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
# UNIFORM ASSIGNMENT OF RENTS ACT

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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 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.
UNIFORM ASSIGNMENT OF RENTS ACT

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

SECTION 2. DEFINITIONS. In this [act]:

(1) “Assignee” means a person entitled to enforce an assignment of rents.

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

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

(4) “Cash proceeds” means money, checks, deposit accounts, or the like.

(5) “Day” means calendar day.

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

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

(8) “Good faith” means honesty in fact and the observance of reasonable
commercial standards of fair dealing.

(9) “Notification” means a document containing information required under this
(10) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government, or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

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

(12) “Rents” means:

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

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

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

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

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

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

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

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

(G) any other sums that are defined as rents under the law of this state.
other than this [act]; and

(H) cash proceeds received upon collection of any sum or claim identified

in subparagraphs (A) through (G).

(13) “Secured obligation” means an obligation the performance of which is

secured by a security interest in real property.

(14) “Security instrument” means an agreement that creates or provides for a

security interest in real property, however denominated, whether or not it also creates or provides

for a lien upon personal property.

(15) “Security interest” means an interest in real property that arises by agreement

and secures performance of an obligation.

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

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

(B) to attach to or logically associate with the document an electronic

sound, symbol, or process.

(17) “State” means a state of the United States, the District of Columbia, Puerto

Rico, the United States Virgin Islands, or any territory or insular possession subject to the

jurisdiction of the United States.

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

Preliminary Comments

1. “Assignee.” The term “assignee” means the party entitled to enforce an assignment of

rents in the manner specified by this Act.

2. “Assignment of rents.” In many commercial transactions, it is customary for the lender

to require the borrower to execute multiple documents, including both a “mortgage” covering the
land and an “assignment of rents and leases” which assigns to the lender all leases covering the
mortgaged premises and all rents accruing under those leases. In some transactions, the lender
may simply incorporate into the mortgage language sufficient to assign to the lender all leases
covering the mortgaged premises and rents accruing under such leases, without a separate
assignment document. The Act uses the term “assignment of rents” to mean the actual transfer of
an interest in rents, whether that transfer occurs by virtue of the mortgage, a separate document
titled “assignment of leases and rents,” or otherwise.

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

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

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

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

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

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

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

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

11. “Record.” To “record” means that the person submitting a document has complied
with the state’s existing recording act. However, for purposes of this Act, a document is
“recorded” even if the recording office’s personnel have indexed it incorrectly or otherwise failed
to comply with their legal duties.
12. “Rents.” In many commercial real estate developments (e.g., office buildings, industrial parks, retail shopping centers, and 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), sums paid by tenant occupiers undoubtedly constitute “rent” in the nature of real property. Thus, a mortgage lender taking a security interest in “rents” must comply with the provisions of real property law in order to obtain and enforce that security interest. In other words, 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 the county where the land is situated.

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

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

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

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

The Act takes the view that “rents” should include all sums paid by a person in order to acquire the right to possess or occupy the real property of another. In this regard, a person “possesses” the land of another if that person has possessory interest in that land (e.g., the interest
of a tenant under a lease). A person “occupies” the land of another if that person has a contractual right that typically permits them to occupy the real property of another on an overnight or continuing basis. The application of this definition is demonstrated by the following illustrations:

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

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

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

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

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

In addition, the Act defines rents to include a number of other charges that are often characterized as “rent” under leases or occupancy agreements, as well as sums that constitute an economic substitute for rents that might otherwise have accrued or been collected. These sums include the proceeds of rental interruption insurance payable to the assignor; claims arising out of a default in the payment of rents (e.g., liquidated damages); sums payable in order to terminate a lease or occupancy agreement; sums payable for the purpose of paying or reimbursing the
assignor’s payment of expenses incurred in operating and maintaining the real property (such as
taxes or insurance) or in constructing or installing improvements; and any security deposit
forfeited by a possessor or occupier of the real property.

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

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

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

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

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

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

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

SECTION 3. MANNER OF GIVING NOTIFICATION.

