enacted in 1872, states in pertinent part: "No person whose interest is subject to the lien of a mortgage may do any act which will substantially impair the mortgagee's security." This language is identical to that of the New York provision.

9. 5 POWELL & ROHAN, *supra* note 3, ¶ 636, at 5. *See* Leipziger, *The Mortgagee's Remedies for Waste*, 64 CALIF. L. REV. 1086 (1976), in which the author defines waste as "conduct done or permitted by one in rightful possession of the property that causes physical damage or destruction. It includes both voluntary waste . . . and permissive waste, such as allowing the property to fall into disrepair." *Id.* at 1087.

10. For the sake of convenience, these terms will be used interchangeably with their deed of trust counterparts, beneficiary and trustor. The deed of trust is by far the most commonly used instrument in California, and the law with respect to the two instruments is virtually identical, at least in matters relevant to the focus of this Note.

11. The obligation is frequently more important than the security. An obligation can exist without security, but there can be no security without an underlying obligation. The secured obligation is typically a promise to pay money, but it may be broader. *See, e.g.*, CAL. CIV. CODE §§ 2872, 2920 (West 1974), which are phrased in terms of "performance of an act." *Cf.* Willys of Marin Co. v. Pierce, 140 Cal. App. 2d. 826, 296 P.2d 25 (1956); *see also* Stub v. Belmont, 20 Cal. 2d 208, 124 P.2d 826 (1942) (crop-servicing contract); Congregational Church Bldg. Soc'y v. Osborn, 153 Cal. 197, 94 P. 881 (1908) (promise to use property for church purposes); Valley Vista Land Co. v. Nipomo Water & Sewer Co., 266 Cal. App. 2d 331, 72 Cal. Rptr. 181 (1968) (promise to furnish water and sewer facilities). For a lucid explanation of the relationship between "obligation" and "security" see J. HETLAND, R. BERNHARDT, & J. HILL, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS ch. 4 (1970) [hereinafter cited as HETLAND & BERNHARDT].

12. 24 Cal. 467, 472-73 (1864). California, along with about 27 other states, has adopted an analysis of a mortgage as a lien acquired by the mortgagee against the property for the amount of the debt. *See, e.g.*, CAL. CIV. PROC. CODE § 744 (West 1974). An initial hurdle to the maintenance of an action by a mortgagee not in posession was finding a sufficient "estate" of the mortgagee upon which to base the suit. The California court in *Robinson* followed the lead of the New York court which was the first to hold that a mortgagee in a "lien" jurisdiction may sue in tort for waste to protect an interest in the preservation of the value of the property securing the mortgagor's obligation. 24 Cal. at 473, *citing* Van Pelt v. McGraw, 4 N.Y. 110 (1850).

which was later codified in California.[13] Early statutes recognizing an action for waste presented some difficult problems of construction, including the degree of impairment and the type of conduct necessary to constitute waste. Today, it is generally agreed that the impairment must be "substantial"[14] and that a mortgagor may commit waste by acts of omission as well as by affirmative acts.[15]

In the eight states where a mortgage is considered a conveyance of title, the mortgagee's status as owner of the property constitutes a sufficient interest in the property to maintain a suit for waste.

13. CAL. CIV. CODE § 2929 (West 1974).

14. The court in *Van Pelt v. McGraw* reasoned that in order for there to be a real threat to the debt, the impairment of the mortgagee's security must be "substantial." 4 N.Y. 110, 112 (1850). Today, over a century later, there still isn't complete agreement as to what constitutes "substantial impairment." The majority view is that the has not substantially impaired the mortgagee's security until the waste has reduced the value of the encumbered property to a point where it is worth less than the unpaid balance of the debt. Leipziger, *supra* note 9, at 1097 n.51. The California authority most often cited as following the majority rule is Levenson v. Standard Soap Co., 80 Cal. 245, 22 P. 184 (1889), although it does so by implication only. If such is the standard in California, it would appear that no action for waste could be brought by a mortgagee independent of a foreclosure action, which is the proper vehicle for determining the value of the property. Giandeini v. Ramirez, 11 Cal. App. 2d 469, 473, 54 P. 2d 91, 93 (1936). Leipziger, *supra* note 9, argues that, with certain exceptions, this should be the case. *Id.* at 1122-29. *But see* G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES 212-14 (1970).

However, there is support for a "margin standard" of "whether the conduct threatened will reduce the value of the property enough to decrease the percentage of value over the debt below that insisted upon by business practice in granting a loan." 5 POWELL & ROHAN, *supra* note 3, ¶ 648, at 40; G. OSBORNE, *supra* at 212-13. For a discussion of what the proper margin should be see Leipziger, *supra* note 9, at 1099-1100; Note, *Mortgagee's Remedy for Damage to or Injury of the Res*, 10 TEX. L. REV. 475, 482 (1932).

The essence of the margin standard, as argued by a lender, is that the loan would not have been made without the cushion of a difference between the amount lent and the value of the property, and that this buffer is part of the security that the courts should protect from impairment.

15. While the Marlbridge and Gloucester statutes stated that certain persons should not be allowed to "make" waste, the English courts quickly rejected arguments that the statutes did not apply to omissions. 5 POWELL & ROHAN, *supra* note 3, ¶ 640, at 23. In holding "permissive waste" within the ambit of such statutes, the courts reasoned that one could make waste with equally destructive consequences by inaction as by action. *Id.* In California, the ability of an aggreived party to recover for permissive waste was also recognized at an early date, in the case of Parrott v. Barney, 18 F. Cas. 1249 (C.C.D. Ca. 1868). The court there talked in terms of strict liability for permissive waste, without the necessity for negligence or culpability. *Id.* at 1251.

Recovery for permissive waste may be successfully accomplished only if it is demonstrated that the possessor has breached the duty to repair and maintain the premises. However, the failure to must encompass more than normal wear and tear and must be shown to have caused dilapidation or other injury to the premises. 5 POWELL & ROHAN, *supra* note 3, ¶ 640, at 22. The type of inaction that will cause sufficient damage to constitute waste may vary, depending upon the nature of the property and the possessor's estate. Hickman v. Mulder, 58 Cal. App. 3d 900, 909, 130 Cal. Rptr. 304, 310 (1976). *See* 5 POWELL & ROHAN, *supra* note 3, ¶ 637, at 9. For language support-

B. Legislative Protection of the Debtor

The traditional scenario running throughout the history of mortgages is one of necessitous debtors and overreaching creditors. Because mortgagors are unable to protect their own interests, they must look to the courts and to the legislature for help. The response of the legislature has been a threefold protection of the debtor: the one action rule;[16] the fair value provisions of the California Code of Civil Procedure;[17] and the anti-deficiency statutes.[18]

One Action Rule

When property is mortgaged, the mortgagor signs a promissory note for the amount of money borrowed, in addition to signing the mortgage which secures the note.[19] Prior to 1872, California law permitted an action upon the promissory note, in addition to an action in equity to foreclose the mortgage given to secure the note.[20] The primary drawback to such a scheme was that it allowed creditors to harass debtors by instituting multiple lawsuits rather than enforcing all their rights in one action.[21] In response to this abuse by creditors, the legislature, in 1872, adopted the "one action rule" embodied in Code of Civil Procedure section 726, which states that "[t]here can be but one form of action for the recovery of any debt, or the enforcement of any right secured by a mortgage upon real property,"[22] an action for foreclosure. By requiring creditors to proceed via the foreclosure action alone, the legislature sought to suppress the mischief of multiple lawsuits and to compel creditors to exhaust their security before proceeding personally against the debtors.[23] The provision

---

ing an action for permissive waste regardless of the nature or duration of the possessor's estate see Parrott v. Barney, 18 F. Cas. 1249, 1251 (C.C.D. Ca. 1868).

