

COMMENT ON MERRILL ON THE LAW OF WASTE



Richard A. Posner

Courtesy of The University of Chicago Law School.

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I have been asked to comment on Professor Thomas Merrill's article about the doctrine of waste in the common law of property, and specifically about his criticism of the approach to that doctrine that I take in my book *Economic Analysis of Law*.

I discuss the application of the doctrine only to the competing interests of life tenants and remaindermen. The incentive of a life tenant is to maximize not the value of the property—that is, the present value of the entire stream of future earnings obtainable from it—but only the present value of the earnings stream obtainable during his expected lifetime. So he will, for example, want to cut timber before it has attained its mature growth even though the present value of the timber would be greater if the cutting of some or all of it were postponed; for the added value from waiting would inure to the remainderman. The law of waste forbids the tenant to reduce the value of the property as a whole by considering only his own interest in it.

I pointed out in my book that the doctrine might not be thought necessary because the life tenant and the remainderman would have an incentive to negotiate an optimal plan for exploiting the property, either when the property was first divided between them or when the life tenant thought he could make some alteration in the property that would increase the value of his interest without impairing the remainderman's interest more. Any alteration that improved the property in an economic sense would create surplus value for life tenant and remainderman to divide; both would be better off if the improvement were made, provided that they could divide the surplus value between them. But since tenant and remainderman would have only each other to contract with, the situation would be one of

bilateral monopoly and transaction costs might be high. Also, the remaindermen might be children, and children do not have the legal capacity to make binding contracts; they might even be unborn children. The problem of bilateral monopoly is less acute in the analogous case of landlord and tenant, I explained in my book, because the terms of a lease are established before the parties become locked into a relationship with each other. But a life tenancy is often created by a will, and the testator (for whom estate planning may be a once-in-a-lifetime experience) may not be alert to the potential conflicts between life tenants and remaindermen.

The law of waste, I further noted, has largely been supplanted by a more efficient method of administering property: the trust. By placing property in trust, the grantor can split the beneficial interest as many ways as he pleases without worrying about the inefficiencies of divided ownership. The trustee will manage the property as a unit, maximizing its value and allocating that value among the trust's beneficiaries in the proportions desired by the grantor. Of course, the trustee has to be given the proper incentives to do this. Both carrot and stick are employed to this end. The trustee is compensated, but he is also placed under a duty (a "fiduciary" duty, as it is called) to administer the trust as if it were his own property and he had the same preferences, including attitude toward risk, as the beneficiaries of the trust are known or can be assumed to have. ▶▶

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I did not discuss in my book the fork in the road that Merrill emphasizes: the choice whether to forbid, as waste, the life tenant's making any material change in the property, or merely to forbid his making a change that reduces the overall value of the property. But the discussion of waste in my book implicitly favors the latter criterion, and this becomes the focus of Merrill's criticism of that discussion, as of the current law, which, he states, strongly supports the economic-value-maximizing approach, which I support.

Merrill discusses and rejects a third approach. That is to ask whether the tenant's proposed alteration of the property would comport with the intentions of the grantor of the divided interests in the property. As with many issues of intentionality in law, determining the grantor's intentions with respect to the rights of the respective interest holders is likely to prove indeterminate in practice, so I agree with Merrill's rejection of the intentions approach to determining waste, but we'll see that he brings intentions in by the back door.

Merrill doesn't like the value approach either (I should have expected him at least to like it more than the intentions approach). He calls it "expensive. Experts will have to testify about different uses of property and different market values for different uses." He adds that "there will often be uncertainties about the proper unit of time or the proper physical unit for applying the economic-value test. For example, persons often acquire property intending to hold it for future expansion or development. This may entail holding it in a suboptimal use for a significant time until the development can take place. Likewise, persons may hold multiple parcels of property, which fit together in a general scheme or plan, even though individual parcels are deployed in ways that are suboptimal from a market perspective."

These *could* be problems in particular cases, but Merrill doesn't discuss any cases in which they actually have been problems. In fact, he discusses only two cases, one the nineteenth-century case in the title of his article, another a case in New York from the 1920s. In both, it seems plain (in fact, it doesn't seem to have been disputed) that the tenant's proposed action—in both cases the demolition of an antiquated mansion in a modernizing city—would increase the value of the property.

Maybe the reason for the absence, as it seems, of cases in which the fears he expresses have materialized is that there are no such cases; or maybe it is simply "[t]he extreme infrequency of modern cases applying the

doctrine of waste." That infrequency would normally be thought a good thing; it suggests that the law is sufficiently clear, in application as well as in concept, to enable the vast majority of cases to be settled, probably, indeed, in advance of being filed. Nor does this appear to be an area in which asymmetry of discovery costs often forces settlement of cases that have no merit, as in class action litigation, or in which an asymmetry of stakes or resources in favor of potential defendants discourages the filing of meritorious lawsuits, as in some areas of consumer law. But Merrill argues that the reason for the dearth of cases is that persons sharing interests in property bargain to the optimal solution to their joint-maximization problem, and from this he infers that the "material alteration" criterion for waste is superior to the "value" criterion because it encourages a bargained-for resolution of the parties' conflicting interests.

