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FOR DISCUSSION ONLY

UNIFORM ASSIGNMENT OF RENTS ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

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WITH PREFATORY NOTE AND PRELIMINARY COMMENTS

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By

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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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.

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

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

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

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

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

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

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

Characterization of Real Property Revenues. In many commercial real estate developments (*e.g.*, office buildings, retail shopping centers, apartment complexes), the owner and occupiers of the development stand in a landlord-tenant relationship, based upon the execution of leases covering portions of the development. Because the common law has treated unaccrued rents as an interest in land (an incorporeal hereditament), there is no question that in these cases, the sums paid by tenant occupiers constitute “rent.” Thus, a mortgage lender taking a security interest in those “rents” must comply with the provisions of real estate law in order to obtain and enforce that security interest — *i.e.*, the mortgage lender must have the mortgagor execute and deliver an instrument sufficient to convey an interest in “rents” and must record that instrument on the public land records. In many other developments, however, the occupiers are not “tenants,” but merely licensees (*e.g.*, nursing home residents, persons occupying garage spaces or marina slips, hotel guests, and the like). Court decisions involving security interest in the revenues paid by such occupiers have disagreed over the proper characterization of these revenues — with some treating them as “rents” in the nature of real property, and others treating them as “accounts” subject to the provisions of Uniform Commercial Code Article 9. These decisions have created uncertainty regarding both the proper way to create and perfect a security interest in these occupancy revenues, as well as the appropriate treatment of a security interest in those revenues generated during the pendency of a bankruptcy case. The Act establishes that rents include any sum paid by a tenant, licensee, or other person for the right to possess or occupy the real property of another. For further background, *see* Act § 2, Preliminary Comment 11.

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. For further background, *see* Act § 8,

Preliminary Comment 1.

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 § 9, Comments 1 through 6.

Expenses of Operating and Preserving the Real Property. 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.”

California’s comprehensive assignment of rents statute places an affirmative 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). A prudent lender may well choose to apply collected rents to the payment of real property taxes, insurance, and project maintenance in order to protect its own security. Nevertheless, under the traditional view, a lender that collect rents without taking actual or constructive possession of the real property may apply those rents to the mortgage debt without any obligation to apply such sums to the payment of taxes, insurance, or property maintenance.

If the assignor fails to pay real property taxes or insurance or fails to perform its obligations with respect to project maintenance, a tenant injured by such failure may have a claim or defense with respect to its continuing liability for rents. Although the assignee has no affirmative obligation to pay these real property-related expenses prior to obtaining possession or ownership of the real property, the Act does make clear that the assignee’s ability to collect rents is subject to any such claim or defense that the tenant may have based upon the assignor’s nonperformance (absent an enforceable agreement not to assert such a claim or defense). For further background, *see* Act § 13, Preliminary Comments 1-2.

Coordination with Uniform Commercial Code Article 9. The Act provides that a perfected security interest in rents extends automatically into the identifiable proceeds received

upon collection of rent. In the typical case, however, “proceeds” of rents will constitute personal property in which another person may also hold or acquire a claim or a security interest under Article 9 of the Uniform Commercial Code. This means that conflicting interests may arise in the same proceeds — the assignee’s interest by virtue of this Act, and another person’s by virtue of other law (such as Article 9). The Act provides a set of rules to establish priority between such conflicting interests. To ensure the coordination of this Act with Article 9, this Act generally treats the assignee’s “proceeds” interest as if it had arisen under Article 9 and applies Article 9’s priority rules. For example, the Act protects a third person to whom an assignor transfers money that constitute proceeds of rents, so long as the transferee is not acting in collusion with the assignor to violate the rights of the assignee. *Cf.* U.C.C. § 9-332(a). For further background, *see* Act § 15, Preliminary Comments 1-4.

1 **UNIFORM ASSIGNMENT OF RENTS ACT**

2

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

4 Rents Act.

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

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

7 (2) “Assignment of rents” means a transfer of an interest in rents made in

8 connection with an obligation secured by real property located in this state.

9 (3) “Assignor” means a person that makes an assignment of rents or the successor

10 owner of the real property from which the rents arise.

11 (4) “Cash proceeds” means proceeds that are money, checks, deposit accounts, or

12 the like.

13 (5) “Day” means calendar day.

14 (6) “Deposit account” means a demand, time, savings, passbook, or similar

15 account maintained with a bank, savings bank, savings and loan association, credit union, or trust

16 company.

17 (7) “Document” means information that is inscribed on a tangible medium or that

18 is stored on an electronic or other medium and is retrievable in perceivable form.

19 (8) “Notification” means a document containing information required under this

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

21 (9) “Person” means an individual, corporation, business trust, estate, trust,

22 partnership, limited liability company, association, joint venture, public corporation, government,

1 or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

2 (10) "Proceeds" means personal property that is received or collected on account
3 of a tenant's obligation to pay rents.

4 (11) "Purchase" means to take by sale, lease, discount, negotiation, mortgage,
5 pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an
6 interest in property.

7 (12) "Rents" includes:

8 (A) the right to collect sums payable for the right to possess or occupy, or
9 for the actual possession or occupation of, real property of another person;

10 (B) the right to collect sums payable to an assignor under a policy of rental
11 interruption insurance covering real property;

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

14 (D) the right to collect sums payable to terminate an agreement to possess
15 or occupy real property;

16 (E) the right to collect sums payable to pay or reimburse an assignor for
17 payment of expenses incurred in operating and maintaining, or in constructing or installing
18 improvements on, real property; and

19 (F) any other right to payment that is defined as rents under the law of this
20 state other than this [act].

21 (13) "Secured obligation" means an obligation the performance of which is
22 secured by an assignment of rents.

1 (14) “Security interest” means an interest in property that arises by agreement and
2 secures performance of an obligation.

3 (15) “Sign” means, with present intent to authenticate or adopt a document:

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

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

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

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

13 (18) “Tenant” means a person that holds a right to possess or occupy the real
14 property of another person and has a corresponding obligation to pay rents.

15 **Preliminary Comments**

16 1. “Assignee.” The term “assignee” means the person entitled to enforce an assignment
17 of rents.

18
19 2. “Assignment of rents.” In many commercial transactions, it is customary for the lender
20 to require the borrower to execute multiple documents, including both a “mortgage” covering the
21 land and an “assignment of rents and leases” which assigns to the lender all leases covering the
22 mortgaged premises and all rents accruing under those leases. In some transactions, the lender
23 may simply incorporate into the mortgage language sufficient to assign to the lender all leases
24 covering the mortgaged premises and rents accruing under such leases, without a separate
25 assignment document. The Act uses the term “assignment of rents” to mean the actual transfer of
26 an interest in rents, rather than the document by which the transfer is made.

27
28 3. “Assignor.” The term “assignor” means a person that makes an assignment of rents or

1 the successor owner of the real property subject to the assignment.

2
3 4. “Day.” The Act defines “day” as a calendar day.

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

8
9 6. “Document.” The definition of “document” is media-neutral and comparable to the
10 definition used in Section 102(3) of the Uniform Residential Mortgage Satisfaction Act. Because
11 this Act uses the term “record” in its customary fashion under real estate law — *i.e.*, as a verb to
12 describe the act of filing an instrument of conveyance with the recorder’s office — the Act does
13 not use the term “record” as a noun, and instead uses the term “document.”

14
15 7. “Notification.” The Act permits an assignee to enforce an assignment of rents by
16 giving a notification to the assignor (Section 8) or by giving a notification to tenants of the
17 assignor (Section 9). In any circumstance in which the Act requires notification to be given to a
18 person, any such notification shall be in the form of a document, as defined in Section 2(7), and
19 shall contain the information required by the specific section authorizing that notification.

20
21 8. “Person” includes both natural persons (individuals) and all forms of legally
22 recognized public and private organizations.

23
24 9. “Proceeds.” In this Act, the term “proceeds” means whatever is collected from a
25 tenant on account of the tenant’s obligation to pay rent. In most instances, these proceeds will be
26 in the form of cash or checks. The Act provides that a security interest in rents extends
27 automatically to any proceeds of those rents so long as those proceeds are identifiable. Section
28 14(b), (c).

29
30 It is possible that an assignee may claim a security interest in proceeds of rents and that
31 another creditor or person may also claim a conflicting interest in those proceeds by virtue of
32 other law, particularly Article 9 of the Uniform Commercial Code. The Act provides priority
33 rules in Section 15 to address such potential priority conflicts.

34
35 10. “Purchase” is defined in the same manner as in Uniform Commercial Code Section
36 1-201(b)(29), and includes any voluntary transaction creating an interest in property.

37
38 11. “Rents.” In many commercial real estate developments (*e.g.*, office buildings,
39 industrial parks, retail shopping centers, and apartment complexes), the owner stands in a
40 landlord-tenant relationship with the occupiers of the development, based upon the execution of
41 leases covering portions of the development. Because the common law has treated unaccrued
42 rents as an interest in land (an incorporeal hereditament), the right to collect sums paid by tenant
43 occupiers undoubtedly constitutes “rent” in the nature of real property. Thus, a mortgage lender

1 taking a security interest in “rents” must comply with the provisions of real property law in order
2 to obtain and enforce that security interest. In other words, the mortgage lender must have the
3 mortgagor execute and deliver an instrument sufficient to convey an interest in “rents” and must
4 record that instrument on the public land records in the county where the land is situated.
5

6 In many other developments, however, the owner does not stand in a landlord-tenant
7 relationship with the user/occupier of land because that user/occupier is only a licensee.
8 Examples of this type of project include nursing homes, parking garages, golf courses, landfills,
9 marinas, stadiums/arenas, student dormitories, and hotels/motels. If the development’s occupier
10 is a licensee and not a tenant, a significant classification problem arises. Is the right to collect
11 sums from project occupiers “rent” governed by real estate law (such that the lender would
12 obtain and record an assignment of rents in the land records), or “accounts” governed by Article
13 9 of the Uniform Commercial Code (such that the lender would obtain a security interest by
14 creating a floating lien on accounts and perfect that interest by filing a financing statement
15 covering accounts in the Article 9 filing system)?
16

17 In theory, a lender could moot the resolution of this characterization question simply by
18 (a) making sure that its loan documents took a security interest in both “rents” and “accounts,”
19 and (b) properly recording/filing evidence of those interests in the respective filing systems. This
20 “belt and suspenders” approach would appear to give the lender a perfected security interest in
21 the right to collect unaccrued occupancy charges, regardless of how a court resolved the
22 characterization question.
23

24 Unfortunately, Bankruptcy Code § 552(a) complicates this analysis. Section 552(a)
25 generally provides that any pre-petition security agreement covering after-acquired property does
26 not affect property that the bankruptcy estate acquires post-petition. By itself, section 552(a)
27 would suggest that a lender’s security interest in pre-petition revenues would not attach to post-
28 petition revenues (which would, in turn, mean that those revenues would not constitute the
29 lender’s cash collateral). Congress drew a careful distinction, however, between *property*
30 *received by the debtor post-petition* and *post-petition proceeds of pre-petition collateral*. This
31 distinction is reflected in section 552(b), which provides that a valid and properly perfected pre-
32 petition security interest in collateral will attach to any rents, profits, and proceeds of that
33 collateral that are received by the debtor post-petition.
34

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

41 Most of the bankruptcy cases addressing this characterization question involved hotels
42 and security interests in hotel room revenues. Prior to 1994, a few decisions sensibly treated
43 hotel room revenues as the functional equivalent of tenant rents and concluded that § 552(b)’s

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

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

38 The Act takes the view that “rents” should include the right to collect all sums due in
39 exchange for the right to possess or occupy the real property of another. A person “possesses”
40 the land of another if that person has possessory interest in that land (*e.g.*, the interest of a tenant
41 under a lease). A person “occupies” the land of another if that person has a contractual right that
42 permits them to occupy the real property of another to the exclusion of persons other than the
43 owner. Thus, the Act defines the term “rents” to include all sums paid by a person in order to

1 acquire the right to possess or occupy the real property of another.

