

D R A F T

FOR DISCUSSION ONLY

# UNIFORM ASSIGNMENT OF RENTS ACT

---

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

---

MEETING IN ITS ONE-HUNDRED-AND-THIRTEENTH YEAR  
PORTLAND, OREGON  
JULY 30-AUGUST 6, 2004

# UNIFORM ASSIGNMENT OF RENTS ACT

*WITH PREFATORY NOTE AND PRELIMINARY COMMENTS*

Copyright ©2004

By

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM STATE LAWS

---

*The ideas and conclusions set forth in this draft, including the proposed statutory language and any comments or reporter's notes, have not been passed upon by the National Conference of Commissioners on Uniform State Laws or the Drafting Committee. They do not necessarily reflect the views of the Conference and its Commissioners and the Drafting Committee and its Members and Reporters. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.*

## **DRAFTING COMMITTEE ON UNIFORM ASSIGNMENT OF RENTS ACT**

MICHAEL B. GETTY, *Chair*, 1560 Sandburg Terr., Suite 1104, Chicago, IL 60610  
TERRY J. CARE, 333 South Sixth St., Las Vegas, NV 89101  
BRYAN T. FREDRICKSON, 831 Royal Gorge Blvd., Ste. 329, Canon City, CO 81202  
THOMAS T. GRIMSHAW, 1700 Lincoln St., Suite 3800, Denver, CO 80203  
BARRY C. HAWKINS, 300 Atlantic St., Stamford, CT 06901, *Enactment Plan Coordinator*  
THEODORE C. KRAMER, 45 Walnut St., Brattleboro, VT 05301  
ROGER P. MORGAN, 82 Kenmore Rd., Bloomfield, CT 06002-2111  
ELWAINE F. POMEROY, 1415 SW Topeka Blvd., Topeka, KS 66612-1818  
PATRICK A. RANDOLPH, JR., University of Missouri - Kansas City, School of Law, 5100  
Rockhill Road, Kansas City, MO 64110  
R. WILSON FREYERMUTH, University of Missouri-Columbia School of Law, 215 Hulston  
Hall, Columbia, MO 65211, *Reporter*

### **EX OFFICIO**

FRED H. MILLER, University of Oklahoma, College of Law, 300 Timberdell Road, Room  
3056, Norman, OK 73019, *President*  
LANI LIU EWART, Suite 1800, Alii Pl., 1099 Alakea St., Honolulu, HI 96813, *Division Chair*

### **AMERICAN BAR ASSOCIATION ADVISOR**

IRA J. WALDMAN, 2049 Century Park East, Suite 2800, Los Angeles, CA 90067-3284

### **EXECUTIVE DIRECTOR**

WILLIAM H. HENNING, University of Alabama School of Law, Box 870382, Tuscaloosa, AL  
35487-0382, *Executive Director*  
WILLIAM J. PIERCE, 1505 Roxbury Road, Ann Arbor, MI 48104, *Executive Director Emeritus*

Copies of this Act may be obtained from:  
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS  
211 E. Ontario Street, Suite 1300  
Chicago, Illinois 60611  
312/915-0195  
[www.nccusl.org](http://www.nccusl.org)

**UNIFORM ASSIGNMENT OF RENTS ACT**

**TABLE OF CONTENTS**

SECTION 1. SHORT TITLE ..... 6

SECTION 2. DEFINITIONS ..... 6

SECTION 3. MANNER OF GIVING NOTIFICATION ..... 13

SECTION 4. ASSIGNMENT OF RENTS CREATES SECURITY INTEREST ..... 16

SECTION 5. RECORDATION OF ASSIGNMENT OF RENTS; EFFECT OF  
RECORDATION ..... 19

SECTION 6. ENFORCEMENT OF SECURITY INTEREST IN RENTS ..... 23

SECTION 7. ENFORCEMENT BY APPOINTMENT OF RECEIVER ..... 24

SECTION 8. ENFORCEMENT BY NOTIFICATION TO TENANT ..... 27

SECTION 9. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR ..... 35

SECTION 10. MORTGAGEE IN POSSESSION ..... 37

SECTION 11. EFFECT OF ENFORCEMENT; NO AGENCY OR STATUS AS  
MORTGAGEE IN POSSESSION; ENFORCEABILITY OF SECURED  
OBLIGATION ..... 38

SECTION 12. APPLICATION OF RENTS COLLECTED ..... 40

SECTION 13. PAYMENT OF EXPENSES FOR PROTECTING REAL PROPERTY ..... 41

SECTION 14. TURNOVER OF RENTS; COMMINGLING AND IDENTIFIABILITY OF  
RENTS; TRANSFER OF RENTS BY ASSIGNOR. .... 45

SECTION 15. PRIORITY AMONG COMPETING SECURITY INTERESTS IN RENTS;  
PRIORITY AMONG RECEIVERS ..... 49

SECTION 16. SCOPE OF TERM “TENANT.” ..... 50

SECTION 17. UNIFORMITY OF APPLICATION AND CONSTRUCTION ..... 51

SECTION 18. EFFECTIVE DATE ..... 51

SECTION 19. REPEALS ..... 51

SECTION 20. APPLICATION TO EXISTING RELATIONSHIPS ..... 51

# UNIFORM ASSIGNMENT OF RENTS ACT

## Prefatory Note

In the majority of American states that follow the lien theory of mortgages, a mortgage grants the mortgagee only a right of security, capable of being enforced via foreclosure in the event of the mortgagor's default. Under the lien theory, until such enforcement occurs, a mortgage does not by itself convey to the mortgagee the right to collect rents accruing from the mortgaged real estate. As a result, it has become customary that when a lender makes a mortgage loan on income-producing real estate, the lender requires the borrower to execute a document typically entitled an "Assignment of Leases and Rents."

This assignment can serve a number of practical purposes, but its most significant purpose is to provide the mortgagee with a security interest in rents that accrue prior to the time that the mortgagee can complete a foreclosure proceeding. In many states, the foreclosure process can be quite lengthy, and the mortgage lender faces a heightened risk that while a foreclosure proceeding is pending, the borrower may continue to collect project revenues and spend them other than to reduce the mortgage debt (a process often referred to as "milking" the rents). By taking the assignment, the lender makes clear its intention to have a lien upon all future rents produced by the real property, including those that accrue during the period between the mortgagor's default and the mortgagee's completion of a foreclosure proceeding. The assignment typically permits the lender to take steps following the borrower's default to collect rents and apply them to reduce the mortgage debt. These steps may include, *inter alia*, the lender's taking physical possession of the project (becoming a "mortgagee in possession"), obtaining the appointment of a receiver for the project, or notifying tenants to direct all future rent payment to the lender.

State law generally governs the creation and enforcement of security interests in rents. Unfortunately, most states do not have detailed statutory provisions dealing with the creation and enforcement of security interests in rents (by contrast to the comprehensive provisions in Uniform Commercial Code Article 9 for the creation and enforcement of security interests in personal property receivables). Thus, the creation and enforcement of security interests in rents tends to be governed by the common law of real property. Not surprisingly, this has produced undesirable variation in the rules governing the creation and enforcement of security interest in rents. Perhaps more significantly, disagreements regarding security interests in rents tend to be resolved in the federal bankruptcy courts, after the owner of mortgaged real estate has resorted to bankruptcy to obtain a stay from creditor collection efforts. Bankruptcy courts have proven exceptionally adept at creatively interpreting (or misinterpreting) state law principles — in some cases to disencumber a lender's security interest in rents altogether, or in other cases to exclude post-bankruptcy rents from the bankruptcy estate altogether.

To address some of these concerns, the Act seeks to bring consistency to commercial real estate transactions by establishing a comprehensive statutory model for the creation, perfection,

and enforcement of a security interest in rents. The Act addresses, *inter alia*, the following issues:

*Security Interest in Rents is Distinct Form of Collateral.* As stated above, the most significant purpose of an assignment of leases and rents is to provide the mortgagee with a security interest in rents that accrue prior to the time that the mortgagee can complete a foreclosure proceeding. Most courts have held that this security interest in rents constitutes a separate form of collateral, distinct from the mortgagee's lien on the land itself. Unfortunately, some court decisions have wrongly concluded that rents do not constitute separate collateral, but are "subsumed within the land." In reaching this conclusion, these courts have held that a bankrupt mortgagor/owner may use rents during the pendency of its bankruptcy, without regard to the lender's security interest in rents, so long as the mortgaged land itself is not decreasing in value. The Act rejects these decisions and confirms the prevailing view that a security interest in rents is a form of collateral that is separate and distinct from the a lien on the land that generates those rents. For further background, *see* Act § 4, Preliminary Comment 1.

*"Perfection" of a Security Interest in Rents.* The Act codifies the principle that an assignment of rents is perfected and effective against third persons upon its proper recordation. The Act thus establishes, as a matter of state law, that once a lender has recorded an assignment of rents, no further action is necessary to protect the enforceability and priority of the lender's security interest in rents against subsequent purchasers or creditors. The Act should thus resolve any remaining ambiguity regarding the enforceability of a lender's security interest in rents accruing during the pendency of a mortgagor/owner's bankruptcy case, as the Bankruptcy Code makes clear that the bankruptcy trustee/debtor-in-possession cannot use its "strong-arm" avoiding power [11 U.S.C. § 544(a)] to avoid a security interest that was properly perfected prior to bankruptcy. The Act would thus overrule case law suggesting that a security interest in rents was "inchoate" or ineffective until the lender takes affirmative action after default to obtain possession of the real property, impound the rents, secure the appointment of a receiver, or some other similar action. For further background, *see* Act § 5, Preliminary Comment.

*"Absolute" Assignments of Rents.* Often, an assignment of leases and rents will state that the assignor is making an "absolute" transfer of rents, even though the context of the transaction (and often the terms of the assignment itself) indicate that the assignor is making the assignment only as security for repayment of the mortgage obligation. Mortgage law has long established that instruments purporting to make an absolute conveyance of title to land nevertheless constitute equitable mortgages if the surrounding circumstances demonstrate that the parties are using title to land to secure payment of a debt. Consistent with this long-established principle, the Act establishes that an assignment of rents executed in conjunction with and as security for an obligation creates only a security interest in rents, even if the assignment purports to constitute an absolute transfer of the rents. For further background, *see* Act § 4, Preliminary Comment 2.

*Appointment of a Receiver.* In some states, there are comprehensive statutory provisions that address the circumstances in which a court should appoint a receiver for mortgaged real

property. In many states, however, there is little statutory guidance. As a result, standards governing the appointment of receivers in most states are defined judicially, and tend to vary somewhat from jurisdiction to jurisdiction — and, within many jurisdictions, from judge to judge. Some decisions require that the mortgagee’s security be inadequate or that the land is subject to existing or threatened waste; others require a showing of mortgagor insolvency. By contrast, many courts will appoint a receiver in any circumstance in which the mortgage contains a receivership clause authorizing such an appointment after default. The Act establishes consistent standards to govern the appointment of a receiver for mortgaged real estate, including the effectiveness of a receivership clause. For further background, *see* Act § 7, Preliminary Comments 1-5.

*Characterization of Real Property Revenues.* In many commercial real estate developments (*e.g.*, office buildings, retail shopping centers, apartment complexes), the owner and occupiers of the development stand in a landlord-tenant relationship, based upon the execution of leases covering portions of the development. Because the common law has treated unaccrued rents as an interest in land (an incorporeal hereditament), there is no question that in these cases, the sums paid by tenant occupiers constitute “rent.” Thus, a mortgage lender taking a security interest in those “rents” must comply with the provisions of real estate law in order to obtain and enforce that security interest — *i.e.*, the mortgage lender must have the mortgagor execute and deliver an instrument sufficient to convey an interest in “rents” and must record that instrument on the public land records. In many other developments, however, the occupiers are not “tenants,” but merely licensees (*e.g.*, nursing home residents, persons occupying garage spaces or marina slips, hotel guests, and the like). Court decisions involving security interest in the revenues paid by such occupiers have disagreed over the proper characterization of these revenues — with some treating them as “rents” in the nature of real property, and others treating them as “accounts” subject to the provisions of Uniform Commercial Code Article 9. These decisions have created uncertainty regarding both the proper way to create and perfect a security interest in these occupancy revenues, as well as the appropriate treatment of a security interest in those revenues generated during the pendency of a bankruptcy case. The Act establishes that rents include any sum paid by a tenant, licensee, or other person for the right to possess or occupy the real property of another. For further background, *see* Act § 2, Preliminary Comment 12.

*Enforcement by Demand to Assignor/Owner.* The traditional weight of case authority required that an assignee of rents could enforce its security interest in rents only by taking steps sufficient to divest the assignor of control over those rents. Under this approach, it did not suffice for the assignee to make a demand upon the mortgagor/assignor to turn over rentals as they were collected. These decisions reflected a concern that as long as the mortgagor was collecting and retaining net rentals, third party claimants (such as trade creditors to whom the mortgagor might make payments) could be easily misled by the mortgagor’s control over those cash proceeds. The Act rejects this approach and permits an assignee to enforce its security interest in rents by giving a notification demanding that the assignor turn over any rents that it may collect following the notification — and thus an assignor who fails to turn over any such rents to the assignee is liable for conversion of those rents. The Act protects third persons to

whom the assignor pays cash that constitute proceeds of rents if the third persons are not acting in collusion with the assignor to violate the assignee's security interest in rents. For further background, *see* Act § 9, Preliminary Comment 1; § 14, Preliminary Comments 2 and 3.

*Enforcement by Demand to Tenants.* The Act seeks to facilitate the enforcement of a security interest in rents by allowing the assignee to give a notification to tenants demanding that the tenants make future rent payments directly to the assignee. The Act addresses the liability of the tenant for making payments to the assignor following receipt of such a notification, the need for a tenant to have adequate opportunity to seek counsel regarding the legal effect of the notification, and the possibility of a tenant receiving a notification from multiple rents assignees. The Act also provides a standard form notification suitable for use by assignees. For further background, *see* Act § 8, Comments 1 through 6.

*“Additional Rent” for Taxes, Insurance, and Maintenance.* Often, commercial leases obligate the tenant to pay a sum characterized as “additional rent.” This sum is typically based upon the tenant's pro rata share of the cost of real property taxes, insurance, and maintenance expenses (or the increase in such costs or expenses beyond an established baseline amount), and serves to reimburse the landlord for the payment of these expenses. Leases customarily characterize the tenant's obligation to pay these sums as “rent,” and assignments of leases and rents typically require the landlord/assignor to grant a security interest in these sums. Based upon these customary practices, the Act treats such sums as “rents.”

The Committee is currently divided, however, about whether a lender that collects “additional rents” after enforcing an assignment of rents may apply those sums to the satisfaction of the secured obligation rather than applying those sums to the payment of taxes, insurance, and maintenance expenses. California's comprehensive assignment of rents statute places an obligation on the assignee to use whatever rents it collects to pay the reasonable expenses of operating and maintaining the real property. By contrast, under the traditional rule prevailing in most states, the landlord's obligation to pay these expenses — even if the obligation is expressed or implied into its tenant leases — does not bind the lender as a successor until the lender acquires possession or ownership of the land (by becoming a mortgagee in possession or purchasing the premises at foreclosure). Under this view, the lender could collect rents and apply them to the mortgage debt without applying such sums to the payment of taxes, insurance, or property maintenance.