16. Cal. Civ. Proc. Code § 726 (West 1974).

17. *Id.* §§ 580(a), 726.

18. *Id.* §§ 580(b), 580(d).

19. *See* note 11 *supra*.

20. For a discussion of the law prior to the enactment of the "one action rule" see Felton v. West, 102 Cal. 266, 269-70, 36 P. 676, 677 (1894).

21. *Id.*

22. Cal. Civ. Proc. Code § 726 (West 1974).

23. Section 726 was derived from section 905 of the proposed New York Code of Civil Procedure of 1850, the express purpose of which was "to prevent a multiplicity of actions." Comment, *Mortgages and Trust Deeds: Enforcement of a Secured Debt in California*, 31 Calif. L. Rev. 429, 430 (1943) [hereinafter cited as Comment, *Mortgages and Trust Deeds*].

was considered so essential to the debtor protection scheme that it was made mandatory.[24]

Fair Value Provisions

Although section 726 requires mortgagees to exhaust their security before seeking to enforce the debt,[25] the statute does not prevent a subsequent deficiency judgment against the mortgagor should the foreclosure sale produce less than the balance due on the indebtedness.[26] The severe hardships that this situation could create were demonstrated in dramatic fashion during the Great Depression of the 1930s.[27] The legislature responded by adding the "fair value" provisions of sections 726[28] and 580(a)[29] to the Code of Civil Procedure. In order to protect the debtor from personal liability when depressed economic conditions are responsible for declining property values, sections 726[30] and

24. *See* Windleman v. Dises, 31 Cal. App. 2d 387, 88 P.2d 147 (1939). *See also* CAL. CIV. CODE § 2955 (West, 1974), codifying the invalidity of a section 726 waiver. However, section 726 may be waived subsequent to the grant of the mortgage on the theory that, at that time, the borrower's position is not so desperate as to require protection. Salter v. Ulrich, 22 Cal. 2d 263, 267, 138 P.2d 7, 9 (1943).

25. CAL. CIV. PROC. CODE § 726 (West 1974); *see* Walker v. Community Bank, 10 Cal. 3d 729, 733-34, 518 P.2d 329, 331-32, 111 Cal. Rptr. 897, 899-900 (1974).

26. Cornelison v. Kornbluth, 15 Cal. 3d 590, 600, 542 P.2d 981, 988, 125 Cal. Rptr. 557, 564 (1975). It has been argued that the effect of the one action rule alone may actually be of more benefit to the creditor than the debtor. *See* Comment, *Mortgages and Trust Deeds*, *supra* note 23, at 434-35.

27. During that period of economic hardship, with its dearth of money and declining property values, a mortgagee was able to purchase the subject property at the foreclosure sale for a depressed price far below its normal fair market value. Thereafter, the mortgagee could proceed to obtain a "double recovery" by holding the debtor to a large deficiency. *Cornelison v. Kornbluth*, 15 Cal. 3d at 600, 542 P.2d at 988, 125 Cal. Rptr. at 564; Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 40, 378 P.2d 97, 99, 27 Cal. Rptr. 873, 875 (1963). The mortgagee could accomplish this without the necessity of actually tendering money by credit-bidding up to the amount of the balance due on the debt. Central Sav. Bank of Oakland v. Lake, 201 Cal. 438, 257 P. 521 (1927). Thus, the debtor not only lost the property but also became liable on a personal judgment, even though the true value of the property in normal times could be expected to fully cover the debt. *Roseleaf Corp. v. Chierighino*, 59 Cal. 2d at 40, 378 P.2d at 99, 27 Cal. Rptr. at 875.

28. CAL. CIV. PROC. CODE § 726 (West 1974), originally enacted in 1872, was amended in 1933 by 1933 Cal. Stats. 2118 and in 1937 by 1937 Cal. Stats. 770.

29. CAL. CIV. PROC. CODE § 580(a) (West 1974) (originally enacted by 1933 Cal. Stats. 1672). For the relevant text of section 580(a) see note 31 *infra*.

30. Section 726 provides in pertinent part:

> In the event that a deficiency is not waived or prohibited and it is decreed that any defendant is personally liable for such debt, then upon application of the plaintiff filed at any time within three months of the date of the foreclosure sale and after a hearing thereon at which the court shall take evidence and at which hearing either party may present evidence as to

580(a)[31] limit the amount of a deficiency judgment to the difference between the debt and the highest bid, or the debt and the fair value[32] of the property, whichever is less.[33]

> the fair value of the property or the interest therein, sold as of the date of sale, the court shall render a money judgment against such defendant or defendants for the amount by which the amount of the indebtedness with interest and costs of sale and of action exceeds the fair value of the property or interest therein sold as of the date of sale; provided, however, that in no event shall the amount of said judgment, exclusive of interest from the date of sale and of costs, exceed the difference between the amount for which the property was sold and the entire amount of the indebtedness secured by said mortgage or deed of trust.

Id. § 726.

31. Section 580(a) states in pertinent part:

> Whenever a money judgment is sought for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, the plaintiff shall set forth in his complaint the entire amount of the indebtedness which was secured by said deed of trust or mortgage at the time of sale, the amount for which such real property or interest therein was sold and the fair market value thereof at the date of sale and the date of such sale. Upon the application of either party made at least 10 days before the time of trial the court shall, and upon its own motion the court at any time may, appoint one of the inheritance tax referees provided for by law to appraise the property or the interest therein sold as of the time of sale. . . . Before rendering any judgment the court shall find the fair market value of the real property, or interest therein sold, at the time of sale. The court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property or interest therein sold at the time of sale with interest thereon from the date of sale; provided, however, that in no event shall the amount of said judgment, exclusive of interest after the date of sale, exceed the difference between the amount for which the property was sold and the entire amount of the indebtness secured by said deed of trust or mortgage.

Id. § 580(a). For all practical purposes, this statute may have been rendered obsolete by the enactment of section 580(d). J. HETLAND, SECURED REAL ESTATE TRANSACTIONS § 9.3, at 183-84 (1974). For a short discussion of the possible revival of this statute as a result of the *Cornelison* decision see note 73 *infra*.

32. While section 726 uses the term "fair value," and section 580(a) uses "fair market value," the discrepancy has been ignored by the courts and thus has little significance. HETLAND & BERNHARDT, *supra* note 11, § 6.1, at 234.