2
3 In addition, the Act defines rents to include the right to collect a number of other charges
4 that are often characterized as “rent” under leases or occupancy agreements, as well as the right
5 to collect other sums that constitute an economic substitute for rents that might otherwise have
6 accrued or been collected. These include the right to collect proceeds of rental interruption
7 insurance; claims arising out of a default in the payment of rents (*e.g.*, liquidated damages); and
8 the right to collect sums payable in order to terminate a lease or occupancy agreement; the right
9 to collect sums payable for the purpose of paying or reimbursing the assignor’s payment of
10 expenses incurred in operating and maintaining the real property (such as taxes or insurance) or
11 in constructing or installing improvements.

12
13 The Act also provides that the term “rents” includes any right to payment on account of
14 the actual possession or occupation of the real property of another. Thus, the right to collect
15 from a tenant at sufferance for the period in which that tenant holds over following the
16 termination of its lease constitutes “rents,” even if the landlord chooses to treat the holdover
17 tenant as a trespasser and institute eviction proceedings.

18
19 The application of this definition is demonstrated by the following illustrations:

20
21 *Illustration 1.* ABC Life Insurance Company holds a mortgage and an assignment of
22 rents on the Friendly Shopping Center. Grocer signs a 20-year lease for an anchor
23 tenancy within the Friendly Shopping Center. The lease provides that Grocer will pay
24 base rent and (depending upon sales) percentage rent. The right to collect payments from
25 Grocer under the terms of the lease (whether for base rent or percentage rent) constitutes
26 “rent” within the meaning of the Act.

27
28 *Illustration 2.* ABC Life Insurance Company holds a mortgage and an assignment of
29 rents on the Friendly Hotel. Heinsz is a guest of Friendly Hotel for three nights.
30 Although Heinsz may not have a possessory interest in room vis-a-vis the owner of
31 Friendly Hotel, Heinsz does “occupy” the room in a fashion that essentially excludes
32 other third persons. The right to collect room occupancy charges that Heinsz incurs
33 during his stay is “rents” within the meaning of the Act. Charges that Heinsz incurs for
34 additional hotel-related services (such as room service meals, dry cleaning or laundry
35 services, or the like) would not constitute “rent,” as they are not for incurred in exchange
36 for the right to occupy the room.

37
38 *Illustration 3.* ABC Life Insurance Company holds a mortgage and an assignment of
39 rents on the Friendly Nursing Home, where Davis is a resident. Although Davis may not
40 have a possessory interest in the room vis-a-vis the owner of Friendly Nursing Home,
41 Davis does “occupy” the room in a fashion that essentially excludes other third persons.
42 The right to collect room occupancy charges that Davis incurs during his stay is “rent”
43 within the meaning of the Act. Charges that Davis incurs for medical treatment,

1 medication, physical therapy, or the like would not constitute “rent,” as they are not
2 incurred in exchange for the right to occupy the room.

3
4 *Illustration 4.* First Bank holds a mortgage and an assignment of rents on the Friendly
5 Marina. Smith has a contract with Friendly Marina pursuant to which he pays a monthly
6 fee for a slip at which he may dock his yacht. The right to collect this monthly fee from
7 Smith is “rent” within the meaning of the Act.

8
9 *Illustration 5.* First Bank holds a mortgage and an assignment of rents on Friendly
10 Parking Garage. Smith has a contract with Friendly Parking Garage pursuant to which he
11 pays \$150 per month for a reserved parking space. The right to collect Smith’s \$150
12 monthly fee constitutes “rent” within the meaning of the Act.

13
14 *Illustration 6.* First Bank holds a mortgage and an assignment of rents on Friendly Golf
15 Course. Smith pays greens fees to play at Friendly Golf Course. The right to collect fees
16 that Smith pays is not “rent” within the meaning of the Act, as Smith does not “occupy”
17 the land but is merely using it in a temporary and essentially nonexclusive fashion.

18
19 In jurisdictions adopting this Act, there will remain certain developments for which the
20 definition of “rents” does not unambiguously resolve the classification dilemma. For example,
21 consider a stadium that stages athletic or entertainment events. On the one hand, one might
22 characterize as “rents” the right to collect admission fees from patrons, on the ground that while
23 patrons do not have a possessory interest, they may “occupy” a stadium seat in a more or less
24 exclusive fashion (as two persons cannot literally occupy the same seat). On the other hand, one
25 might characterize the right to collect admission fees as “accounts” governed by Uniform
26 Commercial Code Article 9, on the ground that patrons have merely a temporary interest that is
27 more appropriately characterized as “use” rather than “occupancy.” In such cases, a prudent
28 lender may choose to follow the “belt and suspenders” approach — taking both an assignment of
29 rents (and recording it in the real property records) and an Article 9 security interest in present
30 and after-acquired accounts (and perfecting it by filing an Article 9 financing statement) — in
31 order to assure that it has a perfected security interest in the revenues generated by the project.

32
33 12. “Secured obligation.” The term “secured obligation” covers any obligation the
34 performance of which is secured by an assignment of rents.

35
36 13. “Security interest.” Under the Act, a security interest arises in any transaction,
37 regardless of its form, in which a person receives or retains an interest in property for the purpose
38 of securing an obligation owed to that person. Thus, the term “security interest” as used in this
39 Act would cover both a security interest in “rents” taken by an assignee as well as a security
40 interest in the proceeds of rents taken by a secured party under the provisions of Article 9 of the
41 Uniform Commercial Code.

42
43 14. “Sign.” This definition is media-neutral and comparable to that contained in

1 Uniform Commercial Code § 2-103(1)(p).

2
3 15. “Submit for recording.” This definition is comparable to that contained in Section
4 102(21) of the Uniform Residential Mortgage Satisfaction Act. To “submit for recording” means
5 that the person has submitted a document that has complied with the appropriate legal
6 requirements for the document submitted, along with required fees and taxes, to the appropriate
7 recording official. Whether an assignment of rents that is submitted for recording is actually
8 recorded is determined by the state’s recording act.
9

10 16. “State.” This definition is the boilerplate definition of the term as used in uniform
11 acts.
12

13 17. “Tenant.” For purposes of this Act, a “tenant” is any person that holds a right to
14 possess or occupy the land of another and is thereby obligated to pay rents. The Act defines
15 “rents” to include sums payable by occupants of land that do not have a possessory interest in the
16 land and thus do not stand in a landlord-tenant relationship with the assignor. Although the Act
17 treats such a licensee as a “tenant” for the purposes of this Act, it does not render such a licensee
18 a tenant within the meaning of the state’s law of landlord-tenant law. Thus, for example, nothing
19 in this Act would grant a licensee the benefit of the state’s forcible entry and detainer statutes, the
20 benefit of an implied warranty of habitability, or any other right recognized under the state’s
21 general law of landlord and tenant.
22

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

24 (a) Except as otherwise provided in subsections (c) and (d), a person gives a
25 notification or a copy of a notification under this [act] by depositing it with the United States
26 Postal Service or with a commercially reasonable delivery service, properly addressed to the
27 intended recipient’s address as specified in subsection (b), with first-class postage or cost of
28 delivery provided for.

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

31 (1) A person giving a notification to an assignee shall use the address for
32 notices to the assignee provided in the document creating the assignment of rents, but if the

1 assignee has provided the person giving the notification with a more recent address for notices,
2 the person giving the notification shall use that address.

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

7 (3) A person giving a notification to a tenant shall use the address of the
8 leased premises. However, if the tenant's lease provides an address for notices and the person
9 giving notification has received a copy of the lease or knows the address for notices specified in
10 the lease, the person giving the notification shall use that address.

11 (c) If a person giving a notification pursuant to this [act] and the recipient have
12 agreed to the method for giving a notification, any notification must be given by that method.

13 (d) If a notification is not given in accordance with subsection (a) or (c) but is
14 received by the recipient, it is given as of the time of receipt.

15 Preliminary Comments

16
17 1. *Methods of giving notification.* This section specifies the methods for giving any
18 notification required by this Act. Under subsection (a), notices required by the Act may be
19 transmitted by first-class United States mail or via a commercial reasonable delivery service.
20 Proper dispatch, not receipt, satisfies the obligation to give notification. The person asserting
21 that notification was given has the burden of proof that notification was given in accordance with
22 the provisions of this section.

23
24 Subsection (c) provides that if an agreement between the person giving a notification and
25 the recipient dictates a method of notification other than the methods permitted under subsection
26 (a), any notification must be given by the agreed-upon method. Subsection (c) would thus permit
27 the giving of a notification by electronic mail or other form of electronic communication, but
28 only where there recipient had agreed to receive notifications by that manner of delivery. Such
29 an agreement may arise either by express written provisions or by virtue of an established course

1 of conduct between the giver and recipient of the notification.

2
3 Under subsection (d), a notification actually given in a manner not authorized by
4 subsection (a) or (c), but received by the recipient, is treated as given as of the time of receipt.

5
6 *2. Identifying the address for notification.* Typically, an assignment of rents contains a
7 provision specifying addresses for notices to the assignor and the assignee. Subsection (b)
8 provides that the respective addresses for notice contained in an assignment of rents will be the
9 default addresses for any notification to the assignor or assignee under this Act. If the intended
10 recipient has provided the person giving a notification with a more recent address, then the Act
11 requires the person giving the notification to use that address. For example, if an assignee gives
12 a notification to the assignor enforcing its interest in rents under Section 8 (which governs
13 enforcement by notification to the assignor), and that notification specifies a new address for
14 future notices to the assignee, the assignor would thereafter be obligated to use that new address
15 in giving any notification required by the Act.

16
17 Subsection (b)(3) provides that a tenant's address for notification will be the address of
18 the leased premises, unless the lease provides an alternative address for notification to the tenant
19 and the notifier either has a copy of the lease or knows of the alternative address.

20
21 *3. Obligations under the Act triggered by receipt.* While a person obliged to give a
22 notification under the Act satisfies the obligation to give that notification by dispatch in
23 accordance with subsection (a), several substantive provisions of the Act effectively require that
24 the intended recipient actually receive notification. For example, although an assignee may give
25 notification to a tenant by mail directing that tenant to pay rents to the assignee, the Act does not
26 legally obligate the tenant to pay rents to the assignee until the tenant receives the notification.
27 *See Section 9(b).*

28 29 **SECTION 4. ASSIGNMENT OF RENTS CREATES SECURITY INTEREST.** An

30 assignment of rents creates a presently effective security interest in all accrued and unaccrued
31 rents arising from the real property described in the document creating the assignment, whether
32 the document is denominated an absolute assignment, an absolute assignment conditioned upon
33 default, an assignment as additional security, or otherwise. The security interest in rents is
34 separate and distinct from any security interest held by the assignee in the real property.

