UNIFORM MORTGAGEE ACCESS TO RENTS ACT

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM LAWS

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With Reporter’s Notes

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DRAFTING COMMITTEE ON UNIFORM MORTGAGEE ACCESS TO RENTS ACT

MICHAEL B. GETTY, Chair, 1560 Sandburg Terr., Suite 1104, Chicago, IL 60610
TERRY J. CARE, 333 South Sixth St., Las Vegas, NV 89101
BRYAN T. FREDRICKSON, 831 Royal Gorge Blvd., Suite 329, Canon City, CO 81202
THOMAS T. GRIMSHAW, 1700 Lincoln St., Suite 3800, Denver, CO 80203
THEODORE C. KRAMER, 45 Walnut St., Brattleboro, VT 05301
ROGER P. MORGAN, 82 Kenmore Rd., Bloomfield, CT 06002-2111
ELWAINE F. POMEROY, 1415 SW Topeka Blvd., Topeka, KS 66612-1818
ANNE BOWEN POULIN, Villanova University School of Law, 299 N. Spring Mill Rd., Garey Hall, Villanova, PA 19085
PATRICK A. RANDOLPH, JR., University of Missouri - Kansas City, School of Law, 5100 Rockhill Rd., Kansas City, MO 64110
JACKSON W. WILLOUGHBY, 309 Roundhill Ct., Roseville, CA 95747
BARRY C. HAWKINS, 300 Atlantic St., Stamford, CT 06901, Enactment Plan Coordinator
R. WILSON FREYERMUTH, University of Missouri-Columbia School of Law, 215 Hulston Hall, Columbia, MO 65211, Reporter

EX OFFICIO

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

AMERICAN BAR ASSOCIATION ADVISOR

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

EXECUTIVE DIRECTOR

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

Copies of this Act may be obtained from:
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS
211 E. Ontario Street, Suite 1300
Chicago, Illinois 60611
312/915-0195
www.nccusl.org
## UNIFORM MORTGAGEE ACCESS TO RENTS ACT

### TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>SHORT TITLE</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>DEFINITIONS</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>ASSIGNMENT OF RENTS CREATES SECURITY INTEREST</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>RECORDATION OF ASSIGNMENT OF RENTS; EFFECT OF RECORDATION</td>
<td>12</td>
</tr>
<tr>
<td>5</td>
<td>ENFORCEMENT OF SECURITY INTEREST IN RENTS</td>
<td>16</td>
</tr>
<tr>
<td>6</td>
<td>ENFORCEMENT BY APPOINTMENT OF RECEIVER</td>
<td>18</td>
</tr>
<tr>
<td>7</td>
<td>ENFORCEMENT BY NOTIFICATION TO TENANTS</td>
<td>22</td>
</tr>
<tr>
<td>8</td>
<td>ENFORCEMENT BY NOTIFICATION TO ASSIGNOR</td>
<td>26</td>
</tr>
<tr>
<td>9</td>
<td>MORTGAGEE IN POSSESSION</td>
<td>27</td>
</tr>
<tr>
<td>10</td>
<td>EFFECT OF ENFORCEMENT; NO AGENCY OR “MORTGAGEE IN POSSESSION” STATUS; ENFORCEABILITY OF SECURED OBLIGATIONS</td>
<td>28</td>
</tr>
<tr>
<td>11</td>
<td>APPLICATION OF RENTS COLLECTED</td>
<td>30</td>
</tr>
<tr>
<td>12</td>
<td>PAYMENT OF COSTS OF PROTECTING REAL PROPERTY</td>
<td>31</td>
</tr>
<tr>
<td>13</td>
<td>TURNOVER OF RENTS; COMMINGLING AND IDENTIFIABILITY OF RENTS; TRANSFER OF RENTS BY ASSIGNOR</td>
<td>32</td>
</tr>
<tr>
<td>14</td>
<td>PRIORITY AMONG COMPETING CLAIMS TO RENTS</td>
<td>35</td>
</tr>
<tr>
<td>15</td>
<td>UNIFORMITY OF APPLICATION AND CONSTRUCTION</td>
<td>37</td>
</tr>
<tr>
<td>16</td>
<td>EFFECTIVE DATE</td>
<td>37</td>
</tr>
<tr>
<td>17</td>
<td>REPEALS</td>
<td>37</td>
</tr>
</tbody>
</table>
UNIFORM MORTGAGEE ACCESS TO RENTS ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Mortgagee Access to Rents Act.

SECTION 2. DEFINITIONS. In this [act]:

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

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

(3) “Assignor” means the person who makes an assignment of rents or, if such person no longer owns an interest in the real property covered by the assignment, the current owner of the real property covered by the assignment.

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

(5) “Notification” means a document containing required information and signed by the person required to provide the information.

(6) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, or government, governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

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

**ALTERNATIVE A**

(8) “Rents” means sums payable by a lessee, licensee, or other person for the right to possess, use, or occupy the real property of another person.

**ALTERNATIVE B**

(8) “Rents” means sums payable by a lessee for the right to possess the real property of another person.

(9) “Security instrument” means an agreement that creates or provides for a security interest in real property, whether denominated a mortgage, deed of trust, trust deed, security deed, or otherwise. Such an agreement is a security instrument even if it also creates or provides for a lien upon personal property.

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

(11) “Secured obligations” means all obligations the performance of which are secured by a security interest.

(12) “Sign” means to execute or adopt any symbol with the present intent to adopt or accept a document.

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

**Reporter’s Notes**
1. “Assignee.” The term “assignee” means the party entitled to enforce an assignment of rents in the manner specified by this Act.

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

3. “Assignor.” The Act defines an “assignor” as the person who makes an assignment of rents. If the original assignor no longer owns an interest in the real property covered by the assignment of rents, then the term “assignor” means the current owner of the real property covered by the assignment.

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

5. “Notification.” The Act permits an assignee to enforce an assignment of rents by delivering a notification to the assignor (Section 8) or by delivering a notification to tenants of the assignor (Section 7). Any such notification shall be in the form of a document, as defined in Section 2(4), and contain the information required by the specific section authorizing that notification.

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

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


In the typical commercial real estate mortgage loan transaction, the lender also secures the borrower’s obligation by requiring the borrower to grant a security interest in the revenue stream.
produced by the development. In many commercial real estate developments (e.g., office buildings, industrial parks, retail shopping centers, and apartment complexes), the owner and occupiers of the development stand in a landlord-tenant relationship, based upon the execution of leases covering portions of the development. Because the common law has treated unaccrued rents as an interest in land (an incorporeal hereditament), 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 the county where the land is situated.

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

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

The protection accorded to secured creditors by section 552(b) makes the resolution of this classification question critical for the commercial real estate mortgage lender. If postpetition project revenues are “rents,” “profits,” or “proceeds” of the land, the lender’s security interest attaches to those revenues. If not, then section 552(a) extinguishes the lender’s interest in postpetition project revenues.
Most of the bankruptcy cases addressing this characterization question involved hotels and security interests in hotel room revenues. Prior to 1994, a few decisions sensibly treated hotel room revenues as the functional equivalent of tenant rents and concluded that § 552(b)’s protection for “rents” preserved a lender’s properly perfected interest in postpetition hotel room revenues. See, e.g., In re S.F. Drake Hotel Assocs., 131 B.R. 156, 158-61 (Bankr. N.D. Cal. 1991), aff’d, 147 B.R. 538 (N.D. Cal. 1992); In re Mid-City Hotel Assocs., 114 B.R. 634, 638-642 (Bankr. D. Minn. 1990); Travelers Ins. Co. v. First Nat’l Bank, 621 N.E.2d 209 (Ill. App. 1993); Great-West Life Assur. Co. v. Raintree Inn, 837 P.2d 267 (Colo. App. 1992); Financial Security Assur., Inc. v. Tollman-Hundley Dalton, L.P., 74 F.3d 1120 (11th Cir. 1996); In re Days California Riverside Ltd. Partnership, 27 F.3d 374 (9th Cir. 1994); Matter of T-H New Orleans Ltd. Partnership, 10 F.3d 1099 (5th Cir. 1993); Great-West Life & Annuity Assur. Co. v. Parke Imperial Canton, Ltd., 177 B.R. 843 (N.D. Ohio 1994); In re Bellevue Place Assocs., 173 B.R. 1009 (Bankr. N.D. Ill. 1994). Most courts, however, concluded that postpetition hotel room revenues were accounts (personal property) and were neither “rents,” “profits,” or “proceeds” of the land. See, e.g., In re Northview Corp., 130 Bankr. 543, 548 (9th Cir. BAP 1991); In re Green Corp., 154 B.R. 819 (Bankr. D. Me. 1993); In re Shore Haven Motor Inn, Inc., 124 B.R. 617 (Bankr. S.D. Fla. 1991); In re Majestic Motel Assocs., 131 B.R. 523 (Bankr. D. Me. 1991); In re Corpus Christi Hotel Partners, Ltd., 133 Bankr. 850, 854-55 (Bankr. S.D. Tex. 1991); In re Airport Inn Associates, Ltd., 132 Bankr. 951, 960 (Bankr. D. Colo. 1991); In re Sacramento Mansion, Ltd., 117 Bankr. 592, 602-07 (Bankr. D. Colo. 1990); In re Investment Hotel Properties, Ltd., 109 Bankr. 990, 994-97 (Bankr. D. Colo. 1990). These courts typically applied the formalistic reasoning that room revenues could not be “rent” because hotel guests were not “tenants.” As a result, many bankruptcy courts routinely invalidated lenders’ claimed interests in postpetition hotel revenues.