This is a complicated argument. Actually I don't understand it. So here is how I would recast it. The trust, as I suggested earlier, is a more efficient way of dealing with the problem of conflicting interests in the same piece of property than the law of waste. It establishes a neutral third party—the trustee—to arbitrate the parties' competing claims. This avoids litigation except in the rare case where the trustee's resolution of the dispute can be challenged in court with a fair chance of success despite the broad discretion that trust law vests in trustees. The rise of the trust—a rise that is a broad-based phenomenon that has little if anything to do with the choice between material alteration and economic value as criteria of waste—may largely explain the decline in litigated waste cases. Merrill presents no evidence that the use of the trust in situations that would otherwise be governed by the law of waste is attributable to the adoption by most states of the value criterion, when once the material-alteration criterion reigned. Merrill himself suggests that nonjudicial solutions to traditional "waste" situations are attributable to declining costs of contracting.

Merrill is right that, other things being equal (an important qualification, but one I can ignore), a clear rule will reduce disputants' recourse to adjudication, and that is usually a good thing, though he does not discuss the complication introduced by my reference to bilateral monopoly. But if the courts have substituted, as he believes, a vague standard (economic value)—vague in application, he believes, not conceptually vague—for a clear rule (material alteration), why isn't that reflected in litigation? Maybe the answer is that its

vagueness drove parties to adopt contractual alternatives ex ante, such as the trust, so that if and when a tenant decided to alter the property there would be no occasion for litigation. Merrill does say that the infrequency of modern cases “strongly suggests that contractual solutions are the norm, not litigation,” but unless I have missed something he does not attribute this norm to the vagueness of the economic-value concept.

This may seem to make the choice of the standard for determining waste academic. In effect, holders of property interests have opted out of the law of waste. No cases—so no legal niceties to trouble the mind. But this is an overstatement. Cases of waste may be infrequent, but they do occur, as of course Merrill knows. He says: “The law of waste functions as a default rule or baseline for contracting, not as a decisional rule applied by courts—at least not very often.” He thinks that there would be even fewer cases (and that this would be all to the good) if courts would revert to the material-alteration criterion, because, he says, it is clearer than the economic-value criterion. But is it? He says that to apply the material-alteration criterion “[o]ne need only examine the property itself or—in the event the property has been modified—consult architectural drawings, photographs, or evidence about its condition when title was divided.” The property must have been altered, or there would be no dispute. The question is whether the alteration was “material.” Materiality is relative to some goal, interest, or value, and Merrill is unclear about what that goal, interest, or value is. He refers repeatedly to protecting the “subjective expectations” of the parties. Does he consider “subjective expectations” litigable? And what if the parties’ subjective expectations differ? In that case he says that it’s normally the owner’s subjective expectations that should govern. But he acknowledges that that doesn’t work if the grantor is different from the remainderman or if the lease has a very long term, such as 99 years, which is de facto ownership.

He does suggest, a little more concretely, that a tenant who “changes the condition” of the property has committed waste, and that the condition of the property is a “physical fact.” But not every change in the condition of property could plausibly be thought a *material* alteration. Is it waste to install central air conditioning? To convert a barn to a garage? To pave a driveway? Are all improvements that alter a property physically waste? Merrill retreats to “normal owner behavior,” or “contemporary community standards,” as keys to determining materiality.

Merrill gives a version of the timber example that I use in my book; he says that “[i]f an agricultural tenant would normally cut some trees to repair fences and for firewood, then this would not be a material alteration. If an agricultural tenant would not normally cut trees for commercial sale, then it would be a material alteration.” That’s fine, but Merrill should be pressed to explain *why* an agricultural tenant would not “normally” cut trees for commercial sale. Is this to be thought just some quaint rural custom, to be inferred from testimony by the locals? Isn’t the real point that if the tenant is allowed to go into the lumber business he will reduce the overall value of the property by cutting down the trees prematurely? And isn’t this point clear without testimony from the locals, or for that matter from the expert witnesses whose expensiveness bothers Merrill? I imagine that in practice the criterion of material alteration has always been implicitly economic and that all the courts have done is made its economic character transparent.

Merrill concludes with a short Richard Epstein-like paean to property “as an individual right” that “confer[s] sovereign-like powers on those we regard as owners.” He regards this “my home is my castle” concept of property rights as strongly buttressing his argument that the material-alteration criterion would minimize litigation. But from an economic standpoint, which is the standpoint (obviously) of *Economic Analysis of Law*, property rights are instrumental to achieving economic efficiency, rather than being ultimate social desiderata. Merrill has not shown that from the standpoint of overall efficiency (minimizing all costs) the material-alteration criterion is superior to the economic-value criterion for determining whether a life tenant or other holder of a property interest has unilaterally altered the property in a way that constitutes what the law forbids in the name of waste.

I am guessing that Merrill’s philosophical conception of property rights is the real motivation of his article, and not a desire to minimize waste litigation. The reason is that by his account there is almost no such litigation any more. If there are on average only three reported waste decisions a year, there cannot be very many waste cases filed, so trusts and contracts must indeed have displaced waste as the legal regime for regulating divided property interests. If as he believes this displacement is a good thing, why change the doctrine? Could a change in doctrine really be expected to reduce litigation to zero? Of course not: any new doctrine will promote litigation, at least initially, as judges and litigants expound and refine and interpret and apply the doctrine. ■