At present, the Act provides that if a lender collects any rents that are expressly designated by the lease as additional rents for the payment of real property taxes and insurance (or reimbursing the assignor's payment of such expenses), the lender must apply those rents (defined as “dedicated rents”) to the payment of taxes and insurance. The Committee has taken this position because most prudent assignees already use collected rents to satisfy any unpaid real property taxes and to ensure that the real property remains insured. However, the Act does not provide comparable treatment for additional rents designated for the payment of real property maintenance expenses. Often, the assignor or an affiliate of the assignor performs project

maintenance and collects a substantial fee for these services, and the assignee may understandably be resistant to using rents to allow the assignor to profit from operating the real property while the assignor is failing to pay its debt service obligation to the assignee. An assignee might choose to continue to pay such sums to the assignor if the assignee is comfortable that the assignor's management agreement was commercially reasonable. Indeed, a rents assignee has a strong economic incentive to make sure that these expenses are paid in the ordinary course, so as to preserve the going-concern value of the real property and to avoid triggering defaults under tenant leases. Nevertheless, at present the Act does not place on a rents assignee any legal obligation to use collected rents for the purpose of paying or reimbursing property maintenance expense.

The Committee anticipates further discussion on this issue, and particularly welcomes input from the Annual Meeting on the appropriate resolution of this issue. For further background, *see* Act § 13, Preliminary Comments 1 through 5.

1 **UNIFORM ASSIGNMENT OF RENTS ACT**

2  
3 **SECTION 1. SHORT TITLE.** This [act] may be cited as the Uniform Assignment of  
4 Rents Act.

5 **SECTION 2. DEFINITIONS.** In this [act]:

6 (1) "Assignee" means a person entitled to enforce an assignment of rents.

7 (2) "Assignment of rents" means a transfer of an interest in rents made in  
8 connection with an obligation secured by real property located in this state, whether the  
9 assignment is made as part of a security instrument covering the real property or in a separate  
10 document.

11 (3) "Assignor" means a person that makes an assignment of rents or a successor in  
12 interest to such person.

13 (4) "Cash proceeds" means money, checks, deposit accounts, or the like.

14 (5) "Day" means calendar day.

15 (6) "Deposit account" means a demand, time, savings, passbook, or similar  
16 account maintained with a bank, savings bank, savings and loan association, credit union, or trust  
17 company.

18 (7) "Document" means information that is inscribed on a tangible medium or that  
19 is stored on an electronic or other medium and is retrievable in perceivable form.

20 (8) "Good faith" means honesty in fact and the observance of reasonable  
21 commercial standards of fair dealing.

22 (9) "Notification" means a document containing information required under this

1 [act] and signed by the person required to provide the information.

2 (10) "Person" means an individual, corporation, business trust, estate, trust,  
3 partnership, limited liability company, association, joint venture, public corporation, government,  
4 or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

5 (11) "Record" means to submit a document complying with applicable legal  
6 standards, with required fees and taxes, to the appropriate governmental office under [the  
7 recording act of this state].

8 (12) "Rents" means:

9 (A) sums payable for the right to possess or occupy the real property of  
10 another person;

11 (B) the proceeds of rental interruption insurance payable to an assignor;

12 (C) claims arising out of a default in the payment of sums payable for the  
13 right to possess or occupy the real property of another person;

14 (D) sums payable to terminate an agreement to possess or occupy the real  
15 property of another person;

16 (E) sums payable to pay or reimburse an assignor for payment of:

17 (i) expenses incurred in operating and maintaining the real  
18 property; or

19 (ii) expenses incurred in constructing or installing improvements  
20 on the real property;

21 (F) a security deposit forfeited by a possessor or occupier of real property;

22 (G) any other sums that are defined as rents under the law of this state

1 other than this [act]; and

2 (H) cash proceeds received upon collection of any sum or claim identified  
3 in subparagraphs (A) through (G).

4 (13) “Secured obligation” means an obligation the performance of which is  
5 secured by a security interest in real property.

6 (14) “Security instrument” means an agreement that creates or provides for a  
7 security interest in real property, however denominated, whether or not it also creates or provides  
8 for a lien upon personal property.

9 (15) “Security interest” means an interest in real property that arises by agreement  
10 and secures performance of an obligation.

11 (16) “Sign” means, with present intent to adopt or accept a document:

12 (A) to execute or adopt a tangible symbol; or

13 (B) to attach to or logically associate with the document an electronic  
14 sound, symbol, or process.

15 (17) “State” means a state of the United States, the District of Columbia, Puerto  
16 Rico, the United States Virgin Islands, or any territory or insular possession subject to the  
17 jurisdiction of the United States.

18 (18) “Tenant” means a person obligated to pay rents.

19 **Preliminary Comments**

20 1. “Assignee.” The term “assignee” means the party entitled to enforce an assignment of  
21 rents in the manner specified by this Act.

22  
23 2. “Assignment of rents.” In many commercial transactions, it is customary for the lender  
24 to require the borrower to execute multiple documents, including both a “mortgage” covering the

1 land and an “assignment of rents and leases” which assigns to the lender all leases covering the  
2 mortgaged premises and all rents accruing under those leases. In some transactions, the lender  
3 may simply incorporate into the mortgage language sufficient to assign to the lender all leases  
4 covering the mortgaged premises and rents accruing under such leases, without a separate  
5 assignment document. The Act uses the term “assignment of rents” to mean the actual transfer of  
6 an interest in rents, whether that transfer occurs by virtue of the mortgage, a separate document  
7 entitled “assignment of leases and rents,” or otherwise.  
8

9 3. “Assignor.” The Act defines an “assignor” as the person who makes an assignment of  
10 rents, or a successor in interest to the original assignor.  
11

12 4. “Cash proceeds.” This definition is similar to that contained in U.C.C. Section 9-  
13 102(a)(9). The Act defines “rents” to include the cash proceeds received upon collection of  
14 rents.  
15

16 5. “Day.” The Act defines “day” as a calendar day.  
17

18 6. “Deposit account.” This definition is similar to that contained in U.C.C. Section 9-  
19 102(a)(29). The term uses the term “bank” in a fashion comparable to the definition contained in  
20 U.C.C. Section 1-201(b)(4).  
21

22 7. “Document.” The definition of “document” is media-neutral and is consistent with the  
23 definition of the term “record” as used in Section 2(7) of the Uniform Real Property Electronic  
24 Recordation Act. Because this Act uses the term “record” in its customary fashion under real  
25 estate law — *i.e.*, as a verb to describe the act of filing an instrument of conveyance with the  
26 recorder’s office — the Act does not use the term “record” as a noun, and instead uses the term  
27 “document.”  
28

29 8. “Good faith.” This definition is identical to that contained in U.C.C. § 1-201(b)(20).  
30

31 9. “Notification.” The Act permits an assignee to enforce an assignment of rents by  
32 giving a notification to the assignor (Section 8) or by giving a notification to tenants of the  
33 assignor (Section 7). In any circumstance in which the Act requires notification to be given to a  
34 person, any such notification shall be in the form of a document, as defined in Section 2(7), and  
35 shall contain the information required by the specific section authorizing that notification.  
36

37 10. “Person” includes both natural persons (individuals) and all forms of legally  
38 recognized public and private organizations.  
39

40 11. “Record.” To “record” means that the person submitting a document has complied  
41 with the state’s existing recording act. However, for purposes of this Act, a document is  
42 “recorded” even if the recording office’s personnel have indexed it incorrectly or otherwise failed  
43 to comply with their legal duties.

1           12. “Rents.” In many commercial real estate developments (*e.g.*, office buildings,  
2 industrial parks, retail shopping centers, and apartment complexes), the owner and occupiers of  
3 the development stand in a landlord-tenant relationship, based upon the execution of leases  
4 covering portions of the development. Because the common law has treated unaccrued rents as  
5 an interest in land (an incorporeal hereditament), sums paid by tenant occupiers undoubtedly  
6 constitute “rent” in the nature of real property. Thus, a mortgage lender taking a security interest  
7 in “rents” must comply with the provisions of real property law in order to obtain and enforce  
8 that security interest. In other words, the mortgage lender must have the mortgagor execute and  
9 deliver an instrument sufficient to convey an interest in “rents” and must record that instrument  
10 on the public land records in the county where the land is situated.

11  
12           In many other developments, however, the owner and occupier of land do not have a  
13 landlord-tenant relationship. In many commercial land developments, the user/occupier might be  
14 only a licensee. Examples of this type of project include nursing homes, parking garages, golf  
15 courses, landfills, marinas, stadiums/arenas, student dormitories, and hotels/motels. Where the  
16 development’s occupier is a licensee and not a tenant, a significant classification problem arises.  
17 Are the development revenues “rents” governed by real estate law (such that the lender would  
18 obtain and record an assignment of rents in the land records) or “accounts” governed by U.C.C.  
19 Article 9 (such that the lender would obtain a security interest by creating a floating lien on  
20 accounts and perfect that interest by filing a financing statement covering accounts in the U.C.C.  
21 filing system)?

22  
23           In theory, a lender could moot the resolution of this characterization question simply by  
24 (a) making sure that its loan documents took a security interest in both “rents” and “accounts,”  
25 and (b) properly recording/filing evidence of those interests in the respective filing systems. This  
26 “belt and suspenders” approach would appear to give the lender a perfected security interest in  
27 unaccrued project revenues regardless of how a court resolved the characterization question.  
28 Here, however, one must consider the impact of Bankruptcy Code § 552(a). Section 552(a)  
29 generally provides that any pre-petition security agreement covering after-acquired property does  
30 not affect property that the bankruptcy estate acquires post-petition. By itself, section 552(a)  
31 would suggest that a lender’s security interest in pre-petition revenues would not attach to post-  
32 petition revenues (which would, in turn, mean that those revenues would not constitute the  
33 lender’s cash collateral). Congress drew a careful distinction, however, between *property*  
34 *received by the debtor post-petition* and *post-petition proceeds of pre-petition collateral*. This  
35 distinction is reflected in section 552(b), which provides that a valid and properly perfected pre-  
36 petition security interest in collateral will attach to any rents, profits, and proceeds of that  
37 collateral that are received by the debtor post-petition.

38  
39           The protection accorded to secured creditors by section 552(b) makes the resolution of  
40 this classification question critical for the commercial real estate mortgage lender. If post-  
41 petition project revenues are “rents,” “profits,” or “proceeds” of the land, the lender’s security  
42 interest attaches to those revenues. If not, then section 552(a) extinguishes the lender’s interest  
43 in post-petition project revenues.

1 Most of the bankruptcy cases addressing this characterization question involved hotels  
2 and security interests in hotel room revenues. Prior to 1994, a few decisions sensibly treated  
3 hotel room revenues as the functional equivalent of tenant rents and concluded that § 552(b)'s  
4 protection for "rents" preserved a lender's properly perfected interest in post-petition hotel room  
5 revenues. *See, e.g., In re S.F. Drake Hotel Assocs.*, 131 B.R. 156, 158-61 (Bankr. N.D. Cal.  
6 1991), *aff'd*, 147 B.R. 538 (N.D. Cal. 1992); *In re Mid-City Hotel Assocs.*, 114 B.R. 634, 638-  
7 642 (Bankr. D. Minn. 1990). Most courts, however, concluded that post-petition hotel room  
8 revenues were accounts (personal property) and were neither "rents," "profits," or "proceeds" of  
9 the land. *See, e.g., In re Northview Corp.*, 130 Bankr. 543, 548 (9th Cir. BAP 1991); *In re*  
10 *Investment Hotel Properties, Ltd.*, 109 Bankr. 990, 994-97 (Bankr. D. Colo. 1990). These courts  
11 typically applied the formalistic reasoning that room revenues could not be "rent" because hotel  
12 guests were not "tenants." As a result, many bankruptcy courts routinely invalidated lenders'  
13 claimed interests in post-petition hotel revenues. The formalistic invalidation of a hotel lender's  
14 interest in post-petition room revenues was particularly inappropriate, as hotel room revenues are  
15 economically identical to the "rents" paid by tenants under apartment, office, or industrial leases.  
16 *See, e.g., R. Wilson Freyermuth, Of Hotel Revenues, Rents, and Formalism in the Bankruptcy*  
17 *Courts: Implications for Reforming Commercial Real Estate Finance*, 40 UCLA L. Rev. 1461  
18 (1993). Recognizing this unfairness, Congress amended section 552(b) in 1994 to preserve the  
19 lender's interest in post-petition "fees, charges, accounts, or other payments for the use or  
20 occupancy of rooms and other public facilities in hotels, motels, or other lodging properties."

21  
22 This amendment provided a practical solution to the classification problem with respect  
23 to hotels and other "lodging properties." Unfortunately, it did not address a wide variety of other  
24 income-generating projects. Courts have generally concluded that golf course green fees do not  
25 constitute "rents," "profits," or "proceeds" of the land. *See, e.g., In re McKim*, 217 B.R. 97  
26 (Bankr. D.R.I. 1998); *In re GGVXX, Ltd.*, 130 B.R. 322 (Bankr. D. Colo. 1991). Likewise,  
27 courts have refused to characterize stadium/arena revenue as rents. *See, e.g., Klingner v. Pocono*  
28 *International Raceway, Inc.*, 433 A.2d 1357 (Pa. Super. 1981); *In re Zeeway Corp.*, 71 B.R. 210  
29 (9th Cir. Bankr. 1987). By contrast, courts have treated revenue from parking garages as rents,  
30 *see, e.g., In re Ashford Apartments Ltd. Partnership*, 132 B.R. 217 (Bankr. D. Mass. 1991), and  
31 likewise have treated landfill dumping fees as being rents. *See, e.g., In re West Chestnut Realty*  
32 *of Haverford, Inc.*, 166 B.R. 53 (Bankr. E.D. Pa. 1993), *aff'd*, 173 B.R. 322 (E.D. Pa. 1994).  
33 Courts have split in the characterization of marina slip fees, with some characterizing these as  
34 "rents" depending upon the duration of use and others characterizing such fees as accounts  
35 subject to Article 9. *Compare In re Northport Marina Assocs.*, 136 B.R. 911 (Bankr. E.D.N.Y.  
36 1992) (fees paid by marina users for assigned slip for periods of six months or more were in  
37 nature of "rents," while fees paid by transitory users were "accounts") *with In re Harbour Pointe*  
38 *Ltd. Partnership*, 132 B.R. 501 (Bankr. D.D.C. 1991) (fees generated by marina treated as  
39 "rents") and *In re Hamlin's Landing Joint Venture*, 77 B.R. 916 (Bankr. M.D. Fla. 1987) (same).

40  
41 The Act takes the view that "rents" should include all sums paid by a person in order to  
42 acquire the right to possess or occupy the real property of another. In this regard, a person  
43 "possesses" the land of another if that person has possessory interest in that land (*e.g.*, the interest

1 of a tenant under a lease). A person “occupies” the land of another if that person has a  
2 contractual right that typically permits them to occupy the real property of another on an  
3 overnight or continuing basis. The application of this definition is demonstrated by the following  
4 illustrations:

5  
6 *Illustration 1.* ABC Life Insurance Company holds a mortgage and an assignment of  
7 rents on the Friendly Hotel. Heinsz is a guest of Friendly Hotel for three nights. The  
8 room occupancy charges that Heinsz incurs during his stay are “rents” within the meaning  
9 of the Act. Charges that Heinsz incurs for additional hotel-related services (such as room  
10 service meals, dry cleaning or laundry services, or the like) would not constitute “rents,”  
11 as they are not incurred in exchange for the right to occupy the room.