35 **Preliminary Comments**

1 Source: Cal. Civ. Code § 2938(a); Restatement (Third) of Property — Mortgages §
2 4.2(b).
3

4 1. *Rents as a distinct source of collateral.* An assignment of rents permits the assignee to
5 collect rents that accrue between the date of the assignor's default and the date that the assignee
6 can complete a mortgage foreclosure on the underlying land. In many states, this foreclosure
7 process can be quite lengthy. In these states, a mortgagee faces a heightened risk that the
8 mortgagor may collect project revenues and expend them other than to reduce the mortgage debt
9 (a process often referred to as "milking" the rents) while a foreclosure proceeding is pending. By
10 taking an assignment of rents, the assignee demonstrates its intention to have a lien upon all
11 future rents produced by the project, including those that accrue between default and the
12 completion of a foreclosure sale — a period that may be extended if the assignor files a
13 bankruptcy petition that stays the foreclosure.
14

15 Traditionally, state law has governed the creation and enforcement of security interests in
16 rents. Most frequently, however, disagreements regarding security interests in rents arise in the
17 federal bankruptcy courts. On its face, the Bankruptcy Code appears to recognize that state law
18 has traditionally treated "rents" that accrue between default and foreclosure as a source of
19 collateral that is separate and distinct from the land that generated those rents. The Bankruptcy
20 Code characterizes rents from mortgaged property as "cash collateral," 11 U.S.C. § 363(a), and
21 preserves a secured creditor's pre-bankruptcy lien on rents that the debtor receives after it files a
22 bankruptcy petition, *id.* § 552(b). These provisions appear to acknowledge that a pre-bankruptcy
23 assignment of rents creates a separate security interest in the rents (*i.e.*, separate from the
24 underlying mortgage lien against the land itself).
25

26 Most bankruptcy court decisions have treated post-petition rents as a separate and distinct
27 source of collateral, but a few bankruptcy court decisions have instead concluded that post-
28 petition rents do not constitute separate collateral because the post-petition rent stream is in fact
29 "subsumed" within the valuation of the land itself. *See, e.g., In re Wrecclesham Grange, Inc.*,
30 221 B.R. 978 (Bankr. M.D. Fla. 1997); *In re Embassy Properties N. Ltd. Partnership*, 196 B.R.
31 172 (Bankr. D. Kan. 1996); *In re Citicorp Park Assocs.*, 180 B.R. 15 (Bankr. D. Me. 1995); *In re*
32 *Barkley 3A Investors, Ltd.*, 175 B.R. 755 (Bankr. D. Kan. 1994); *In re Mullen*, 172 B.R. 473
33 (Bankr. D. Mass. 1994). These courts have thus concluded that a debtor can use post-petition
34 rents without regard to a pre-bankruptcy assignment of rents as long as the mortgage lender's
35 interest in the mortgaged land is adequately protected (*i.e.*, as long as the land itself is not
36 declining in value), even if the land was worth less than the mortgage debt.
37

38 The Act rejects the view of state law expressed in these cases that rents accruing prior to
39 foreclosure are subsumed within the land. The Act instead confirms that all rents accruing prior
40 to the completion of a foreclosure constitute a source of collateral that is separate and distinct
41 from the real property from which those rents accrued.
42

43 2. *The "Absolute Assignment of Rents."* As many American states adopted the lien

1 theory of mortgages, some mortgagees began requiring the mortgagor to make an “absolute”
2 assignment of rents. Under a so-called “absolute” assignment of rents, the assignor purported to
3 transfer “title” to unaccrued rents to the assignee, ostensibly placing the assignee in the same
4 legal position as it would have occupied under the title theory of mortgages. Frequently, a so-
5 called “absolute” assignment will specify that it is “not merely for purposes of security” and that
6 the assignor has no title to or interest in unaccrued rents, other than a revocable license (*i.e.*, not a
7 “property” right) to collect such rents prior to default.
8

9 Mortgagees have argued that the so-called “absolute” assignment of rents strengthens
10 their position with respect to rents in the bankruptcy context. When a debtor files for
11 bankruptcy, all of the debtor’s property becomes property of the bankruptcy estate. 11 U.S.C. §
12 541(a). The debtor generally may use property of the estate in the course of its bankruptcy
13 proceeding, subject to the obligation to provide adequate protection to a secured creditor holding
14 a lien upon that property. 11 U.S.C. § 363(b). Moreover, a secured party holding a security
15 interest in property of the estate is subject to the automatic stay and cannot enforce its lien or
16 otherwise collect the debt outside the context of the bankruptcy proceeding. *Id.* § 362(a). As a
17 result, a debtor that owns an income-producing real estate project gains significant leverage if the
18 project’s post-petition rents constitute property of the bankruptcy estate. By contrast, the
19 mortgagee/assignee would prefer that the law characterize the post-petition rents as property that
20 is **not** part of the bankruptcy estate. If the project’s post-petition rents are not property of the
21 estate, the automatic stay would place no limitation upon the mortgagee’s ability to collect those
22 rents and apply them to the debt.
23

24 Obviously, if a mortgagee had already completed a foreclosure sale prior to bankruptcy,
25 the land belongs to the foreclosure purchaser and thus unaccrued rents from that land would not
26 constitute property of the bankruptcy estate. But if no foreclosure has yet occurred — and thus
27 equitable ownership of the land remains in the debtor — unaccrued post-petition rents would
28 seem to fit squarely within the broad concept “property of the estate” as articulated in § 541(a).
29 Nevertheless, in an attempt to boost their leverage in context of bankruptcy, mortgage lenders
30 have argued that under a so-called “absolute” assignment of rents, “title” to the post-petition
31 rents is in the lender and such rents therefore do not constitute property of the bankruptcy estate.
32 A number of courts have accepted this argument *See, e.g.*, *First Fidelity Bank v. Jason Realty,*
33 *L.P. (In re Jason Realty, L.P.),* 59 F.3d 423 (3d Cir.1995); *In re Kingsport Ventures, L.P.,* 251
34 *B.R. 841 (Bankr. E.D. Tenn. 2000); In re Robin Associates,* 275 B.R. 218 (Bankr. W.D. Pa.
35 2001); *In re Carretta,* 220 B.R. 203 (D.N.J. 1998); *see also NCNB Texas Nat’l Bank v. Sterling*
36 *Projects, Inc.,* 789 S.W.2d 358 (Tex. App. 1990) (“The absolute assignment does not create a
37 security interest but instead passes title to the rents. An absolute assignment of rents is not
38 security but is a pro tanto payment of the obligation.”).
39

40 The Restatement (Third) of Property — Mortgages and most commentators have rejected
41 this view. In the typical transaction, the assignor executes an assignment of rents and leases
42 contemporaneously with its execution of the mortgage. The assignee does not immediately begin
43 collecting rents from tenants as soon as it takes the assignment, and typically has no intention to

1 do so at any time prior to the assignor’s default — indeed, the typical assignment expressly
2 acknowledges the assignor’s right to collect and expend the rents prior to default. Under such an
3 “assignment,” the circumstances demonstrate that the parties intend for the rents to secure the
4 repayment of the mortgage debt. In other words, the “absolute” assignment is merely a security
5 device, regardless of its “absolute” characterization.
6

7 Mortgage law has long established that instruments purporting absolutely to convey an
8 interest in land nevertheless constitute equitable mortgages when the circumstances demonstrate
9 that the parties are using an interest in land to secure payment of a debt. *See, e.g.,* Restatement of
10 Property (Third) — Mortgages § 3.2 (absolute deed intended to secure an obligation constitutes a
11 mortgage); *Smith v. Player*, 601 So.2d 946 (Ala. 1992) (same); *Steckelberg v. Randolph*, 404
12 N.W.2d 144 (Iowa 1987) (same). Under this same principle, courts should treat a typical
13 “absolute” assignment of rents as an assignment for security purposes, and the weight of modern
14 judicial authority so provides. *See, e.g., In re Cavros*, 262 B.R. 206 (Bankr. D. Conn. 2001); *In*
15 *re 5877 Poplar, L.P.*, 268 B.R. 140 (Bankr. W.D. Tenn. 2001); *National Operating, L.P. v.*
16 *Mutual Life Ins. Co. of New York*, 630 N.W.2d 116 (Wis. 2001); *In re Guardian Realty Group,*
17 *L.L.C.*, 205 B.R. 1 (Bankr. D.D.C. 1997); *In re RV Centennial Partnership*, 202 B.R. 774 (Bankr.
18 D. Colo. 1996); *In re Lyons*, 193 B.R. 637, 644 (Bankr. D. Mass. 1996). Under this view, where
19 the underlying land is property of the bankruptcy estate, post-petition rents from that property
20 would likewise constitute property of the bankruptcy estate. However, the assignee of those rents
21 would continue to have a security interest in those rents by virtue of Bankruptcy Code § 552(b),
22 and the debtor/assignor would be obliged to provide adequate protection of the assignee’s interest
23 in those rents under Bankruptcy Code § 363.
24

25 The Act adopts the view that any “assignment of rents” as defined in this Act (Section
26 2(2)) creates a security interest in rents, regardless of whether the document creating that
27 assignment is in form denominated an “absolute” assignment. The term “assignment of rents”
28 includes only an assignment of rents made in conjunction with a secured loan, and any such
29 assignment creates a security interest governed by this Act. By contrast, nothing in the Act
30 precludes an owner of land from making a truly absolute transfer of rents in a transaction that is
31 not a security transaction, such as a “true sale” of rents (in which the owner of the land transfers
32 full legal, equitable ownership and control of unaccrued rents immediately upon execution and
33 delivery). Such a transfer, however, is not an “assignment of rents” as defined in this Act (unless
34 applicable state law dictates otherwise), and thus the provisions of this Act governing the
35 enforcement of an assignment of rents would not apply to such a transfer.
36

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

1 rents, but leaves this question to other state law. For example, if an assignor has signed and
2 delivered a document entitled “Assignment of Rents,” but the assignee has not yet extended
3 credit to the assignor and state law provides that no transfer of rents occurs until such credit is
4 actually extended, the document would not effect an “assignment of rents” until the credit is
5 actually extended.
6

7 **SECTION 5. RECORDATION; PERFECTION OF SECURITY INTEREST IN**
8 **RENTS; PRIORITY OF CONFLICTING INTERESTS IN RENTS.**

9 (a) A document creating an assignment of rents may be submitted for recording in
10 the [appropriate governmental office under the recording act of this state] in the same manner as
11 any other conveyance of an interest in real property.

12 (b) Upon recording, the security interest in rents created by an assignment of rents
13 is fully perfected, notwithstanding any provision of the document creating the assignment or law
14 of this state other than this [act] which would preclude or defer enforcement of the security
15 interest until the occurrence of a subsequent event, including a subsequent default of the
16 assignor, the assignee’s obtaining possession of the real property, or the appointment of a
17 receiver.

18 (c) A perfected security interest in rents takes priority over the rights of a person
19 that, after the security interest is perfected:

20 (1) acquires a judgment lien against the rents or the real property from
21 which they arise; or

22 (2) purchases an interest in the rents or the real property from which they
23 arise.

24 **Preliminary Comment**

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

2 1. *Recording.* An assignee may submit a document creating an assignment of rents for
3 recording in accordance with the requirements of the state’s recording act. The document is
4 “submitted for recording” when it is presented to the appropriate recording official. Whether the
5 recording official must actually record the document depends upon the assignee’s compliance
6 with the substantive and procedural requirements of the recording act. Likewise, the state’s
7 recording act governs whether the document is actually “recorded” under state law. For example,
8 in some states a misindexed instrument is considered to be unrecorded, while in other states a
9 misindexed instrument is considered to be properly recorded.

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

31
32 By contrast, mortgage law did not customarily use the term “perfection.” Under
33 mortgage law, recording of a mortgage interest served to make that interest valid as against
34 subsequent creditors and bona fide purchasers of the land. Analytically, of course, “recording” in
35 this sense is similar to the Article 9 concept of perfection. By analogy, one could argue that if a
36 mortgage lender had taken and properly recorded an assignment of rents prior to bankruptcy, that
37 mortgage lender should have a security interest in rents that was “perfected” and thus enforceable
38 against third parties. Under this analysis, the trustee/debtor-in-possession could not avoid the
39 mortgage lender’s security interest in rents under § 544(a), and thus the mortgage lender would
40 retain its security interest in post-petition rents under § 552(b). A number of courts in fact
41 adopted this analytical approach, treating post-petition rents as the lender’s cash collateral so
42 long as the mortgagee had properly recorded its assignment of rents prior to bankruptcy. *See,*

1 *e.g., In re Millette*, 186 F.3d 638 (5th Cir. 1999); *Steinberg v. CrossLand Mortgage Corp. (In re*
2 *Park at Dash Point L.P.)*, 985 F.2d 1008, 1011 (9th Cir. 1993); *Vienna Park Properties v. United*
3 *Postal Sav. Ass’n (In re Vienna Park Properties)*, 976 F.2d 106, 112-15 (2d Cir 1992).

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

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

40
41 These diverse interpretations of state mortgage law produced substantial nonuniformity in
42 the treatment of security interests in rents, both from state to state and even from district to
43 district within a particular state. This nonuniformity produced significant criticism among

1 academics, real estate practitioners, and commercial mortgage lenders. *See, e.g.,* R. Wilson
2 Freyermuth, *The Circus Continues — Security Interests in Rents, Congress, the Bankruptcy*
3 *Courts, and the “Rents Are Subsumed in the Land” Hypothesis*, 6 J. Bankr. L. & Prac. 115, 118
4 (1997); Julia Patterson Forrester, *A Uniform and More Rational Approach to Rents as Security*
5 *for the Mortgage Loan*, 46 Rutgers L. Rev. 349 (1993); Patrick A. Randolph, Jr., *Recognizing*
6 *Lenders’ Rents Interests in Bankruptcy*, 27 Real Prop., Prob. & Trust J. 281 (1992).