33. Therefore, if a foreclosure sale produces less than the fair value of the property due to deliberate underbidding or depressed economic conditions, the mortgagee will nevertheless be barred from recovering the difference by way of a deficiency judgment.

Anti-Deficiency Statutes

The protection afforded mortgagors in California by the fair value rules is augmented by the specific anti-deficiency provisions of sections 580(b)[34] and 580(d).[35] Section 580(b) provides that a deficiency judgment on a purchase money mortgage shall be barred in most cases.[36] The purpose of this additional protection

---

Cornelison v. Kornbluth, 15 Cal. 3d at 600-601, 542 P.2d at 988, 125 Cal. Rptr. at 567. See also J. HETLAND, *supra* note 31, § 9.3, at 183-84. By removing the temptation to underbid and thereby create a windfall deficiency, the legislature sought to ensure that foreclosure sales would produce the theoretically correct economic results.

Although sections 726 and 580(a) remove the incentive to underbid when property is worth more than the amount of the debt, they provide no impetus for the mortgagee to bid the actual value of the property when it exceeds the amount owed. The provisions are not triggered unless a deficiency judgment is sought. When the property is worth more than the debt, a foreclosure sale under normal conditions would produce a surplus which would go to the mortgagor in the absense of other creditors. However, nothing in the statutory scheme encourages the mortgagee to go the extra mile to create the surplus to which the mortgagor is theoretically entitled. Unless the mortgagee truly wants the property, the maximum rational bid is the balance due on the debt. The mortgagee can credit bid to the extent of this amount, but any bid in excess must be satisfied with cash. Additionally, during a period of economic depression with its shortage of available cash, the mortgagee's ability to credit bid will frequently result in the purchase of the property at the sale, since all other bidders must tender cash. Nomellini Constr. Co. v. Modesto Sav. & Loan Ass'n., 275 Cal. App. 2d 114, 79 Cal. Rptr. 717 (1969). The hope held out by these provisions that the mortgagor would get fair value for the property, even during hard times, turns out to be illusory.

Additionally, the fair value provisions do not apply to junior creditors whose interests are extinguished by the foreclosure sale. In defending an action by a "soldout junior" for recovery of his or her debt, the mortgagor cannot assert that the foreclosing senior creditor credit bid less than the fair value of the property. The hardship of this situation is demonstrated by the following example. The property is worth 40, the foreclosing senior creditor is owed 30, and the junior creditor is owed 5. There is no incentive for the foreclosing senior to bid more than 30. Although the senior would not be entitled to a deficiency judgment, the junior can seek a personal judgment because the security has become valueless. Saving Bank v. Central Mkt. Co., 122 Cal. 28, 54 P. 273 (1898). Even though the value of the property was sufficient to cover both debts, the mortgagor is in the lamentable position of both losing the property and being personally liable on the debt for 5, when the sale should have produced a surplus of 5.

34. CAL. CIV. PROC. CODE § 580(b) (West 1974).

35. *Id.* § 580(d).

36. Section 580(b) provides in relevant part:

> No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage given to the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser .

Id. § 580(b).

for mortgagors in California is twofold. First, it purportedly prevents overvaluation of the property by the seller (mortgagee) at the time of the sale to the buyer (mortgagor)[37] by placing on the seller the risk that the property's value may not completely cover the debt should foreclosure become necessary.[38] Second, the statute operates as a stabilizing factor in land sales.[39] If inadequacy of security on foreclosure results from a decline in property values during a general or local depression, section 580(b) serves to prevent the aggravation of the economic downturn that would result if defaulting purchasers were additionally burdened with personal liability.[40]

Section 580(d) provides that a deficiency judgment after a private foreclosure sale shall be barred altogether. The purpose of the statute is to achieve parity between the remedies of private

---

37. Bargioni v. Hill, 59 Cal. 2d 121, 123, 378 P.2d 593, 594, 28 Cal. Rptr. 321, 322 (1963); Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 42, 378 P.2d 97, 101, 27 Cal. Rptr. 873, 877 (1963).

38. However, whether the statute is effective in preventing overvaluation is speculative at best. For example, a seller trying to decide whether to sell property for 40 (its value) or 50 (an inflated price) will not be discouraged by section 580(b) from asking for the higher figure. If the buyer pays the full amount, the seller is that much better off. If the buyer defaults, the seller is no worse off than if the property had been sold at 40, since in no event is recovery allowed for more than the amount realized at the foreclosure sale. HETLAND & BERNHARDT, *supra* note 11, § 6.23, at 268-71; Leipziger, *Deficiency Judgments in California: The Supreme Court Tries Again*, 22 U.C.L.A. L. REV. 753, 762 n.31 (1975).

Similarly, the statute does not discourage the buyer from paying more for the property than it is worth inasmuch as it precludes liability for a deficiency judgment. *Id.* at 759 n.24. The statute's failure to promote its declared objectives was recognized in Heckes v. Sapp, 229 Cal. App. 2d 549, 552, 40 Cal. Rptr. 485, 487 (1964), *citing* Hetland, *Deficiency Judgment Limitations in California—A New Judicial Approach*, 51 CALIF. L. REV. 1, 4 (1963). *See also* Spangler v. Memel, 7 Cal. 3d 603, 498 P.2d 1055, 102 Cal. Rptr. 807 (1972), wherein the court expressed the opinion that buyers would make a "more accurate assessment" when the risk of overvaluation was placed on their shoulders. *Id.* at 612-14, 498 P.2d at 1060-62, 102 Cal. Rptr. at 812-14. Although the holding in *Spangler* is arguably limited to its facts (subordination agreement and construction loan), the logic that overvaluation is best prevented by subjecting buyers to liability would seem to have broader application.

39. Spangler v. Memel, 7 Cal. 3d 603, 612, 498 P.2d 1055, 1060, 102 Cal. Rptr. 807, 812 (1972); Bargioni v. Hill, 59 Cal. 2d 121, 123, 378 P.2d 593, 594, 28 Cal. Rptr. 321, 322 (1963); Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 42, 378 P.2d 97, 101, 27 Cal. Rptr. 873, 877 (1963); Heckes v. Sapp, 229 Cal. App. 2d 549, 552, 40 Cal. Rptr. 485, 487 (1964).

40. Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 42, 378 P.2d 97, 101, 27 Cal. Rptr. 873, 877 (1963); Heckes v. Sapp, 229 Cal. App. 2d 549, 552, 40 Cal. Rptr. 485, 487 (1964). Whether section 580(b) actually has any economic effect is problematical. *See* HETLAND & BERNHARDT, *supra* note 11, § 6.22, at 266-68. For an analysis of how the operation of 580(b) may actually work to aggravate a depression see Leipziger, *supra* note 38, at 763-66, 785-86.

and judicial foreclosure sales.[41] When property is sold at a judicial foreclosure sale, although the mortgagor may subsequently seek a deficiency judgment, the property is subject to the debtor's statutory rights to redeem the property by tendering to the purchaser the price paid at the foreclosure sale.[42] Property sold at private foreclosure sales is not subject to such redemption rights.[43] However, prior to the enactment of section 580(d), the mortgagee could also seek a deficiency judgment following a private foreclosure. The mortgagee was thus provided with a significant advantage by foreclosing privately, since both irredeemable title to the property and a deficiency judgment could be obtained. Section 580(d) reduces this advantage by denying the creditor in a private foreclosure sale the ability to obtain a subsequent deficiency judgment. If a deficiency judgment is anticipated, the creditor must foreclose judicially and thereby subject the sale to the mortgagor's statutory redemption rights. If the creditor wishes the sale to result in nonredeemable title, he or she may foreclose privately, but in doing so, will give up the right to a deficiency judgment. In either case, the debtor is given some protection,[44] and a parity of remedies between private and judicial foreclosure sales is created.