12  
13 *Illustration 2.* ABC Life Insurance Company holds a mortgage and an assignment of  
14 rents on the Friendly Nursing Home. Heinsz is a patient at Friendly Nursing Home. The  
15 room occupancy charges that Heinsz incurs during his stay are “rents” within the meaning  
16 of the Act. Charges that Heinsz incurs for medical treatment, medication, physical  
17 therapy, or the like would not constitute “rents,” as they are not incurred in exchange for  
18 the right to occupy the room.

19  
20 *Illustration 3.* First Bank holds a mortgage and an assignment of rents on the Friendly  
21 Marina. Smith pays a monthly fee to maintain a docking slip at Friendly Marina for the  
22 purpose of docking his yacht. The monthly fee Smith incurs is “rent” within the meaning  
23 of the Act. However, daily fees that Friendly Marina may collect from boaters who may  
24 use slips only on a daily or transitory basis would not constitute rents, unless the law of  
25 this state other than this Act defines those fees as “rent.”

26  
27 *Illustration 4.* First Bank holds a mortgage and an assignment of rents on Friendly Golf  
28 Course. Smith pays greens fees to play at Friendly Golf Course. The fees that Smith  
29 pays do not constitute “rents” within the meaning of the Act, as Smith does not “occupy”  
30 the land but is merely using it in a transitory or temporary fashion.

31  
32 *Illustration 5.* First Bank holds a mortgage and an assignment of rents on Friendly  
33 Parking Garage. Smith pays \$150 per month for a reserved parking space. The \$150  
34 monthly fee constitutes “rent” within the meaning of the Act, as payment of the fee  
35 entitles Smith to occupy a parking space on a continuous basis throughout the term of  
36 Smith’s agreement.

37  
38 In addition, the Act defines rents to include a number of other charges that are often  
39 characterized as “rent” under leases or occupancy agreements, as well as sums that constitute an  
40 economic substitute for rents that might otherwise have accrued or been collected. These sums  
41 include the proceeds of rental interruption insurance payable to the assignor; claims arising out of  
42 a default in the payment of rents (e.g., liquidated damages); sums payable in order to terminate a  
43 lease or occupancy agreement; sums payable for the purpose of paying or reimbursing the

1 assignor’s payment of expenses incurred in operating and maintaining the real property (such as  
2 taxes or insurance) or in constructing or installing improvements; and any security deposit  
3 forfeited by a possessor or occupier of the real property.  
4

5 Under the Act’s definition of “rents,” the Act would generally exclude from its scope  
6 sums paid by a user for the temporary use of another’s land (*e.g.*, greens fees, ticket charges at an  
7 arena or theater). Nevertheless, the Act does provide that these charges or fees will constitute  
8 “rent” within the meaning of this Act if state law other than this Act so provides.  
9

10 13. “Secured obligation.” The term “secured obligation” covers any obligation the  
11 performance of which is secured by a security interest.  
12

13 14. “Security instrument.” This definition is identical to that used in Section 102(19) of  
14 the Uniform Nonjudicial Foreclosure Act, and recognizes that the title given to a document by its  
15 parties is not dispositive of whether the document is a security instrument. Instead, the key issue  
16 is whether the document creates a security interest. For purposes of the Act, a “security  
17 instrument” must cover real property, although it may additionally cover personal property.  
18

19 15. “Security interest.” Under the Act, a security interest arises in any transaction,  
20 regardless of its form, in which a person receives or retains an interest in real property for the  
21 purpose of securing an obligation owed to that person.  
22

23 16. “Sign.” This definition is media-neutral and comparable to that contained in  
24 Uniform Commercial Code § 2-103(1)(p).  
25

26 17. “State.” This definition is the boilerplate definition of the term as used in uniform  
27 acts.  
28

29 18. “Tenant.” For purposes of this Act, a “tenant” is any person obligated to pay rents.  
30 The Act defines “rents” to include sums payable by licensees and other occupants of land who do  
31 not have a possessory interest in the land and thus do not stand in a landlord-tenant relationship  
32 with the assignor. While the Act treats such a licensee as a “tenant” for the purposes of this Act,  
33 it does not render such a licensee a tenant within the meaning of the state’s law of landlord-tenant  
34 law. Thus, for example, nothing in this Act would grant a licensee the benefit of the state’s  
35 forcible entry and detainer statutes, an implied warranty of habitability, or any other right  
36 recognized under the state’s general law of landlord and tenant. See Section 16.  
37

38 **SECTION 3. MANNER OF GIVING NOTIFICATION.**

39 (a) Except as otherwise provided in subsections (c) and (d), a person gives a  
40 notification or a copy of a notification under this [act] by

1 (1) handing it to the recipient; or

2 (2) depositing it in the mail or with a commercially reasonable delivery  
3 service, properly addressed to the intended recipient's address as specified in subsection (b), with  
4 postage or cost of delivery provided for.

5 (b) The following rules govern the proper address for giving a notification under  
6 subsection (a)(1):

7 (1) A person giving a notification to an assignee shall use the address for  
8 notices to the assignee provided in the assignment of rents, but if the assignee has provided the  
9 person giving a notification with a more recent address for notices, the person giving the  
10 notification shall use that address.

11 (2) A person giving a notification to an assignor shall use the address for  
12 notices to the assignor as provided in the assignment of rents, but if the assignor has provided the  
13 person giving a notification with a more recent address for notices, the person giving the  
14 notification shall use that address.

15 (3) A person giving a notification to a tenant shall use the address for  
16 notices to the tenant provided in the tenant's lease, but if the tenant has provided the person  
17 giving a notification with a more recent address for notices, the person giving the notification  
18 shall use that address. If the lease does not specify an address for notices to the tenant and the  
19 tenant has not provided an address, the person giving the notification shall use the address of the  
20 leased premises.

21 (c) If a person giving a notification pursuant to this [act] and the recipient have  
22 agreed as to the methods for giving a notification, that agreement is enforceable.

1 (d) If a notification is not given in accordance with subsection (a) but is received  
2 by the recipient within the time it would have been received if properly given, it is given as of the  
3 time of receipt.

#### 4 **Preliminary Comments**

5  
6 1. *Methods of giving notification.* This section specifies the methods for giving any  
7 notification required by this Act. Under subsection (a)(2), notices required by the Act may be  
8 transmitted by registered or certified mail, regular mail, or commercial delivery services. Proper  
9 dispatch, not receipt, satisfies the obligation to give notification. Subsection (a)(1) also permits a  
10 person to give notification by personal service upon the recipient. The person asserting that  
11 notification was given has the burden of proof that notification was given in accordance with the  
12 provisions of this section.

13  
14 A notification given in a manner not authorized by subsection (a), but received by the  
15 recipient within the time it would have been received if given properly, is treated as given as of  
16 the time of receipt.

17  
18 Subsection (c) provides that if an agreement between the person giving a notification and  
19 the recipient dictates a method of notification other than the methods permitted under subsection  
20 (a), that agreement is enforceable.

21  
22 2. *Identifying the address for notification.* Typically, an assignment of rents contains a  
23 provision specifying addresses for notices to the assignor and the assignee. Subsection (b)  
24 provides that the respective addresses for notice contained in an assignment of rents will be the  
25 default addresses for any notification to the assignor or assignee under this Act. If the intended  
26 recipient has provided the person giving a notification with a more recent address, then the Act  
27 requires the person giving the notification to use that address. For example, if an assignee gives  
28 a notification to the assignor enforcing its interest in rents under Section 9 (which governs  
29 enforcement by notification to the assignor), and that notification specifies a new address for  
30 future notices to the assignee, the assignor would thereafter be obligated to use that new address  
31 in giving any notification required by the Act.

32  
33 Subsection (b)(3) provides that a tenant's address for notification will be the address so  
34 specified in the tenant's lease, or any more recent address provided by the tenant to the person  
35 giving notification. If the lease does not specify a particular address for legal notices and the  
36 tenant has not provided a more recent address, then the person giving a notification to a tenant  
37 under this Act may direct it to the tenant at the address of the leased premises.

38  
39 3. *Obligations under the Act triggered by receipt.* While a person obliged to give a  
40 notification under the Act satisfies its obligation to give that notification by dispatch in



1 preserves a secured creditor’s pre-bankruptcy lien on rents that the debtor receives after it files a  
2 bankruptcy petition, *id.* § 552(b). These provisions appear to acknowledge that a pre-bankruptcy  
3 assignment of rents creates a separate security interest in the rents (*i.e.*, separate from the  
4 underlying mortgage lien against the land itself).  
5

6 Most bankruptcy court decisions have treated post-petition rents as a separate and distinct  
7 source of collateral, but a few bankruptcy court decisions have instead concluded that post-  
8 petition rents do not constitute separate collateral because the post-petition rent stream is in fact  
9 “subsumed” within the valuation of the land itself. *See, e.g., In re Wrecclesham Grange, Inc.*,  
10 221 B.R. 978 (Bankr. M.D. Fla. 1997); *In re Embassy Properties N. Ltd. Partnership*, 196 B.R.  
11 172 (Bankr. D. Kan. 1996); *In re Citicorp Park Assocs.*, 180 B.R. 15 (Bankr. D. Me. 1995); *In re*  
12 *Barkley 3A Investors, Ltd.*, 175 B.R. 755 (Bankr. D. Kan. 1994); *In re Mullen*, 172 B.R. 473  
13 (Bankr. D. Mass. 1994). These courts have thus concluded that a debtor can use post-petition  
14 rents without regard to a pre-bankruptcy assignment of rents as long as the mortgage lender’s  
15 interest in the mortgaged land is adequately protected (*i.e.*, as long as the land itself is not  
16 declining in value), even if the land was worth less than the mortgage debt.  
17

18 The Act rejects the view of state law expressed in these cases that rents accruing prior to  
19 foreclosure are subsumed within the land. The Act instead confirms that all rents accruing prior  
20 to the completion of a foreclosure constitute a source of collateral that is separate and distinct  
21 from the land from which those rents accrued.  
22

23 2. *The “Absolute Assignment of Rents.”* As many American states adopted the lien  
24 theory of mortgages, some mortgagees began requiring the mortgagor to make an “absolute”  
25 assignment of rents. Under a so-called “absolute” assignment of rents, the assignor purported to  
26 transfer “title” to unaccrued rents to the assignee, ostensibly placing the assignee in the same  
27 legal position as it would have occupied under the title theory of mortgages. Frequently, a so-  
28 called “absolute” assignment will specify that it is “not merely for purposes of security” and that  
29 the assignor has no interest in unaccrued rents other than a revocable license (*i.e.*, not a  
30 “property” right) to collect such rents prior to default.  
31

32 Mortgagees have argued that the so-called “absolute” assignment of rents strengthens  
33 their position with respect to rents in the bankruptcy context. When a debtor files for  
34 bankruptcy, all of the debtor’s property becomes property of the bankruptcy estate. 11 U.S.C. §  
35 541(a). The debtor generally may use property of the estate in the course of its bankruptcy  
36 proceeding, subject to the obligation to provide adequate protection to a secured creditor holding  
37 a lien upon that property. 11 U.S.C. § 363(b). Moreover, a secured party holding a security  
38 interest in property of the estate is subject to the automatic stay and cannot enforce its lien or  
39 otherwise collect the debt outside the context of the bankruptcy proceeding. *Id.* § 362(a). As a  
40 result, a debtor that owns an income-producing real estate project gains significant leverage if the  
41 project’s post-petition rents constitute property of the bankruptcy estate. By contrast, the  
42 mortgagee/assignee would prefer that the law characterize the post-petition rents as property that  
43 is *not* part of the bankruptcy estate. If the project’s post-petition rents are not property of the

1 estate, the automatic stay would place no limitation upon the mortgagee’s ability to collect those  
2 rents and apply them to the debt.  
3

4 Obviously, if a mortgagee had already completed a foreclosure sale prior to bankruptcy,  
5 the land belongs to the foreclosure purchaser and thus unaccrued rents from that land would not  
6 constitute property of the bankruptcy estate. But if no foreclosure has yet occurred — and thus  
7 equitable ownership of the land remains in the debtor — unaccrued post-petition rents would  
8 seem to fit squarely within the broad concept “property of the estate” as articulated in § 541(a).  
9 Nevertheless, in an attempt to boost their leverage in context of bankruptcy, mortgage lenders  
10 have argued that under a so-called “absolute” assignment of rents, “title” to the post-petition  
11 rents is in the lender and such rents therefore do not constitute property of the bankruptcy estate.  
12 A number of courts have accepted this argument *See, e.g.*, *First Fidelity Bank v. Jason Realty,*  
13 *L.P. (In re Jason Realty, L.P.),* 59 F.3d 423 (3d Cir.1995); *In re Kingsport Ventures, L.P.,* 251  
14 *B.R. 841 (Bankr. E.D. Tenn. 2000); In re Robin Associates,* 275 B.R. 218 (Bankr. W.D. Pa.  
15 2001); *In re Carretta,* 220 B.R. 203 (D.N.J. 1998); *see also NCNB Texas Nat’l Bank v. Sterling*  
16 *Projects, Inc.,* 789 S.W.2d 358 (Tex. App. 1990) (“The absolute assignment does not create a  
17 security interest but instead passes title to the rents. An absolute assignment of rents is not  
18 security but is a pro tanto payment of the obligation.”).  
19

20 The Restatement (Third) of Property — Mortgages and most commentators have rejected  
21 this view. In the typical transaction, the assignor executes an assignment of rents and leases  
22 contemporaneously with its execution of the mortgage. The assignee does not immediately begin  
23 collecting rents from tenants as soon as it takes the assignment, and typically has no intention to  
24 do so at any time prior to the assignor’s default — indeed, the typical assignment expressly  
25 acknowledges the assignor’s right to collect and expend the rents prior to default. Under such an  
26 “assignment,” the circumstances demonstrate that the parties intend for the rents to secure the  
27 repayment of the mortgage debt. In other words, the “absolute” assignment is merely a security  
28 device, regardless of its “absolute” characterization.  
29

30 Mortgage law has long established that instruments purporting absolutely to convey an  
31 interest in land nevertheless constitute equitable mortgages when the circumstances demonstrate  
32 that the parties are using an interest in land to secure payment of a debt. *See, e.g.,* Restatement of  
33 Property (Third) — Mortgages § 3.2 (absolute deed intended to secure an obligation constitutes a  
34 mortgage); *Smith v. Player,* 601 So.2d 946 (Ala. 1992) (same); *Steckelberg v. Randolph,* 404  
35 *N.W.2d 144 (Iowa 1987) (same).* Under this same principle, courts should treat a typical  
36 “absolute” assignment of rents as an assignment for security purposes, and the weight of modern  
37 judicial authority so provides. *See, e.g., In re Cavros,* 262 B.R. 206 (Bankr. D. Conn. 2001); *In*  
38 *re 5877 Poplar, L.P.,* 268 B.R. 140 (Bankr. W.D. Tenn. 2001); *National Operating, L.P. v.*  
39 *Mutual Life Ins. Co. of New York,* 630 N.W.2d 116 (Wis. 2001); *In re Guardian Realty Group,*  
40 *L.L.C.,* 205 B.R. 1 (Bankr. D.D.C. 1997); *In re RV Centennial Partnership,* 202 B.R. 774 (Bankr.  
41 *D. Colo. 1996); In re Lyons,* 193 B.R. 637, 644 (Bankr. D. Mass. 1996). Under this view, where  
42 the underlying land is property of the bankruptcy estate, post-petition rents from that property  
43 would likewise constitute property of the bankruptcy estate. However, the assignee of those rents