(a) Except as otherwise provided in subsections (c) and (d), a person gives a
notification or a copy of a notification under this [act] by
(1) handing it to the recipient; or

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

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

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

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

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

(c) If a person giving a notification pursuant to this [act] and the recipient have agreed as to the methods for giving a notification, that agreement is enforceable.
(d) If a notification is not given in accordance with subsection (a) but is received by the recipient within the time it would have been received if properly given, it is given as of the time of receipt.

**Preliminary Comments**

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

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

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

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

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

3. **Obligations under the Act triggered by receipt.** While a person obliged to give a notification under the Act satisfies its obligation to give that notification by dispatch in
accordance with subsection (a)(1), several substantive provisions of the Act effectively require that the intended recipient actually receive notification. For example, although an assignee may give notification to a tenant by mail directing that tenant to pay rents to the assignee, the Act does not legally obligate the tenant to pay rents to the assignee until the tenant receives the notification. See Section 8(b).

SECTION 4. ASSIGNMENT OF RENTS CREATES SECURITY INTEREST. An assignment of rents creates a presently effective security interest in all accrued and unaccrued rents arising from the real property described in the assignment, whether the assignment is denominated an absolute assignment, an absolute assignment conditioned upon default, an assignment as additional security, or otherwise. The security interest created by an assignment of rents is separate and distinct from any security interest held by the assignee on the real property described in the assignment.

Preliminary Comments

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

1. Rents as a distinct source of collateral. An assignment of rents permits the assignee to collect rents that accrue between the date of the assignor’s default and the date that the assignee can complete a mortgage foreclosure on the underlying land. In many states, this foreclosure process can be quite lengthy. In these states, a mortgagee faces a heightened risk that the mortgagor may collect project revenues and expend them other than to reduce the mortgage debt (a process often referred to as “milking” the rents) while a foreclosure proceeding is pending. By taking an assignment of rents, the assignee demonstrates its intention to have a lien upon all future rents produced by the project, including those that accrue between default and the completion of a foreclosure sale — a period that may be extended if the assignor files a bankruptcy petition that stays the foreclosure.

Traditionally, state law has governed the creation and enforcement of security interests in rents. Most frequently, however, disagreements regarding security interests in rents arise in the federal bankruptcy courts. On its face, the Bankruptcy Code appears to recognize that state law has traditionally treated “rents” that accrue between default and foreclosure as a source of collateral that is separate and distinct from the land that generated those rents. The Bankruptcy Code characterizes rents from mortgaged property as “cash collateral,” 11 U.S.C. § 363(a), and
preserves a secured creditor’s pre-bankruptcy lien on rents that the debtor receives after it files a bankruptcy petition, id. § 552(b). These provisions appear to acknowledge that a pre-bankruptcy assignment of rents creates a separate security interest in the rents (i.e., separate from the underlying mortgage lien against the land itself).

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

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

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

Mortgagees have argued that the so-called “absolute” assignment of rents strengthens their position with respect to rents in the bankruptcy context. When a debtor files for bankruptcy, all of the debtor’s property becomes property of the bankruptcy estate. 11 U.S.C. § 541(a). The debtor generally may use property of the estate in the course of its bankruptcy proceeding, subject to the obligation to provide adequate protection to a secured creditor holding a lien upon that property. 11 U.S.C. § 363(b). Moreover, a secured party holding a security interest in property of the estate is subject to the automatic stay and cannot enforce its lien or otherwise collect the debt outside the context of the bankruptcy proceeding. Id. § 362(a). As a result, a debtor that owns an income-producing real estate project gains significant leverage if the project’s post-petition rents constitute property of the bankruptcy estate. By contrast, the mortgagee/assignee would prefer that the law characterize the post-petition rents as property that is not part of the bankruptcy estate. If the project’s post-petition rents are not property of the
estate, the automatic stay would place no limitation upon the mortgagee’s ability to collect those rents and apply them to the debt.

Obviously, if a mortgagee had already completed a foreclosure sale prior to bankruptcy, the land belongs to the foreclosure purchaser and thus unaccrued rents from that land would not constitute property of the bankruptcy estate. But if no foreclosure has yet occurred — and thus equitable ownership of the land remains in the debtor — unaccrued post-petition rents would seem to fit squarely within the broad concept “property of the estate” as articulated in § 541(a).