While the doctrine of waste is oriented towards protecting the mortgagee, the California fair value and anti-deficiency statutes operate to protect the debtor. The conflicting policies underlying the mortgagee's remedies for waste and the California debtor protection scheme had not been definitively analyzed prior to the decision in *Cornelison v. Kornbluth*.[45]

41. Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 44, 378 P.2d 97, 101-102, 27 Cal. Rptr. 873, 877-78 (1963). *See* HETLAND & BERNHARDT, *supra* note 11, § 6.13, at 248-50.

42. The period within which the right to redeem must be exercised is usually the 12 months following the sale. CAL. CIV. PROC. CODE § 702 (West 1974). However, if the mortgagee could have obtained a deficiency judgment but forwent that opportunity, the redemption period is only three months. *Id.* § 725(a).

43. Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 43, 378 P.2d 97, 101-02, 27 Cal. Rptr. 873, 877-78 (1963).

44. *Id.* at 43-44, 378 P.2d at 101-102, 27 Cal. Rptr. at 877-78. This represents an improvement over the situation that had previously existed, but the debtor is still somewhat at the mercy of the creditor, since the creditor gets to elect which route to take. If the property is worth less than the debt, judicial foreclosure would preserve the right to a deficiency judgment. If the property is worth more than the debt, the impetus is to have a private sale, thereby cutting off the redemption rights and hope for a windfall. Additionally, the mortgagee, having made the choice, is not irrevocably bound to that remedy until the sale actually occurs. Mayhall v. Eppinger, 137 Cal. 5, 69 P. 489 (1902); Carpenter v. Title Ins. & Trust Co., 71 Cal. App. 2d 593, 163 P.2d 73 (1945). For a general discussion of the anti-deficiency legislation see Hetland, *supra* note 38.

45. 15 Cal. 3d 590, 542 P.2d 981, 125 Cal. Rptr. 557 (1975). Easton v. Ash, 18 Cal. 2d 530, 116 P.2d 433 (1941), appears to be the first case subsequent to the enactment of the

II. THE *CORNELISON* DECISION

In *Cornelison*, the California Supreme Court sought to clarify the legal relationship between waste and the anti-deficiency legislation. The case involved a suit by the beneficiary of a deed of trust against a successor in interest of the trustor. The defendant had taken title subject to the deed of trust without assuming liability thereunder for damages caused by his failure to care for

---

anti-deficiency legislation allowing a cause of action for waste by a purchase money mortgagee. In *Easton*, by cutting and removing timber from the mortgaged property, the mortgagor and third persons had rendered the mortgage insufficient security for the debt. Section 580(b) was not discussed by the court, however, due to the fact that it was enacted subsequent to the execution of the mortgage and was therefore inapplicable.

The next case where the relationship between the anti-deficiency statutes and the doctrine of waste presented itself was Weaver v. Bay, 216 Cal. App. 2d 559, 31 Cal. Rptr. 211 (1963). Following a private foreclosure sale of a purchase money deed of trust that produced less than the debt, the beneficiary under the deed of trust brought an action to recover, *inter alia*, damages for waste. Although the plaintiff failed to carry his burden of proving that the impairment of his security was caused by the conduct of the trustor, the court did consider the allegations of waste apart from the defenses of sections 580(b) and (d) and thus implied the availability of an action for waste notwithstanding these provisions. *Id.* at 563, 31 Cal. Rptr. 214.

The relationship between waste and the anti-deficiency statutes was finally addressed directly in American Sav. & Loan Ass'n v. Leeds, 68 Cal. 2d 611, 440 P.2d 933, 68 Cal. Rptr. 453 (1968). In *Leeds*, the holder of a purchase money deed of trust sought to recover the full amount of its loan after an improperly filled lot allegedly became worthless. The plaintiff was unsuccessful because the improper fill had existed at the time the loan was made. However, the court stated that recovery for conditions arising after the loan which render the security inadequate is not barred by section 580(b), for "[s]uch a recovery is not a deficiency judgment." *Id.* at 615 n.2, 440 P.2d at 936 n.2, 68 Cal. Rptr. at 456 n.2. The court reasoned that "[s]ince the purchase money lender is confined to his security, it is all the more important that he be allowed to effectively protect it" through an independent action for waste once that security has been exhausted. *Id.*

Despite the suggestive dicta in *Leeds* and *Bay*, the next court confronted with the question failed to mention either case. Schumacher v. Gaines, 18 Cal. App. 3d 994, 96 Cal. Rptr. 223 (1971). *Schumacher* involved a suit by the beneficiary of a purchase money deed of trust for damage to the property caused by the trustors. The court stated that the application of section 580(b) "deprives the holder of a purchase money note and deed of trust of any remedy other than the right to look solely to the security and no personal judgment may be recovered." *Id.* at 999, 96 Cal. Rptr. at 226. Although the court failed to cite any direct authority to support this proposition, the result in *Schumacher* was technically correct due to the fact that the plaintiff had purchased the property with a full credit bid. The mortgagee's interest in the property is limited to the balance due on the indebtedness, and when the sale produces this amount, even through a credit bid, this interest is satisfied and there is no damage suffered. Duarte v. Lake Gregory Land & Water Co., 39 Cal. App. 3d 101, 104-05, 113 Cal. Rptr. 893, 895 (1974); CAL. CIV. CODE § 2910 (West 1974). The vitality of the *Schumacher* decision is open to serious question today in light of the recent holdings in *Cornelison* and Hickman v. Mulder, 58 Cal. App. 3d 900, 130 Cal. Rptr. 304 (1976).

the property serving as security.[46] Affirming the trial court's grant of the defendant's motion for summary judgment, the California Supreme Court created altogether new categories of waste.