The formalistic invalidation of a hotel lender’s interest in postpetition room revenues was particularly inappropriate, as hotel room revenues are economically identical to the “rents” paid by tenants under apartment, office, or industrial leases. See, e.g., R. Wilson Freyermuth, Of Hotel Revenues, Rents, and Formalism in the Bankruptcy Courts: Implications for Reforming Commercial Real Estate Finance, 40 UCLA L. Rev. 1461 (1993); R. Wilson Freyermuth, The Circus Continues — Security Interests in Rents, Congress, the Bankruptcy Courts, and the “Rents Are Subsumed in the Land” Hypothesis, 6 J. Bankr. L. & Prac. 115 (1997). Recognizing this unfairness, Congress amended section 552(b) in 1994 to preserve the lender’s interest in postpetition “fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties.”

This amendment provided a practical solution to the classification problem with respect to hotels and other “lodging properties.” Unfortunately, it did not address a wide variety of other income-generating projects. Courts have generally concluded that golf course green fees do not constitute “rents,” “profits,” or “proceeds” of the land. See, e.g., In re McKim, 217 B.R. 97 (Bankr. D.R.I. 1998); In re Everett Home Town Ltd. Partnership, 146 B.R. 453 (Bankr. D. Ariz. 1992); In re McCann, 140 B.R. 926 (Bankr. D. Mass. 1992); In re GGVXX, Ltd., 130 B.R. 322 (Bankr. D. Colo. 1991). Likewise, courts have refused to characterize stadium/arena revenue as

The Restatement (Third) of Property — Mortgages attempted to provide some useful guidance by defining “rents” functionally as “the proceeds payable by a lessee, licensee, or other person for the right to possess, use, or occupy the real property of another.” Restatement (Third) of Property — Mortgages § 4.2(a) (1996). This definition leaves some residual uncertainty, as it implicitly bases the proper characterization of project revenues upon the characteristics of the project itself. For example, the comments to the Restatement suggest that revenues from parking garage would constitute “rents,” see Restatement (Third) of Property — Mortgages § 4.2 comment f, illustration 10 (“Because receipts from parking patrons primarily represent fees paid for the right to park motor vehicles on Mortgagor’s real estate, they constitute rents and Mortgagee has the right to collect them until the mortgage obligation is satisfied.”), but that gate receipts from a racetrack would not constitute “rents.” See id. illustration 9 (“Because the gate receipts are derived primarily from the entertainment provided to race track customers, they do not constitute rents and Mortgagee has no right to collect them.”). The Restatement thus places the burden on courts to make case-by-case judgments about the extent to which project revenues are traceable to the “land” as opposed to “services” provided by the operator.

Courts would face significant practical obstacles in making such allocations. First, one might argue that requiring a land/services allocation would require parties to compile and analyze historical information concerning the developer’s capital and operational costs in order to allocate revenue into its rent/nonrent components. R. Wilson Freyermuth, Of Hotel Revenues, Rents, and Formalism in the Bankruptcy Courts: Implications for Reforming Commercial Real Estate Finance, 40 UCLA L. Rev. 1461, 1520 (1993). Second, the extent to which different occupiers are concerned about occupying space as opposed to services is a function of each occupier’s respective preferences, which may differ from user to user. Id. Third, requiring an allocation would be artificial given the contractual behavior of owners and occupiers of commercial real estate … [who] typically do not separate the occupier’s payment obligation into a “use” component and a “services” component. Id. at 1521.

Furthermore, these judgments have significant implications for the scope of U.C.C. Article 9.
Several commentators have proposed that bringing rents within the scope of Article 9 would provide greater coherence in the law of security in rents by effectively unifying the treatment of an assignment of rents with the current treatment of security in accounts receivable. See, e.g., R. Wilson Freyermuth, Of Hotel Revenues, Rents, and Formalism in the Bankruptcy Courts: Implications for Reforming Commercial Real Estate Finance, 40 UCLA L. Rev. 1461, 1520 (1993); Julia Patterson Forrester, A Uniform and More Rational Approach to Rents as Security for the Mortgage Loan, 46 Rutgers L. Rev. 349 (1993). Indeed, under revised Article 9, “rents” would constitute “accounts” under U.C.C. § 9-102(a)(2) (“a right to payment of a monetary obligation ... for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of”), but for the exclusion of an assignment of rents from Article 9’s scope. See U.C.C. § 9-109(c)(11) (“[Article 9] does not apply to ... the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder ...”).

[Note to Drafting Committee: Issues to be resolved include (1) Should “rents” be limited solely to sums generated by leases? Should rents be defined more broadly (as in the Restatement of Mortgages) to include projects where users/occupiers are licensees (e.g., hotels, garages, etc.)? (2) If “rents” is to be limited solely to sums generated by leases, should later Sections be changed to reflect ability of assignee/receiver to collect sums generated other than “rents”? (3) Others?]

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

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

11. “Secured obligations.” The term “secured obligations” covers all obligations the performance of which is secured by a security interest.

12. “Sign.” This definition is media-neutral and comparable to that contained in Uniform Commercial Code § 1-201(b)(37).

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

SECTION 3. ASSIGNMENT OF RENTS CREATES SECURITY INTEREST. Upon execution and delivery, an assignment of rents creates a presently effective security interest in all
accrued and unaccrued rents arising from the real property described in the assignment, whether
the assignment is denominated as an absolute assignment, an absolute assignment conditioned
upon default, an assignment as additional security, or otherwise. The security interest created by
an assignment of rents is separate and distinct from any security interest held by the assignee on
the real property described in the assignment.

Reporter’s Note

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

1. Rents as Distinct Collateral. A mortgage historically operated as an outright conveyance
of title to the mortgagee, typically on a condition subsequent. By virtue of this conveyance, the
mortgagee received all incidents of legal title — including the right to possession of the land and
the right to collect rents from the land — and could exercise these incidents even prior to the
mortgagor’s default. Initially, American states adopted this “title” theory of the mortgage,
although mortgagees commonly permitted mortgagors to remain in occupation of mortgaged land
prior to default — a practice consistent with the notion that the mortgage was in reality a security
device.

Under a pure “title” theory, there would be no specific need for a mortgagee to take a separate
assignment of rents and leases as security for the mortgage debt, because the right to collect rents
would be an inherent incident of the mortgagee’s legal estate. Over time, however, the majority
of American states adopted the “lien” theory of mortgages, under which the mortgage grants the
mortgagee only a right of security, capable of being enforced via foreclosure in the event of the
mortgagor’s default. Under this “lien” theory, until such enforcement occurs, a mortgage itself
does not inherently convey to the mortgagee the right to collect rents accruing from the land.