1 would continue to have a security interest in those rents by virtue of Bankruptcy Code § 552(b),  
2 and the debtor/assignor would be obliged to provide adequate protection of the assignee’s interest  
3 in those rents under Bankruptcy Code § 363.  
4

5 The Act adopts the view that any “assignment of rents” as defined in this Act (Section  
6 2(2)) creates a security interest in rents, regardless of whether it is in form denominated an  
7 “absolute” assignment. The term “assignment of rents” includes only an assignment of rents  
8 made in conjunction with a secured loan, and any such assignment creates a security interest  
9 governed by this Act. By contrast, nothing in the Act precludes an owner of land from making a  
10 truly absolute transfer of rents in a transaction that is not a security transaction, such as a “true  
11 sale” of rents (in which the owner of the land transfers full legal, equitable ownership and control  
12 of unaccrued rents immediately upon execution and delivery). Such a transfer, however, is not  
13 an “assignment of rents” as defined in this Act (unless applicable state law dictates otherwise),  
14 and thus the provisions of this Act governing the enforcement of an assignment of rents would  
15 not apply to such a transfer.  
16

17 3. *Conveyancing formalities.* The Act is not intended to effect any change in the  
18 underlying law of states adopting the Act with respect to the formalities necessary to effect a  
19 conveyance of an interest in real property. If a document entitled “Assignment of Rents” is not  
20 executed in accordance with the formal requirements for an effective conveyance of an interest in  
21 real property, it does not effect a “transfer” of an interest in rents and thus the document would  
22 not constitute an “assignment of rents” as defined in Section 2(3). The Act does not specify  
23 precisely what formalities are necessary for a document to constitute an effective assignment of  
24 rents, but leaves this question to other state law.  
25

26 **SECTION 5. RECORDATION OF ASSIGNMENT OF RENTS; EFFECT OF**

27 **RECORDATION.** An assignment of rents may be recorded in the [appropriate governmental  
28 office under the recording act of this state] in the same manner as any other conveyance of an  
29 interest in real property. Upon recording:

30 (1) the assignment gives constructive notice of its contents with the same effect as  
31 any other recorded conveyance of an interest in real property; and

32 (2) the security interest created by the assignment is fully perfected,  
33 notwithstanding any provision of the assignment or other law of this state which would preclude  
34 or defer enforcement of the security interest until the occurrence of a subsequent event, including

1 a subsequent default of the assignor, the assignee’s obtaining possession of the real property, or  
2 the appointment of a receiver.

### 3 Preliminary Comments

4 Source: Cal. Civ. Code § 2938(b); Restatement (Third) of Property — Mortgages § 4.2(b).

5 Under Bankruptcy Code § 544(a) and its “strong-arm” clause, a debtor-in-possession can  
6 invalidate (or, in bankruptcy parlance, “avoid”) any security interest that a judgment lien creditor  
7 or bona fide purchaser could have avoided under state law as of the petition date.

8  
9 In the 1980s and early 1990s, bankruptcy courts struggled with the proper impact of §  
10 544(a) upon a mortgagee’s right to post-petition rents under an assignment of rents. This  
11 struggle derives in part from the confusion generated by the differing terminologies of mortgage  
12 law and Article 9 of the Uniform Commercial Code. Under Article 9, a secured party obtains a  
13 security interest in collateral by having the debtor execute a security agreement describing that  
14 collateral, and “perfects” that security interest by filing an Article 9 financing statement  
15 describing the collateral. By “perfecting” its security interest, the Article 9 secured party makes  
16 that interest enforceable against subsequent creditors, including judicial lien creditors. U.C.C. §  
17 9-317(a). Because Bankruptcy Code § 544(a) provides the bankruptcy trustee/debtor-in-  
18 possession with the status of a hypothetical judicial lien creditor under state law, the  
19 trustee/debtor-in-possession takes property of the estate subject to any security interest that was  
20 properly perfected under Article 9 prior to the filing of the bankruptcy petition. If the secured  
21 party has a properly perfected security interest prior to the petition date, it is irrelevant whether  
22 the secured party had taken any steps to enforce that security interest prior to bankruptcy — the  
23 perfected security interest continues to remain effective against the collateral and the  
24 trustee/debtor-in-possession cannot avoid that security interest using its § 544(a) avoidance  
25 power.

26  
27 By contrast, mortgage law did not customarily use the term “perfection.” Under  
28 mortgage law, recording of a mortgage interest served to make that interest valid as against  
29 subsequent creditors and bona fide purchasers of the land. Analytically, of course, “recording” in  
30 this sense is similar to the Article 9 concept of perfection. By analogy, one could argue that if a  
31 mortgage lender had taken and properly recorded an assignment of rents prior to bankruptcy, that  
32 mortgage lender should have a security interest in rents that was “perfected” and thus enforceable  
33 against third parties. Under this analysis, the trustee/debtor-in-possession could not avoid the  
34 mortgage lender’s security interest in rents under § 544(a), and thus the mortgage lender would  
35 retain its security interest in post-petition rents under § 552(b). A number of courts in fact  
36 adopted this analytical approach, treating post-petition rents as the lender’s cash collateral so  
37 long as the mortgagee had properly recorded its assignment of rents prior to bankruptcy. *See,*  
38 *e.g., In re Millette*, 186 F.3d 638 (5<sup>th</sup> Cir. 1999); *Steinberg v. CrossLand Mortgage Corp. (In re*  
39 *Park at Dash Point L.P.)*, 985 F.2d 1008, 1011 (9<sup>th</sup> Cir. 1993); *Vienna Park Properties v. United*

1 Postal Sav. Ass'n (*In re Vienna Park Properties*), 976 F.2d 106, 112-15 (2d Cir 1992).

2  
3 Unfortunately, some bankruptcy courts held that § 544(a) permitted the trustee/debtor-in-  
4 possession to invalidate a security interest in post-petition rents if the secured party had not taken  
5 sufficient steps to *enforce* that interest (*e.g.*, actually collect the rents) prior to bankruptcy. To  
6 understand how these decisions confused “perfection” or “enforceability” with “enforcement,” it  
7 is helpful to review the distinction between the lien and title theories of mortgage law. Under the  
8 title theory, the mortgagee held “title” to the land (and thus title to unaccrued rents) by virtue of  
9 the mortgage, even prior to default. By contrast, under the lien theory, a mortgage gave the  
10 mortgagee only a security interest in the land rather than “title” — and thus a mortgage by itself  
11 gave the mortgagee no interest in unaccrued rents until such time as the mortgagee completed a  
12 foreclosure, became a mortgagee in possession, or obtained the appointment of a receiver for the  
13 land.

14  
15 If a mortgagee claims a security interest in rents by virtue of a separate assignment of  
16 rents, however, any legal constraints on the mortgagee’s right to collect rents *by virtue of the*  
17 *mortgage itself* should be irrelevant. Nevertheless, a number of older state court decisions  
18 conflated these two situations, holding that even a separate assignment of rents was not effective  
19 until the mortgagee took affirmative steps after default to enforce that assignment, such as by  
20 obtaining the appointment of a receiver, becoming a mortgagee in possession, or impounding the  
21 rents. *See, e.g.*, *Taylor v. Brennan*, 621 S.W.2d 592, 593-94 (Tex. 1981); *Bevins v. Peoples*  
22 *Bank & Trust Co.*, 671 P.2d 875, 879 (Alaska 1983), *Martinez v. Continental Enters.*, 730 P.2d  
23 308, 316 (Colo. 1986); *Sullivan v. Rosson*, 119 N.E. 405 (N.Y. 1918). Based upon these old  
24 state law decisions, numerous bankruptcy courts concluded that an assignment of leases and rents  
25 created only an “inchoate” lien upon rents that was ineffective against third parties if the  
26 mortgagee had not taken affirmative steps prior to bankruptcy to activate that lien. These courts  
27 concluded that if a mortgagee had not taken action to divest the mortgagor of control over the  
28 property and its rents prior to bankruptcy — such as by obtaining the appointment of a receiver,  
29 taking possession of the land, or notifying tenants to begin paying rents directly to the mortgagee  
30 — the mortgagee’s security interest in post-petition rents was “unperfected” and subject to  
31 avoidance under § 544(a). *See, e.g.*, *In re Century Inv. Fund VIII L.P.*, 937 F.2d 371, 377 (7<sup>th</sup>  
32 Cir. 1991); *In re 1301 Conn. Ave. Assocs.*, 126 B.R. 1, 3 (D.D.C. 1991); *First Federal Sav. &*  
33 *Loan Ass’n v. Hunter (In re Sam A. Tisci, Inc.)*, 133 B.R. 857, 859 (N.D. Ohio 1991); *Condor*  
34 *One, Inc. v. Turtle Creek, Ltd. (In re Turtle Creek, Ltd.)*, 194 B.R. 267, 278 (Bankr. N.D. Ala.  
35 1996); *In re Mews Assocs., L.P.*, 144 B.R. 867, 868-69 (Bankr. W.D. Mo. 1992). Under this  
36 view, the debtor-in-possession could use post-petition rents free and clear of any claim by the  
37 mortgagee while the debtor remained in bankruptcy.

38  
39 These diverse interpretations of state mortgage law produced substantial nonuniformity in  
40 the treatment of security interests in rents, both from state to state and even from district to  
41 district within a particular state. This nonuniformity produced significant criticism among  
42 academics, real estate practitioners, and commercial mortgage lenders. *See, e.g.*, R. Wilson  
43 Freyermuth, *The Circus Continues — Security Interests in Rents, Congress, the Bankruptcy*

1 *Courts, and the “Rents Are Subsumed in the Land” Hypothesis*, 6 J. Bankr. L. & Prac. 115, 118  
2 (1997); Julia Patterson Forrester, *A Uniform and More Rational Approach to Rents as Security*  
3 *for the Mortgage Loan*, 46 Rutgers L. Rev. 349 (1993); Patrick A. Randolph, Jr., *Recognizing*  
4 *Lenders’ Rents Interests in Bankruptcy*, 27 Real Prop., Prob. & Trust J. 281 (1992).  
5

6 In response to this criticism, in 1994 Congress amended Bankruptcy Code § 552(b) in an  
7 apparent attempt to provide more uniform treatment of assignments of rents. Prior to 1994, §  
8 552(b) provided that a pre-petition security interest in land and rents from that land extended to  
9 post-petition rents “to the extent provided by [the] security agreement and by applicable  
10 nonbankruptcy law.” By focusing upon the term “applicable nonbankruptcy law,” many courts  
11 (as noted above) concluded that § 552(b) did not permit the mortgagee to claim a security interest  
12 in post-petition rents where the mortgagee had failed to take the necessary steps to obtain actual  
13 or constructive possession of the land and its rents prior to bankruptcy. In 1994, however,  
14 Congress amended § 552(b) to remove this reference to “applicable nonbankruptcy law.”  
15

16 Many commentators concluded that the amended § 552(b) established a federal standard  
17 for the enforcement of an assignment of rents, thus rendering state rent assignment law irrelevant.  
18 *See, e.g.*, 5 Collier on Bankruptcy ¶ 552.03[1], at 552-17 (“[Section 552(b)(2)] does not refer to  
19 applicable nonbankruptcy law and is intended to provide a creditor with a valid post-petition  
20 interest in rents notwithstanding the creditor’s failure to perfect its security interest in rents under  
21 applicable state law ...”). Unfortunately, while legislative history suggests that Congress  
22 intended to preempt contrary state laws limiting the post-petition effectiveness of an assignment  
23 of rents, the text itself provides no express statement of preemptive intent. Further, § 552(b)’s  
24 protection for a security interest in post-petition rents is expressly subject to § 544’s strong-arm  
25 clause — *which implicitly incorporates underlying state law regarding the enforceability of a*  
26 *security interest versus third parties*. Under § 544(a), there is no question that the debtor-in-  
27 possession may avoid a security interest in rents if a bona fide purchaser of the land could have  
28 avoided that interest under state law as of the petition date. Thus, if state law *actually provides*  
29 that a security interest in rents is ineffective against third parties until the mortgagee has taken  
30 affirmative action to enforce that security interest, § 544(a) would appear to permit the debtor to  
31 avoid the security interest of such a mortgagee — notwithstanding the amendment to § 552(b) —  
32 if the mortgagee failed to take such action prior to bankruptcy.  
33

34 Roughly one-third of the states have enacted statutes making clear that an assignment of  
35 rents is perfected and effective against third persons upon its recordation, without regard to  
36 whether the mortgagee has taken any steps to “activate” or “enforce” that assignment. Cal. Civ.  
37 Code §§ 2938, 2938.1; Del. Code tit. 25, § 2121; Fla. Stat. Ann. § 697.07; 765 Ill. St. § 5/31.5;  
38 Ind. Code Ann. § 32-21-4-2; Kan. Stat. Ann. § 58-2343; La. Rev. Stat. Ann. § 9:4401; Md. Real  
39 Prop. Code Ann. § 3-204; Neb. Rev. Stat. § 52-1704; N.C. Gen. Stat. § 47-20(c); Or. Rev. Stat. §  
40 93.806; S.C. Code § 29-3-100; Tenn. Code Ann. § 66-26-116; Va. Code Ann. § 55-220.1; Wash.  
41 Rev. Code Ann. § 7-28-230(3); Wis. Stat. Ann. § 708.11. The Act adopts this approach.  
42

1           **SECTION 6. ENFORCEMENT OF SECURITY INTEREST IN RENTS.** Upon the  
2 assignor’s default as defined in an assignment of rents, or as otherwise permitted in the  
3 assignment, the assignee may enforce the assignment in accordance with its terms, using one or  
4 more of the methods specified in Sections 7, 8, 9, and 10, or any other method sufficient to  
5 enforce the assignment under the law of this state other than this [act]. From the date of  
6 enforcement, the assignee may collect and receive:

7                   (1) all rents that have accrued but remain unpaid on that date; and

8                   (2) all rents that accrue on or after that date, as those rents accrue.

9   **Preliminary Comments**

10 Source: Cal. Civ. Code § 2938(c); Restatement (Third) of Property — Mortgages § 4.2(c).

11  
12           1. *Nonexclusive method of enforcement.* Section 6 provides that upon default by the  
13 assignor or as otherwise permitted in an assignment of rents, the assignee may enforce the  
14 assignment in accordance with its terms. The Act specifies several methods of enforcement of an  
15 assignment of rents in Sections 7 (appointment of a receiver), 8 (notification to tenants), 9  
16 (notification to the assignor), and 10 (taking possession of the land described in the assignment  
17 of rents and thus becoming a “mortgagee in possession”). The Act also permits enforcement of  
18 an assignment of rents by any other method recognized under other law of this state.

19  
20           Moreover, the various methods that the Act provides for enforcement of an assignment of  
21 rents are not mutually exclusive. An assignee may in appropriate circumstances enforce an  
22 assignment of rents by multiple methods. For example, the assignee may choose to enforce its  
23 security interest by providing simultaneous notification to tenants (under Section 8) and to the  
24 assignor (under Section 9). Likewise, the assignee’s decision to do so would not limit the  
25 assignee’s right to later obtain the appointment of a receiver under Section 7.

26  
27           2. *Rents collectable under this Act.* Upon enforcement, an assignee may collect (1)  
28 accrued but unpaid rents, and (2) unaccrued rents as they accrue in the future. Section 6 does not  
29 authorize the assignee to collect the cash proceeds of rents that the assignor had already collected  
30 prior to enforcement.