The plaintiff alleged in substance that the defendant owed a duty to care properly and adequately for the property and that the defendant had negligently failed to fulfill this obligation, thereby damaging the property.[47] The court acknowledged that the basic thrust of a waste action is to afford protection to concurrent holders of interests in land who are out of possession (*e.g.*, mortgagees) from harm committed by persons who are in possession (*e.g.*, mortgagors).[48] Further, the court recognized that all persons, even nonassuming successors in interest, are under a duty not to impair the mortgagee's security.[49]

The defendant argued that irrespective of the general duty against waste recognized by the court, any recovery by the plaintiff for waste should be barred because it would amount to a deficiency judgment proscribed by sections 580(b) and (d).[50] The court examined the history of those provisions, noting in particu-

46. On July 15, 1964, plaintiff Mary Cornelison sold a single family dwelling to the Chanons, taking back a promissory note in the amount of $18,800, secured by a purchase money first deed of trust. The deed of trust contained covenants to the effect that the Chanons would pay the real property taxes and assessments against the property, that they would care for and maintain the property and that the entire unpaid balance of the debt would become immediately due and payable if they sold the property. On December 10, 1964, the Chanons conveyed the premises to the defendant by grant deed. On September 6, 1968, the defendant sold the property to Richard Larkins. In January, 1969, the county health department condemned the house as unfit for human habitation. The Chanons were in default on the note, and the plaintiff, through a private foreclosure sale, purchased the property herself for $21,921.42, an amount equal to the balance due on the note plus the costs of foreclosure. 15 Cal. 3d at 594, 542 P.2d at 983-84, 125 Cal. Rptr. at 559-60. Although a full credit bid extinguishes a lien, the plaintiff instituted this suit for further damages. As a consequence of the full credit bid, the plaintiff had no compensable interest in the property, and therefore the court did not have to reach the issue of whether a recovery for waste amounts to a deficiency judgment. *Id.* at 608, 542 P.2d at 994, 125 Cal. Rptr. at 570.

47. The plaintiff additionally alleged a contractual violation of the covenants for proper care in the deed of trust. Noting that the defendant had never assumed the deed of trust, the court concluded that he was not required to perform any of its obligations because his assumption of the indebtedness was not specifically provided for in the conveyance. *Id.* at 596-97, 542 P.2d at 985-86, 125 Cal. Rptr. at 561-62.

48. *Id.* at 598, 542 P.2d at 986, 125 Cal. Rptr. at 562.

49. CAL. CIV. CODE § 2929 (West 1974) imposes a duty not to commit waste upon "any person whose interest is subject to the lien." The interest of a nonassuming successor in interest to property is subject to the mortgagee's lien. Braun v. Crew, 183 Cal. 728, 731, 192 P. 531, 533 (1920); Hibernia Sav. & Loan Soc'y v. Dickinson, 167 Cal. 616, 621, 140 P. 265, 268 (1914).

50. 15 Cal. 3d at 599-600, 542 P.2d 987-88, 125 Cal. Rptr. at 563-64.

lar that section 580(b) was adopted primarily as a stabilizing factor in land sales during times of economic instability. The aim of the provision was to protect defaulting mortgagors from the burden of large personal liability which could serve to aggravate a general or local depression.[51] In order to accommodate the policies of section 580(b) with the duty against waste, the court ultimately compromised, declaring that the applicability of section 580(b) to an action for waste is to be determined on a case by case basis.[52] The court will determine in each case to what extent the impairment of the mortgagee's security has been caused by the economic pressures of a market depression upon the mortgagor and to what extent by the "bad faith" acts of the mortgagor.[53] When waste is solely or primarily the result of the economic pressures of a market depression, a mortgagee may not recover damages. If waste is the result of the reckless, intentional or malicious destruction of property, a mortgagee may recover damages for the impairment of the security.[54]

In support of this compromise, the court concluded that recoveries based on waste and personal deficiency judgments "are closely interrelated and may often reflect identical amounts."[55] The court theorized that "[i]f property values in general are declining, a deficiency judgment and a judgment for waste would be identical up to the point at which the harm caused by the mortgagor is equal to or less than the general decline in property values resulting from market conditions."[56] The court thus demonstrated that its primary concern in *Cornelison* was a fear that the mortgagee might recover for waste when the inadequacy of the security actually resulted from a general economic decline and depressed real estate values.[57] The court posited that a mortgagor caught in an economic downturn may be compelled in the normal course of events to forgo the general maintenance and repair of

---

51. *Id.* at 600-02, 542 P.2d at 988-90, 125 Cal. Rptr. at 564-66.

52. *Id.* at 604, 542 P.2d at 991, 125 Cal. Rptr. at 567.

53. *Id.*

54. *Id.* at 603-04, 542 P.2d at 990-91, 125 Cal. Rptr. at 566-67. For shorthand reference throughout the remainder of this Note, the terms "good faith" waste and "bad faith" waste will be used. While the court never used the former, it did introduce the latter term.

55. *Id.* at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566.

56. *Id.*

57. However, it should be noted that a decline in market value due to economic forces does not constitute waste. 78 Am. Jur. 2d *Waste* § 1 (1975); Leipziger, *supra* note 9, at 1141.

the property.[58] Such instances of "good faith" waste should be protected through the operation of section 580(b). Otherwise, the court reasoned, the economic stabilization goals of section 580(b) would be frustrated by burdening the mortgagor with loss of property and with personal liability when the acts giving rise to the liability were direct results of an economic downturn.[59]

A. The Potential Effects of the *Cornelison* Decision

On balance, the problems in *Cornelison*, created by the court's attempt to strike a compromise between the competing rationales of waste and anti-deficiency legislation, far outweigh the benefits. The first problem with the *Cornelison* decision is that the court's definitions of good faith waste and bad faith waste are inadequate for all but the most clear-cut cases. The definitions offer little guidance to the courts that must implement them and make continued judicial conflict likely. Good faith waste is essentially defined as permissive waste committed as a result of a general market depression.[60] Therefore, when the economy is stable or on the upswing, the *Cornelison* decision appears to state that under no factual setting will deterioration of the property be deemed good faith waste. Thus, the class of persons protected from an action for waste by a good faith classification is a limited one.

---

58. 15 Cal. 3d at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566. The implication is that failure to repair which is in fact the result of adverse economic conditions constitutes waste. For a discussion of this point see notes 63-65 *infra* and accompanying text.

59. 15 Cal. 3d at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566. In addition to its main focus upon section 580(b), the court went on to conclude that the good faith-bad faith waste distinction should also be applied when the anti-deficiency provision of section 580(d) is asserted as a defense to an action for waste. *Id.* at 604-05, 542 P.2d at 991, 125 Cal. Rptr. at 567. Section 580(d) bars any deficiency judgment where the property has been sold at a private foreclosure sale. For a discussion of section 580(d) see notes 41-44 *supra* and accompanying text. In assessing the effect of section 580(d) upon an action for waste, the *Cornelison* court reasoned that when recovery is limited to instances of "bad faith" waste, the personal judgment against the mortgagor will be unrelated to the economic issues encompassed by the anti-deficiency legislation and thus will not affect the parity of remedies between private and judicial foreclosure sales established by section 580(d). *Id.* Wary of upsetting the delicate parity of remedies balance by assigning different meanings to the word "deficiency" within subparts of the same statute, the court concluded that the parity between private and judicial foreclosure could be preserved only by giving the anti-deficiency provisions of section 580(d) the same scope with respect to waste as those of section 580(b). *Id.*

60. The example given by the court to illustrate a good faith waste situation is a mortgagor caught in the grip of a general economic downturn who is "compelled in the normal course of events to forego the general maintenance and repair of the property in order to keep up his payments in the mortgage debt." *Id.* at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566.