As the lien theory of mortgages developed into the dominant theory of mortgage law, it
became customary that when a mortgage lender made a mortgage loan on an income-producing
real estate project, the lender would require the borrower not only to execute a mortgage on the
project but also an assignment of leases and rents from the project. An assignment of leases and
rents can serve a number of practical purposes, but perhaps its most significant purpose is to
provide the mortgagee with a security interest in rents that accrue between the date of the
mortgagor’s default and the date that the mortgagee can complete a foreclosure proceeding. In
many states, the foreclosure process can be quite lengthy. In these states, a mortgage lender faces
a heightened risk that while a foreclosure proceeding is pending, the borrower may continue to
collect project revenues and expend them other than in reduction of the mortgage debt (a process
often referred to as “milking” the rents). By taking an assignment of leases and rents, the
mortgage lender ostensibly makes clear its intention to have a lien upon all future rents produced
by the project, including those that accrue during the period between the mortgagor’s default and
the mortgagee’s completion of a foreclosure proceeding.

As a starting point, state law generally governs the creation and enforcement of security
interests in rents. Most frequently, however, disagreements regarding security interests in rents
tend to be resolved in the federal bankruptcy courts. Often, the mortgagor/owner of a distressed
real estate project will resort to bankruptcy in order to take advantage of the automatic stay
afforded to bankrupt debtors. The mortgagor/owner can thus avoid an imminent foreclosure
proceeding and can seek to retain ownership of the mortgaged property by using the provisions of
the Bankruptcy Code to restructure the mortgage obligation.

The Bankruptcy Code seems, on its face, to recognize that state law has traditionally treated
“rents” that accrue between default and foreclosure as a separate form of collateral. The
Bankruptcy Code characterizes rents from mortgaged property as “cash collateral,” 11 U.S.C. §
363(a), and preserves a secured creditor’s pre-bankruptcy lien on rents that are received by the
debtor after the bankruptcy petition, id. § 552(b). These provisions appear to recognize that a
pre-bankruptcy assignment of leases and rents creates a separate security interest in the rents (i.e.,
separate from the underlying mortgage lien against the land itself).

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

The Act rejects the “rents are subsumed within the land” hypothesis advanced by these cases,
and instead confirms that under state law, rents that accrue prior to a completed foreclosure sale
constitute a source of collateral that is separate and distinct from the land from which those rents
accrued.

2. *The “Absolute Assignment of Rents.”* As American states gradually abandoned the title
theory of mortgages in favor of lien theory, some mortgage lenders began using mortgage
documentation by which the mortgagor made an “absolute” assignment of rents. By virtue of an
“absolute” assignment of rents, the mortgagor purported to transfer “title” to unaccrued rents to
the mortgagee/assignee, as of the execution and delivery of the assignment — thereby ostensibly
placing the mortgagee in the same legal position as it would have occupied under the title theory
of mortgages. Frequently, such an “absolute” assignment will specify that it is “not merely for purposes of security” and that the borrower has no interest in unaccrued rents other than a revocable license (i.e., not a “property” right) to collect such rents prior to default. By obtaining an “absolute” assignment of rents, the mortgagee could argue that its assignment of rents was already “activated” upon execution and delivery — as opposed to an assignment of rents for security purposes, which many states treated as an ineffective until enforced post-default.

The characterization of such assignments as “absolute” is pure form over substance. The typical “absolute” assignment of leases and rents is nothing more than a security device, as evidenced by the fact that such assignments typically permit mortgagors to collect and dispose of rents prior to default (and, correspondingly, do not permit the mortgagee to collect rents prior to default). Nevertheless, some state courts in lien theory jurisdictions have recognized a distinction between “absolute” and “collateral” assignments. See, e.g., Taylor v. Brennan, 621 S.W.2d 592 (Tex. 1981); HomeCorp. v. Secor Bank, 659 So.2d 15 (Ala. 1994).

This distinction, though tenuous, has been critical in the context of bankruptcy. When a debtor files for bankruptcy, all of the property in which the debtor holds an interest becomes property of the bankruptcy estate under Bankruptcy Code § 541(a). The debtor generally may use property of the estate in the course of its bankruptcy proceeding, subject to the obligation to provide adequate protection to a secured creditor holding a lien upon that property (assuming that secured creditor requests adequate protection of its lien). 11 U.S.C. § 363(b). Moreover, a secured party holding a security interest in property of the estate is subject to the automatic stay and cannot seek to enforce its lien or otherwise collect the debt outside the context of the bankruptcy proceeding. Id. § 362(a). Thus, a debtor that owns an income-producing real estate project has a significant incentive to argue that the project’s postpetition rents constitute property of the estate. By contrast, the mortgagee/assignee would prefer that the law characterize the rents as property that is not part of the bankruptcy estate. If the project’s postpetition rents are not property of the estate, the automatic stay would place no limitation upon the mortgagee’s ability to collect those rents and apply them to the debt. Such a characterization would be particularly important in a case where a mortgage loan is undersecured (i.e., where the unpaid balance of the mortgage debt exceeds the value of the land), because of the Timbers case, in which the Supreme Court held that an undersecured creditor is not entitled to collect interest upon the debt during the pendency of the bankruptcy case. United Sav. Ass’n of Texas v. Timbers of Inwood Forest, 484 U.S. 365 (1988). If postpetition rents do not constitute property of the estate, then the undersecured lender could collect net postpetition rentals and apply them to reduce the unsecured portion of its claim on a dollar-for-dollar basis, thereby improving its total recovery vis-a-vis the debtor’s other unsecured creditors.

Obviously, if a mortgagee had already completed a foreclosure sale prior to the debtor’s bankruptcy filing, then the land and unaccrued rents would belong to the foreclosure purchaser and would no longer constitute property of the bankruptcy estate. But if no foreclosure has yet occurred — and thus equitable ownership of the land remains in the debtor — unaccrued postpetition rents would seem to fit squarely within the broad concept “property of the estate” as
articulated in § 541(a). Nevertheless, in an attempt to boost their leverage in context of
bankruptcy, mortgage lenders have often argued that where a borrower executed an “absolute”
assignment of rents, unaccrued postpetition rents belong to the lender and therefore do not
constitute property of the bankruptcy estate.

The Restatement (Third) of Property — Mortgages and most commentators have rejected this
view — and properly so, given the context of the typical commercial mortgage loan transaction.
In the typical transaction, the mortgagor executes an assignment of rents and leases
contemporaneously with its execution of the mortgage. The mortgagee does not immediately
begin collecting rents from tenants as soon as it takes the mortgage, and further has no intention
to do so at any time prior to the mortgagor’s default. These circumstances demonstrate clearly
that the parties intend for the assignment of rents to secure the mortgagor’s obligation to repay
the mortgage debt. In other words, the “absolute” assignment is merely a security device,
regardless of its “absolute” characterization.

Mortgage law has long established that instruments purporting absolutely to convey an
interest in land nevertheless constitute equitable mortgages when the circumstances demonstrate
that the parties are using an interest in land to secure payment of a debt. See, e.g., Restatement of
Property (Third) — Mortgages § 3.2 (absolute deed intended to secure an obligation constitutes a
mortgage); Smith v. Player, 601 So.2d 946 (Ala. 1992) (same); Steckelberg v. Randolph, 404
N.W.2d 144 (Iowa 1987) (same). Under this same principle, a court should recharacterize a
typical “absolute” assignment of rents as an assignment for security purposes, and the weight of
modern judicial authority so provides. See, e.g., In re Cavros, 262 B.R. 206 (Bankr. D. Conn.
2001); In re 5877 Poplar, L.P., 268 B.R. 140 (Bankr. W.D. Tenn. 2001); National Operating, L.P.
v. Mutual Life Ins. Co. of New York, 630 N.W.2d 116 (Wis. 2001); In re Guardian Realty
Group, L.L.C., 205 B.R. 1 (Bankr. D.D.C. 1997); In re RV Centennial Partnership, 202 B.R. 774
view, where the mortgagee has not taken sufficient steps to enforce its security interest prior to
bankruptcy, postpetition rents would constitute property of the bankruptcy estate.