31  
32           However, this Act does not prevent the assignee from using any other legal mechanism to  
33 obtain and enforce a security interest in the cash proceeds of rents that the assignor has already  
34 collected prior to enforcement. For example, the express terms of an assignment of rents could

1 (1) require the assignor to deposit the cash proceeds of rents in a particular deposit account, and  
2 (2) grant the assignee a security interest in that deposit account under Article 9 of the Uniform  
3 Commercial Code. If the assignment of rents so provided, the assignee could exercise its  
4 available remedies under Article 9 to collect any sums within that deposit account, including the  
5 cash proceeds of rents collected by the assignor prior to the assignee's enforcement of its  
6 assignment of rents.  
7

8 **SECTION 7. ENFORCEMENT BY APPOINTMENT OF RECEIVER.**

9 (a) An assignee may file a petition for the appointment of a receiver for the real  
10 property described in the assignment with the court before which is pending an action:

11 (1) to foreclose a security interest in the real property described in the  
12 assignment;

13 (2) for specific performance of the assignment;

14 (3) for waste of the real property described in the assignment; or

15 (4) to otherwise enforce the secured obligation or the assignee's remedies  
16 under the assignment.

17 (b) A petitioner under subsection (a) is entitled to appointment of a receiver if:

18 (1) the assignor is in default under the assignment of rents and:

19 (A) the assignor agreed in the security instrument, the assignment,  
20 or another signed document to the appointment of a receiver after default;

21 (B) it appears likely that the real property may not be sufficient to  
22 satisfy the secured obligation; or

23 (C) the assignor has failed to turn over to the assignee rents that  
24 the assignee is entitled to collect; or

25 (2) other circumstances exist that would justify the appointment of a

1 receiver under the law of this state other than this [act].

2 (c) From the date of its appointment, a receiver appointed under this section has  
3 the authority provided in law of this state other than this [act] and the order of appointment.

#### 4 **Preliminary Comments**

5 1. *Actions to which receivership is ancillary.* Traditionally, a receivership of mortgaged  
6 property is a remedy that is ancillary to some action to enforce either the mortgage debt or the  
7 mortgage lien. In states that recognize only judicial foreclosure, the existence of a judicial  
8 foreclosure proceeding provides the action to which a receivership may be ancillary. In states  
9 that authorize power of sale foreclosure, however, a mortgagee may choose to foreclose privately  
10 without any judicial proceeding. In these states, the lack of any pending action raises a concern  
11 regarding whether the mortgagee can obtain the “ancillary” remedy of a receivership.  
12

13 The Act addresses this concern by authorizing the assignee to file an action for specific  
14 performance of the assignment of rents. The pendency of this action would provide a sufficient  
15 jurisdictional predicate for the appointment of a receiver, even if the assignee chose to proceed  
16 with its foreclosure by power of sale.  
17

18 2. *Traditional standards for appointment of a receiver.* Traditionally, courts have  
19 appointed a receiver for mortgaged land if the value of the land was insufficient to satisfy the  
20 mortgage debt (*i.e.*, where the mortgagee’s security was inadequate) or whether the owner of the  
21 mortgaged land was committing waste (thereby threatening the value of the mortgagee’s  
22 security). *See, e.g.*, Restatement (Third) of Property — Mortgages §§ 4.3(a)(2), 4.3(a)(3); 1 G.  
23 Nelson & D. Whitman, Real Estate Finance Law § 4.34 (3d ed. 1993). Consistent with this  
24 traditional approach, Section 6(b)(1)(B) authorizes the appointment of a receiver if the real  
25 property appears insufficient to satisfy the secured obligation. Likewise, Section 6(b)(2)  
26 authorizes the appointment of a receiver where there are “other circumstances” justifying the  
27 appointment of a receiver under the law of this state other than this Act. Such “other  
28 circumstances” would include waste as defined under state law other than this Act. Thus, for  
29 example, if the law of this state other than this Act treats nonpayment of real property taxes as  
30 actionable waste, the assignor’s nonpayment of taxes would provide a justification for the  
31 appointment of a receiver.  
32

33 A few court decisions have required a mortgagee seeking appointment of a receiver to  
34 show that the mortgagor was insolvent. *See, e.g.*, Mutual Benefit Life Ins. Co. v. Frantz Klodt &  
35 Son, Inc., 237 N.W.2d 350 (Minn. 1975); Chase Manhattan Bank v. Turabo Shopping Center,  
36 Inc., 683 F.2d 25 (1<sup>st</sup> Cir. 1982). The Restatement (Third) of Property — Mortgages and most  
37 commentators have rejected this view. The Act does not require the assignee to demonstrate the  
38 assignor’s insolvency as a predicate to obtaining the appointment of a receiver. However,  
39 Section 6(b)(2) would permit an assignee to use the assignor’s insolvency as grounds for

1 appointment of a receiver where other state law has recognized the assignor’s insolvency as  
2 sufficient grounds for a receivership.

3  
4 3. *Receivership Clauses.* The modern commercial mortgage typically contains a  
5 provision in which the mortgagor consents to the appointment of a receiver for the real property  
6 following default. Often, receivership clauses provide that the mortgagor consents to the  
7 appointment of a receiver following default as a matter of contract, without regard to whether the  
8 mortgagor is insolvent or whether the physical condition of the real property would otherwise  
9 justify the appointment of a receiver.

10  
11 Because the appointment of a receiver has traditionally originated from within the court’s  
12 equitable discretion, some courts have refused to appoint a receiver — despite the presence of a  
13 receivership clause — in cases where they would have denied appointment of a receiver  
14 otherwise. *See, e.g.,* Dart v. Western Sav. & Loan Ass’n, 438 P.2d 407 (Ariz. 1968); Chromy v.  
15 Midwest Fed. Sav. & Loan Ass’n, 546 So.2d 1172 (Fla. App. 1989); Sazant v. Foremost  
16 Investments, N.V., 507 So.2d 653 (Fla. App. 1987) (receivership clause not binding on court  
17 where mortgagor had not committed waste and default did not place mortgagee at serious risk of  
18 noncollection); Gage v. First Federal Sav. & Loan Ass’n, 717 F. Supp. 745 (D. Kan. 1989);  
19 Barclays Bank, P.L.C. v. Davidson Ave. Assocs., Ltd., 644 A.2d 685 (N.J. Super. 1994)  
20 (receivership clause “usurps the judicial function” and thus violates public policy). In other  
21 states, courts have treated receivership clauses as presumptively but not conclusively enforceable.  
22 For example, in Barclays Bank v. Superior Court, 137 Cal. Rptr. 743 (Cal. App. 1977), the court  
23 held that a receivership clause presented a prima facie (but rebuttable) evidentiary showing of the  
24 mortgagee’s entitlement to the appointment of a receiver. *See also, e.g.,* Riverside Properties v.  
25 Teachers Ins. & Annuity Ass’n, 590 S.W.2d 736 (Tex. App. 1979); Okura & Co. v. Careau  
26 Group, 783 F. Supp. 482 (C.D. Cal. 1991); Wellman Sav. Bank v. Roth, 432 N.W.2d 697 (Iowa  
27 App. 1988).

28  
29 Consistent with the position adopted by Restatement (Third) of Property — Mortgages §  
30 4.3(b) and significant recent judicial authority, the Act establishes that a receivership clause  
31 alone provides a sufficient basis for the appointment of a receiver following mortgagor default.  
32 *See, e.g.,* Bank of America Nat’l Trust & Sav. Ass’n v. Denver Hotel Ass’n Ltd. Partnership, 830  
33 P.2d 1138 (Colo. App. 1992) (upholding appointment of receiver under receivership clause,  
34 without regard to adequacy of security or solvency of mortgagor, under abuse of discretion  
35 standard); Fleet Bank v. Zimelman, 575 A.2d 731 (Me. 1990) (freely bargained-for receivership  
36 clause should be enforced); Metropolitan Life Ins. Co. v. Liberty Center Venture, 650 A.2d 887  
37 (Pa. Super. 1994); Federal Home Loan Mortgage Corp. v. Nazar, 100 B.R. 555 (D. Kan. 1989).  
38 Statutes in several states provide that a receivership clause is enforceable as a matter of right.  
39 *See, e.g.,* Ind. Code § 32-30-5-1; Minn. Stat. Ann. § 559.17(2) (mortgages of \$100,000 or more);  
40 N.Y. Real Prop. Law § 254(10) (receivership clause enforceable “without notice and without  
41 regard to adequacy of any security of the debt”); Okla. Stat. Ann. tit. 12, § 1551(2)(c) (court shall  
42 appoint receiver when “a condition of the mortgage has not been performed and the mortgage  
43 instrument provides for the appointment of a receiver”). Finally, federal courts have routinely

1 held receivership clauses in federally insured mortgages sufficient to justify the appointment of a  
2 receiver. *See, e.g.,* United States v. Berk & Berk, 767 F. Supp. 593 (D.N.J. 1991); United States  
3 v. Drexel View II, Ltd., 661 F. Supp. 1120 (N.D. Ill. 1987).  
4

5 By expressing the circumstances justifying the appointment of a receiver in the  
6 disjunctive, Section 6(b)(1) adopts the view that a receivership clause is enforceable by the  
7 assignee without regard to the condition of the real property, the solvency of the assignor, or the  
8 adequacy of the security for the secured obligations.  
9

10 4. *Ex parte appointment of a receiver.* Many assignments of rents contain a clause  
11 entitling the assignee to the appointment of a receiver on an *ex parte* basis, without notice to the  
12 assignor. The Act does not establish that the assignee is entitled to a receivership on an *ex parte*  
13 basis, and instead leaves to other state law the question of whether (and in what circumstances)  
14 prior notice to the assignor is excused.  
15

16 5. *Receiver's power to terminate or disaffirm existing leases.* In many states, statutory or  
17 case law regarding receiverships has generally established (or limited) the receiver's power to  
18 terminate leases in default or to disaffirm leases not in default. Likewise, the court order  
19 appointing a receiver will often specify the extent to which a receiver can take these steps with or  
20 without the approval of the court and/or the assignee.  
21

22 As a result, subsection (c) addresses the receiver's power to terminate and/or disaffirm  
23 leases by leaving this question to the terms of the court order appointing the receiver and other  
24 state law.  
25

## 26 SECTION 8. ENFORCEMENT BY NOTIFICATION TO TENANT

27 (a) Upon the assignor's default as defined in an assignment of rents, or as  
28 otherwise permitted in the assignment, the assignee may give to a tenant of the real property a  
29 notification demanding that the tenant pay to the assignee all unpaid accrued rents and all  
30 unaccrued rents as they become due. The assignee shall give a copy of the notification to the  
31 assignor and to any other person that, 10 days before the notification date, held a recorded  
32 assignment of rents relating to the real property. The notification must:

33 (1) identify the tenant, assignor, assignee, premises covered by the lease,  
34 assignment of rents being enforced, and recording data for the assignment;

1 (2) state that the assignee has the right to collect rents in accordance with  
2 the terms of the assignment;

3 (3) state that the tenant is directed to pay to the assignee all unpaid accrued  
4 rents and all unaccrued rents as they come due;

5 (4) describe the manner in which subsections (b) and (c) affect the tenant's  
6 payment obligations;

7 (5) provide the name of a contact person and an address to which the  
8 tenant can direct payment of rents and any inquiry for additional information about the  
9 assignment of rents or the assignee's right to enforce the assignment;

10 (6) contain a statement advising the tenant to consult an attorney if the  
11 tenant has questions about its rights and obligations following receipt of the notification; and

12 (7) be signed by the assignee.

13 (b) Subject to subsection (c), following receipt of a notification under subsection  
14 (a):

15 (1) a tenant is obligated to pay to the assignee all unpaid accrued and all  
16 unaccrued rents as they come due, unless the tenant has previously received a notification from  
17 another assignee of rents given by that assignee in accordance with this section and the other  
18 assignee has not canceled that notification;

19 (2) a tenant that pays rents to the assignor is not discharged of the  
20 obligation to pay rents to the assignee[, unless the tenant occupies the premises as the tenant's  
21 primary residence];

22 (3) a tenant's payment to the assignee in good faith of rents then due

1 satisfies the tenant's obligation under the lease to the extent of the payment made; and

2 (4) a tenant's obligation to pay rent to the assignee continues until the  
3 tenant receives a court order directing the tenant to pay the rent in a different manner or a signed  
4 document from the assignee canceling its notification, whichever occurs first.

5 (c) A tenant that has received a notification under subsection (a) may not be held  
6 in default of the lease for nonpayment of rents accruing after the date notification is given before  
7 the earlier of 10 days after the next regularly scheduled rental payment would be due under the  
8 lease or 30 days after the date of the notification.

9 (d) Upon receiving a notification from another creditor that is entitled to priority  
10 under Section 5 that the other creditor has enforced its interest in rents, an assignee that has  
11 previously given notification to a tenant under subsection (a) shall immediately give a new  
12 notification to the tenant canceling the earlier notification. If the assignee fails to do so:

13 (1) the assignee must turn over to the other creditor any rents that it  
14 collects following receipt of the notification from that creditor; and

15 (2) the other creditor is entitled to other relief as permitted under the law  
16 of this state other than this [act].

17 (e) An assignee's failure to give a notification under subsection (a) to any person  
18 holding a recorded assignment of rents on the real property does not affect the effectiveness of  
19 the notification as to the assignor and those tenants receiving the notification. However, the  
20 person entitled to the notification is entitled to any relief permitted by the law of this state other  
21 than this [act].

22 (f) No particular phrasing is required for the notification specified in subsection

1 (a). However, the following form of notification, when properly completed, is sufficient to  
2 satisfy the requirements of subsection (a):

3  
4  
5 NOTIFICATION TO PAY RENT TO PERSON OTHER THAN LANDLORD

6 Tenant: [Name of Tenant]

7 Property Occupied by Tenant (the "Premises"): [Address]

8 Landlord: [Name of Landlord]

9 Assignee: [Name of Assignee]

10 Address of Assignee and Contact Person: [Address for Payment  
11 of Rent to Assignee and Contact Person for Further  
12 Information]:

13 1. The Assignee named above is the assignee of  
14 rents under [name of document] (the "Assignment of Rents")  
15 dated \_\_\_\_\_, and recorded at [recording data] in the  
16 [appropriate governmental office under the recording act of this  
17 State]. You may request a copy of the Assignment of Rents  
18 from the Assignee at the address listed above.

19 2. The Landlord is in default under the Assignment  
20 of Rents. Under the Assignment of Rents, the Assignee is  
21 entitled to collect rents from the Premises.

22 3. This notification affects your rights and  
23 obligations under the lease or rental agreement (the "Lease") by

1 which you occupy the Premises. In order to provide you with an  
2 opportunity to consult with an attorney, neither the Assignee nor  
3 the Landlord can hold you in default under the Lease for  
4 nonpayment of your next scheduled rental payment until the  
5 earlier of 10 days after the due date of that payment or 30 days  
6 following the date of this notification. You are encouraged to  
7 consult an attorney promptly concerning your rights and  
8 obligations under the Lease and the effect of this notification.

9 4. You must pay to the Assignee at the address  
10 listed above all rents under your Lease which are due and  
11 payable on the date you receive this notification and all rents  
12 accruing under the Lease following the date you receive this  
13 notification. If you pay rents to the Assignee in good faith after  
14 receiving this notification, the payment will satisfy your rental  
15 obligation under the Lease to the extent of that payment.