Nevertheless, in an attempt to boost their leverage in context of bankruptcy, mortgage lenders have argued that under a so-called “absolute” assignment of rents, “title” to the post-petition rents is in the lender and such rents therefore do not constitute property of the bankruptcy estate. A number of courts have accepted this argument. See, e.g., First Fidelity Bank v. Jason Realty, L.P. (In re Jason Realty, L.P.), 59 F.3d 423 (3d Cir.1995); In re Kingsport Ventures, L.P., 251 B.R. 841 (Bankr. E.D. Tenn. 2000); In re Robin Associates, 275 B.R. 218 (Bankr. W.D. Pa. 2001); In re Carretta, 220 B.R. 203 (D.N.J. 1998); see also NCNB Texas Nat’l Bank v. Sterling Projects, Inc., 789 S.W.2d 358 (Tex. App. 1990) (“The absolute assignment does not create a security interest but instead passes title to the rents. An absolute assignment of rents is not security but is a pro tanto payment of the obligation.”).

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

Mortgage law has long established that instruments purporting absolutely to convey an interest in land nevertheless constitute equitable mortgages when the circumstances demonstrate that the parties are using an interest in land to secure payment of a debt. See, e.g., Restatement of Property (Third) — Mortgages § 3.2 (absolute deed intended to secure an obligation constitutes a mortgage); Smith v. Player, 601 So.2d 946 (Ala. 1992) (same); Steckelberg v. Randolph, 404 N.W.2d 144 (Iowa 1987) (same). Under this same principle, courts should treat a typical “absolute” assignment of rents as an assignment for security purposes, and the weight of modern judicial authority so provides. See, e.g., In re Cavros, 262 B.R. 206 (Bankr. D. Conn. 2001); In re 5877 Poplar, L.P., 268 B.R. 140 (Bankr. W.D. Tenn. 2001); National Operating, L.P. v. Mutual Life Ins. Co. of New York, 630 N.W.2d 116 (Wis. 2001); In re Guardian Realty Group, L.L.C., 205 B.R. 1 (Bankr. D.D.C. 1997); In re RV Centennial Partnership, 202 B.R. 774 (Bankr. D. Colo. 1996); In re Lyons, 193 B.R. 637, 644 (Bankr. D. Mass. 1996). Under this view, where the underlying land is property of the bankruptcy estate, post-petition rents from that property would likewise constitute property of the bankruptcy estate. However, the assignee of those rents
would continue to have a security interest in those rents by virtue of Bankruptcy Code § 552(b),
and the debtor/assignor would be obliged to provide adequate protection of the assignee’s interest
in those rents under Bankruptcy Code § 363.

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

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

SECTION 5. RECORDATION OF ASSIGNMENT OF RENTS; EFFECT OF
RECORDATION. An assignment of rents may be recorded in the [appropriate governmental
office under the recording act of this state] in the same manner as any other conveyance of an
interest in real property. Upon recording:

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

(2) the security interest created by the assignment is fully perfected,
notwithstanding any provision of the assignment or other law of this state which would preclude
or defer enforcement of the security interest until the occurrence of a subsequent event, including
a subsequent default of the assignor, the assignee’s obtaining possession of the real property, or
the appointment of a receiver.

Preliminary Comments

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

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

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

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

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

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

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

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

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

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

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

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

Preliminary Comments

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

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

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

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

However, this Act does not prevent the assignee from using any other legal mechanism to obtain and enforce a security interest in the cash proceeds of rents that the assignor has already collected prior to enforcement. For example, the express terms of an assignment of rents could
(1) require the assignor to deposit the cash proceeds of rents in a particular deposit account, and
(2) grant the assignee a security interest in that deposit account under Article 9 of the Uniform
Commercial Code. If the assignment of rents so provided, the assignee could exercise its
available remedies under Article 9 to collect any sums within that deposit account, including the
cash proceeds of rents collected by the assignor prior to the assignee’s enforcement of its
assignment of rents.

SECTION 7. ENFORCEMENT BY APPOINTMENT OF RECEIVER.