Nevertheless, a significant number of court decisions have elevated form over substance and
have given literal effect to an “absolute” assignment of rents. These courts have held that where
the bankrupt borrower has executed an absolute assignment of rents prior to bankruptcy,
postpetition rents do not constitute property of the estate. See, e.g., First Fidelity Bank v. Jason
Realty, L.P. (In re Jason Realty, L.P.), 59 F.3d 423 (3d Cir. 1995); In re Kingsport Ventures, L.P.,
2001); In re Carreta, 220 B.R. 203 (D.N.J. 1998); In re Turtle Creek, 194 B.R. 267 (Bankr. N.D.
Ala. 1996); First Fidelity Bank v. Eleven Hundred Metroplex Assocs., 190 B.R. 510 (S.D.N.Y.
1995); MacArthur Executive Assocs. v. State Farm Ins. Co., 190 B.R. 189 (D.N.J. 1995); In re
Carter, 126 B.R. 811 (Bankr. M.D. Fla. 1991); In re Galvin, 120 B.R. 767 (Bankr. D. Vt. 1990);
In re Gould, 78 B.R. 590 (D. Idaho 1987); In re Fry Road Assocs., 64 B.R. 808 (Bankr. W.D.
Tex. 1986); In re P.M.G. Properties, 55 B.R. 864 (E.D. Mich. 1985). See also NCNB Texas
assignment does not create a security interest but instead passes title to the rents. An absolute
assignment of rents is not security but is a pro tanto payment of the obligation.”); 801 Nolana,
Inc. v. RTC Mortgage Trust 1994-S6, 944 S.W.2d 751 (Tex. App. 1997) (same). These
decisions exalt form over substance and encourage lenders to draft rent assignments using
language that misrepresents those assignments as something other than security devices, in order
to obtain preferred treatment in bankruptcy.

The Act rejects the view of state law expressed in these cases, and limits the concept of an
“absolute” assignment of rents to the extremely limited situations in which security is not the
purpose of the transaction (i.e., where the parties actually intend to transfer full ownership and
control of unaccrued rents immediately upon execution of the assignment).

SECTION 4. RECORDATION OF ASSIGNMENT OF RENTS; EFFECT OF
RECORDATION. An assignment of rents may be recorded in the [appropriate governmental
office under the recording act of this State] in the same manner as any other conveyance of an
interest in real property. Upon recording:

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

(2) the security interest granted by the assignment shall be deemed fully perfected and
enforceable against third parties as of the time of recording, notwithstanding any provision of the
assignment or other law of this State that would preclude or defer enforcement of the security
interest until the occurrence of a subsequent event, including, but not limited to, a subsequent
default of the assignor, the assignee’s obtaining possession of the real property, or the
appointment of a receiver.

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

Under Bankruptcy Code § 544(a) and its “strong-arm” clause, a debtor-in-possession can
invalidate (or, in bankruptcy parlance, “avoid”) any security interest that a judgment lien creditor or bona fide purchaser could have avoided under state law as of the petition date. This provision effectively permits a debtor-in-possession to invalidate a security interest in the debtor’s property if that security interest is unperfected as of the petition date. For example, if a creditor had taken a security interest in the debtor’s inventory but had failed to file an Article 9 financing statement sufficient to perfect that interest, the creditor’s unperfected security interest in inventory would be subordinate (under UCC Article 9) to the lien of a creditor who had obtained a judgment lien against that inventory. U.C.C. § 9-317(a)(2). Upon the debtor’s bankruptcy filing, § 544(a) would thus permit the bankrupt debtor-in-possession to exercise the rights of a lien creditor — enabling the debtor to invalidate the creditor’s unperfected security interest in the inventory and use the proceeds of that inventory to fund its reorganization effort.

In the 1980s and early 1990s, bankruptcy courts struggled significantly over the impact of § 544(a) upon a mortgagee’s right to postpetition rents under an assignment of leases and rents. This struggle derives in part from the confusion generated by the differing terminologies of mortgage law and U.C.C. Article 9. Under Article 9, a secured party obtains a security interest in collateral by having the debtor execute a security agreement describing that collateral, and “perfection” that security interest by filing an Article 9 financing statement describing the collateral. By “perfecting” its security interest, the Article 9 secured party makes that interest enforceable against subsequent creditors — such as lien creditors (and thus the trustee in bankruptcy). If the secured party has a properly perfected security interest prior to the petition date, it is irrelevant whether the secured party had taken any steps to enforce that security interest prior to bankruptcy. The perfected security interest continues to remain effective against the collateral and the debtor cannot avoid that security interest using its § 544(a) avoidance power.

By contrast, mortgage law did not customarily use the term “perfection.” Mortgage law instead advanced the notion that recording of an interest in land served to make that interest valid as against subsequent creditors and bona fide purchasers. Analytically, “recording” in this sense is similar to the Article 9 concept of perfection. By analogy, one could argue that if a mortgage lender had taken and properly recorded an assignment of leases and rents prior to bankruptcy, that mortgage lender should have a security interest in rents that was “perfected” and thus enforceable against third parties. Under this analysis, the debtor could not avoid the mortgage lender’s security interest in rents under § 544(a), and thus the mortgage lender would retain its security interest in postpetition rents under § 552(b). A number of courts in fact adopted this analytical approach, treating postpetition rents as the lender’s cash collateral so long as the mortgagee had properly recorded its assignment of rents prior to bankruptcy. See, e.g., In re Millette, 186 F.3d 638 (5th Cir. 1999); Steinberg v. CrossLand Mortgage Corp. (In re Park at Dash Point L.P.), 985 F.2d 1008, 1011 (9th Cir. 1993); Vienna Park Properties v. United Postal Sav. Ass’n (In re Vienna Park Properties), 976 F.2d 106, 112-15 (2d Cir 1992); J.H. Streiker & Co. v. SeSide Co. (In re SeSide Co.), 152 B.R. 878, 884-85 (E.D. Pa. 1993); In re Northport Marina Assocs., 136 B.R. 911, 917-18 (Bankr. E.D.N.Y. 1992); In re White Plains Dev. Corp., 136 B.R. 93, 95 (Bankr. S.D.N.Y. 1992); In re Rancourt, 123 B.R. 143, 147 (Bankr. D.N.H. 1991); In re Somero, 122 B.R. 634, 638-39 (Bankr. D. Me. 1991); In re Raleigh/Spring Forest
By contrast, however, numerous bankruptcy courts invalidated security interests in postpetition rents where lenders had taken no “affirmative steps” to enforce those interests prior to a bankruptcy petition. To understand these decisions and how they confused “perfection” or “enforceability” with “enforcement,” it is necessary to revisit the distinction between the lien and title theory of mortgages. Under the title theory, the mortgagee held “title” to the land (and unaccrued rents) by virtue of the mortgage, even prior to default. By contrast, under the lien theory, a mortgage by itself gave the mortgagee only a security interest in the land rather than “title” — and thus gave the mortgagee no interest in unaccrued rents until such time as the mortgagee completed a foreclosure, became a mortgagee in possession, or obtained the appointment of a receiver for the land.

Of course, if the mortgage is claiming a security interest in rents by virtue of a separate assignment of leases and rents, then the legal constraints on the mortgagee’s right to rents by virtue of the mortgage itself should be irrelevant. Nevertheless, a number of older state court decisions conflated these two situations, holding that even a separate assignment of rents was not effective until the mortgagee took affirmative steps after default to enforce that assignment. The language of the Texas Supreme Court in *Taylor v. Brennan* is perhaps the best demonstration of this analysis:

Texas follows the lien theory of mortgages. Under this theory the mortgagee is not the owner of the property and is not entitled to its possession, rentals or profits. Thus, it has become a common practice to include in the deed of trust, or in a separate instrument, terms assigning to the mortgagee the mortgagor’s interest in all rents falling due after the date of the mortgage as additional security for payment of the mortgage debt.

The Texas cases addressing rentals assigned as security have followed the common law rule that an assignment of rentals does not become operative until the mortgagee obtains possession of the property, or impounds the rents, or secures the appointment of a receiver, or takes some other similar action. [*Taylor v. Brennan, 621 S.W.2d 592, 593-94 (Tex. 1981)*]

Based upon reasoning such as that reflected in *Taylor* and other state court decisions, see, e.g., Bevins v. Peoples Bank & Trust Co., 671 P.2d 875, 879 (Alaska 1983), Martinez v. Continental Enters., 730 P.2d 308, 316 (Colo. 1986); and Sullivan v. Rosson, 119 N.E. 405 (N.Y. 1918), numerous bankruptcy courts concluded that an assignment of leases and rents created only an “inchoate” lien upon rents that was ineffective against third parties if the mortgagee had not taken affirmative steps prior to bankruptcy to activate that lien. As a result, these bankruptcy courts concluded that where a mortgagee had not taken action sufficient to divest the mortgagor of control over the property and its rents prior to bankruptcy — such as by obtaining the appointment of a receiver, taking possession of the land, or notifying tenants to begin paying


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

Except as provided in sections 363, 506(c), 522, 544, 547, and 548 of this title, an 
notwithstanding section 546(b) of this title, if the debtor and [the secured party] entered 
to a security agreement before the commencement of the case and if the security 
agreement extends to property of the debtor acquired before the commencement of the 
and to amounts paid as rents of such property . . . , then such security interest extends 
to such rents . . . acquired by the estate after the commencement of the case to the extent 
provided in such security agreement, except to any extent that the court, after notice and a 
hearing and based upon the equities of the case, orders otherwise.