16 5. If you pay any rents to the Landlord after  
17 receiving this notification, your payment to the Landlord will not  
18 discharge your rental obligation under your Lease, and the  
19 Assignee may hold you liable for that rental obligation  
20 notwithstanding your payment to the Landlord[, unless you  
21 occupy the Premises as your primary residence. If you occupy  
22 the Premises as your primary residence, you may pay rent to the

1 Assignee as directed by paragraph 4, but any rental payment that  
2 you make to the Landlord will discharge your rental obligation  
3 to the extent of that payment].

4 6. If you have previously received a notification  
5 from another person who also holds an assignment of the rents  
6 due under your Lease, you should continue paying your rents to  
7 the person that sent that notification until that person cancels  
8 that notification. Once that notification is canceled, you must  
9 begin paying rents to the Assignee in accordance with this  
10 notification.

11 7. Your obligation to pay rents to the Assignee will  
12 continue until you receive either:

13 (a) a written order from a court directing you to  
14 pay the rent in a manner specified in that order; or

15 (b) written instructions from the Assignee  
16 canceling this notification.

17 [Name of Assignee]

18 By: [Officer/Authorized Agent of Assignee]]  
19

20  
21 **Preliminary Comments**

22 Source: Cal. Civ. Code §§ 2938(c)(3), 2938(d), 2938(k); U.C.C. §§ 9-406(a).

1           1. *Enforcement by notification to tenants.* Section 8 provides that an assignee may  
2 enforce its security interest in rents by notification to tenants either following default or  
3 otherwise in accordance with the assignment. Because the typical assignment of rents does not  
4 authorize the assignee to collect rents prior to the assignor’s default, enforcement by Section 8  
5 will usually arise only after the assignor’s default.  
6

7           Subsection (a) specifies the required contents of the notification. Although the Act does  
8 not require that the notification be in any particular form, subsection (f) provides a form  
9 notification that is sufficient to satisfy subsection (a) if properly completed.  
10

11           2. *Effect of notification.* Once the tenant receives notification from the assignee  
12 demanding payment of rents pursuant to the assignment, the tenant must pay accrued but unpaid  
13 rents and rents accruing in the future to the assignee in order to satisfy its rental obligation. In  
14 this respect, the Act’s provisions operate similarly to the provisions of U.C.C. § 9-406(a), which  
15 govern the circumstances under which an account debtor can discharge its obligation following  
16 notification and demand by an assignee of that account. Following receipt of a notification, a  
17 tenant cannot discharge its rental obligations by payment to the assignor. Thus, a tenant that pays  
18 its landlord following receipt of a notification under this section faces the risk of having to make  
19 double payment of the sums necessary to discharge its rental obligation. The bracketed portion  
20 of subsection (b)(2) would permit a state to adopt a more protective rule for residential tenants  
21 that would allow them to be discharged by payment to the assignor.  
22

23           The tenant’s obligation to direct payment of rents to the assignee following receipt of a  
24 notification under subsection (a) is subject to one other caveat: the tenant need not comply if it  
25 has previously received a notification from another assignee of rent given by that assignee in  
26 accordance with this section, and the other assignee has not cancelled that notification. Until  
27 such a tenant receives instructions canceling that prior notification, the tenant may continue to  
28 pay the other assignee in accordance with the prior notification.  
29

30           3. *Notification to other rents assignees.* Subsection (a) requires that the enforcing  
31 assignee give notification to any person from which the assignee has received a signed document  
32 claiming a security interest in the rents or that, 10 days prior to the notification date, held a  
33 recorded assignment of rents on the real property. Under this provision, an enforcing assignee  
34 must search the public records to identify any other creditors holding a recorded assignment of  
35 rents and provide notification of enforcement to such creditors. Notification will alert another  
36 person holding a recorded assignment of rents as to the pending enforcement effort and permit  
37 that person to take whatever steps it considers justified in protecting its secured position with  
38 respect to the rents. For example, if the enforcing rents assignee holds a junior assignment of  
39 rents, notification to the senior would permit the senior to take steps to enforce its senior interest  
40 in rents immediately (assuming its assignment permitted immediate action under the  
41 circumstances) — thereby avoiding the risk that the junior might by collection acquire effective  
42 priority as to the following period’s rents. By contrast, if the enforcing rents assignee holds a  
43 senior assignment of rents, notification to the junior would alert the junior as to the need to

1 investigate the status of the senior obligations.  
2

3 Failure to give notification to another rents assignee under this section does not defeat the  
4 effectiveness of the notification as to the assignor and tenants receiving the notification. If a  
5 rents assignee fails to give a required notification to another creditor entitled to notification,  
6 subsection (e) entitles the other creditor to any relief provided by law other than this Act. This  
7 would permit the other creditor to plead and prove any damages proximately caused by the  
8 failure to give notification.  
9

10 4. *Tenant protected for good faith payment to assignee.* Subsection (b)(3) provides that a  
11 tenant that in good faith pays rents to the assignee following receipt of a notification under this  
12 section discharges its rental obligation to the extent of such payment. Even if the assignor  
13 subsequently established that the assignee's notification was wrongful, the assignor would not be  
14 able to declare a tenant in breach for nonpayment of rent if that tenant paid the assignee in good  
15 faith pursuant to the notification.  
16

17 5. *Extension of time for payment of next rental payment following notification.* If a tenant  
18 receives a notification directing payment of rents to an assignee, the tenant reasonably may wish  
19 to obtain counsel regarding the effect of the notification. However, if the notification arrives  
20 shortly before the tenant's rental due date, the tenant may find it difficult to obtain that advice  
21 before its rental obligation would become past due. In order to permit the tenant a reasonable  
22 opportunity to obtain counsel, subsection (c) provides that neither the assignor nor the assignee  
23 may hold a tenant in default of a lease solely for nonpayment of rents that accrue after the  
24 notification is given until the earlier of 10 days after the next regularly scheduled rental payment  
25 would be due under the lease or 30 days after the date of the notification. Subsection (c) would  
26 not in any way protect a tenant from the consequences of a breach of the lease on grounds other  
27 than nonpayment of rent, or for nonpayment of rents that had accrued prior to the notification.  
28

29 The application of subsection (c) is demonstrated by the following illustrations:  
30

31 *Illustration 1.* Tenant's rent is due and payable to Assignor monthly, on the first of each  
32 month. On March 28, Tenant receives a notification from Assignee demanding that Tenant pay  
33 future rents to Assignee. Neither Assignor nor Assignee may declare Tenant in default of the  
34 April 1 rent payment until after April 11.  
35

36 *Illustration 2.* Tenant's rent is due and payable to Assignor monthly, on the first of each  
37 month. On March 3, Tenant receives a notification from Assignee demanding that Tenant pay  
38 future rents to Assignee. Neither Assignor nor Assignee may declare Tenant in default of the  
39 April 1 rent payment until after April 3.  
40

41 *Illustration 3.* Tenant's rent is due and payable to Assignor quarterly, on the first of  
42 January, April, July, and October. On February 28, Tenant receives a notification from Assignee  
43 demanding that Tenant pay future rents to Assignee. Under subsection (c), Tenant receives no

1 extension of the time for his April1 quarterly rent payment.

2  
3 *6. Enforcement by multiple rent assignees.* In some circumstances, multiple creditors  
4 may seek to collect rents directly from tenants pursuant to this Act. If a subordinate rents  
5 assignee collect rents under this section, the Act provides that the subordinate rents assignee may  
6 keep the rents collected and apply those rents to its secured obligations notwithstanding its  
7 subordinate position, until such time as the senior rents assignee enforces its superior collection  
8 rights. See Section 15(b).

9  
10 Once a subordinate rents assignee that has enforced its security interest in rents under this  
11 section receives a notification that a senior assignee has enforced its interest in rents, subsection  
12 (d) obligates the subordinate rents assignee to give an immediate notification to tenants canceling  
13 its previous payment instructions. If the subordinate rents assignee fails to do so, the subordinate  
14 rents assignee is liable to a senior creditor for turnover of any rents it thereafter collects, and for  
15 such other relief as the senior creditor is entitled under state law other than this Act.

## 16 17 **SECTION 9. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR.**

18 (a) Upon the assignor’s default as defined in an assignment of rents, or as  
19 otherwise permitted in the assignment, the assignee may give to the assignor a notification  
20 demanding that the assignor pay over all rents that the assignee is entitled to collect under  
21 Section 6. The assignee shall also give a copy of the notification to any other person that, 10  
22 days before the notification date, held a recorded assignment of rents relating to the real property.

23 (b) An assignee’s failure to give notification under subsection (a) to any person  
24 holding a recorded assignment of rents on the real property does not defeat the effectiveness of  
25 the notification as to the assignor, but the other person is entitled to relief as permitted under the  
26 law of this state other than this [act].

### 27 **Preliminary Comments**

28 Source: Cal. Civ. Code §§ 2938(c)(4); Restatement (Third) of Property — Mortgages §  
29 4.2(c), (d).

30  
31 1. *Enforcement by notification to assignor.* An assignment of rents typically requires the

1 assignor to pay rents to the assignee following default, either immediately or upon demand by the  
2 assignee. As discussed in the Preliminary Comments to Section 5, however, many bankruptcy  
3 courts concluded that applicable state law required certain affirmative conduct by the lender,  
4 post-default, in order to render an assignment of rents enforceable. Many of these courts required  
5 conduct of greater intensity than merely making a formal demand to the assignor for payment of  
6 the rents — instead requiring such steps as the appointment of a receiver, judicial sequestration  
7 of rents, acquiring possession of the land, or providing notification to tenants to pay rent to the  
8 assignee.  
9

10 The Restatement (Third) of Property — Mortgages adopted the view that notification to  
11 the assignor following default is sufficient to enforce a perfected security interest in rents and to  
12 give the assignee the legal right to possession of the rents. *See* Restatement (Third) of Property  
13 — Mortgages § 4.2(c). This position effectively places an obligation on the assignor to pay over  
14 to the assignee any rents thereafter collected by the assignor; the assignor’s collection and  
15 retention of rents following such notification would constitute waste that would potentially  
16 subject the assignor to liability for damages. *Id.* §§ 4.6(a)(5), 4.6(b)(3).  
17

18 The Act likewise adopts this approach, authorizing the assignee to enforce an assignment  
19 of rents by means of a notification to the assignor following default under the assignment. As  
20 discussed in Section 14(b), the assignor’s failure to pay any rents it collects following receipt of  
21 such notification would subject to the assignor to liability for conversion.  
22

23 *2. Notification to other record rents assignees.* Subsection (a) provides that an assignee  
24 enforcing an assignment of rents must give notification not only to the assignor, but also to any  
25 other person from which the assignee has received a signed document claiming a security interest  
26 in the rents or that, 10 days before the notification date, held a recorded assignment of rents  
27 covering the real property. Notification will alert another person holding a recorded assignment  
28 of rents as to the pending enforcement effort and permit that person to take whatever steps it  
29 considers justified in protecting its secured position with respect to the rents. For example, if the  
30 enforcing rents assignee holds a junior assignment of rents, notification to the senior would  
31 permit the senior to take steps to enforce its senior interest in rents immediately (assuming its  
32 assignment permitted immediate action under the circumstances) — thereby avoiding the risk  
33 that the junior might by collection acquire effective priority as to the following period’s rents.  
34 By contrast, if the enforcing rents assignee holds a senior assignment of rents, notification to the  
35 junior would alert the junior as to the need to investigate the status of the senior obligations.  
36

37 Subsection (b) provides that the failure of the enforcing assignee to give notification to  
38 other rents assignees does not negate the effectiveness of the notification as to the assignor. If  
39 the assignor received the notification and subsequently collected rents but failed to turn those  
40 over to the assignee, the assignor would face liability under Section 14(b) regardless of whether  
41 the enforcing assignee had given notification to other rents assignees. If a rents assignee  
42 fails to give a required notification to another creditor entitled to notification, subsection (b)  
43 entitles the other creditor to any relief provided by law other than this Act. This would permit

1 the other creditor to plead and prove any damages proximately caused by the failure to give  
2 notification.

3  
4 3. *Nonexclusivity of means of enforcement.* As expressed in Section 6, the Act specifies  
5 methods of enforcement that are not exclusive in nature. The primary benefit associated with  
6 enforcement by notification to the assignor under Section 9 may be that such enforcement  
7 quickly triggers the assignor’s liability under Section 14 for turning over any rents thereafter  
8 collected. By contrast, an assignee that wants more immediate control over actual collection of  
9 rents as they accrue may simultaneously choose to enforce its assignment of rents by means of  
10 appointment of a receiver (Section 7) or notification to tenants (Section 8). Nothing in the Act  
11 limits the ability of an assignee to enforce its interest in rents by multiple methods.  
12

13 **SECTION 10. MORTGAGEE IN POSSESSION.** Upon the assignor’s default as  
14 defined in an assignment of rents, the assignee may enforce the assignment by taking possession  
15 of the real property described in the assignment to the extent permitted by law of this state other  
16 than this [act].

17 **Preliminary Comment**

18 At common law, a mortgagee holding an assignment of rents could enforce that  
19 assignment by means of taking steps sufficient to constitute the mortgagee as a “mortgagee in  
20 possession” pending completion of a foreclosure or redemption by the mortgagor. Generally  
21 speaking, mortgage lenders are loathe to assume the status of a mortgagee in possession for a  
22 variety of reasons, including potential tort liability to third parties, the obligation to account for  
23 rentals collected, and the assumption of a duty to maintain the physical condition of the premises.  
24 *See, e.g.,* 1 GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 4.24 - 4.29,  
25 at 213-230 (3d ed. 1993).

26  
27 Because in rare cases a mortgagee may voluntarily choose to enforce an assignment of  
28 rents by becoming a mortgagee in possession, the Act is not intended (either explicitly or  
29 implicitly) to eliminate or overrule the mortgagee-in-possession doctrine. Thus, the Act provides  
30 that an assignee can choose to enforce an assignment of rents by becoming a mortgagee in  
31 possession, to the extent such an act is permitted by applicable law other than this Act and by the  
32 terms of the parties’ loan documents. Furthermore, the Act does not specify what constitutes  
33 “possession” for purposes of mortgagee-in-possession status; the Act leaves this question to other  
34 law.  
35

36 **SECTION 11. EFFECT OF ENFORCEMENT; NO AGENCY OR STATUS AS**

1     **MORTGAGEE IN POSSESSION; ENFORCEABILITY OF SECURED OBLIGATION.**

2     The enforcement of an assignment of rents under Section 7, 8, or 9, the application of rents by  
3     the assignee under Section 12 after enforcement, the payment of expenses under Section 13, or a  
4     civil action under Section 14(d) does not:

5             (1) make the assignee a mortgagee in possession of the real property, unless the  
6     assignee obtains physical possession of the real property;

7             (2) make the assignee an agent of the assignor;

8             (3) constitute an election of remedies that would preclude a later action to enforce  
9     the secured obligation;

10            (4) make the secured obligation unenforceable[; or][;]

11            (5) limit any right available to the assignee with respect to the secured  
12     obligation[.][;]

13            [(6) violate any “one action” provision existing under the laws of this state; or

14            (7) bar a deficiency judgment pursuant to any law of this state governing or  
15     relating to deficiency judgments following the enforcement of any encumbrance, lien, or security  
16     interest.]