7
8 In response to this criticism, Congress amended Bankruptcy Code § 552(b) in 1994 in an
9 apparent attempt to provide more uniform treatment of assignments of rents. Prior to 1994, §
10 552(b) provided that a pre-petition security interest in land and rents from that land extended to
11 post-petition rents “to the extent provided by [the] security agreement and by applicable
12 nonbankruptcy law.” By focusing upon the term “applicable nonbankruptcy law,” many courts
13 (as noted above) concluded that § 552(b) did not permit the mortgagee to claim a security interest
14 in post-petition rents where the mortgagee had failed to take the necessary steps to obtain actual
15 or constructive possession of the land and its rents prior to bankruptcy. In 1994, however,
16 Congress amended § 552(b) to remove this reference to “applicable nonbankruptcy law.”
17

18 Many commentators concluded that the amended § 552(b) established a federal standard
19 for the enforcement of an assignment of rents, thus rendering state rent assignment law irrelevant.
20 *See, e.g.,* 5 Collier on Bankruptcy ¶ 552.03[1], at 552-17 (“[Section 552(b)(2)] does not refer to
21 applicable nonbankruptcy law and is intended to provide a creditor with a valid post-petition
22 interest in rents notwithstanding the creditor’s failure to perfect its security interest in rents under
23 applicable state law”). Unfortunately, while legislative history suggests that Congress
24 intended to preempt contrary state laws limiting the post-petition effectiveness of an assignment
25 of rents, the text itself provides no express statement of pre-emptive intent. Further, § 552(b)’s
26 protection for a security interest in post-petition rents is expressly subject to § 544’s strong-arm
27 clause — *which implicitly incorporates underlying state law regarding the enforceability of a*
28 *security interest versus third parties*. Under § 544(a), there is no question that the debtor-in-
29 possession may avoid a security interest in rents if a bona fide purchaser of the land could have
30 avoided that interest under state law as of the petition date. Thus, if state law *actually provides*
31 that a security interest in rents is ineffective against third parties until the mortgagee has taken
32 affirmative action to enforce that security interest, § 544(a) would appear to permit the debtor to
33 avoid the security interest of such a mortgagee — notwithstanding the amendment to § 552(b) —
34 if the mortgagee failed to take such action prior to bankruptcy.
35

36 Roughly one-third of the states have enacted statutes making clear that an assignment of
37 rents is “perfected,” without regard to whether the mortgagee has taken any steps to “activate” or
38 “enforce” that assignment. Cal. Civ. Code §§ 2938, 2938.1; Del. Code tit. 25, § 2121; Fla. Stat.
39 Ann. § 697.07; 765 Ill. St. § 5/31.5; Ind. Code Ann. § 32-21-4-2; Kan. Stat. Ann. § 58-2343; La.
40 Rev. Stat. Ann. § 9:4401; Md. Real Prop. Code Ann. § 3-204; Neb. Rev. Stat. § 52-1704; N.C.
41 Gen. Stat. § 47-20(c); Or. Rev. Stat. § 93.806; S.C. Code § 29-3-100; Tenn. Code Ann. § 66-26-
42 116; Va. Code Ann. § 55-220.1; Wash. Rev. Code Ann. § 7-28-230(3); Wis. Stat. Ann. § 708.11.
43 The Act adopts this approach, and provides that a perfected security interest in rents cannot be

1 avoided by a person that thereafter becomes a judgment lien creditor or a purchaser of the rents
2 or the real property from which they arise.
3

4 **SECTION 6. ENFORCEMENT OF SECURITY INTEREST IN RENTS.**

5 (a) An assignee may enforce an assignment of rents using one or more of the
6 methods specified in Sections 7, 8, and 9, or any other method sufficient to enforce the
7 assignment under law of this state other than this [act].

8 (b) From the date of enforcement, the assignee or, in the case of enforcement by
9 appointment of a receiver under Section 7, the receiver, is entitled to collect:

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

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

12 **Preliminary Comments**

13 Source: Cal. Civ. Code § 2938(c); Restatement (Third) of Property — Mortgages § 4.2(c).
14

15 1. *Nonexclusive method of enforcement.* Section 6 provides that the assignee may enforce
16 an assignment of rents in accordance with its terms. The Act specifies several methods of
17 enforcement of an assignment of rents in Sections 7 (appointment of a receiver), 8 (notification
18 to the assignor), and 9 (notification to tenants).
19

20 The Act also permits enforcement of an assignment of rents by any other method
21 recognized under other law of this state. Thus, for example, this Act would not prevent an
22 assignee holding a mortgage on the real property from taking possession of the real property and
23 thus becoming a “mortgagee in possession.” Generally speaking, mortgage lenders are loathe to
24 assume the status of a mortgagee in possession for a variety of reasons, including potential tort
25 liability to third parties, the obligation to account for rentals collected, and the assumption of a
26 duty to maintain the physical condition of the premises. *See, e.g.,* 1 GRANT S. NELSON & DALE
27 A. WHITMAN, REAL ESTATE FINANCE LAW §§ 4.24 - 4.29, at 213-230 (3d ed. 1993). Still, in rare
28 cases a mortgagee may voluntarily choose to become a mortgagee in possession, and the Act is
29 not intended (either explicitly or implicitly) to eliminate the mortgagee-in-possession doctrine.
30 Thus, to the extent that becoming a mortgagee in possession under the law of this state would be
31 sufficient to enforce a security interest in rents, this Act would permit an assignee to enforce its
32 interest in this manner.
33

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

7
8 2. *Rents collectable under this Act.* Upon enforcement, an assignee may collect (1)
9 accrued but unpaid rents, and (2) unaccrued rents as they accrue in the future.

10
11 Section 6 does not authorize the assignee to collect the proceeds of rents that the assignor
12 had already collected prior to enforcement. However, this Act does not prevent the assignee
13 from using another legal mechanism to obtain and enforce a security interest in the proceeds of
14 rents that the assignor has already collected prior to enforcement. For example, the express terms
15 of an assignment of rents could (1) require the assignor to deposit the cash proceeds of rents into
16 a particular deposit account, and (2) grant the assignee a security interest in that deposit account
17 under Article 9 of the Uniform Commercial Code. If the assignment of rents so provided, the
18 assignee could exercise its available remedies under Article 9 to collect any sums within that
19 deposit account, including the proceeds of rents collected by the assignor prior to the assignee's
20 enforcement of its assignment of rents.

21
22 3. *Date of enforcement.* The Act specifies a "date of enforcement" of a security interest
23 in rents. This date is important for two reasons. First, under Section 6, the assignee may collect
24 rents beginning on the date of enforcement. Second, under Section 14, an assignor that collects
25 rents after the date of enforcement is obligated to turn those rents over to the assignee and faces
26 liability if it fails to do so.

27
28 The date of enforcement will depend upon the method of enforcement used by the
29 assignee. If the assignee enforces the assignment by appointment of a receiver, the date of
30 enforcement will be the date that the court appoints the receiver. Section 7(c). If the assignee
31 enforces the assignment by notification to the assignor, the date of enforcement will be the date
32 that the assignor receives the notification. Section 8(b). If the assignee enforces the assignment
33 by notification to a tenant, the date of enforcement with respect to rents payable by that tenant is
34 the date that the tenant receives the notification. Section 9(b).

35 36 **SECTION 7. ENFORCEMENT BY APPOINTMENT OF RECEIVER.**

37 (a) An assignee is entitled to the appointment of a receiver for the real property
38 subject to the assignment of rents if:

39 (1) the assignor is in default as defined in the document creating the

1 assignment and:

2 (A) the assignor has agreed in a signed document to the
3 appointment of a receiver after default;

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

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

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

10 (b) An assignee may file a petition for the appointment of a receiver with a court
11 before which an action is pending:

12 (1) to foreclose a security interest in the real property subject to the
13 assignment of rents;

14 (2) for specific performance of the assignment;

15 (3) seeking a remedy on account of actual or threatened waste of the real
16 property subject to the assignment; or

17 (4) otherwise to enforce the secured obligation or the assignee's remedies
18 arising from the assignment.

19 (c) If an assignee enforces an assignment of rents under this section, the date of
20 enforcement is the date on which the court enters an order appointing a receiver for the real
21 property subject to the assignment.

22 (d) From the date of its appointment, a receiver has the authority provided in

1 Section 6(b), the order of appointment, and law of this state other than this [act].

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

3 (1) If more than one assignee qualifies under this section for the
4 appointment of a receiver, a receivership requested by an assignee entitled to priority in rents
5 under this [act] has priority over a receivership requested by a subordinate assignee, even if a
6 court has previously appointed a receiver for the subordinate assignee.

7 (2) If a subordinate assignee obtains the appointment of a receiver, that
8 receiver has the right, until a receiver is appointed under a senior assignment of rents, to collect
9 the rents and apply the proceeds in the manner specified in the order appointing the receiver.

10 **Preliminary Comments**

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

18
19 The Act addresses this concern by authorizing the assignee to file an action for specific
20 performance of the assignment of rents. The pendency of this action would provide a sufficient
21 jurisdictional predicate for the appointment of a receiver, even if the assignee chose to proceed
22 with its foreclosure by power of sale.

23
24 2. *Traditional standards for appointment of a receiver.* Traditionally, courts have
25 appointed a receiver for mortgaged land if the value of the land was insufficient to satisfy the
26 mortgage debt (*i.e.*, where the mortgagee’s security was inadequate) or whether the owner of the
27 mortgaged land was committing waste (thereby threatening the value of the mortgagee’s
28 security). *See, e.g.*, Restatement (Third) of Property — Mortgages §§ 4.3(a)(2), 4.3(a)(3); 1 G.
29 Nelson & D. Whitman, Real Estate Finance Law § 4.34 (3d ed. 1993). Consistent with this
30 traditional approach, Section 7(a)(1)(B) authorizes the appointment of a receiver if the real
31 property appears insufficient to satisfy the secured obligation. Likewise, Section 7(a)(2)
32 authorizes the appointment of a receiver where there are “other circumstances” justifying the
33 appointment of a receiver under the law of this state other than this Act. Such “other

1 circumstances” would include waste as defined under state law other than this Act. Thus, for
2 example, if the law of this state other than this Act treats nonpayment of real property taxes as
3 actionable waste, the assignor’s nonpayment of taxes would provide a justification for the
4 appointment of a receiver.

5
6 A few court decisions have required a mortgagee seeking appointment of a receiver to
7 show that the mortgagor was insolvent. *See, e.g.,* Mutual Benefit Life Ins. Co. v. Frantz Klodt &
8 Son, Inc., 237 N.W.2d 350 (Minn. 1975); Chase Manhattan Bank v. Turabo Shopping Center,
9 Inc., 683 F.2d 25 (1st Cir. 1982). The Restatement (Third) of Property — Mortgages and most
10 commentators have rejected this view. The Act does not require the assignee to demonstrate the
11 assignor’s insolvency as a predicate to obtaining the appointment of a receiver. However,
12 Section 7(a)(2) would permit an assignee to use the assignor’s insolvency as grounds for
13 appointment of a receiver where other state law has recognized the assignor’s insolvency as
14 sufficient grounds for a receivership.

15
16 3. *Receivership Clauses.* The modern commercial mortgage typically contains a
17 provision in which the mortgagor consents to the appointment of a receiver for the real property
18 following default. Often, receivership clauses provide that the mortgagor consents to the
19 appointment of a receiver following default as a matter of contract, without regard to whether the
20 mortgagor is insolvent or whether the physical condition of the real property would otherwise
21 justify the appointment of a receiver.

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

40
41 Consistent with the position adopted by Restatement (Third) of Property — Mortgages §
42 4.3(b) and significant recent judicial authority, the Act establishes that a receivership clause
43 alone provides a sufficient basis for the appointment of a receiver following mortgagor default.