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

Roughly one-third of the states have enacted statutes making clear that an assignment of rents 
is perfected and effective against third persons upon its recordation, without regard to whether 
the mortgagee has taken any steps to “activate” or “enforce” that assignment. Cal. Civ. Code §§ 

SECTION 5. ENFORCEMENT OF SECURITY INTEREST IN RENTS. Upon default 
in performance of an obligation secured by an assignment of rents, the assignee may enforce the
assignment in accordance with its terms, using one or more of the methods specified in Sections 6, 7, 8, or 9, or any other method sufficient to enforce an assignment of rents under other law of this state. From the date of enforcement, the assignee shall be entitled to collect and receive:

(1) all rents that have accrued but remain unpaid and uncollected by the assignor on that date;

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

(3) the proceeds of all rents that have been collected by the assignor, to the extent that such proceeds are identifiable.

**Reporter’s Note**

Source: Cal. Civ. Code § 2938(c); Restatement (Third) of Property — Mortgages § 4.2(c); U.C.C. § 9-315.

Section 5 provides that upon default by the assignor, the assignee may enforce the assignment according to its terms in order to collect rents and apply them to the obligation secured by the assignment. The Act specifies several methods of enforcement of an assignment of rents in Sections 6 (appointment of a receiver), 7 (notification to tenants), 8 (notification to the assignor), and 9 (taking possession of the land described in the assignment of rents and thus becoming a “mortgagee in possession”). The Act, however, would permit enforcement of an assignment of rents by any other method recognized under the law of the state other than this Act.

The Act provides that upon default and enforcement, an assignee may collect (1) accrued but unpaid rents, (2) unaccrued rents as they accrue in the future, and (3) the proceeds of all rents that have been collected by the assignor, to the extent that such proceeds are identifiable. In this regard, the Act goes beyond the provisions of Cal. Civ. Code § 2938(c), which by its terms does not purport to cover proceeds of rents already collected by the assignor as of the date of enforcement. While the Act recognizes the assignee’s right to the proceeds of rents previously collected by the assignor, the Act also recognizes two significant limitations upon this right. First, any such proceeds must be “identifiable.” In this context, “identifiable” has the same meaning as it does in U.C.C. § 9-315(a), under which a secured party has a security interest in the identifiable proceeds of its original collateral. As a result, if the assignor has commingled the proceeds of collected rents with other operating funds of the assignor, those proceeds will remain identifiable only if the assignee can identify them by a method of tracing (such as the lowest intermediate balance rule) that is recognized by law other than this Act with respect to commingled property. Second, any third parties who receive payments of the proceeds of
collected rents from the assignor will be protected by Section 13(c) — which recognizes the negotiability of cash — so long as the third party receiving such funds has not acted in collusion with the assignor to deprive the assignee of its interest in the funds. See, e.g., U.C.C. § 9-332.

SECTION 6. ENFORCEMENT BY APPOINTMENT OF RECEIVER.

(a) Upon default in performance of an obligation secured by an assignment of rents, the assignee may petition [the appropriate court] for the appointment of a receiver for the real property described in the assignment.

(b) Upon the filing of a petition under subsection (a), the court shall appoint a receiver if the real property described in the assignment of rents is not occupied by the assignor as the assignor’s principal residence, and:

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

(2) the assignor is not personally liable for the secured obligations.

(3) it appears that the assignor is committing waste or that the real property or its rents are in danger of being lost, removed, or materially injured; or

(4) it appears that the real property or its rents may not be sufficient to satisfy the secured obligations.

(c) For purposes of subsections (b)(1) and (b)(2), it is irrelevant whether the real property or its rents are in danger of being lost, removed, or materially injured, or whether the real property or its rents are sufficient to satisfy the secured obligations.

(d) From the date of its appointment, a receiver appointed under this Section has the authority to:
(1) preserve the real property described in the assignment of rents;

(2) to collect rents accruing after its appointment and any rents accrued but unpaid as of the date of its appointment;

(3) to pay real estate taxes and senior liens;

(4) to enter into, enforce, and terminate leases for the purpose of generating rental income;

(5) to pay to the assignee, for credit to the secured obligations, all rents collected from the real property, less amounts paid for real estate taxes, senior liens, and other reasonable expenses incurred by the receiver in the management, maintenance, and repair of the real property; and

(6) to carry out such other functions as may be authorized by the court to enforce the receivership.

[(e) The appointment of a receiver creates no inherent authority in the receiver to disaffirm a lease in existence at the time of the appointment. However,

(1) a receiver may disaffirm any lease or related agreement between the assignor and a tenant that contravenes a provision of a prior recorded security instrument covering the real property that includes the premises covered by that lease or related agreement, and

(2) a receiver may disaffirm any lease or related agreement between the assignor and a tenant that was made while the assignor was in default to the assignee and that was not commercially reasonable when it was consummated.]

**Reporter’s Note**

Source: Ind. Code § 32-30-5-1(4); Restatement (Third) of Property — Mortgages §§ 4.3, 4.4
1. *Traditional Standards for Appointment of a Receiver.* Traditionally, courts have appointed a receiver for mortgaged land where the value of the land was insufficient to satisfy the mortgage debt (i.e., where the mortgagee’s security was inadequate) or whether the owner of the mortgaged land was committing waste (thereby threatening the value of the mortgagee’s security). *See, e.g.,* Restatement (Third) of Property — Mortgages §§ 4.3(a)(2), 4.3(a)(3); 1 G. Nelson & D. Whitman, Real Estate Finance Law § 4.34 (3d ed. 1993). Consistent with this traditional approach, Section 6(b) authorizes the appointment of a receiver in these situations.

Courts in some states traditionally required a mortgagee seeking appointment of a receiver to show that the mortgagor was insolvent. *See, e.g.,* Mutual Benefit Life Ins. Co. v. Frantz Klodt & Son, Inc., 237 N.W.2d 350 (Minn. 1975); Chase Manhattan Bank v. Turabo Shopping Center, Inc., 683 F.2d 25 (1st Cir. 1982). The Restatement (Third) of Property — Mortgages and most commentators have rejected this view:

Such a requirement is clearly unjustifiable where, as is common in contemporary commercial financing transactions, the mortgage obligation is “non-recourse.” In such a setting the mortgagee has no right to look to the personal solvency of the mortgagor to collect the obligation and thus mortgagor’s financial status should be irrelevant for receivership purposes. Neither ... should insolvency be required where mortgagor is personally liable on the debt. Proving mortgagor insolvency is often a difficult and complex process, and would impose an unfair burden on the mortgagee in situations where the timely appointment of a receiver is crucial. [Restatement (Third) of Property — Mortgages § 4.3, Reporters’ Note]

Consistent with this view, the Act does not require the assignee to demonstrate the assignor’s insolvency as a predicate to obtaining the appointment of a receiver.

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

Because the appointment of a receiver has traditionally originated from within the court’s equitable discretion, some courts have refused to appoint a receiver — despite the presence of a receivership clause — in cases where they would have denied appointment of a receiver otherwise. *See, e.g.,* Dart v. Western Sav. & Loan Ass’n, 438 P.2d 407 (Ariz. 1968); Chromy v. Midwest Fed. Sav. & Loan Ass’n, 546 So.2d 1172 (Fla. App. 1989); Sazant v. Foremost Investments, N.V., 507 So.2d 653 (Fla. App. 1987) (receivership clause not binding on court where mortgagor had not committed waste and default did not place mortgagee at serious risk of noncollection); Gage v. First Federal Sav. & Loan Ass’n, 717 F. Supp. 745 (D. Kan. 1989); Barclays Bank, P.L.C. v. Davidson Ave. Assocs., Ltd., 644 A.2d 685 (N.J. Super. 1994)
1 (receivership clause “usurps the judicial function” and thus violates public policy).