17     *Legislative Note: A state that does not have a “one action” statute or anti-deficiency legislation*  
18     *may wish to omit subsections (6) and (7).*

19                             **Preliminary Comments**

20             Source: Cal. Civ. Code §§ 2938(e); Restatement (Third) of Property — Mortgages § 8.2

21  
22             1. *Mere enforcement of security interest in rents does not trigger mortgagee-in-*  
23     *possession status.* A number of common law decisions suggest that a mortgagee can become a  
24     “mortgagee in possession” — with the legal responsibilities attendant to that status — without

1 physical occupation of the mortgaged premises. *See, e.g.*, 1 GRANT S. NELSON & DALE A.  
2 WHITMAN, REAL ESTATE FINANCE LAW §§ 4.25, at 218 & nn. 1-9 (3d ed. 1993) (collecting  
3 cases). This result is not surprising, given the factual and legal uncertainty attendant to the term  
4 “possession.” This ambiguity can produce concern for the assignee that wishes to protect its  
5 security interest in rents without assuming the duties and liabilities attendant to mortgagee-in-  
6 possession status.

7  
8 The commentary to the Restatement (Third) of Property — Mortgages took the view that  
9 mere collection of rents “does not constitute the mortgagee a ‘mortgagee in possession,’ with the  
10 duties and liabilities attendant to that status.” Restatement (Third) of Property — Mortgages §  
11 4.2 cmt. c. California’s rent-collection statute is more explicit, making clear that no enforcement  
12 action authorized by the statute will constitute the assignee as a mortgagee in possession, short of  
13 the assignee taking *actual possession* of the premises. In an effort to provide clarity, the Act  
14 adopts the position reflected in the California statute.

15  
16 2. *Cumulative nature of mortgagee’s remedies.* Under the traditional rule, the mortgagee  
17 holding an assignment of rents could proceed after default to enforce its right to collect rents  
18 without concern about the impact that action might have on the mortgagee’s other remedies. The  
19 traditional approach treated the mortgagee’s remedies as cumulative; the mortgagee’s selection  
20 of one remedy did not preclude the mortgagee from subsequently seeking another remedy (*e.g.*,  
21 initially suing on the mortgage note, and later foreclosing on the mortgage). *See, e.g.*,  
22 Restatement (Third) of Property — Mortgages § 8.2 Reporters’ Note (collecting cases).

23  
24 The Act adopts this view, and makes clear that the assignee’s enforcement of its  
25 assignment of rents does not constitute an election of remedies that would preclude a later action  
26 to enforce the secured obligation, render the secured obligation unenforceable, or otherwise limit  
27 any rights available to the assignee with respect to the secured obligation. Thus, for example, if  
28 an assignee enforces its security interest by obtaining the appointment of a receiver under Section  
29 7, and the appointment is ancillary to an action by the assignee for specific performance of the  
30 assignment of rents, the assignee’s enforcement action does not preclude the assignee from  
31 subsequently asserting any other remedies it may have to enforce the secured obligation or any  
32 other collateral it may hold securing that obligation.

33  
34 3. *“One action” rules and anti-deficiency provisions.* In some states, “one action” rules  
35 provide that there can be only one form of action for the recovery of any debt secured by real  
36 property. *See, e.g.*, Cal. Code Civ. Pro. § 726(a); Idaho Code § 6-101(1); Mont. Code Ann. § 71-  
37 1-222(1); Nev. Rev. Stat. § 40.430(1); Utah Code § 78-37-1; *see also* First State Bank of  
38 Cooperstown v. Ihringer, 217 N.W.2d 857 (N.D. 1974). Under this approach, for example, a  
39 mortgagee’s decision to sue on the mortgage note would constitute an “action” that subsequently  
40 barred the mortgagee from foreclosing the mortgage.

41  
42 Ambiguity over the scope of a “one action” rule — and whether it would treat an attempt  
43 to enforce an assignment of rents as an “action” that would prevent other collection efforts —

1 could create significant confusion with respect to the enforcement of an assignment of rents. For  
2 this reason, the Restatement (Third) of Property — Mortgages, while generally rejecting the one-  
3 action approach, further argued that any limitation on the mortgagee’s remedies with respect to  
4 foreclosure of the mortgage should not limit the mortgagee’s enforcement of its security in rents:

5  
6 [Section 8.2] does not affect the mortgagee’s right to enforce a mortgage on rents under §  
7 4.2 or to the appointment of a receiver under § 4.3. This is because, under § 4.2, the  
8 mortgagee is proceeding against separate security and, under § 4.3, a receivership is an  
9 interim remedy ancillary to the remedies delineated in [Sections 8.2(a) and (b)]. Nor  
10 does this section limit the mortgagee’s remedies for waste under § 4.6 or the recovery of  
11 sums expended by the mortgagee for the protection of the security under § 2.2.

12 [Restatement (Third) of Property — Mortgages § 8.2, cmt. b]  
13

14 Consistent with this approach, the rent-collection statute in California (a one-action rule state)  
15 specifically provides that enforcement of a security interest in rents and collection of rents does  
16 not constitute an “action” for the purposes of the one-action rule or a “deficiency” action for the  
17 purposes of the state’s anti-deficiency statutes. In order to make the Act workable in states with  
18 one-action rules and deficiency legislation, the Act follows the California approach.  
19

20 4. *Marshaling requirements.* Nothing in this section limits a court’s equitable discretion  
21 to order lien marshaling in appropriate cases. For example, assume that Debtor owes Bank \$2  
22 million, secured by a mortgage and an assignment of rents on Blackacre and a separate mortgage  
23 on Whiteacre. Debtor also owes Henning \$1 million secured only by a mortgage on Whiteacre.  
24 Nothing in Section 11 is intended to constrain a court’s equitable discretion to order Bank to  
25 proceed against Blackacre and its rents first before foreclosing against Whiteacre.  
26

27 **SECTION 12. APPLICATION OF RENTS COLLECTED.** An assignee that collects  
28 rents under this [act] or collects upon a judgment in a civil action under Section 14(d) shall apply  
29 the sums collected in the following order to:

30 (1) the assignee’s reasonable expenses of enforcing its assignment of rents,  
31 including, to the extent provided for in the assignment, reasonable attorney’s fees and court costs  
32 incurred by the assignee;

33 (2) payment of expenses in accordance with Section 13;

34 (3) satisfaction of the secured obligation;

35 (4) satisfaction of any obligation secured by a subordinate security interest or

1 other lien on the rents, if the assignor and assignee receive a notification from the holder of the  
2 interest or lien demanding payment of the rents before distribution of the rents; and  
3 (5) the assignor.

#### 4 **Preliminary Comments**

5 Source: Cal. Civ. Code §§ 2938(c), (e); U.C.C. § 9-607.

6  
7 The term “reasonable attorney’s fees and costs” in subsection (1) includes those fees and  
8 costs incurred by the assignee in enforcing its assignment of rents. This would include, *inter*  
9 *alia*, the fees and costs incurred in obtaining the appointment of a receiver, providing a  
10 notification under Section 10, or collecting rents from tenants following notification to tenants  
11 under Section 9. Unlike U.C.C. § 9-607(d) — under which an assignee’s right to recover these  
12 expenses from collected receivables arises automatically — the assignee may recover reasonable  
13 attorney’s fees under this Act only to the extent such fees are provided for in the assignment of  
14 rents.

15  
16 The assignee may also incur other attorney’s fees and legal expenses in proceeding  
17 against the assignor, such as expenses incurred in foreclosing the mortgage or seeking a  
18 deficiency judgment. Whether the assignee has a right to collect those fees and expenses  
19 depends on the parties’ agreement and the provisions of law other than this Act.  
20

#### 21 **SECTION 13. PAYMENT OF EXPENSES FOR PROTECTING REAL** 22 **PROPERTY.**

23 (a) In this section, “dedicated rents” means any rents that, by the terms of a lease  
24 covering all or any portion of the real property described in an assignment of rents, are expressly  
25 designated as additional rent for the purpose of paying, or for reimbursing the assignor’s payment  
26 of:

27 (1) real property taxes;

28 (2) insurance on the real property;

29 (3) ground rents under a ground lease covering the real property;

1 (4) common interest ownership association assessments, to the extent that  
2 such assessments would take priority over the security interest of an assignee if unpaid; and

3 (5) any other expense the nonpayment of which would give rise to a lien  
4 that would take priority over the security interest of an assignee.

5 (b) If the assignee collects any dedicated rents after enforcement of an assignment  
6 of rents under Section 8 or 9, any of the following may give to the assignee a notification  
7 demanding that the assignee apply the dedicated rents to the payment of the expenses for which  
8 they are dedicated:

9 (1) the assignor;

10 (2) any person holding a recorded assignment of rents on the real property;

11 and

12 (3) a tenant that paid the dedicated rents.

13 (c) After receipt of a notification under subsection (b), the assignee shall apply  
14 any dedicated rents to the payment of the expenses for which they are dedicated. This obligation  
15 continues until the assignee obtains the appointment of a receiver under Section 7 or the date on  
16 which the assignee ceases to enforce the assignment, whichever occurs first.

17 (d) This section does not require an assignee to:

18 (1) operate or manage the real property; or

19 (2) apply any rents other than dedicated rents to the payment of the  
20 expenses identified in subsection (a).

## 21 **Preliminary Comments**

22 1. *Operation and management of the real property.* If the assignee enforces its

1 assignment of rents by means of Section 8 (notification to tenants) or Section 9 (notification to  
2 the assignor), the assignor effectively remains in day-to-day possession and control of the real  
3 property. Subsection (d)(1) makes clear that the assignee’s collection of rents and payment of  
4 property-related expenses does not place day-to-day operational and management responsibility  
5 upon the assignee, and that such responsibility remains upon the assignor. This provision  
6 operates in conjunction with Section 11, which makes clear that the assignee’s collection and  
7 enforcement actions do not render the assignee as an agent of the assignor, unless the assignee  
8 has actually assumed the responsibilities of a mortgagee in possession under Section 10.  
9

10 *2. Payment of costs of taxes, insurance, and certain other expenses.* If the assignee  
11 begins collecting rents following the assignor’s default, the assignor may lack the funds  
12 necessary to pay the costs of real property taxes, insurance, ground rents, CIOA charges, or other  
13 expenses the nonpayment of which would either prime the mortgage lien or threaten the  
14 mortgagee’s security. Further, the assignor’s nonpayment of these costs may adversely affect the  
15 interests of tenants — who may reasonably expect that a portion of their rental payments to be  
16 directed to the payment of these project costs. Such an expectation is particularly significant  
17 when a commercial lease specifically requires the tenant to pay a sum denominated “additional  
18 rent” based upon the tenant’s proportionate share of the landlord’s expected costs for real estate  
19 taxes, insurance, and maintenance (or the increases in such costs beyond a baseline established in  
20 the lease).  
21

22 Under the traditional rule prevailing in most states, the landlord’s obligation to pay taxes,  
23 insurance, or maintenance expenses (either expressed or implied in tenant leases) does not bind  
24 the lender as a successor until the lender acquires possession or ownership of the land. For  
25 example, if the lender purchases the mortgaged premises at foreclosure, the lender would become  
26 obligated to fulfill the landlord’s responsibilities under the tenant leases, as the landlord’s  
27 covenants in those leases would run with the land to bind the lender. Likewise, if the lender  
28 enforces its security interest in rents by becoming a mortgagee in possession, the lender (as the  
29 succeeding possessor) would become bound to fulfill the landlord’s responsibilities under tenant  
30 leases. However, if state law permits the lender to collect rents prior to completing foreclosure  
31 without becoming a mortgagee in possession, the lender may collect those sums and apply them  
32 to the mortgage debt without a legal obligation to apply them to the payment of taxes, insurance,  
33 or property maintenance expenses. Such a lender is not a successor that is bound to perform the  
34 landlord’s covenants under tenant leases; further, courts have not generally treated such sums as  
35 being impressed with a “trust” obligating the lender to apply such sums to the payment of taxes,  
36 insurance, or property maintenance.  
37

38 Section 13 retains this approach in general terms, but does identify a special subcategory  
39 of rents defined as “dedicated rents.” This category includes any rents payable by a tenant and  
40 specifically allocated by contract for the payment of real property taxes and insurance, as well as  
41 ground rents under a ground lease covering the real property and common interest ownership  
42 association assessments or other expenses the nonpayment of which would give rise to a lien that  
43 would take priority over the security interest of an assignee. If an assignee collects any dedicated

1 rents while enforcing its security interest in rents, then the assignor, another recorded rents  
2 assignee, or a tenant may give notification to the collecting assignee requesting that the assignee  
3 apply any dedicated rents to the payment of the expenses for which they are dedicated. Upon  
4 receiving such a notification, the collecting assignee must apply any dedicated rents as requested  
5 until such time as a receiver is appointed under Section 7 or the collecting assignee ceases to  
6 enforce its security interest in rents.

7  
8 Subsection (d)(2) makes clear that the assignee has no obligation to apply non-dedicated  
9 rents to pay the costs of real property taxes, insurance, or maintenance of the real property  
10 covered by the assignment of rents.

11  
12 The Act draws a distinction between rents specifically allocated to taxes and insurance  
13 (which are dedicated rents under the Act) and rents specifically allocated to property maintenance  
14 (which are not dedicated rents under the Act). Often, the assignor or an affiliate of the assignor  
15 performs project maintenance and collects a substantial fee for these services. If the assignor is  
16 in default and is not meeting its debt service obligations, an assignee understandably may not  
17 wish to be legally bound to pay maintenance charges to the assignor, thereby allowing the  
18 assignor to continue to profit from operating the real property during default. A rents assignee  
19 might voluntarily choose to continue to pay such expenses to the assignor if the assignee was  
20 comfortable that the assignor's management agreement was commercially reasonable. Indeed, a  
21 rents assignee has a strong economic incentive to make sure that these expenses are paid in the  
22 ordinary course, so as to preserve the going-concern value of the real property. However, the Act  
23 does not impose on the rents assignee any legal obligation to use collected rents for those  
24 purposes.

25  
26 3. *Illustrations.* The proper application of Section 12 is demonstrated by the following  
27 illustrations:

28  
29 *Illustration 1.* Following Assignor's default under an assignment of rents covering an  
30 office building, Assignee begins collecting rents from the building's tenants. Under the tenant  
31 leases, Assignee collects both "base rents" and "additional rents," with the "additional rents"  
32 specifically allocated to reimburse the Assignor for payment of real property taxes, insurance,  
33 and common area maintenance. Assignor has not paid real property taxes for the current year,  
34 and this tax obligation is now past due. Upon receipt of a proper notification from Assignor,  
35 Assignee must apply the "additional rents" collected for payment of real property taxes to the  
36 payment of real property taxes, to the extent of the total additional rents collected for that  
37 purpose. Assignee has no legal obligation, however, to apply any of the "base rents" to the  
38 payment of real property taxes.