1 *See, e.g.,* Bank of America Nat'l Trust & Sav. Ass'n v. Denver Hotel Ass'n Ltd. Partnership, 830
2 P.2d 1138 (Colo. App. 1992) (upholding appointment of receiver under receivership clause,
3 without regard to adequacy of security or solvency of mortgagor, under abuse of discretion
4 standard); Fleet Bank v. Zimelman, 575 A.2d 731 (Me. 1990) (freely bargained-for receivership
5 clause should be enforced); Metropolitan Life Ins. Co. v. Liberty Center Venture, 650 A.2d 887
6 (Pa. Super. 1994); Federal Home Loan Mortgage Corp. v. Nazar, 100 B.R. 555 (D. Kan. 1989).
7 Statutes in several states provide that a receivership clause is enforceable as a matter of right.
8 *See, e.g.,* Ind. Code § 32-30-5-1; Minn. Stat. Ann. § 559.17(2) (mortgages of \$100,000 or more);
9 N.Y. Real Prop. Law § 254(10) (receivership clause enforceable “without notice and without
10 regard to adequacy of any security of the debt”); Okla. Stat. Ann. tit. 12, § 1551(2)(c) (court shall
11 appoint receiver when “a condition of the mortgage has not been performed and the mortgage
12 instrument provides for the appointment of a receiver”). Finally, federal courts have routinely
13 held receivership clauses in federally insured mortgages sufficient to justify the appointment of a
14 receiver. *See, e.g.,* United States v. Berk & Berk, 767 F. Supp. 593 (D.N.J. 1991); United States
15 v. Drexel View II, Ltd., 661 F. Supp. 1120 (N.D. Ill. 1987).
16

17 By expressing the circumstances justifying the appointment of a receiver in the
18 disjunctive, Section 7(a)(1) adopts the view that a receivership clause is enforceable by the
19 assignee without regard to the condition of the real property, the solvency of the assignor, or the
20 adequacy of the security for the secured obligations.
21

22 4. *Priority between conflicting receivers.* Subsection (e), which is modeled upon § 4.5 of
23 the Restatement (Third) of Property — Mortgages, provides a priority rule in the event where
24 multiple rents assignees obtain the appointment of a receiver. As a threshold matter, conflicting
25 security interests in rents are resolved based upon the priorities established by the state’s
26 recording act, and thus an assignee holding a recorded assignment of rents would be entitled to
27 priority over the interest of a later assignee of the same rents. Section 5(c). Consistent with this
28 approach, if the senior assignee is entitled to the appointment of a receiver under Section 7, the
29 court’s appointment of that receiver will take priority over and displace a prior receivership
30 obtained by a subordinate assignee. Any proceeds actually collected by the receiver for the
31 subordinate assignee, however, need not be turned over to the receiver for the senior assignee;
32 instead, the receiver for the subordinate assignee shall apply those sums in the manner specified
33 in its order of appointment.
34

35 5. *Ex parte appointment of a receiver.* Many assignments of rents contain a clause
36 entitling the assignee to the appointment of a receiver on an *ex parte* basis, without notice to the
37 assignor. The Act does not establish that the assignee is entitled to a receivership on an *ex parte*
38 basis, and instead leaves to other state law the question of whether (and in what circumstances)
39 prior notice to the assignor is excused.
40

41 6. *Receiver’s power to terminate or disaffirm existing leases.* In many states, statutory or
42 case law regarding receiverships has generally established (or limited) the receiver’s power to
43 terminate leases in default or to disaffirm leases not in default. Likewise, the court order

1 appointing a receiver will often specify the extent to which a receiver can take these steps with or
2 without the approval of the court and/or the assignee. As a result, subsection (d) addresses the
3 receiver's power to terminate and/or disaffirm leases by leaving this question to the terms of the
4 court order appointing the receiver and other state law.
5

6 **SECTION 8. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR.**

7 (a) Upon the assignor's default as defined in the document creating an assignment
8 of rents or as otherwise agreed by the assignor, the assignee may give the assignor a notification
9 demanding that the assignor pay over all rents that the assignee is entitled to collect under
10 Section 6. The assignee shall also give a copy of the notification to any other person that, 10
11 days before the notification date, held a recorded assignment of rents arising from the real
12 property.

13 (b) If an assignee enforces an assignment of rents under this section, the date of
14 enforcement is the date on which the assignor receives a notification under subsection (a).

15 (c) An assignee's failure to give notification under subsection (a) to any person
16 holding a recorded assignment of rents does not affect the effectiveness of the notification as to
17 the assignor, but the other person is entitled to relief permitted under law of this state other than
18 this [act].

19 **Preliminary Comments**

20 Source: Cal. Civ. Code §§ 2938(c)(4); Restatement (Third) of Property — Mortgages §
21 4.2(c), (d).
22

23 1. *Enforcement by notification to assignor.* An assignment of rents typically requires the
24 assignor to pay rents to the assignee following default, either immediately or upon demand by the
25 assignee. The Restatement (Third) of Property — Mortgages adopted the view that notification
26 to the assignor following default is sufficient to enforce a perfected security interest in rents and
27 to give the assignee the legal right to possession of the rents. *See* Restatement (Third) of
28 Property — Mortgages § 4.2(c). This position effectively places an obligation on the assignor to

1 pay over to the assignee any rents thereafter collected by the assignor; the assignor's collection
2 and retention of rents following such notification would constitute waste that would potentially
3 subject the assignor to liability for damages. *Id.* §§ 4.6(a)(5), 4.6(b)(3).
4

5 The Act likewise adopts this approach, authorizing the assignee to enforce an assignment
6 of rents by means of a notification to the assignor following default under the assignment. As
7 provided in Section 13(c), the assignor's failure to pay over to the assignee any rents it collects
8 following receipt of such notification would subject to the assignor to liability to the assignee for
9 the amount of the rents not turned over.
10

11 *2. Notification to other record rents assignees.* Subsection (a) provides that an assignee
12 enforcing an assignment of rents must give notification not only to the assignor, but also to any
13 other person that, 10 days before the notification date, held a recorded assignment of rents
14 covering the real property. Notification will alert another person holding a recorded assignment
15 of rents as to the pending enforcement effort and permit that person to take whatever steps it
16 considers justified in protecting its secured position with respect to the rents. For example, if the
17 enforcing rents assignee holds a junior assignment of rents, notification to the senior would
18 permit the senior to take steps to enforce its senior interest in rents immediately (assuming its
19 assignment permitted immediate action under the circumstances) — thereby avoiding the risk
20 that the junior might by collection acquire effective priority as to the following period's rents.
21 By contrast, if the enforcing rents assignee holds a senior assignment of rents, notification to the
22 junior would alert the junior as to the need to investigate the status of the senior obligations.
23

24 Subsection (c) provides that the failure of the enforcing assignee to give notification to
25 other rents assignees does not negate the effectiveness of the notification as to the assignor. If
26 the assignor received the notification and subsequently collected rents but failed to turn those
27 over to the assignee, the assignor would face liability under Section 14(d) regardless of whether
28 the enforcing assignee had given notification to other rents assignees. If a rents assignee fails to
29 give a required notification to another creditor entitled to notification, subsection (c) entitles the
30 other creditor to any relief provided by law other than this Act. This would permit the other
31 creditor to plead and prove any damages proximately caused by the failure to give notification.
32

33 *3. Nonexclusivity of means of enforcement.* The Act's various methods of enforcement of
34 an assignment of rents are not exclusive in nature. The primary benefit of enforcement by
35 notification to the assignor under Section 8 may be that such enforcement quickly triggers the
36 assignor's liability under Section 14(d) for failure to turn over any rents thereafter collected. By
37 contrast, an assignee that wants more immediate control over actual collection of rents as they
38 accrue may simultaneously choose to enforce its assignment of rents by means of appointment of
39 a receiver (Section 7) or notification to tenants (Section 9). The Act does not limit the ability of
40 an assignee to enforce its interest in rents by multiple methods.
41

42 **SECTION 9. ENFORCEMENT BY NOTIFICATION TO TENANT.**

1 (a) Upon the assignor's default as defined in the document creating an assignment
2 of rents, or as otherwise agreed by the assignor, the assignee may give to a tenant of the real
3 property a notification demanding that the tenant pay to the assignee all unpaid accrued rents and
4 all unaccrued rents as they become due. The assignee shall give a copy of the notification to the
5 assignor and to any other person that, 10 days before the notification date, held a recorded
6 assignment of rents arising from the real property. The notification must:

7 (1) identify the tenant, assignor, assignee, premises covered by the lease,
8 and assignment of rents being enforced;

9 (2) provide the recording data for the document creating the assignment or
10 other reasonable proof that the assignment has been made;

11 (3) state that the assignee has the right to collect rents in accordance with
12 the assignment;

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

15 (5) describe the manner in which subsections (c) and (d) affect the tenant's
16 payment obligations;

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

20 (7) contain a statement that the tenant may consult an attorney if the tenant
21 has questions about its rights and obligations; and

22 (8) be signed by the assignee.

1 (b) If an assignee enforces an assignment of rents under this section, the date of
2 enforcement is the date on which the tenant receives a notification substantially complying with
3 subsection (a).

4 (c) Subject to subsection (d) and any other claim or defense that a tenant has under
5 law of this state other than this [act], following receipt of a notification substantially complying
6 with subsection (a):

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

11 (2) a tenant that pays rents to the assignor is not discharged from the
12 obligation to pay rents to the assignee, unless the tenant occupies the premises as the tenant's
13 primary residence;

14 (3) a tenant's payment to the assignee of rents then due satisfies the
15 tenant's obligation under the lease to the extent of the payment made; and

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

19 (d) A tenant that has received a notification under subsection (a) is not in default
20 of the lease for nonpayment of rents accruing after the date notification is given before the earlier
21 of:

22 (1) 10 days after the date that the next regularly scheduled rental payment

1 would be due under the lease; or

2 (2) 30 days after the date of the notification.

3 (e) Upon receiving a notification from another creditor that is entitled to priority
4 under Section 5(c) that the other creditor has enforced and is continuing to enforce its interest in
5 rents, an assignee that has previously given notification to a tenant under subsection (a) shall
6 immediately give a new notification to the tenant canceling the earlier notification.

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

11 Preliminary Comments

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

13
14 1. *Enforcement by notification to tenants.* Section 9 provides that an assignee may
15 enforce its security interest in rents by notification to tenants either following default or
16 otherwise in accordance with the assignment. Because many assignments of rents do not
17 authorize the assignee to collect rents prior to the assignor's default, enforcement by Section 9
18 will usually arise only after the assignor's default. Nevertheless, this Act would permit the
19 assignor and assignee to allow the assignee to collect rents directly from the tenants even prior to
20 default.

21
22 Subsection (a) specifies the required contents of the notification. Although the Act does
23 not require that the notification be in any particular form, Section 10 provides a form notification
24 that is sufficient to satisfy subsection (a) if properly completed.