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

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

(2) for specific performance of the assignment;

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

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

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

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

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

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

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

(2) other circumstances exist that would justify the appointment of a
receiver under the law of this state other than this [act].

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

Preliminary Comments

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

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

2. Traditional standards for appointment of a receiver. Traditionally, courts have
appointed a receiver for mortgaged land if the value of the land was insufficient to satisfy the
mortgage debt (i.e., where the mortgagee’s security was inadequate) or whether the owner of the
mortgaged land was committing waste (thereby threatening the value of the mortgagee’s
security). See, e.g., Restatement (Third) of Property — Mortgages §§ 4.3(a)(2), 4.3(a)(3); 1 G.
traditional approach, Section 6(b)(1)(B) authorizes the appointment of a receiver if the real
property appears insufficient to satisfy the secured obligation. Likewise, Section 6(b)(2)
authorizes the appointment of a receiver where there are “other circumstances” justifying the
appointment of a receiver under the law of this state other than this Act. Such “other
circumstances” would include waste as defined under state law other than this Act. Thus, for
example, if the law of this state other than this Act treats nonpayment of real property taxes as
actionable waste, the assignor’s nonpayment of taxes would provide a justification for the
appointment of a receiver.

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

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

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

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

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

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

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

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

SECTION 8. ENFORCEMENT BY NOTIFICATION TO TENANT

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

1. identify the tenant, assignor, assignee, premises covered by the lease, assignment of rents being enforced, and recording data for the assignment;
(2) state that the assignee has the right to collect rents in accordance with
the terms of the assignment;

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

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

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

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

(7) be signed by the assignee.

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

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

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

(3) a tenant’s payment to the assignee in good faith of rents then due
satisfies the tenant’s obligation under the lease to the extent of the payment made; and

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

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

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

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

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

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

(f) No particular phrasing is required for the notification specified in subsection
However, the following form of notification, when properly completed, is sufficient to satisfy the requirements of subsection (a):

**NOTIFICATION TO PAY RENT TO PERSON OTHER THAN LANDLORD**

Tenant: [Name of Tenant]

Property Occupied by Tenant (the “Premises”): [Address]

Landlord: [Name of Landlord]

Assignee: [Name of Assignee]

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

1. The Assignee named above is the assignee of rents under [name of document] (the “Assignment of Rents”) dated __________, and recorded at [recording data] in the [appropriate governmental office under the recording act of this State]. You may request a copy of the Assignment of Rents from the Assignee at the address listed above.

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

3. This notification affects your rights and obligations under the lease or rental agreement (the “Lease”) by
which you occupy the Premises. In order to provide you with an opportunity to consult with an attorney, neither the Assignee nor the Landlord can hold you in default under the Lease for nonpayment of your next scheduled rental payment until the earlier of 10 days after the due date of that payment or 30 days following the date of this notification. You are encouraged to consult an attorney promptly concerning your rights and obligations under the Lease and the effect of this notification.

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

5. If you pay any rents to the Landlord after receiving this notification, your payment to the Landlord will not discharge your rental obligation under your Lease, and the Assignee may hold you liable for that rental obligation notwithstanding your payment to the Landlord[, unless you occupy the Premises as your primary residence. If you occupy the Premises as your primary residence, you may pay rent to the
Assignee as directed by paragraph 4, but any rental payment that
you make to the Landlord will discharge your rental obligation
to the extent of that payment].

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

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

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

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

[Name of Assignee]

By: [Officer/Authorized Agent of Assignee]

Preliminary Comments

Source: Cal. Civ. Code §§ 2938(c)(3), 2938(d), 2938(k); U.C.C. §§ 9-406(a).
1. **Enforcement by notification to tenants.** Section 8 provides that an assignee may enforce its security interest in rents by notification to tenants either following default or otherwise in accordance with the assignment. Because the typical assignment of rents does not authorize the assignee to collect rents prior to the assignor’s default, enforcement by Section 8 will usually arise only after the assignor’s default.

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

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

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

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

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

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

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

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

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

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

**Illustration 3.** Tenant’s rent is due and payable to Assignor quarterly, on the first of January, April, July, and October. On February 28, Tenant receives a notification from Assignee demanding that Tenant pay future rents to Assignee. Under subsection (c), Tenant receives no
extension of the time for his April1 quarterly rent payment.