The court defined bad faith waste as waste not committed "solely or primarily as a result of the economic pressures of a market depression."[61] However, as particular examples of bad faith waste, the court pointed to "reckless, intentional, and at times even malicious [despoliation] of property."[62] By referring to such one-sided examples, the court left the term bad faith waste open to interpretive manipulation. Is bad faith waste to serve as a catch-all category limited only by the restrictive definition of good faith waste discussed above? Or, alternatively, has the court in fact opted for a narrow definition of bad faith, as well as good faith waste? Assuming the latter, a showing of bad faith waste would be precluded in all but the most egregious instances of affirmative conduct, including any waste which arises as a result of inaction by the mortgagor.[63] Such a reading would create a large void between instances of good and bad faith waste, with the majority of mortgagors falling into the void. Assuming a broad interpretation, bad faith waste will directly encompass all but the limited number of mortgagors who can meet the good faith definition. This reading appears to be more compatible with the economic stabilization goal of section 580(b), which motivated the court's creation of the good faith waste category in *Cornelison*. This legislative rationale reflects a concern with the general depression of land values, not the mere inability of an individual mortgagor to meet mortgage payments. When there is no possibility of what the *Cornelison* court termed an "aggravation of the downturn"[64] due to the absence of a general downturn, the principles of section 580(b) should not be invoked and the plea of good faith waste to bar recovery should not be available.[65] The broad definition of bad faith waste would fill any void which might exist between good faith and bad faith waste. This would

61. *Id.* at 603-04, 542 P.2d at 990-91, 125 Cal. Rptr. at 566-67.

62. *Id.* at 604, 542 P.2d at 991, 125 Cal. Rptr. at 567.

63. A lender who is not permitted to recover for loss in the value of the property due to the mortgagor's conduct except under the most flagrant of circumstances will be less inclined to lend money for residential housing and will feel compelled either to charge a higher rate of interest or to require a large down payment. If impairment of security is defined as the value of the property dropping below the amount of the debt, a larger down payment may somewhat assuage a lender's worries. Under a margin definition, however, a lender will still be likely to charge more for the increased risk of loss, notwithstanding a larger down payment. For a discussion of these two definitions of "substantial impairment" see note 14 *supra*.

64. 15 Cal. 3d at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566.

65. Presumably, the existence of a general depression would not enable mortgagors to defend against a suit for waste by invoking the "aggravation of the downturn" language of *Cornelison*.

assure that good faith waste would not be subject to future judicial expansion beyond the legislative intent of section 580(b). However, as a consequence of this more harmonious and justifiable interpretation of bad faith waste, the substantive impact of the good faith waste protection of *Cornelison* upon mortgagor-mortgagee relations diminishes dramatically. Good faith waste will be the rare exception and bad faith waste will be the rule, with the mortgagee recovering for most conduct that previously could be categorized simply as waste under the traditional definition.

To the extent that the *Cornelison* decision might subsequently be applied, courts will be forced to expand and elaborate on the definition of good faith or bad faith waste. A recent example of such judicial construction is represented by *Hickman v. Mulder*,[66] in which the court of appeal concluded that inaction, at least insofar as agricultural lands are concerned, may constitute bad faith waste because "[t]o preserve the quality of agricultural lands requires affirmative effort, and so the failure to do what is needed can uniquely be described here as willful."[67] Thus, the court in *Hickman* chose to broaden the definition of bad faith waste beyond the example presented in *Cornelison*.[68]

A second shortcoming of the *Cornelison* decision is that the creation of two categories of waste is unnecessary. Recoveries for waste and personal deficiency judgments are not as closely related as the court's decision might suggest. The court's conclusion—that recovery for waste and a deficiency judgment would be identical up to a certain point[69]—fails to recognize that loss of property value due to waste may be distinguished from loss due to adverse economic conditions, even though both factors exist simultaneously. Although in both instances the plaintiff seeks to recover for an inadequate security, the cause of the inadequacy is different.[70] Adverse economic conditions generate

66. 58 Cal. App. 3d 900, 130 Cal. Rptr. 304 (1976).

67. *Id.* at 909, 130 Cal. Rptr. at 310.

68. The court in *Hickman* rejected the defendant's argument that the example of bad faith waste in *Cornelison* was definitive, concluding instead that the language "was only illustrative." *Id.* Furthermore, while it is arguable that the rule in *Hickman* might be limited to cases involving agricultural lands, it seems equally likely that a properly drafted complaint could withstand a demurrer when other types of property are involved. It would be no great extension to include normally actionable permissive waste under the term "willful mismanagement." For a discussion of permissive waste see note 15 *supra*.

69. 15 Cal. 3d at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566.

70. There are essentially three possible factors that may render the security inadequate: (1) original overvaluation of property; (2) adverse economic conditions in so-

large-scale declines in the marketability of property in general. Thus, even properly maintained property may decline in value and produce less at a foreclosure sale. Property that has been improperly cared for will suffer additional diminution in value as its component parts deteriorate. Overall property value diminution consists of the sum total of these two independent and cumulative forces. The impact of each may be separately valued and dealt with.[71]

A third shortcoming of the *Cornelison* decision is that it actually does very little to prevent the situation in which the mortgagee may acquire irredeemable title to the property without surrendering the possibility of a personal recovery against the mortgagor.[72] The mortgagee may preserve such a cause of action by simply failing to enter a "full credit bid" at the foreclosure sale,[73] for, as the *Cornelison* court cogently stated:

---

ciety; or (3) harm inflicted upon the property. As noted earlier, section 580(b) seeks to minimize the effects of the first two causes. For a discussion of this point see notes 36-40 *supra* and accompanying text. However, to find section 580(b) applicable, the court must determine that the particular factual setting at issue fits within the purposes sought to be furthered by the statute. *See, e.g.*, Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 378 P.2d 97, 27 Cal. Rptr. 873 (1963). By its terms, the statute does not apply to all lenders. *See* Leipziger, *supra* note 38, at 802-03. The plaintiff in a waste action seeks a remedy for impairment of security as a result of harm inflicted upon the property by the mortgagor subsequent to the loan. It is the mortgagor's conduct, unrelated to any original overvaluation or adverse economic conditions in society, that has reduced the property's value and thereby rendered the security inadequate.

71. The independent vitality of market conditions and wasteful conduct as they affect property values are apparently acknowledged by the court in its analysis of the situation wherein waste occurs in a rising market. The court states that there would be no impairment of security unless the harm to the property exceeds the general increase in property values. 15 Cal. 3d at 603, 542 P.2d at 990, 125 Cal. Rptr. at 566. The recognition of this fact in one context makes the court's analysis of waste in another context, that of a falling market, even more puzzling.

72. The court demonstrates a tendency to which the California courts often succumb, that of attempting to establish strict rules for the application of anti-deficiency legislation while hinting to counsel how such rules might be avoided. Leipziger, *supra* note 38, at 757. *See* Kistler v. Vasi, 71 Cal. 2d 261, 455 P.2d 106, 78 Cal. Rptr. 170 (1969); Union Bank v. Gradsky, 265 Cal. App. 2d 40, 71 Cal. Rptr. 64 (1968).