2 In other states, courts have treated receivership clauses as presumptively but not conclusively
3 enforceable. For example, in Barclays Bank v. Superior Court, 137 Cal. Rptr. 743 (Cal. App.
4 1977), the court held that a receivership clause presented a prima facie (but rebuttable)
5 evidentiary showing of the mortgagee’s entitlement to the appointment of a receiver. See also,
6 e.g., Riverside Properties v. Teachers Ins. & Annuity Ass’n, 590 S.W.2d 736 (Tex. App. 1979);
7 Okura & Co. v. Careau Group, 783 F. Supp. 482 (C.D. Cal. 1991); Wellman Sav. Bank v. Roth,
8 432 N.W.2d 697 (Iowa App. 1988).

9 The Restatement (Third) of Property — Mortgages § 4.3(b) rejected these approaches, and
10 instead adopted the position that a receivership clause provides a sufficient basis for the
11 appointment of a receiver following mortgagor default. There is significant recent judicial
12 authority for the Restatement’s position. See, e.g., Bank of America Nat’l Trust & Sav. Ass’n v.
14 of receiver under receivership clause, without regard to adequacy of security or solvency of
15 mortgagor, under abuse of discretion standard); Fleet Bank v. Zimelman, 575 A.2d 731 (Me.
16 1990) (freely bargained-for receivership clause should be enforced); Metropolitan Life Ins. Co. v.
17 Liberty Center Venture, 650 A.2d 887 (Pa. Super. 1994); Federal Home Loan Mortgage Corp. v.
18 Nazar, 100 B.R. 555 (D. Kan. 1989). Statutes in several states provide that a receivership clause
19 is enforceable as a matter of right. See, e.g., Ind. Code § 32-30-5-1; Minn. Stat. Ann. §
20 559.17(2) (mortgages of $100,000 or more); N.Y. Real Prop. Law § 254(10) (receivership clause
21 enforceable “without notice and without regard to adequacy of any security of the debt”); Okla.
22 Stat. Ann. tit. 12, § 1551(2)(c) (court shall appoint receiver when “a condition of the mortgage
23 has not been performed and the mortgage instrument provides for the appointment of a
24 receiver”). Finally, federal courts have routinely held receivership clauses in federally insured
25 mortgages sufficient to justify the appointment of a receiver. See, e.g., United States v. Berk &
27 (N.D. Ill. 1987); United States v. Baptist Towers II, Ltd., 661 F. Supp. 1124 (N.D. Ill. 1987);
30 position that a receivership clause is enforceable without regard to the condition of the real
31 property, the solvency of the assignor, or the adequacy of the security for the obligation secured
32 by the assignment. This position is implicit in subsection (b); to make the point unmistakably
33 clear, subsection (c) makes the position explicit.

34 3. Nonrecourse Mortgages. Ind. Code § 32-30-5-1(4) provides that the court must appoint a
35 receiver upon default where the mortgagor has no personal obligation on the mortgage debt. In
36 this situation, of course, the land and its rents provides the only meaningful recourse for the
37 mortgagee in recovering the mortgage debt, and thus the mortgagee should have the ability to
38 enforce an assignment of rents by obtaining a receiver immediately upon default. The Act
39 adopts this approach.

40
Notes to Drafting Committee: Other potential issues to discuss/explore include:

1. Should Act address the basis for appointment of a receiver in power of sale foreclosure states, where no civil action is pending to which the receivership would be ancillary?

2. Should Act address the question of whether receivership is available on an *ex parte* basis, or should this be left to other state law?

3. Should Act address the impact of the appointment of a receiver on existing leases, or should this be left to other state law? Existing paragraph (e), which I have bracketed for now, addresses this issue using language based upon the Restatement (Third) of Property — Mortgages § 4.4.

4. Should the Act attempt to specify the extent of bonding required incident to the appointment of a receiver?

5. Other issues?

SECTION 7. ENFORCEMENT BY NOTIFICATION TO TENANTS

(a) Upon default in performance of an obligation secured by an assignment of rents, the assignee may deliver to any tenant of the real property a notification demanding that the tenant pay to the assignee all accrued but unpaid rents as well as all unaccrued rents as they become due, provided that the assignor shall also deliver a copy of the notification to the assignor [and to any other assignee of record of the leases and rents of the real property].

(b) A notification under subsection (a) shall be effective against a tenant when received by the tenant at the address for notices provided under the lease or other contractual agreement under which the tenant occupies the premises, or if no address for notices is so provided, at the premises. Upon receipt of the notification, the tenant shall be obligated to pay to the assignee all accrued but unpaid rents and all unaccrued rents as they come due, unless the tenant has previously received a notification from another assignee of the leases and rents sent by the other
assignee in accordance with this section.

(c) Payment of the amount then due under the lease to an assignee following receipt of a notification under subsection (a) shall satisfy the tenant’s obligation to pay the amount then due under the lease. If a tenant pays rent to the assignor after receipt of a notification, the tenant shall not be discharged of the obligation to pay rent to the assignee[, unless the tenant occupies the property for residential purposes.]

(d) The obligation of a tenant to pay rent to the assignee after notification from the assignee shall continue until the tenant receives a court order directing the tenant to pay the rent in a different manner or written instructions from the assignee canceling its notification, whichever occurs first. Upon receiving notice that another creditor entitled to priority under Section 4 has enforced its interest in rents, the assignee shall immediately send a notice to any tenant to whom it has given notification under subsection (a), informing the tenant that the assignee cancels its earlier notification to pay rent to the assignee.

(e) If requested by a tenant, an assignee shall furnish reasonable proof that the assignee is entitled to demand payment of rents. Unless the assignee complies, the tenant may discharge its obligation by paying the assignor, even if the tenant has received a notification under subsection (a).

(f) No particular form is required for the notification specified in subsection (a); however, the notification shall be sufficient if it is delivered in the following form:

DEMAND TO PAY RENT TO PARTY OTHER THAN LANDLORD

Tenant: [Name of Tenant]

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

Assignee: [Name of Assignee]

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

   The Assignee named above is the assignee of leases, rents, issues, and profits under [name of document] dated __________, and recorded at [recording information] in the [appropriate governmental office under the recording act of this State]. You may request a copy of such assignment from the Assignee at the address listed above.

   THIS NOTICE AFFECTS YOUR LEASE OR RENTAL AGREEMENT RIGHTS AND OBLIGATIONS. YOU ARE THEREFORE ADVISED TO CONSULT AN ATTORNEY CONCERNING THOSE RIGHTS AND OBLIGATIONS IF YOU HAVE ANY QUESTIONS REGARDING YOUR RIGHTS AND OBLIGATIONS UNDER THIS NOTICE.

   You are hereby directed to pay to the Assignee at the address listed above all rents under your lease or other rental agreement for the occupancy of the Premises which are due and payable on the date you receive this demand, and all rents accruing under the lease or other rental agreement following the date you receive this demand. If you pay the rent to the Assignee in accordance with this demand, you do not have to pay the rent to the Landlord. If you pay any rent to the Landlord that by the terms of this demand you are required to pay to the Assignee, you may be subject to damages incurred by the Assignee by reason of your failure to comply with this demand, and you may not be discharged from your obligation to pay such rent to the Assignee.

   Your obligation to pay rent under this demand shall continue until you receive either (1) a written notice from a court directing you to pay the rent in a manner provided therein, or (2) a written notice from the Assignee canceling this demand.
Assignee: [Name of Assignee]

By: [Officer/Authorized Agent of Assignee]]

**Reporter’s Note**

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

1. An assignment of rents typically authorizes a lender to enforce its interest in rents following default by giving notification to tenants to direct rent payments to the lender. Generally speaking, courts have treated such notification as a sufficient affirmative action to enforce or activate an assignment of rents. As discussed in the Reporter’s Note following Section 4, many bankruptcy courts required such an affirmative action prior to bankruptcy and concluded that if no such affirmative action had occurred prior to a bankruptcy petition, the lender’s interest in rents was unperfected under state law and thus did not attach to postpetition rents. Section 4 makes clear that a security interest in rents is perfected under state law, and generally enforceable against other creditors, if the assignment of rents is properly recorded — actual enforcement is not necessary in order for the lender to have a perfected security interest in rents.