39  
40 *Illustration 2.* Following Assignor's default under an assignment of rents covering an  
41 apartment building, Assignee begins collecting rents from the building's tenants. Under the  
42 tenant leases, the tenants are obligated to pay "rent," but none of the rental obligation is  
43 specifically allocated for the reimbursement of particular property-related expenses. Assignor

1 has not paid real property taxes for the current year, and this tax obligation is now past due.  
2 Even if Assignor so requests, Assignee has no obligation to apply any of the rents collected to the  
3 payment of real property taxes, as none of the rents are “dedicated rents” within the meaning of  
4 subsection (a).  
5

6 4. *Receivership.* Section 13 authorizes a tenant, the assignor, or a subordinate rents  
7 assignee to demand that the collecting assignee use dedicated rents to pay the expenses for which  
8 such rents are earmarked. Section 13 does not authorize such a demand where the assignee  
9 enforces its assignment of rents via the appointment of a receiver under Section 7, as the  
10 provisions of Section 7 already authorize the receiver to use collected rents to pay such expenses  
11 consistent with the terms of the court order appointing the receiver.  
12

13 In many cases, leases for a particular project are structured as “gross leases,” and no  
14 specified portion of the rental obligation is allocable to payment of real property taxes, insurance,  
15 or maintenance. In these situations, the assignor/landlord’s nonpayment of taxes, insurance, or  
16 maintenance costs may significantly frustrate the expectations of tenants; nevertheless, because  
17 the tenants’ rents are not specifically dedicated, the assignee would be under no legal obligation  
18 to apply collected rents to the payment of these expenses.  
19

20 Nothing in this Act would preclude a tenant from seeking the appointment of a receiver if  
21 the assignee’s nonpayment of these expenses so harmed the tenant’s interest as to justify the  
22 appointment of a receiver under law other than this Act.  
23

24 5. *Mortgagee-in-possession status.* Section 13 does not authorize a demand for  
25 application of dedicated rents if the assignee has enforced its assignment of rents by becoming a  
26 mortgagee-in-possession under Section 10. Such a demand would be unnecessary in that  
27 context, as a mortgagee in possession would already have the legal duty to pay the expenses of  
28 maintaining the real property.  
29

30 **SECTION 14. TURNOVER OF RENTS; COMMINGLING AND**  
31 **IDENTIFIABILITY OF RENTS; TRANSFER OF RENTS BY ASSIGNOR.**

32 (a) If the assignor or its agent collects rents that the assignee is entitled to collect  
33 or receive under Section 6:

34 (1) the assignor or its agent shall turn over the rents to the assignee, less  
35 any amount representing payment of expenses authorized by the assignee; and

36 (2) the assignee continues to have a security interest in the rents so long as

1 they are identifiable.

2 (b) For purposes of subsection (a), rents are identifiable if they are maintained in a  
3 segregated account or, if commingled with other funds, to the extent the assignee can identify  
4 them by a method of tracing, including application of equitable principles, that is permitted under  
5 law of this state other than this [act] with respect to commingled funds. If the assignment of  
6 rents was recorded, the assignee's security interest in identifiable rents remains perfected and  
7 enforceable against the assignor and, subject to subsection (c), any other person in possession of  
8 the rents.

9 (c) A person to which the assignor transfers cash that is identifiable cash proceeds  
10 of rents takes the cash free of the assignee's security interest, unless the transferee acted in  
11 collusion with the assignor in violating the rights of the assignee.

12 (d) In addition to any other remedy available to the assignee under the law of this  
13 state other than this [act], if the assignor fails to turn over rents to the assignee in violation of  
14 subsection (a), the assignee may recover from the assignor an amount equal to the rents that the  
15 assignor was obligated to turn over under subsection (a) and reasonable attorney's fees and costs  
16 to the extent provided for in the assignment of rents. The assignee may maintain an action under  
17 this subsection without bringing an action to foreclose any security interest that it may have in  
18 the real property. Any sums recovered in an action must be applied in the manner specified in  
19 Section 12.

## 20 **Preliminary Comments**

21 Source: Cal. Civ. Code §§ 2938(f); U.C.C. §§ 9-315(a), 9-315(b), 9-332(a); Restatement  
22 (Third) of Property — Mortgages §§ 4.6(a)(5), 4.6(b)(3).  
23

1           1. “*Milking*” of rents and existing law. The owner of a distressed real estate project may  
2 sometimes engage in “milking” of rents — *i.e.*, collecting rents from the project and using those  
3 rents to pay expenses other than the mortgage debt and expenses of preserving or maintaining the  
4 mortgaged premises. Milking of rents that have been assigned as security poses a significant  
5 threat to an undersecured mortgagee, who cannot expect to obtain full recovery of the mortgage  
6 debt via foreclosure. This threat is even more severe where the mortgagee holds a nonrecourse  
7 mortgage debt and the mortgagor thus has no personal liability for a deficiency judgment. Such a  
8 threat typically prompts the mortgagee to take prompt action following default to enforce its  
9 security interest in rents and thereby divest the mortgagor of control over project rents.

10  
11           Between the time that the mortgagor goes into default and the time that the mortgagee  
12 finally enforces its security interest in rents, the mortgagor has often collected and disposed of  
13 rents. In this situation, an undersecured mortgagee may desire to recover damages that it suffered  
14 because the mortgagor collected and disposed of rents that might otherwise have reduced the  
15 mortgage obligations.

16  
17           All authorities agree that the mortgagee has no basis for recovering cash proceeds of rent  
18 paid in the ordinary course to third parties acting in good faith; such parties would take those  
19 cash proceeds free of the mortgagee’s claims by virtue of the common law negotiability of  
20 money. The mortgagee might have a damage claim against the mortgagor, however, on account  
21 of the mortgagor’s disposition of rents. The common law of mortgages treated this conduct as a  
22 species of legal waste — consistent with its treatment of “rents” as an incorporeal hereditament  
23 in the nature of real property. The common law generally imposed liability upon a mortgagor  
24 who took any action that damaged or destroyed the mortgaged property, thereby reducing its  
25 value. [In title theory jurisdictions, this liability extended to the full reduction in the collateral’s  
26 value; under the lien theory, this liability existed only to the extent that the waste actually  
27 impaired the mortgagee’s security.] In the context of rents, the weight of available authority  
28 suggests that the mortgagor’s diversion of rents would constitute legal waste, at least where the  
29 mortgagee had taken sufficient steps to enforce its security interest in rents. *See, e.g.*, Taylor v.  
30 Brennan, 621 S.W.2d 592 (Tex. 1981) (mortgagor’s collection and disposition of rents following  
31 mortgagee’s enforcement of security interest in rents would constitute waste, but holding that no  
32 waste occurred because mortgagee had not taken sufficient steps post-default to enforce its  
33 security interest in rents); Ginsberg v. Lennar Florida Holdings, 645 So.2d 490 (Fla. App. 1994).  
34 The Restatement (Third) of Property — Mortgages adopts this view in § 4.6(a)(5) which  
35 provides that “[w]aste occurs when, without the mortgagee’s consent, the mortgagor ... retains  
36 possession of rents to which the mortgagee has the right to possession....”).

37  
38           The Act does not precisely duplicate the Restatement approach, as it does not specifically  
39 use the term “waste” to identify the basis of the assignor’s liability for milking rents. In lien  
40 theory states, courts traditionally held that the mortgagor was liable for waste only to the extent  
41 that its conduct impaired the mortgagee’s security. Rather than focusing upon impairment of  
42 security — which would require proof regarding the value of the mortgaged premises — the Act  
43 instead takes a more straightforward approach. If the assignor is obligated to turn over rents to

1 the assignee under Sections 6 and 14(a), but fails to do so, the assignor is liable for damages  
2 equal to the full amount of the rents not turned over. Any such recovery must be applied by the  
3 assignee in the manner specified by Section 12, so the assignee’s total recovery could not exceed  
4 the loss actually suffered by the assignee. Any surplus proceeds remaining after full satisfaction  
5 of the secured obligation would be returned to the assignor or to subordinate lienholders in  
6 accordance with Section 12.

7  
8 *2. Assignor’s liability to turn over rents.* The Act provides that upon default or as  
9 otherwise permitted by an assignment of rents, an assignee may collect (1) accrued but unpaid  
10 rents and (2) unaccrued rents as they accrue in the future. If the assignor collects any such sums  
11 following enforcement by the assignee, the assignor must turn over such sums to the assignee  
12 under subsection (a), or face personal liability for failure to do so by virtue of subsection (d).

13  
14 In cases involving nonrecourse obligations (either by virtue of specific contractual  
15 nonrecourse provisions or the intervention of antideficiency legislation), mortgagors who have  
16 milked rents often argue that the mortgagee’s action is in the nature of a deficiency judgment and  
17 should therefore be dismissed. The weight of authority rejects this view and concludes that an  
18 action for damages for waste of rents or conversion of the proceeds of rents is not in the nature of  
19 a deficiency action. *See, e.g.,* Hoelting Enters. v. Nelson, 929 P.2d 183 (Kan. App. 1996);  
20 International Business Machines Corp. v. Axinn, 676 A.2d 552 (N.J. Super. 1996). *See also* In re  
21 Evergreen Ventures, 147 B.R. 751 (Bankr. D. Ariz. 1992) (distinguishing deficiency action and  
22 waste action). The Act follows this approach.

23  
24 Subsection (d) makes clear that an assignee may bring an action to recover damages on  
25 account of the assignor’s failure to turn over rents, without first having to foreclose on the  
26 underlying real property or pursue other legal remedies. Requiring the assignee to pursue  
27 foreclosure first “would probably result in more foreclosures.” Restatement (Third) of Property  
28 — Mortgages § 4.6 cmt. f. Moreover, as provided in Section 11 of the Act, the assignee’s action  
29 under Section 14(d) would not constitute an election of remedies thereby precluding later action  
30 to enforce the secured obligation, or an action to enforce the debt within the meaning of a state’s  
31 one-action law.

32  
33 *3. Enforceability of security interest in rents vs. third parties.* Section 14(b) makes clear  
34 that the assignor’s failure to turn over rents collected following enforcement by the assignee does  
35 not automatically deprive the assignee of its perfected security interest in the cash proceeds of  
36 those rents, and thus the assignee can continue to enforce that interest as against the assignor and  
37 third parties (such as the trustee in bankruptcy following the assignor’s filing of a bankruptcy  
38 petition).

39  
40 The Act recognizes two significant limitations, however, upon the assignee’s right to  
41 enforce the security interest against third parties. First, any such cash proceeds of rents must be  
42 “identifiable.” In this context, “identifiable” has the same meaning as it does in U.C.C. § 9-  
43 315(a), under which a secured party has a security interest in the identifiable proceeds of its

1 original collateral. As a result, if the assignor has commingled the proceeds of collected rents  
2 with other operating funds of the assignor, those proceeds will remain identifiable only if the  
3 assignee can identify them by a method of tracing (such as the lowest intermediate balance rule)  
4 that is recognized by law other than this Act with respect to commingled property. Second,  
5 subsection (c) of the Act recognizes the negotiability of money and provides that any third parties  
6 who receive payments of the proceeds of collected rents from the assignor will be protected so  
7 long as the transferee of the funds has not acted in collusion with the assignor to deprive the  
8 assignee of its interest in the funds. *See, e.g.*, U.C.C. § 9-332. A protected transferee under  
9 subsection (c) could include another creditor collecting rents pursuant to a subordinate  
10 assignment of rents, and a bank exercising a set-off right against a deposit account that contains  
11 identifiable cash proceeds of rents.  
12

13 **SECTION 15. PRIORITY AMONG COMPETING SECURITY INTERESTS IN**  
14 **RENTS; PRIORITY AMONG RECEIVERS.**

15 (a) Except as otherwise provided in this [act], the priority of liens among  
16 creditors concerning rents is governed by Section 5.

17 (b) If an assignee entitled to priority under subsection (a) enforces its interest in  
18 rents after another creditor holding a subordinate security interest in rents has enforced its interest  
19 under Section 8, 9, or 10, the assignee may collect rents that are accrued but unpaid as of the date  
20 of the assignee's enforcement and rents that accrue thereafter, but the creditor holding the  
21 subordinate security interest in rents is not obligated to turn over any rents collected in the  
22 ordinary course of business before the senior assignee enforces its interest in rents.

23 (c) Priority among receivers is governed by the following rules:

24 (1) If more than one assignee qualifies for the appointment of a receiver  
25 under Section 7, a receivership request by an assignee entitled to priority under Section 5 has  
26 priority over a receivership request by a subordinate assignee, even if a court has previously  
27 appointed a receiver for the subordinate assignee.

1 (2) If a subordinate assignee obtains the appointment of a receiver, that  
2 receiver has the right, until a receiver is appointed under a senior assignment of rents, to collect  
3 the rents and apply them in the manner specified in the order of appointment. The receiver for  
4 the subordinate assignee need not turn over collected rents to the receiver for the senior assignee,  
5 even if those rents are otherwise identifiable as provided in Section 14(b).

6 **Preliminary Comments**

7 Source: Cal. Civ. Code § 2938(h); Restatement (Third) of Property — Mortgages § 4.5

8  
9 1. *Priority between competing assignees.* Generally speaking, priority between  
10 conflicting rent assignments is resolved by reference to the state’s recording act. See Section 5.

11  
12 2. *Priority as to rents collected by a subordinate assignee.* The Act provides that if a  
13 senior assignee enforces its right to rents after a subordinate assignee has already enforced its  
14 rights, then the senior assignee will have priority as to unaccrued rents and accrued but unpaid  
15 rents. However, subsection (b) provides that this priority will not extend to rents already  
16 collected by the subordinate assignee. The subordinate assignee may retain already collected  
17 rents and apply them in accordance with Section 12, without regard to any turnover demand by  
18 the senior assignee. This provision places the subordinate assignee in the same position, vis-a-  
19 vis the senior assignee, as any other third party creditor that received payment of rents from the  
20 assignor — such third party creditors would take the proceeds of those rents free of the senior  
21 assignee’s security interest so long as they were not acting in collusion with the assignor to defeat  
22 the senior assignee’s rights.

23  
24 3. *Priority between conflicting receivers.* Subsection (c), which is modeled upon § 4.5 of  
25 the Restatement (Third) of Property — Mortgages, provides the same basic priority rule with  
26 respect to conflicting receivers. If the senior assignee is entitled to the appointment of a receiver  
27 under Section 7, the court’s appointment of that receiver will take priority over and displace a  
28 prior receivership obtained by a subordinate assignee. Any rents actually collected by the  
29 receiver for the subordinate assignee, however, need not be turned over to the receiver for the  
30 senior assignee; instead, the receiver for the subordinate assignee shall apply those sums in the  
31 manner specified in its order of appointment.

32  
33 **SECTION 16. SCOPE OF TERM “TENANT.”** The law of this state other than this  
34 [act] governs whether a licensee or other occupier of real property has a possessory interest in the

1 real property.

2 **Preliminary Comments**

3 For ease of reference, the Act characterizes as a “tenant” anyone who is obligated to pay  
4 “rents” as defined in the Act. Thus, under the Act, the term “tenant” may include licensees and  
5 other occupiers of land that do not have a possessory interest and thus do not constitute tenants as  
6 that term is used in the general law of landlord and tenant. Nothing in the Act is intended to  
7 make such a person a “tenant” for purposes other than this Act. Thus, for example, the fact that  
8 this Act characterizes a hotel guest as a “tenant” would not give the hotel guest any rights  
9 generally available to tenants under other laws of this state (such as a tenant’s protection from  
10 dispossession under a forcible entry and detainer statute).  
11

12 **SECTION 17. UNIFORMITY OF APPLICATION AND CONSTRUCTION.** In  
13 applying and construing this Uniform Act, consideration must be given to the need to promote  
14 uniformity of the law with respect to its subject matter among states that enact it.  
15

16 **SECTION 18. EFFECTIVE DATE.** This [act] takes effect on \_\_\_\_\_.  
17

18 **SECTION 19. REPEALS.** The following acts are repealed: [List statutes to be  
19 specifically repealed.]  
20

21 **SECTION 20. APPLICATION TO EXISTING RELATIONSHIPS.** This [act]  
22 applies to the enforcement of an assignment of rents, even if executed and delivered before [the  
23 effective date of this [act]].