73. Since there is frequently a lack of competitive bidding at private foreclosure sales, with the beneficiary automatically becoming the highest bidder, a bid of the full value of the property is not in the mortgagee's best interest whenever waste is believed to have occurred. Where the value of the property and the extent of harm to the property are difficult to estimate, a mortgagee will use a lower bid as a hedge. However, a mortgagee might also enter a low bid as a matter of course, thereby hoping to recover inflated waste claims in a subsequent personal action against the mortgagor. In neither case will the mortgagee have anything to lose by underbidding. Rather, the result will be both acquisition of irredeemable title to the property and a personal judgement for waste against the mortgagor.

The impact of the fair value provisions in this area is unclear. *See* Cricker, *Beneficiary's Underbid—A Neglected Tool*, 44 L.A.B. BULL. 295, 297 (1969) (conclusiveness of

> If the beneficiary or mortgagee at the foreclosure sale enters a bid for the full amount of the obligation owing to him together with the costs and fees due in connection with the sale, he cannot recover damages for waste, since he cannot establish any impairment of security, the lien of the deed of trust or mortgage having been theretofore extinguished by his full credit bid and all his security interest in the property thereby nullified. If, however, he bids less than the full amount of the obligation and thereby acquires the property valued at less than the full amount, his security has been impaired and 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.[74]

A fourth drawback of the *Cornelison* decision is that it will increase the complexity and the cost of litigating the various aspects of the inadequacy of the security following foreclosure. As courts develop a workable definition of good faith waste, which in turn will circumscribe the boundaries of bad faith waste, they will be forced to struggle with the nebulous, but crucial, question of what constitutes a general market depression or economic downturn. It is also unclear whether the downturn must be national or statewide in scope. The *Cornelison* decision mandates an inquiry into the cause of the inadequacy of the security as well as the extent of the impairment attributable to bad faith waste. These difficult issues of causation and valuation will necessitate the employment of expert economists and appraisers, which will markedly increase the expense of litigation. As these questions of fact

---

the price established at a private sale). It is arguable, however, that *Cornelison* has revived the operation of section 580(a), which was rendered obsolete by the passage of section 580(d). Although the court effectively held that a recovery for bad faith waste is not a deficiency judgment, the phraseology of section 580(a) may be broad enough to apply to such a recovery. For the relevant text and a discussion of section 580(a) see note 31 *supra*. Section 726, however, speaks in terms of a "judgment for a deficiency." Since the court has defined a recovery for bad faith waste as not constituting a deficiency judgment, it is arguable that the mortgagee can avoid the fair value provisions. Underbidding at a judicial sale, on the other hand, is less likely to occur because by underbidding, the mortgagee encourages the mortgagor to redeem. Thus, if the fair value provisions were found inapplicable, the parity of remedies rationale of section 580(d) would be impaired.

74. 15 Cal. 3d at 607, 542 P.2d at 993, 125 Cal. Rptr. at 569.

are decided on a case by case basis, the probable result will be a series of inconsistent decisions.

III. THE NINTH CIRCUIT REJECTS THE *CORNELISON* APPROACH

In *United States v. Haddon Haciendas Co.*,[75] the Ninth Circuit Court of Appeals declined to follow the *Cornelison* good faith-bad faith waste distinction in construing a no-deficiency clause in a deed of trust[76] insured by the Federal Housing Administration (FHA)[77] under section 221(d)(4) of the National Housing Act (NHA).[78] In so doing, the court implied that the approach of the California courts would foster a deterioration of the quality of the housing supply.[79] The defendants in *Haddon* contended that the no-deficiency clause in the FHA agreement should be construed to cover an action for waste.[80] Although the California Supreme Court in *Cornelison* found that an action for "good faith" waste should be construed as a form of deficiency judgment, the *Haddon* court felt no similar need to distinguish between good faith and bad faith waste. Relying heavily upon the purposes and goals of

75. 541 F.2d 777 (9th Cir. 1976). Haddon Haciendas Company was a limited partnership, with defendants Rudoff and Nahum as general partners. In 1966, Haddon acquired title to a housing project in Los Angeles which was subject to a note, a deed of trust and a regulatory agreement that had been a requirement for obtaining FHA insurance pursuant to section 221(d)(4) of the National Housing Act (NHA). *See* note 78 *infra*. The regulatory agreement obligated the owner to "maintain the project in good repair and condition." Haddon assumed and agreed to be bound by the note, deed of trust and regulatory agreement. In 1969, Haddon defaulted on his payments to the beneficiary of the deed of trust. The FHA, as insurer, paid off the note and then instituted foreclosure proceedings, purchasing the property at a judicial sale for a bid of $750,000 on a total outstanding debt of $992,027. The government then amended its complaint to recover damages for waste and for breach of the obligations in the agreement. Upon finding that the defendant had failed to keep the property in good repair, the district court awarded as damages $13,500 expended in restoring the property. The defendants appealed, and the Ninth Circuit Court of Appeals affirmed. 541 F.2d at 780.

76. The clause prohibits the United States from seeking "any judgment for a deficiency in any action to foreclose this deed of trust." 541 F.2d at 781.

77. The FHA acts as an insurer rather than as a mortgagee. However, on paying off a claim of its insured mortgagee, it steps into the mortgagee's shoes. *See generally* Note, *The Role of State Deficiency Judgment Law in FHA Insured Mortgage Transactions*, 56 MINN. L. REV. 463 (1972) [hereinafter cited as Note, *Role of State Deficiency Judgment Law*].

78. *As amended by* Housing Act of 1954, ch. 649, § 123, 68 Stat. 599 (current version at 12 U.S.C. § 1715(d)(4) (Supp. V 1975)).

79. 541 F.2d at 782.

80. *Id.* at 781. The defendants initially argued that their liability should be limited to affirmative conduct. The court quickly rejected the active-passive touchstone, stating: "That the various acts of neglect . . . might be characterized as failures to act rather than affirmative misconduct is irrelevant." *Id.* For a short discussion of permissive waste see note 15 *supra*.

the NHA, the court held that the no-deficiency clause contained in the FHA mortgage did not preclude an action for waste.[81] The court stated that equating an action for waste with a suit for a deficiency would undermine one of the objectives of the NHA, which is to "preserv[e] the housing stock and [prevent] its deterioration into slums."[82]

The defendants also argued that the California anti-deficiency statutes and the *Cornelison* decision should be applied either of their own force or as an adopted federal rule.[83] Although there was no serious opposition to the proposition that federal law governed the relations between the United States and the mortgagor of a federally insured mortgage,[84] it was contended by the defendants that the court should incorporate the California law on this matter into the federal scheme. Such an approach is typically taken when a state's laws can serve as a convenient vehicle for achieving the relevant federal objectives.[85] The court was thus faced with the determination of whether adoption of the

81. 541 F.2d at 781-83.