2. Once the tenant receives notification from the assignee demanding payment of rents pursuant to the assignment, the tenant must pay accrued but unpaid rents and rents accruing in the future to the assignee in order to satisfy its rental obligation. In this respect, the Act’s provisions operate comparably to the provisions of U.C.C. § 9-406(a), which govern the circumstances under which an account debtor can discharge its obligation following notification and demand by an assignee of that account.

3. Subsection (e), which is modeled upon U.C.C. § 9-406(c), provides that a tenant may request reasonable proof that the assignee is entitled to demand payment of rents, and that the tenant may continue to discharge its obligation by payment to the assignor until the assignee provides reasonable proof. Comment 4 to U.C.C. § 9-406 addresses the situation further:

An account debtor may face another problem if its obligation becomes due while the account debtor is awaiting reasonable proof of the assignment that it has requested from the assignee. This section does not excuse the account debtor from timely compliance with its obligations. Consequently, an account debtor that has received a notification of assignment and who has requested reasonable proof of the assignment may discharge its obligation by paying the assignor at the time (or even earlier if reasonably necessary to avoid risk of default) when a payment is due, even if the account debtor has not yet received a response to its request for proof. On the other hand, after requesting reasonable proof of the assignment, an account debtor may not discharge its obligation by paying the assignor substantially in advance of the time that the payment is due unless the assignee has failed to provide the proof seasonably.
[Notes to Drafting Committee: Issues to explore include

(1) Should enforcing assignee be obliged to send copy of notification to all other recorded assignees, or only senior assignees?

(2) Should the Act establish a particular form notification, as does the California statute? The bracketed form in subsection (f) is based roughly on the California form, but is not as extensive.

(3) Should the Act include, in subsection (c) — as per the bracketed language — the California statute’s blanket protection of residential tenants from the risk of double liability for paying the assignor following receipt of notice? Or should the Act instead track the approach of U.C.C. § 9-406, which provides that its provisions subjecting an account debtor to the risk of double payment are “subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes”?

(4) The provisions of subsection (b), which are based on the California statute, deal with the problem of demands by multiple assignees by relieving the tenant of the burden of paying the later-enforcing assignee until the earlier-enforcing assignee gives notice terminating the effectiveness of its earlier notification. Is this sensible, or should the Act take another approach?

(5) Other issues?]

SECTION 8. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR. Upon default in performance of an obligation secured by an assignment of rents, the assignee may deliver to the assignor a notification demanding that the assignor pay over all amounts that the assignee is entitled to collect under Section 5. The assignee shall deliver this notification at the address for notices provided in the assignment or, if the assignee has reason to know of a more accurate address, at that address. The assignee shall mail a copy of this notification to any other person holding an recorded assignment of rents on the real property at the address for notices provided in that assignment or, if none, to the address to which that assignment was to be mailed after recording.
Reporter’s Note

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

1. An assignment of rents typically requires the assignor to pay rents to the assignee following default, either immediately or upon demand by the assignee. As discussed in the Reporter’s Note following Section 4, however, many bankruptcy courts concluded that applicable state law required certain affirmative conduct by the lender, post-default, in order to render an assignment of rents enforceable. Many of these courts required conduct of greater intensity than merely making a formal demand to the assignor for payment of the rents, instead requiring such steps as the appointment of a receiver, judicial sequestration of rents, acquiring possession of the land, or providing notification to tenants to pay rent to the assignee. Section 4 of the Act rejects this approach, and makes clear that a security interest in rents is perfected under state law, and generally enforceable against other creditors, if the assignment of rents is properly recorded — actual enforcement is not necessary in order for the lender to have a perfected security interest in rents.

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

The Act takes this approach, authorizing the assignee to enforce an assignment of rents by means of a notification to the assignor following default under the assignment. As discussed in Section 13(b), the assignor’s failure to pay any rents it collects following receipt of such notification would subject the assignor to liability for conversion.

SECTION 9. MORTGAGEE IN POSSESSION. Upon default in performance of an obligation secured by an assignment of rents, the assignee may enforce the assignment by taking possession of the real property described in the assignment, to the extent permitted by applicable law other than this act and the terms of the assignment or any security instrument that secures the secured obligations.
At common law, a mortgagee holding an assignment of rents could enforce that assignment by means of taking steps sufficient to constitute the mortgagee as a “mortgagee in possession” pending completion of a foreclosure or redemption by the mortgagor. Generally speaking, mortgage lenders are loath to assume the status of a mortgagee in possession for a variety of reasons, including potential tort liability to third parties, the obligation to account for rentals collected, and the assumption of a duty to maintain the physical condition of the premises. See, e.g., 1 Grant S. Nelson & Dale A. Whitman, Real Estate Finance Law §§ 4.24 - 4.29, at 213-230 (3d ed. 1993).

While few mortgagees may choose to enforce an assignment of rents by becoming a mortgagee in possession, the Act is not intended (either explicitly or implicitly) to eliminate or overrule the mortgagee-in-possession doctrine. Thus, the Act provides that an assignee can choose to enforce an assignment of rents by becoming a mortgagee in possession, to the extent such an act is permitted by applicable law other than this Act and by the terms of the parties’ loan documents.

SECTION 10. EFFECT OF ENFORCEMENT; NO AGENCY OR “MORTGAGEE IN POSSESSION” STATUS; ENFORCEABILITY OF SECURED OBLIGATIONS. The enforcement of an assignment of rents under Sections 6, 7, or 8, the application of rents by the assignee under Section 11 following enforcement, the payment of expenses under Section 12, or a civil action under Section 13(d) shall not:

1. render the assignee as a mortgagee in possession of the real property, unless the assignee shall obtain actual possession of the real property;
2. render the assignee as an agent of the assignor;
3. constitute a civil action to enforce the secured obligations;
4. render the secured obligations unenforceable;
5. violate any “one form of action” provision existing under the laws of this state,
6. limit any rights available to the assignee with respect to the secured obligations, other
than with respect to marshaling requirements; or

(7) be deemed to create any bar to a deficiency judgment pursuant to any provision of the
case governing or relating to deficiency judgments following the enforcement of any

encumbrance, lien, or security interest.

**Reporter’s Note**

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

1. **Mortgagee in possession status.** A number of common law decisions suggest that a
mortgagee can become a “mortgagee in possession” — with the legal responsibilities attendant to
that status — without physical occupation of the mortgaged premises. See, e.g., 1 GRANT S.
1993) (collecting cases). This result is not surprising, given the factual and legal uncertainty
attendant to the term “possession.”

This ambiguity can produce concern for the assignee that wishes to protect its security
interest in rents without assuming the duties and liabilities attendant to mortgagee-in-possession
status. The commentary to the Restatement (Third) of Property — Mortgages took the view that
mere collection of rents “does not constitute the mortgagee a ‘mortgagee in possession,’ with the
duties and liabilities attendant to that status.” Restatement (Third) of Property — Mortgages §
4.2 cmt. c. The California statute is more explicit, making clear that no enforcement action
authorized by the statute will constitute the assignee as a mortgagee in possession short of the
assignee taking actual possession of the premises. In an effort to provide clarity, the Act takes
this position.

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

In some state, “one action” rules provide that there can be only one form of action for the
recovery of any debt secured by real property. See, e.g., Cal. Code Civ. Pro. § 726(a); Idaho
Code § 6-101(1); Mont. Code Ann. § 71-1-222(1); Nev. Rev. Stat. § 40.430(1); Utah Code § 78-
37-1; see also First State Bank of Cooperstown v. Ihringer, 217 N.W.2d 857 (N.D. 1974). Under
this approach, for example, a mortgagee’s decision to sue on the mortgage note would constitute
an “action” that subsequently barred the mortgagee from foreclosing the mortgage.
Ambiguity over the scope of a “one action” rule — and whether it would treat an attempt to enforce an assignment of rents as an “action” that would prevent other collection efforts — could create significant confusion with respect to the enforcement of an assignment of rents. For this reason, the Restatement (Third) of Property — Mortgages, while generally rejecting the one-action approach, further argued that any limitation on the mortgagee’s remedies with respect to foreclosure of the mortgage should not limit the mortgagee’s enforcement of its security in rents:

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

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

SECTION 11. APPLICATION OF RENTS COLLECTED. An assignee that collects rents under this act, or recovers a judgment in a civil action under Section 13(d), shall apply such sums in the following order to:

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

(2) payment of costs in accordance with Section 12 of this act;

(3) satisfaction of the secured obligations in accordance with the terms of the documents evidencing the obligations;

(4) satisfaction of the obligations secured by any subordinate security interest or other lien on the rents, if the assignee receives a notification demanding payment of the rents before
distribution of the rents is completed; and

(5) to the assignor, to the extent of any remaining sums.