25
26 2. *Effect of notification.* Once the tenant receives notification from the assignee
27 demanding payment of rents pursuant to the assignment, the tenant must pay accrued but unpaid
28 rents and rents accruing in the future to the assignee in order to satisfy its rental obligation. In
29 this respect, the Act's provisions generally operate comparably to Uniform Commercial Code
30 Section 9-406(a), which governs the circumstances under which an account debtor can discharge
31 its obligation following notification and demand by an assignee of that account. Following
32 receipt of a notification, a tenant cannot discharge its rental obligations by payment to the

1 assignor. Thus, a tenant that pays its landlord following receipt of a notification under this
2 section faces the risk of having to make double payment of the sums necessary to discharge its
3 rental obligation.
4

5 The Act does provide an exception to this rule in the case of a tenant that occupies the
6 premises as its primary residence. The Act does permit an assignee to notify residential tenants
7 to pay rents to the assignee, and also provides that any such tenant that pays the assignee
8 following receipt of such a notification is discharged to the extent of the payment. However,
9 under subsection (c)(2), a tenant that occupies the premises as its primary residence is discharged
10 by payment to the assignor, even if the tenant has received a notification directing it to pay rents
11 to the assignee. This exception prevents a residential tenant that has paid the assignor from being
12 evicted from its primary residence. The exception is viewed as a justifiable protection for
13 residential tenants in light of the fact that the assignee of rents arising from residential property
14 can more effectively enforce its security interest in rents through alternative means (such as by
15 obtaining the appointment of a receiver).
16

17 The tenant's obligation to direct payment of rents to the assignee following receipt of a
18 notification under subsection (a) is subject to one other caveat: the tenant need not comply if it
19 has previously received a notification from another assignee of rents given by that assignee in
20 accordance with this section, and the other assignee has not cancelled that notification. Until
21 such a tenant receives instructions canceling that prior notification, the tenant may continue to
22 pay the other assignee in accordance with the prior notification.
23

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

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

1 failure to give notification.
2

3 4. *Tenant protected for payment to assignee.* Subsection (c)(3) provides that a tenant that
4 pays rents to the assignee following receipt of a notification under this section discharges its
5 rental obligation to the extent of such payment. Even if the assignor subsequently established
6 that the assignee's notification was wrongful, the assignor would not be able to declare a tenant
7 in breach for nonpayment of rent if that tenant paid the assignee pursuant to the notification.
8

9 5. *Extension of time for payment of next rental payment following notification.* If a tenant
10 receives a notification directing payment of rents to an assignee, the tenant reasonably may wish
11 to obtain counsel regarding the effect of the notification. However, if the notification arrives
12 shortly before the tenant's rental due date, the tenant may find it difficult to obtain that advice
13 before its rental obligation would become past due.
14

15 In order to permit the tenant a reasonable opportunity to obtain counsel, subsection (d)
16 provides that neither the assignor nor the assignee may hold a tenant in default of a lease solely
17 for nonpayment of rents that accrue after the notification is given until the earlier of 10 days after
18 the next regularly scheduled rental payment would be due under the lease or 30 days after the
19 date of the notification. Subsection (d) would not in any way protect a tenant from the
20 consequences of a breach of the lease on grounds other than nonpayment of rent, or for
21 nonpayment of rents that had accrued prior to the notification.
22

23 The application of subsection (d) is demonstrated by the following illustrations:
24

25 *Illustration 1.* Tenant's rent is due and payable to Assignor monthly, on the first
26 of each month. On March 28, Tenant receives a notification from Assignee
27 demanding that Tenant pay future rents to Assignee. Neither Assignor nor
28 Assignee may declare Tenant in default of the April 1 rent payment until after
29 April 11.
30

31 *Illustration 2.* Tenant's rent is due and payable to Assignor monthly, on the first
32 of each month. On April 3, Tenant receives a notification from Assignee
33 demanding that Tenant pay future rents to Assignee. Neither Assignor nor
34 Assignee may declare Tenant in default of the May 1 rent payment until after May
35 3.
36

37 *Illustration 3.* Tenant's rent is due and payable to Assignor quarterly, on the first
38 of January, April, July, and October. On February 28, Tenant receives a
39 notification from Assignee demanding that Tenant pay future rents to Assignee.
40 Under subsection (c), Tenant receives no extension of the time for his April 1
41 quarterly rent payment.
42

43 *Illustration 4.* Tenant's lease provides that base rental is due and payable to

1 Assignor monthly, on the first of each month. Tenant's lease also provides a
2 percentage rental clause by which percentage rental is payable on an annual basis
3 each October 1. On September 15, Tenant receives a notification from Assignee
4 demanding that Tenant pay future rents to Assignee. Neither Assignor nor
5 Assignee may declare Tenant in default for failure to pay the October 1 base rent
6 payment until after October 15. Neither Assignor nor Assignee may declare
7 Tenant in default for failure to pay the October 1 percentage rental payment until
8 after October 31.
9

10 6. *Enforcement by multiple rent assignees.* In some circumstances, multiple creditors
11 may seek to collect rents directly from tenants pursuant to this Act. If a subordinate rents
12 assignee collect rents under this section, the subordinate rents assignee may keep the rents
13 collected in good faith and apply those rents to its secured obligations notwithstanding its
14 subordinate position, until such time as the senior rents assignee enforces its superior collection
15 rights. Once a subordinate rents assignee that has enforced its security interest in rents under this
16 section receives a notification that a senior assignee has enforced its interest in rents, subsection
17 (e) obligates the subordinate rents assignee to give an immediate notification to tenants canceling
18 its previous payment instructions. A subordinate rents assignee that fails to cancel its prior
19 notification may not thereafter collect rents in good faith within the meaning of Section 14(f).
20

21 **SECTION 10. NOTIFICATION TO TENANT: FORM.** No particular phrasing is
22 required for the notification specified in Section 9. However, the following form of notification,
23 when properly completed, is sufficient to satisfy the requirements of Section 9:
24

25 NOTIFICATION TO PAY RENT TO PERSON OTHER THAN LANDLORD

26 Tenant: [Name of Tenant]

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

28 Landlord: [Name of Landlord]

29 Assignee: [Name of Assignee]

30 Address of Assignee and Contact Person: [Address for Payment of Rent to

31 Assignee and Contact Person for Further Information]:

32 1. The Assignee named above is the assignee of rents under [name

1 of document] (the “Assignment of Rents”) dated _____, and recorded at
2 [recording data] in the [appropriate governmental office under the recording act
3 of this State]. You may request a copy of the Assignment of Rents from the
4 Assignee at the address listed above.

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

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

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

22 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.

6. If you have previously received a notification from another person that 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]]

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

The enforcement of an assignment of rents by one or more of the methods identified in Sections 7, 8, and 9, the application of rents by the assignee under Section 12 after enforcement, the

1 payment of expenses under Section 13, or a civil action under Section 14(d) does not:

2 (1) make the assignee a mortgagee in possession of the real property;

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

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

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

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

9 [(6) violate [cite the “one-action” statute of this state]; or

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

13 **Legislative Note:** *A state that does not have a “one action” statute or anti-deficiency legislation*
14 *should omit subsections (6) and (7).*
15

16 Preliminary Comments

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

18
19 1. *Mere enforcement of security interest in rents does not trigger mortgagee-in-*
20 *possession status.* A number of common law decisions suggest that a mortgagee can become a
21 “mortgagee in possession” — with the legal responsibilities attendant to that status — without
22 physical occupation of the mortgaged premises. *See, e.g.,* 1 GRANT S. NELSON & DALE A.
23 WHITMAN, REAL ESTATE FINANCE LAW §§ 4.25, at 218 & nn. 1-9 (3d ed. 1993) (collecting
24 cases). This result is not surprising, given the factual and legal uncertainty attendant to the term
25 “possession.” This ambiguity can produce concern for the assignee that wishes to protect its
26 security interest in rents without assuming the duties and liabilities attendant to mortgagee-in-
27 possession status. Consistent with commentary to the Restatement (Third) of Property —
28 Mortgages, the Act provides that the mere collection of rents does not render the mortgagee a
29 “mortgagee in possession” with the duties and liabilities attendant to that status. *Cf.* Restatement
30 (Third) of Property — Mortgages § 4.2 cmt. c.

1 2. *Cumulative nature of mortgagee’s remedies.* Under the traditional rule, the mortgagee
2 holding an assignment of rents could proceed after default to enforce its right to collect rents
3 without concern about the impact that action might have on the mortgagee’s other remedies. The
4 traditional approach treated the mortgagee’s remedies as cumulative; the mortgagee’s selection
5 of one remedy did not preclude the mortgagee from subsequently seeking another remedy (*e.g.*,
6 initially suing on the mortgage note, and later foreclosing on the mortgage). *See, e.g.*,
7 Restatement (Third) of Property — Mortgages § 8.2 Reporters’ Note (collecting cases).
8

9 The Act adopts this view, and makes clear that the assignee’s enforcement of its
10 assignment of rents does not constitute an election of remedies that would preclude a later action
11 to enforce the secured obligation, render the secured obligation unenforceable, or otherwise limit
12 any rights available to the assignee with respect to the secured obligation. Thus, for example, if
13 an assignee enforces its security interest by obtaining the appointment of a receiver under Section
14 7, and the appointment is ancillary to an action by the assignee for specific performance of the
15 assignment of rents, the assignee’s enforcement action does not preclude the assignee from
16 subsequently asserting any other remedies it may have to enforce the secured obligation or any
17 other collateral it may hold securing that obligation.
18

19 3. *“One action” rules and anti-deficiency provisions.* In some states, “one action” rules
20 provide that there can be only one form of action for the recovery of any debt secured by real
21 property. *See, e.g.*, Cal. Code Civ. Pro. § 726(a); Idaho Code § 6-101(1); Mont. Code Ann. § 71-
22 1-222(1); Nev. Rev. Stat. § 40.430(1); Utah Code § 78-37-1; *see also* First State Bank of
23 Cooperstown v. Ihringer, 217 N.W.2d 857 (N.D. 1974). Under this approach, for example, a
24 mortgagee’s decision to sue on the mortgage note would constitute an “action” that subsequently
25 barred the mortgagee from foreclosing the mortgage.
26

27 Ambiguity over the scope of a “one action” rule — and whether it would treat an attempt
28 to enforce an assignment of rents as an “action” that would prevent other collection efforts —
29 could create significant confusion with respect to the enforcement of an assignment of rents. For
30 this reason, the Restatement (Third) of Property — Mortgages, while generally rejecting the one-
31 action approach, further argued that any limitation on the mortgagee’s remedies with respect to
32 foreclosure of the mortgage should not limit the mortgagee’s enforcement of its security in rents:
33

34 [Section 8.2] does not affect the mortgagee’s right to enforce a mortgage on rents under §
35 4.2 or to the appointment of a receiver under § 4.3. This is because, under § 4.2, the
36 mortgagee is proceeding against separate security and, under § 4.3, a receivership is an
37 interim remedy ancillary to the remedies delineated in [Sections 8.2(a) and (b)]. Nor
38 does this section limit the mortgagee’s remedies for waste under § 4.6 or the recovery of
39 sums expended by the mortgagee for the protection of the security under § 2.2.
40 [Restatement (Third) of Property — Mortgages § 8.2, cmt. b]
41

42 Consistent with this approach, the rent-collection statute in California (a one-action rule state)
43 specifically provides that enforcement of a security interest in rents and collection of rents does
44 not constitute an “action” for the purposes of the one-action rule or a “deficiency” action for the

1 purposes of the state’s anti-deficiency statutes. In order to make the Act workable in states with
2 one-action rules and deficiency legislation, the Act follows the California approach.

3
4 4. *Marshaling requirements.* Nothing in this section limits a court’s equitable discretion
5 to order lien marshaling in appropriate cases. For example, assume that Debtor owes Bank \$2
6 million, secured by a mortgage and an assignment of rents on Blackacre and a separate mortgage
7 on Whiteacre. Debtor also owes Henning \$1 million secured only by a mortgage on Whiteacre.
8 Nothing in Section 10 is intended to constrain a court’s equitable discretion to order Bank to
9 proceed against Blackacre and its rents first before foreclosing against Whiteacre.
10

11 **SECTION 12. APPLICATION OF PROCEEDS.** Unless otherwise agreed, an
12 assignee that collects rents under this [act] or collects upon a judgment in a civil action under
13 Section 14(d) shall apply the sums collected in the following order to:

14 (1) the assignee’s reasonable expenses of enforcing its assignment of rents,
15 including, to the extent provided for by agreement and not prohibited by applicable law other
16 than this [act], reasonable attorney’s fees and court costs incurred by the assignee;

17 (2) payment of expenses incurred by the assignee to preserve the real property
18 subject to the assignment;

19 (3) satisfaction of the secured obligation;

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

23 (5) the assignor.

24 **Preliminary Comments**

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

26
27 The term “reasonable attorney’s fees and costs” in Section 12(1) includes those fees and
28 costs incurred by the assignee in enforcing its assignment of rents. This would include, *inter*

1 *alia*, the fees and costs incurred in obtaining the appointment of a receiver, providing a
2 notification under Section 8, or collecting rents from tenants following notification to tenants
3 under Section 9. Unlike U.C.C. § 9-607(d) — under which an assignee’s right to recover these
4 expenses from collected receivables arises automatically — the assignee may recover reasonable
5 attorney’s fees under this Act only to the extent such fees are provided for in the assignment of
6 rents and are not prohibited by applicable law other than this Act.