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

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

SECTION 9. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR.

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

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

Preliminary Comments

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

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

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

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

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

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

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

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

Preliminary Comment

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

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

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

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

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

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

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

(4) make the secured obligation unenforceable;

(5) limit any right available to the assignee with respect to the secured obligation;

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

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

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

Preliminary Comments

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

1. Mere enforcement of security interest in rents does not trigger mortgagee-in-possession status. A number of common law decisions suggest that a mortgagee can become a “mortgagee in possession” — with the legal responsibilities attendant to that status — without
physical occupation of the mortgaged premises. See, e.g., 1 Grant S. Nelson & Dale A.
cases). This result is not surprising, given the factual and legal uncertainty attendant to the term
“possession.” This ambiguity can produce concern for the assignee that wishes to protect its
security interest in rents without assuming the duties and liabilities attendant to mortgagee-in-
possession status.

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

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

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

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

Ambiguity over the scope of a “one action” rule — and whether it would treat an attempt
to enforce an assignment of rents as an “action” that would prevent other collection efforts —
could create significant confusion with respect to the enforcement of an assignment of rents. For this reason, the Restatement (Third) of Property — Mortgages, while generally rejecting the one-action approach, further argued that any limitation on the mortgagee’s remedies with respect to foreclosure of the mortgage should not limit the mortgagee’s enforcement of its security in rents:

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

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

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

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

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

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

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

(3) satisfaction of the secured obligation;

(4) satisfaction of any obligation secured by a subordinate security interest or
other lien on the rents, if the assignor and assignee receive a notification from the holder of the
interest or lien demanding payment of the rents before distribution of the rents; and

(5) the assignor.

**Preliminary Comments**

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

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

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

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

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

(1) real property taxes;

(2) insurance on the real property;

(3) ground rents under a ground lease covering the real property;
(4) common interest ownership association assessments, to the extent that
such assessments would take priority over the security interest of an assignee if unpaid; and
(5) any other expense the nonpayment of which would give rise to a lien
that would take priority over the security interest of an assignee.

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

(1) the assignor;
(2) any person holding a recorded assignment of rents on the real property;
and
(3) a tenant that paid the dedicated rents.

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

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

(1) operate or manage the real property; or
(2) apply any rents other than dedicated rents to the payment of the
expenses identified in subsection (a).

Preliminary Comments

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

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

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

Section 13 retains this approach in general terms, but does identify a special subcategory of rents defined as “dedicated rents.” This category includes any rents payable by a tenant and specifically allocated by contract for the payment of real property taxes and insurance, as well as ground rents under a ground lease covering the real property and common interest ownership association assessments or other expenses the nonpayment of which would give rise to a lien that would take priority over the security interest of an assignee. If an assignee collects any dedicated
rents while enforcing its security interest in rents, then the assignor, another recorded rents assignee, or a tenant may give notification to the collecting assignee requesting that the assignee apply any dedicated rents to the payment of the expenses for which they are dedicated. Upon receiving such a notification, the collecting assignee must apply any dedicated rents as requested until such time as a receiver is appointed under Section 7 or the collecting assignee ceases to enforce its security interest in rents.

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

The Act draws a distinction between rents specifically allocated to taxes and insurance (which are dedicated rents under the Act) and rents specifically allocated to property maintenance (which are not dedicated rents under the Act). Often, the assignor or an affiliate of the assignor performs project maintenance and collects a substantial fee for these services. If the assignor is in default and is not meeting its debt service obligations, an assignee understandably may not wish to be legally bound to pay maintenance charges to the assignor, thereby allowing the assignor to continue to profit from operating the real property during default. A rents assignee might voluntarily choose to continue to pay such expenses to the assignor if the assignee was 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. However, the Act does not impose on the rents assignee any legal obligation to use collected rents for those purposes.