**Reporter’s Note**

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

1. **Attorney’s fees and costs of enforcement.** The term “reasonable attorney’s fees and costs” in subsection (1) includes those fees and costs incurred by the assignee in enforcing its assignment of rents. This would include, inter alia, the fees and costs incurred in obtaining the appointment of a receiver, providing a notification under Section 8, or collecting rents from tenants following notification to tenants under Section 7. Consistent with U.C.C. § 9-607(d), the assignee’s right to recover these expenses from collected rents arises automatically under Section 11 of the Act.

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

**SECTION 12. PAYMENT OF COSTS OF PROTECTING REAL PROPERTY.**

(a) If the assignee collects any rents following enforcement of an assignment of rents under Section 7 or Section 8, the assignor or any other person holding a recorded assignment of rents on the real property may deliver to the assignee a notification demanding that the assignee pay the reasonable costs of protecting and preserving the real property, including payment of taxes and insurance.

(b) Following receipt of a notification under subsection (a), the assignee shall pay for the reasonable costs of protecting and preserving the real property to the extent of any rents actually received by the assignee. This obligation shall continue until the date on which the assignee obtains the appointment of a receiver under Section 6 or the date on which the assignee ceases to enforce the assignment, whichever occurs first.
Section 13. Turnover of Rents; Commingling and Identifiability of Rents; Transfer of Rents by Assignor.

(a) If the assignor or its agent collects rents that the assignee is entitled to collect or receive under Section 5, the assignor or its agent shall turn over the rents to the assignee, less any amount representing payment of expenses authorized by the assignee.

(b) The assignee shall continue to have a security interest in all rents that the assignee is entitled to collect under Section 5, despite their collection by the assignor or its agent, so long as
the rents are identifiable. For purposes of this section, the rents are identifiable if they are
maintained in a segregated account or, if commingled with other funds, to the extent that the
assignee can identify them by a method of tracing, including application of equitable principles,
that is permitted under law other than this act with respect to commingled funds. The assignee’s
security interest in identifiable rents shall be continuously perfected and enforceable against the
assignor and, subject to subsection (c), any other person in possession of such rents.

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

(d) If the assignor fails to turn over rents to the assignee in violation of subsection (a), the
assignee can bring an action and recover damages from the assignor in the amount equal to the
rents that the assignor is obligated to turn over under subsection (a). The assignee may bring
such an action without the necessity of bringing an action to foreclose any security interest which
it may have in the real property. Any sums recovered in such an action shall be applied in the
manner specified in Section 11.

**Reporter’s Note**

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

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

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

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

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

2. **Rents already collected by the assignor.** The Act provides that upon default and
enforcement, an assignee may collect (1) accrued but unpaid rents, (2) unaccrued rents as they
accrue in the future, and (3) the proceeds of all rents that have been collected by the assignor, to
the extent that such proceeds are identifiable. In this regard, the Act goes beyond the provisions
of Cal. Civ. Code § 2938(c), which does not purport to cover the proceeds of rents already
collected by the assignor as of the date of enforcement.

While the Act recognizes the assignee's right to the proceeds of rents previously collected by
the assignor, the Act also recognizes two significant limitations upon this right. First, any such
proceeds must be "identifiable." In this context, "identifiable" has the same meaning as it does
in U.C.C. § 9-315(a), under which a secured party has a security interest in the identifiable
proceeds of its original collateral. As a result, if the assignor has commingled the proceeds of
collected rents with other operating funds of the assignor, those proceeds will remain identifiable
only if the assignee can identify them by a method of tracing (such as the lowest intermediate
balance rule) that is recognized by law other than this Act with respect to commingled property.
Second, subsection (c) of the Act recognizes the negotiability of money and provides that any
third parties who receive payments of the proceeds of collected rents from the assignor will be
protected so long as the recipient of the funds has not acted in collusion with the assignor to
deprive the assignee of its interest in the funds. See, e.g., U.C.C. § 9-332.

3. Action to recover rents is not a deficiency action or an action for personal liability on
mortgage debt. In cases involving nonrecourse obligations (either by virtue of specific
contractual nonrecourse provisions or the intervention of antideficiency legislation), mortgagors
who have milked rents often argue that the mortgagee's action is in the nature of a deficiency
judgment and should therefore be dismissed. The weight of authority rejects this view and
concludes that an action for damages for waste of rents or conversion of the proceeds of rents is
See also In re Evergreen Ventures, 147 B.R. 751 (Bankr. D. Ariz. 1992) (distinguishing
deficiency action and waste action). The Act follows this approach.

4. Action to recover damages can precede foreclosure. Subsection (d) makes clear that an
assignee may bring an action to recover damages on account of the assignor's failure to turn over
rents, without first having to foreclose on the underlying real property or pursue other legal
remedies. Requiring the assignee to pursue foreclosure first "would probably result in more
foreclosures." Restatement (Third) of Property — Mortgages § 4.6 cmt. f. Moreover, as
provided in Section 10 of the Act, the assignee's action under Section 13(d) would not constitute
an "action" within the meaning of any state's one-action law.

SECTION 14. PRIORITY AMONG COMPETING CLAIMS TO RENTS.

(a) Except as otherwise provided by this act, the lien priorities among creditors
concerning rents shall be governed by Section 4.

(b) If an assignee entitled to priority under Section 14(a) seeks to enforce its interest in rents after another creditor holding a subordinate security interest in rents has taken enforcement action under Section 7, 8, or 9, the assignee may collect rents that are accrued but unpaid as of the date of its enforcement action and rents that accrue thereafter, but may not collect any rents previously collected by the creditor holding the subordinate security interest in rents.

(c) Priority among competing receivers shall be governed as follows:

(1) Where more than one assignee qualifies for the appointment of a receiver under Section 6, a receivership request by an assignee entitled to priority under Section 4 has priority over a receivership request by a subordinate assignee, even if a court has previously appointed a receiver for the subordinate assignee.

(2) When a subordinate assignee obtains the appointment of a receiver, that receiver has the right, until a receiver is appointed under a senior assignment of rents, to collect rents from the real property and, after first using them to pay real property taxes and other reasonable expenses associated with the maintenance and repair of the real property, to apply the balance to the obligations secured by the subordinate assignment of rents. The receiver for the subordinate assignee shall not be obligated to turn over collected rents to the receiver for the senior assignee, even if those rents are otherwise identifiable as provided in Section 13(b).

**Reporter’s Note**

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

1. *Priority between competing assignees.* Generally speaking, priority between conflicting rent assignments is resolved by reference to the state’s recording act. See Section 4.
2. **Priority as to rents collected by a subordinate assignee.** The Act provides that if a senior assignee enforces its right to rents after a subordinate assignee has already enforced its rights, then the senior assignee will have priority as to unaccrued rents and accrued but unpaid rents. However, subsection (b) provides that this priority will not extend to rents already collected by the subordinate assignee. The subordinate assignee may retain already collected rents and apply them in accordance with Section 11, without regard to any turnover demand by the senior assignee. This provision places the subordinate assignee in the same position, vis-a-vis the senior assignee, as any other third party creditor that received payment of rents from the assignor — such third party creditors would take the proceeds of those rents free of the senior assignee’s security interest so long as they were not acting in collusion with the assignor to defeat the senior assignee’s rights.

3. **Priority between conflicting receivers.** Subsection (c), which is modeled upon § 4.5 of the Restatement (Third) of Property — Mortgages, provides the same basic priority rule with respect to conflicting receivers. If the senior assignee is entitled to the appointment of a receiver under Section 6, the court’s appointment of that receiver will take priority over and displace a prior receivership obtained by a subordinate assignee. Any rents actually collected by the receiver for the subordinate assignee, however, need not be turned over to the receiver for the senior assignee; instead, the receiver for the subordinate assignee shall apply those sums in the manner specified in Section 6.

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

SECTION 16. **EFFECTIVE DATE.** This [act] takes effect on _________________, and shall apply thereafter to the enforcement of an assignment of rents, even if that assignment was executed and delivered prior to the effective date of this act.

SECTION 17. **REPEALS.** The following acts are repealed: [List statutes to be specifically repealed.]