7
8 The assignee may also incur other attorney’s fees and legal expenses in proceeding
9 against the assignor, such as expenses incurred in foreclosing the mortgage or seeking a
10 deficiency judgment. Whether the assignee has a right to collect those fees and expenses
11 depends on the parties’ agreement and the provisions of law other than this Act.
12

13 **SECTION 13. APPLICATION OF RENTS TO EXPENSES OF PROTECTING**
14 **REAL PROPERTY; CLAIMS AND DEFENSES OF TENANT.**

15 (a) Unless otherwise agreed by the assignee, an assignee that collects rents
16 following enforcement under Sections 8 or 9 may apply those rents in accordance with Section
17 12 and has no duty to apply those rents to the payment of expenses of protecting or maintaining
18 the real property subject to the assignment.

19 (b) Unless a tenant has made an enforceable agreement not to assert claims or
20 defenses, the right of the assignee to collect rents from the tenant is subject to the terms of the
21 agreement between the assignor and tenant and any claim or defense arising from the assignor’s
22 nonperformance of that agreement.

23 (c) Nothing in this [act] limits the ability of a tenant to request a court to appoint
24 a receiver for the real property subject to the assignment upon motion by the tenant that the
25 assignee’s nonpayment of expenses of protecting or maintaining the real property has caused or
26 threatened harm to the tenant’s interest in the property. Whether the tenant is entitled to the
27 appointment of a receiver is governed by law of this state other than this [act].

Preliminary Comments

1. *Expenses of operation and preservation of the real property.* Typically, a tenant's payment of rents enables the assignor to defray the expenses of operating and preserving the real property (such as real property taxes, insurance, and maintenance). In many commercial leases, the tenant pays a sum designated as "additional rent," specifically to reimburse the assignor for the tenant's pro rata share of real property taxes, insurance, and maintenance expenses.

If an assignor defaults and an assignee enforces its assignment of rents, the assignor may be unable to collect rents that it needs to pay the expenses of operating and preserving the real property on a going-forward basis. Potentially, the assignor's nonpayment of these expenses or the nonperformance of its obligation to maintain the real property poses a threat to the interests of the tenants.

In some circumstances, an assignee's enforcement of an assignment of rents will result in little or no disruption of the operation and preservation of the real property. For example, if an assignee enforces an assignment of rents by obtaining the appointment of a receiver under Section 7, the receivership order will authorize the receiver to apply collected rents to the costs of operating and preserving the real property. Likewise, if an assignee enforces an assignment of rents by becoming a mortgagee in possession, the mortgagee-in-possession rule imposes upon the assignee a duty to apply collected rents to the operation and preservation of the real property.

However, the assignor's obligation to pay taxes, insurance, or maintenance expenses (whether expressed or implied in tenant leases) does not generally bind the assignee as a successor if the lender has not yet acquired possession or ownership of the land. If a lender purchases mortgaged premises at foreclosure, the lender would become obligated to fulfill the assignor's responsibilities under the tenant leases, as the landlord's covenants in those leases would run with the land to bind the lender. However, if the lender collects rents prior to completing foreclosure without taking either actual or constructive possession of the land, the lender may collect those sums and apply them to the mortgage debt and has no 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" that obligates the lender to apply such sums to the payment of taxes, insurance, or property maintenance.

As a result, if the assignee enforces its assignment of rents by means of Section 8 (notification to the assignor) or Section 9 (notification to tenants), the assignor effectively remains in day-to-day possession and control of the real property. In such a case, 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 responsibility remains upon the assignor. Such an assignee may apply the collected rents to the mortgage debt in accordance with Section 12, and need not apply such rents to property-related expenses (such as taxes, insurance, and/or maintenance), absent a contrary agreement by the assignee. A prudent

1 assignee may choose, however, to apply collected rents to the payment of such expenses, both to
2 protect its own interest in the premises and to avoid any possible claim or defense that a tenant
3 have to payment of rent based upon the assignor's nonperformance of the lease agreement.
4

5 *2. Tenant's defenses or claims.* Subsection (b) provides that the assignee's ability to
6 collect rents is subject to the agreement between the assignor and the tenant and any defense or
7 claim that the tenant may have arising from the nonperformance of that agreement, unless the
8 tenant has made an enforceable agreement not to assert such defenses or claims. *Cf.* U.C.C.
9 Section 9-404(a)(1).
10

11 In some cases, an assignor's failure to perform its lease covenants (such as a covenant to
12 maintain the premises or common areas) will permit the tenant to raise a defense to subsequent
13 payment of rent or to assert a right of recoupment or set-off in reduction of its subsequent rental
14 obligation. This Act recognizes that unless the tenant has made an enforceable agreement not to
15 assert such a claim or defense, the tenant may raise such a claim or defense in the event that the
16 assignee attempts to collect rents from the tenant under this Act.
17

18 In many transactions, mortgage lenders may require tenants to execute a subordination,
19 nondisturbance and attornment agreement (SNDA) agreement in which the tenant agrees not to
20 assert against the lender any claims or defenses arising out of the landlord's nonperformance.
21 Subsection (b) recognizes the enforceability of such waiver agreements.
22

23 *3. Receivership.* A tenant that pays rents expects that the assignor/landlord will apply
24 some portion of those rents to the payment of real property taxes, insurance, and property
25 maintenance. If the assignee begins collecting rents from tenants after the assignor's default
26 (without obtaining the appointment of a receiver or becoming a mortgagee in possession),
27 subsection (a) does not impose a general obligation on the assignee to apply such rents to the
28 costs of operating and preserving the property. Nevertheless, the assignor may fail to pay such
29 costs, especially if enforcement of the assignment of rents has divested the assignor of control
30 over the rents. In this circumstance, the expectations of a tenant can be significantly frustrated,
31 particularly if the nonperformance of the assignor's maintenance significantly compromises the
32 tenant's operations. Subsection (c) recognizes that such a tenant could seek the appointment of a
33 receiver, if the tenant can demonstrate that the nonpayment of expenses of operating and
34 preserving the real property has threatened the tenant's interest in the real property.
35

36 **SECTION 14. TURNOVER OF RENTS; COMMINGLING AND**

37 **IDENTIFIABILITY OF RENTS; LIABILITY OF ASSIGNOR.**

38 (a) In this section, "good faith" means honesty in fact and the observance of
39 reasonable commercial standards of fair dealing.

1 (b) If an assignor collects rents that the assignee is entitled to collect under this
2 [act]:

3 (1) the assignor shall turn over the proceeds to the assignee, less any
4 amount representing payment of expenses authorized by the assignee; and

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

7 (c) For purposes of this [act], cash proceeds are identifiable if they are maintained
8 in a segregated account or, if commingled with other funds, to the extent the assignee can
9 identify them by a method of tracing, including application of equitable principles, that is
10 permitted under law of this state other than this [act] with respect to commingled funds.

11 (d) In addition to any other remedy available to the assignee under law of this state
12 other than this [act], if an assignor fails to turn over proceeds to the assignee as required by
13 subsection (b), the assignee may recover from the assignor an amount equal to:

14 (1) the proceeds that the assignor was obligated to turn over under
15 subsection (b); and

16 (2) reasonable attorney's fees and court costs incurred by the assignee to
17 the extent provided for by agreement and not prohibited by law of this state other than this [act].

18 (e) The assignee may maintain an action under subsection (d) without bringing an
19 action to foreclose any security interest that it may have in the real property. Any sums recovered
20 in the action must be applied in the manner specified in Section 12.

21 (f) Unless otherwise agreed, if an assignee entitled to priority under Section 5(c)
22 enforces its interest in rents after another creditor holding a subordinate security interest in rents

has enforced its interest under Section 8 or 9, the creditor holding the subordinate security interest in rents is not obligated to turn over any proceeds collected in good faith before the creditor receives notification that the senior assignee has enforced its interest in rents.

Preliminary Comments

Source: Cal. Civ. Code §§ 2938(f); U.C.C. §§ 9-315(a), 9-315(b); 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

1 security interest in rents); *Ginsberg v. Lennar Florida Holdings*, 645 So.2d 490 (Fla. App. 1994).
2 The Restatement (Third) of Property — Mortgages adopts this view in § 4.6(a)(5) which
3 provides that “[w]aste occurs when, without the mortgagee’s consent, the mortgagor ... retains
4 possession of rents to which the mortgagee has the right to possession....”).

5
6 The Act does not precisely duplicate the Restatement approach, as it does not specifically
7 use the term “waste” to identify the basis of the assignor’s liability for milking rents. In lien
8 theory states, courts traditionally held that the mortgagor was liable for waste only to the extent
9 that its conduct impaired the mortgagee’s security. Rather than focusing upon impairment of
10 security — which would require proof regarding the value of the mortgaged premises — the Act
11 instead takes a more straightforward approach. If the assignor is obligated to turn over rents to
12 the assignee under Sections 6 and 14(b), but fails to do so, the assignor is liable for damages
13 equal to the full amount of the rents not turned over. Any such recovery must be applied by the
14 assignee in the manner specified by Section 12, so the assignee’s total recovery could not exceed
15 the loss actually suffered by the assignee. Any surplus proceeds remaining after full satisfaction
16 of the secured obligation would be returned to the assignor or to subordinate lienholders in
17 accordance with Section 12.

18
19 *2. Assignor’s liability to turn over rents.* The Act provides that upon default as defined in
20 the document creating an assignment of rents or as otherwise agreed, an assignee may collect (1)
21 accrued but unpaid rents and (2) unaccrued rents as they accrue in the future. If the assignor
22 collects any such sums following enforcement by the assignee, the assignor must turn over such
23 sums to the assignee under subsection (b), or face personal liability for failure to do so by virtue
24 of subsection (d).

25
26 In cases involving nonrecourse obligations (either by virtue of specific contractual
27 nonrecourse provisions or the intervention of antideficiency legislation), mortgagors who have
28 milked rents often argue that the mortgagee’s action is in the nature of a deficiency judgment and
29 should therefore be dismissed. The weight of authority rejects this view and concludes that an
30 action for damages for waste of rents or conversion of the proceeds of rents is not in the nature of
31 a deficiency action. *See, e.g., Hoelting Enters. v. Nelson*, 929 P.2d 183 (Kan. App. 1996);
32 *International Business Machines Corp. v. Axinn*, 676 A.2d 552 (N.J. Super. 1996). *See also* *In re*
33 *Evergreen Ventures*, 147 B.R. 751 (Bankr. D. Ariz. 1992) (distinguishing deficiency action and
34 waste action). The Act follows this approach.

35
36 Subsection (e) makes clear that an assignee may bring an action to recover damages on
37 account of the assignor’s failure to turn over rents, without first having to foreclose on the
38 underlying real property or pursue other legal remedies. Requiring the assignee to pursue
39 foreclosure first “would probably result in more foreclosures.” Restatement (Third) of Property
40 — Mortgages § 4.6 cmt. f. Moreover, as provided in Section 11 of the Act, the assignee’s action
41 under Section 14(d) would not constitute an election of remedies thereby precluding later action
42 to enforce the secured obligation, or an action to enforce the debt within the meaning of a state’s
43 one-action law.

1 3. *Commingling*. An assignor that collects rents following enforcement of an assignment
2 of rents may commingle those funds with other funds that are not rents or the proceeds of rents.
3 For example, an assignor hotel operator might receive a notification of enforcement from the
4 assignee under Section 8, and thereafter might generate a day's worth of revenues comprised in
5 part of rents (room revenues) and in part of nonrents (food and beverage revenues). Subsections
6 (b) and (c) make clear that the assignor's commingling of these funds does not automatically
7 deprive the assignee of its security interest in the rents. As long as the proceeds of the rents are
8 "identifiable," the assignee's interest remains enforceable against those proceeds. In this context,
9 "identifiable" has the same meaning as it does in U.C.C. § 9-315(a). As a result, if the assignor
10 has commingled the proceeds of collected rents with other operating funds of the assignor, those
11 proceeds will remain identifiable only if the assignee can identify them by a method of tracing
12 (such as the lowest intermediate balance rule) that is recognized by law other than this Act with
13 respect to commingled property.
14

15 4. *Collection of Rents by Subordinate Assignee*. Subsection (f) provides that a person
16 holding a subordinate assignment of rents generally may enforce that assignment, collect rents,
17 and apply any proceeds collected in good faith to its debt without having any obligation to turn
18 over those proceeds to a senior assignee. This protection is subject to two limitations, however.
19 First, once the junior assignee receives a notification from the senior assignee that the senior
20 assignee has enforced its assignment of rents, the junior assignee must turn over any proceeds
21 that it collects after receiving that notification. Second, if the junior assignee has entered into an
22 intercreditor agreement that obliges it to turn over any collected proceeds to the senior assignee,
23 the senior assignee may enforce that agreement. Furthermore, the protection extends only to
24 rents collected by the subordinate assignee in good faith. If the subordinate assignee collects
25 rents under Sections 8 or 9 of this Act without having given notification of its enforcement to the
26 senior assignee as required by the Act, the subordinate assignee would not be collecting rents in
27 good faith and would not be protected by subsection (f).
28

29 **SECTION 15. PERFECTION AND PRIORITY OF ASSIGNEE'S SECURITY**

30 **INTEREST IN PROCEEDS.**

31 (a) In this section:

32 (1) "Article 9" means Article 9 of the Uniform Commercial Code as
33 adopted in this state or, to the extent applicable to any particular issue, Article 9 as adopted by
34 the state whose laws govern that issue under the conflict of laws rules contained in Article 9 as
35 adopted by this state; and

1 (2) “Conflicting interest” means:

2 (A) a security interest in proceeds arising under Article 9, or

3 (B) the interest of any other person in proceeds if Article 9 resolves
4 the priority conflict between that person and a secured party with a conflicting security interest in
5 the proceeds.