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

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

Illustration 2. Following Assignor’s default under an assignment of rents covering an apartment building, Assignee begins collecting rents from the building’s tenants. Under the tenant leases, the tenants are obligated to pay “rent,” but none of the rental obligation is specifically allocated for the reimbursement of particular property-related expenses. Assignor
has not paid real property taxes for the current year, and this tax obligation is now past due. Even if Assignor so requests, Assignee has no obligation to apply any of the rents collected to the payment of real property taxes, as none of the rents are “dedicated rents” within the meaning of subsection (a).

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

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

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

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

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

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

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

(2) the assignee continues to have a security interest in the rents so long as
they are identifiable.

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

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

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

Preliminary Comments

Source: Cal. Civ. Code §§ 2938(f); U.C.C. §§ 9-315(a), 9-315(b), 9-332(a); Restatement (Third) of Property — Mortgages §§ 4.6(a)(5), 4.6(b)(3).
1. “Milking” of rents and existing law. The owner of a distressed real estate project may sometimes engage in “milking” of rents — i.e., collecting rents from the project and using those rents to pay expenses other than the mortgage debt and expenses of preserving or maintaining the mortgaged premises. Milking of rents that have been assigned as security poses a significant threat to an undersecured mortgagee, who cannot expect to obtain full recovery of the mortgage debt via foreclosure. This threat is even more severe where the mortgagee holds a nonrecourse mortgage debt and the mortgagor thus has no personal liability for a deficiency judgment. Such a threat typically prompts the mortgagee to take prompt action following default to enforce its security interest in rents and thereby divest the mortgagor of control over project rents.

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

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

The Act does not precisely duplicate the Restatement approach, as it does not specifically use the term “waste” to identify the basis of the assignor’s liability for milking rents. In lien theory states, courts traditionally held that the mortgagor was liable for waste only to the extent that its conduct impaired the mortgagee’s security. Rather than focusing upon impairment of security — which would require proof regarding the value of the mortgaged premises — the Act instead takes a more straightforward approach. If the assignor is obligated to turn over rents to
the assignee under Sections 6 and 14(a), but fails to do so, the assignor is liable for damages
equal to the full amount of the rents not turned over. Any such recovery must be applied by the
assignee in the manner specified by Section 12, so the assignee’s total recovery could not exceed
the loss actually suffered by the assignee. Any surplus proceeds remaining after full satisfaction
of the secured obligation would be returned to the assignor or to subordinate lienholders in
accordance with Section 12.

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

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

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

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

The Act recognizes two significant limitations, however, upon the assignee’s right to
enforce the security interest against third parties. First, any such cash proceeds of rents must be
“identifiable.” In this context, “identifiable” has the same meaning as it does in U.C.C. § 9-
315(a), under which a secured party has a security interest in the identifiable proceeds of its
original collateral. As a result, if the assignor has commingled the proceeds of collected rents with other operating funds of the assignor, those proceeds will remain identifiable only if the assignee can identify them by a method of tracing (such as the lowest intermediate balance rule) that is recognized by law other than this Act with respect to commingled property. Second, subsection (c) of the Act recognizes the negotiability of money and provides that any third parties who receive payments of the proceeds of collected rents from the assignor will be protected so long as the transferee of the funds has not acted in collusion with the assignor to deprive the assignee of its interest in the funds. See, e.g., U.C.C. § 9-332. A protected transferee under subsection (c) could include another creditor collecting rents pursuant to a subordinate assignment of rents, and a bank exercising a set-off right against a deposit account that contains identifiable cash proceeds of rents.

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

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

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

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

(1) If more than one assignee qualifies for the appointment of a receiver under Section 7, a receivership request by an assignee entitled to priority under Section 5 has priority over a receivership request by a subordinate assignee, even if a court has previously appointed a receiver for the subordinate assignee.
(2) If a subordinate assignee obtains the appointment of a receiver, that receiver has the right, until a receiver is appointed under a senior assignment of rents, to collect the rents and apply them in the manner specified in the order of appointment. The receiver for the subordinate assignee need not turn over collected rents to the receiver for the senior assignee, even if those rents are otherwise identifiable as provided in Section 14(b).

**Preliminary Comments**

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

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

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

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

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

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

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

SECTION 18. EFFECTIVE DATE. This [act] takes effect on _________________.

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

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