82. *Id.* at 782. For an acknowledgment of the manner in which a no-deficiency clause promotes this function see S. REP. No. 1472, 83d Cong., 2d Sess. 2 (1954), *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 2723, 2724, 2734-35. A careful reading of *Haddon*, however, shows that the *Haddon* court may have misinterpreted the function of the anti-deficiency clause. It appears that Congress inserted a no-deficiency judgment clause not as a means to prevent slums, but because it preferred a "share the risk" approach to encourage care on the part of the lending institutions.

In fact, there is a definite similarity between the objectives of the FHA and of section 580(b). Both were spawned by the same conditions. The FHA was created under the NHA by Congress in 1934 as a response to the problems and difficulties of the economic depression of the 1930s. National Housing Act, ch. 847, tit. 1, § 1, 48 Stat. 1246 (1934) (current version at 12 U.S.C. § 1701 (1970)). It was charged generally with the following broad responsibilities: (1) to encourage improvement in housing standards and conditions; (2) to provide a system of mutual mortgage insurance; (3) to facilitate a sound home-financing program on reasonable terms; and (4) to achieve a stabilizing influence in the residential mortgage market. *See* Note, *Federal Courts—Refusal to Apply State Redemption Statute to FHA-Insured Mortgage Foreclosure*, 17 WAYNE L. REV. 178, 179 n.8 (1971). The similarity between purposes (3) and (4) and the goals of section 580(b) is evident. For a discussion of section 580(b) see notes 36-40 *supra* and accompanying text.

83. 541 F.2d at 782-83.

84. *See* Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943); United States v. Stadium Apartments, Inc., 425 F.2d 358, 360 (9th Cir.), *cert. denied sub. nom.* Lynch v. United States, 400 U.S. 926 (1970); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380, 382 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959).

85. *See, e.g.*, Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380, 382 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959). A detailed analysis of choice of law is beyond the scope of this Note. For an analysis of the methodology that should be applied see generally Note, *State Statutory Redemption Right and The Federal Housing Administration: Reconciliation of Real and Illusory Conflicts*, 49 B.U.L. REV. 717 (1969).

California state law, under which the federal government would be denied recovery in an action for waste, would substantially impair the statutory purposes of the FHA insurance program.[86] A prime goal of the insurance program is the development of stable housing and the prevention of the spread of blight and slums.[87] As a result, there was a concern in *Haddon* with deterring

> the exploitive management of federally-insured projects and the resulting substandard and slum-like housing conditions that the NHA was designed to eliminate. The federal housing program is not furthered by insuring investments in housing stock declining in standards of decency, safety, and sanitation . . . [A]doption of the California law on waste actions would remove a powerful incentive for

---

86. Regarding the issue of adoption of state law limiting the enforcement of a federal right, the court was confronted with conflicting authority. One line of reasoning is represented by United States v. Yazell, 283 U.S. 341 (1966). *Yazell* involved a suit by the federal government to collect the balance due on a loan made by the Small Business Administration, with the defendant relying on a state law which limited the contractual powers of married women. *Id.* at 342-43. Even though, as in *Haddon*, federal law governed the loan, the Court held that state law was applicable in determining the defendant's contractual capacity. *Id.* at 352. This result was due largely to the Court's opinion that the parties had contracted with state law in mind, *id.* at 350, and that the government should, therefore, be precluded from reaching assets for which it had not bargained. *Id.* at 353. The other line of reasoning is represented by United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied sub nom.* Lynch v. United States 400 U.S. 926 (1970), in which the defendant attempted to preserve Idaho's statutory redemption rights following the FHA's foreclosure of its mortgage, which the FHA had guaranteed. Again, federal law clearly governed the rights of the parties. Nevertheless, the court in *Stadium Apartments* refused to apply the state's redemption statute, reasoning in part that protection of the federal fiscal resources predominates over the state's interest in assuring redemption rights. 425 F.2d at 363.

The *Haddon* court concluded that *Stadium Apartments* was the applicable authority and therefore rejected the defendant's contention that state law should be applied as part of the federal statutory scheme. 541 F.2d at 782. Despite the fact that *Yazell* and *Stadium Apartments* might be distinguishable in that they involved different government programs and agencies, the *Haddon* court declined to rest its decision solely on any such distinction. *Id.* at 783. Rather, the court justified its decision as striking a reasonable accommodation between competing federal anti-slum and California debtor-protection policies. *Id.* at 784-85. *See generally* Note, *Role of State Deficiency Judgment Law*, *supra* note 77; Note, *Federal Courts—Choice of Controlling Law in Cases Involving Federally Insured Mortgages*, 49 N.C.L. REV. 358 (1971); Note, *State Redemption Statutes Not Applicable to Foreclosure by the United States on FHA Insured Mortgage*, 23 VAND. L. REV. 1384 (1970); Note, *Refusal to Apply State Redemption Statute to FHA-Insured Mortgage Foreclosure*, 17 WAYNE L. REV. 178 (1971).

87. S. REP. NO. 1472, 83d Cong., 2d Sess. 2 (1954), *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 2723, 2724.

> landlords to maintain housing projects in decent condition.[88]

The analysis of the *Haddon* court underscores a major weakness of the *Cornelison* decision. The *Cornelison* court, in describing an instance of good faith waste, referred to the mortgagor who forgoes general property maintenance and repair in order to keep up the mortgage payments, but who eventually defaults as a result of the economic pressures of a market depression.[89] As noted by the *Haddon* court, a policy that encourages people to stay with a project after losing the ability to maintain it is of questionable wisdom. Even though a mortgagor may not be completely responsible for an inability to meet mortgage payments, fires of depression are nevertheless fed by the deterioration of the property and the deleterious influence of the dilapidated property upon neighboring parcels. The California policy, as declared by the court in *Cornelison*, which encourages the mortgagor to hang on in the face of all odds, may actually aggravate the downturn by adversely affecting neighboring property values.

IV. CONCLUSION

In assessing the impact of the *Cornelison* opinion, one draws the conclusion that its current effect is minimal and that it would be best if the California courts allowed it to slip into desuetude. The disavowal of an active-passive touchstone for determining good faith waste, the requirement of a general market depression and its inapplicability whenever federal programs such as the FHA are involved all limit its impact. The experimental distinction drawn between good faith and bad faith waste was an unfortunate venture into the field of judicial legislation.

To the extent that a court is concerned with the prospect of mortgagees pursuing deficiency judgments under the guise of waste actions, there are adequate safeguards other than good faith waste. If the property proved inadequate because of an economic decline or overvaluation, a cause of action for waste would not be stated. Presumably, courts sophisticated enough to make the good faith-bad faith determinations required by the *Cornelison* decision should be able to discern a waste subterfuge. Therefore, the concern of the *Cornelison* court is already satisfied

88. 541 F.2d at 784.

89. 15 Cal. 3d at 603-04, 542 P.2d at 990-91, 125 Cal. Rptr. at 566-67.

by established flexible common law principles delineating the doctrine of waste. In light of the problems presented by the *Cornelison* court's holding and the notable lack of benefits derived therefrom, the court should not have compromised as it did.

Henry E. O'Neill