6 (b) An assignee’s security interest in identifiable cash proceeds is perfected if its
7 security interest in rents was perfected. An assignee’s security interest in identifiable noncash
8 proceeds is perfected only if the assignee perfects that interest in accordance with Article 9.

9 (c) Except as provided in subsection (d), priority between an assignee’s security
10 interest in identifiable proceeds and a conflicting interest is governed by the priority rules
11 expressed in Article 9.

12 (d) An assignee’s perfected security interest in identifiable cash proceeds is
13 subordinate to a conflicting interest that is perfected by control under Article 9, but has priority
14 over a conflicting interest that is perfected other than by control.

15 Preliminary Comments

16 1. “*Conflicting interests.*” If two or more persons claim a conflicting security interest in
17 rents, the priority of those interests is generally resolved by Section 5(c). However, once rents
18 are actually collected and held as “proceeds” as defined in this Act, conflicts may arise between
19 an assignee of rents that holds a security interest in “proceeds” as recognized by this Act and
20 certain third parties other than rents assignees. For example, these third parties might include,
21 *inter alia*, persons who hold a security interest in the proceeds by virtue of Article 9 of the
22 Uniform Commercial Code, persons who take transfers of cash proceeds from the assignor in the
23 ordinary course, or a bank claiming a right of set-off against cash proceeds held in a deposit
24 account maintained at that bank. Section 15 provides priority rules sufficient to govern such
25 disputes. As discussed in the following comments, these rules generally incorporate the priority
26 rules already expressed in Article 9.

27
28 Section 15 applies to any priority conflict as to proceeds between an assignee of rents and

1 the holder of a “conflicting interest.” A “conflicting interest” is a security interest in the
2 proceeds that arises under Article 9, or any other interest in the proceeds if Article 9’s priority
3 rules resolve a conflict between that interest and a conflicting Article 9 security interest.
4

5 *2. Perfection and priority of assignee’s security interest in cash proceeds.* In the typical
6 case, a tenant’s payment of rent will produce cash proceeds. An assignee of rents would have a
7 security interest in cash proceeds of rents as long as the assignee could satisfy the tracing burden
8 imposed by Section 14’s “identifiability” standard. *See* Sections 14(a), (b). Further, Section
9 15(b) makes clear that the assignee’s security interest in cash proceeds is perfected so long as the
10 assignee’s security interest in rents was perfected. *Cf.* U.C.C. § 9-315(c), (d) (continuous
11 perfection of Article 9 security interest in identifiable cash proceeds where security interest in
12 original collateral was perfected).
13

14 Generally speaking, priority between an assignee’s security interest in identifiable
15 proceeds and a conflicting interest is governed by the priority rules expressed in Article 9.
16 However, an assignee’s perfected security interest in identifiable cash proceeds has priority over
17 a conflicting interest that is perfected under Article 9 by a means other than by control.
18

19 This Act only addresses the perfection and priority of a security interest that an assignee
20 claims in “proceeds” of rents under this Act. This Act does not prevent an assignee from
21 entering into a security agreement with the assignor that would create an Article 9 security
22 interest in those proceeds. For example, an assignee and assignor could enter into a security
23 agreement granting assignee an Article 9 security interest in the deposit account into which
24 assignor’s rent collections are deposited. If the assignee obtains such an Article 9 security
25 interest, the perfection and priority of that interest is governed by Article 9.
26

27 *3. Perfection and priority of assignee’s security interest in noncash proceeds.* It is
28 possible — though not common — that a tenant’s payment of rent could produce noncash
29 proceeds. For example, a tenant might make payment of its rent obligation to assignor by
30 transfer of a piece of equipment rather than a cash payment. Alternatively, a tenant might make
31 payment in the form of cash, and the assignor might take the cash and use it to purchase a piece
32 of equipment. Under Section 14, an assignee of rents would have a security interest in noncash
33 proceeds of rents as long as the assignee could satisfy the tracing burden imposed by Section 14’s
34 “identifiability” standard. However, Section 15(b) makes clear that the assignee’s security
35 interest in identifiable noncash proceeds will be perfected only if the assignee perfects that
36 interest in accordance with the requirements of Article 9. Thus, if the assignee is claiming a
37 security interest in an item of equipment that assignor received in satisfaction of a tenant’s rents
38 obligation (or that the assignor purchased using proceeds of rents), the assignee’s security interest
39 in that equipment will be unperfected unless the assignee files a financing statement covering the
40 equipment in the proper Article 9 filing office. Likewise, any conflict between an assignee
41 claiming a security interest in an item of personal property as noncash proceeds of rents and a
42 secured party claiming an Article 9 security interest in the same item will be resolved by the
43 appropriate Article 9 priority rules.

1 4. *Illustrations.* The application of the priority rules expressed in Section 15 is
2 demonstrated in the following illustrations:
3

4 *Illustration 1.* In year 1, Debtor grants to Secured Party an effective security interest in
5 all of Debtor's existing and after-acquired assets, and Secured Party perfects this security
6 interest by filing. In year 2, Debtor makes an assignment of rents to Assignee, and
7 Assignee promptly records. In year 3, Debtor receives a rent check from Tenant.
8 Assignee has a perfected security interest in the check as identifiable cash proceeds of
9 rents. Secured Party has a perfected security interest in the check, but Secured Party's
10 security interest is perfected only by filing. Thus, Assignee has priority as to the check
11 under subsection (d).
12

13 *Illustration 2.* Same as Illustration 1, except Debtor deposits the check into a deposit
14 account maintained at Bank. Secured Party has not established control over the deposit
15 account in accordance with U.C.C. § 9-104. Assignee has a perfected security interest in
16 the deposited funds as identifiable cash proceeds of rents. Secured Party also has an
17 Article 9 security interest in the deposited funds as proceeds of the check, but that
18 security interest is perfected only by virtue of Article 9's continuous perfection as to
19 identifiable cash proceeds under U.C.C. § 9-315(c), (d)(2). Thus, Assignee has priority as
20 to the deposited funds under subsection (d).
21

22 *Illustration 3.* Same as Illustration 2, except that Secured Party has established control
23 over the deposit account by virtue of a control agreement as provided in U.C.C. § 9-
24 104(a)(2). Secured Party has priority as to the deposited funds under subsection (d).
25

26 *Illustration 4.* Same as Illustration 2, except that Bank attempts to exercise a right of set-
27 off against Debtor after Debtor defaults to Bank in repayment of an unsecured line of
28 credit. Bank's right of set-off has priority over Assignee's security interest in the
29 deposited funds. *Cf.* § 9-340(a), (b) (bank's right of set-off generally not affected by
30 existence of security interest in deposited funds).
31

32 *Illustration 5.* Same as Illustration 4, but assume that Assignee has entered into a control
33 agreement with Debtor and Bank as described in U.C.C. § 9-104(a)(3). Bank's exercise
34 of its set-off right would be ineffective against Assignee. *Cf.* U.C.C. § 9-340(c) (exercise
35 of bank's set-off right ineffective against a person holding a security interest in the
36 deposit account who becomes bank's customer with respect to that account).
37

38 *Illustration 6.* Assignor makes an assignment of rents to Assignee, and Assignee
39 promptly records. The following month, Assignor receives a rent check from Tenant, and
40 deposits the check into a bank account containing only proceeds of rents. Assignor then
41 write a check drawn on that bank account to Supplier in payment of an account incurred
42 by Assignor to purchase office equipment and supplies. In good faith, Supplier accepts
43 the check and presents it for payment and the check is paid. Even though Assignee had a

1 perfected security interest in the proceeds of rents deposited into the bank account,
2 Supplier takes the funds paid from the bank account free and clear of the Assignee's
3 security interest in those funds. *Cf.* U.C.C. § 9-332(b) (transferee of funds from deposit
4 account takes them free of a security interest in the deposit account unless the transferee
5 acts in collusion with debtor in violating rights of secured party).
6

7 *Illustration 7.* Assignor makes an assignment of rents to Assignee, and Assignee
8 promptly records. The following month, Assignor receives cash from Tenant in payment
9 of Tenant's rent obligation. Assignor uses the cash to purchase cleaning equipment from
10 Supplier in an ordinary course transaction. Assignor does not file an Article 9 financing
11 statement covering the cleaning equipment. Even though Assignee had a perfected
12 security interest in the cash collected from Tenant, Supplier took the cash free and clear
13 of the Assignee's security interest. *Cf.* U.C.C. § 9-332(a) (transferee of money takes it
14 free of a security interest unless the transferee acts in collusion with debtor in violating
15 rights of secured party). Furthermore, while Assignee may have a security interest in the
16 cleaning equipment as the identifiable noncash proceeds of rents, Assignee's security
17 interest in the cleaning equipment is unperfected under subsection (b), and would be
18 subordinate to any perfected Article 9 security interest in the cleaning equipment. *Cf.*
19 U.C.C. § 9-322(a)(2) (perfected security interest has priority over conflicting unperfected
20 security interest).
21

22 *Illustration 8.* Same as Illustration 7, but assume that Assignee has filed an Article 9
23 financing statement sufficient to cover all of Assignor's assets. Assignee has a perfected
24 security interest in the cleaning equipment. The priority of that security interest versus
25 other conflicting interests will be governed by the priority rules expressed in Article 9.
26 *Cf.* U.C.C. § 9-322(a)(1) (conflicting perfected security interests); U.C.C. § 9-317(b)
27 (buyers other than in ordinary course).
28

29 **SECTION 16. PRIORITY SUBJECT TO SUBORDINATION.** This [act] does not
30 preclude subordination by agreement by a person entitled to priority as to rents or proceeds
31 therefrom.

32 **Preliminary Comments**

33 Source: U.C.C. § 9-339. Section 16 makes it clear that a person entitled to priority under
34 this Act may effectively agree to subordinate its claim. Contractual subordination of a security
35 interest in rents and/or proceeds may occur in the context of an intercreditor agreement between
36 persons holding conflicting security interests in rents.
37
38

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

4 **SECTION 18. EFFECTIVE DATE.** This [act] takes effect on _____.

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

7 **SECTION 20. APPLICATION TO EXISTING RELATIONSHIPS.**

8 (a) Except as otherwise provided in this section, this [act] governs the
9 enforcement of an assignment of rents and the perfection and priority of a security interest in
10 rents, even if the document creating the assignment was signed and delivered before this [act]
11 takes effect.

12 (b) This [act] does not affect an action or proceeding commenced before this [act]
13 takes effect.

14 (c) This [act] does not affect:

15 (1) the enforceability of an assignee's security interest in rents or proceeds
16 of rents if that security interest is enforceable immediately before this [act] takes effect;

17 (2) the perfection of an assignee's security interest in rents or proceeds of
18 rents if that security interest is perfected immediately before this [act] takes effect; or

19 (3) the priority of an assignee's security interest in rents or proceeds of
20 rents with respect to the interest of another person if the interest of the other person is
21 enforceable and perfected, and that priority is established, immediately before this [act] takes
22 effect.