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UNIFORM ASSIGNMENT OF RENTS ACT

Prefatory Note

Traditionally, under the title theory of mortgages, a mortgage effected a transfer of legal title to real property as security for the mortgage debt. As an incident of this legal title, the mortgagee obtained the right to collect rents arising from the real property and apply them to the mortgage debt unless the mortgage stated otherwise. By contrast, in the majority of American states that follow the lien theory of mortgages, a mortgage grants the mortgagee only a right of security, capable of being enforced via foreclosure in the event of the mortgagor’s default. Under the lien theory, until such enforcement occurs, a mortgage does not by itself convey to the mortgagee the right to collect rents accruing from the mortgaged real property.

As a result, it has become customary that when a lender makes a mortgage loan on income-producing real property, the lender requires the borrower to execute a document typically entitled an “Assignment of Leases and Rents.” This assignment can serve a number of practical purposes, but its most significant purpose is to provide the mortgagee with a security interest in rents that accrue before the mortgagee can complete a foreclosure proceeding. In many states, the foreclosure process can be quite lengthy, and the mortgage lender faces a heightened risk that while a foreclosure proceeding is pending, the borrower may continue to collect project revenues and spend them other than to reduce the mortgage debt or paying operating expenses of the real property (a process often referred to as “milking” the rents). By taking the assignment, the lender makes clear its intent to hold a lien upon all future rents produced by the real property, including those that accrue during the period between the mortgagor’s default and the mortgagee’s completion of a foreclosure proceeding. The assignment typically permits the lender to take steps following the borrower’s default to collect rents and apply them to reduce the mortgage debt. These steps may include, among others, the lender’s taking physical possession of the project (becoming a “mortgagee in possession”), obtaining the appointment of a receiver for the project, or notifying tenants to direct all future rent payments to the lender.

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

**Security Interest in Rents is Distinct Form of Collateral.** As stated above, the most significant purpose of an assignment of leases and rents is to provide the mortgagee with a security interest in rents that accrue before the mortgagee can complete a foreclosure proceeding. Most courts have held that this security interest in rents constitutes a separate form of collateral, distinct from the mortgagee’s lien on the real property itself. Unfortunately, some court decisions have wrongly concluded that rents do not constitute separate collateral, but are “subsumed within the land.” In reaching this conclusion, these courts have held that a bankrupt mortgagor/owner may use rents during the pendency of its bankruptcy, without regard to the lender’s security interest in rents, so long as the mortgaged real property itself is not decreasing in value. The Act rejects these decisions and confirms the prevailing view that a security interest in rents is a form of collateral that is separate and distinct from the lien on the real property that generates those rents. For further background, see Act § 4(b), Preliminary Comment 2.

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

**“Absolute” Assignments of Rents.** Often, an assignment of leases and rents will state that the assignor is making an “absolute” transfer of rents, even though the context of the transaction (and often the terms of the assignment itself) indicate that the assignor is making the assignment only as security for repayment of the mortgage obligation. Mortgage law has long established that instruments purporting to make an absolute conveyance of title nevertheless constitute equitable mortgages if the surrounding circumstances demonstrate that the parties are using title to secure payment of a debt. Consistent with this long-established principle, the Act establishes that an assignment of rents executed in conjunction with and as security for an obligation creates only a security interest in rents, even if the assignment purports to constitute an absolute transfer of the rents. For further background, see Act § 4(b), Preliminary Comment 3.
Appointment of a Receiver. In some states, comprehensive statutory provisions address the circumstances in which a court should appoint a receiver for mortgaged real property. In many states, however, there is little statutory guidance. As a result, standards governing the appointment of receivers in most states are defined judicially, and tend to vary somewhat from jurisdiction to jurisdiction — and, within many jurisdictions, from judge to judge. Some decisions require that the mortgagee’s security be inadequate or that the real property be subject to existing or threatened waste; others require a showing of mortgagor insolvency. By contrast, many courts will appoint a receiver in any circumstance in which the mortgage contains a receivership clause authorizing such an appointment after default. The Act establishes consistent standards to govern the appointment of a receiver for mortgaged real property, including the effectiveness of a receivership clause. For further background, see Act § 7, Preliminary Comments 1-5.

Characterization of Real Property Revenues. In many commercial real property developments (e.g., office buildings, retail shopping centers, apartment complexes), the owner and occupiers of the development stand in a landlord-tenant relationship, based upon the execution of leases covering portions of the development. Because the common law has treated unaccrued rents as an interest in real property (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 property 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 in the public real property records. In many other developments, however, the occupiers are not “tenants,” but merely licensees (e.g., nursing home residents, persons occupying garage spaces or marina slips, hotel guests, and the like). Court decisions involving security interests in the revenues paid by such occupiers have disagreed over the proper characterization of these revenues — with some treating them as “rents” in the nature of real property, and others treating them as “accounts” subject to the provisions of Uniform Commercial Code Article 9. These decisions have created uncertainty regarding both the proper way to create and perfect a security interest in these occupancy revenues, as well as the appropriate treatment of a security interest in those revenues generated during the pendency of a bankruptcy case. The Act establishes that rents include any sum paid by a tenant, licensee, or other person for the right to possess or occupy the real property of another. For further background, see Act § 2, Preliminary Comment 12.

Enforcement by Demand to Assignor/Owner. The traditional weight of case authority required that an assignee of rents could enforce its security interest in rents only by taking steps sufficient to divest the assignor of control over those rents. Under this approach, it did not suffice for the assignee to make a demand upon the mortgagor/assignor to turn over rentals as they were collected. These decisions reflected a concern that as long as the mortgagor was collecting and retaining net rentals, third party claimants (such as trade creditors to whom the mortgagor might make payments) could be easily misled by the mortgagor’s control over those cash proceeds. The Act rejects this approach and permits an assignee to enforce its security
interest in rents by giving a notification demanding that the assignor turn over any rents that it
may collect following the notification — and thus an assignor who fails to turn over any such
rents to the assignee is liable for conversion of those rents. For further background, see Act § 8,
Preliminary Comment 1.

   Enforcement by Demand to Tenants. The Act seeks to facilitate the enforcement of a
security interest in rents by allowing the assignee to give a notification to tenants demanding that
the tenants make future rent payments directly to the assignee. The Act addresses the liability of
the tenant for making payments to the assignor following receipt of such a notification, the need
for a tenant to have adequate opportunity to seek counsel regarding the legal effect of the
notification, and the possibility of a tenant receiving a notification from multiple rents assignees.
The Act also provides a standard form notification suitable for use by assignees. For further
background, see Act § 9, Comments 1 through 6.

   Mortgage Creates a Security Interest in Rents by Default. Under Uniform Commercial
Code Article 9, a security interest in personal property automatically extends to proceeds of that
property unless the security agreement provides otherwise. Because Article 9 defines “proceeds”
to include whatever is received upon disposition (including a lease) of the collateral, a security
interest in personal property collateral automatically extends to rentals arising from that
collateral. Article 9’s treatment of personal property rents as “proceeds” reflects the presumed
intention of lender and borrower that the lender’s security interest should extend to sums (e.g.,
rents) that reflect a return upon the economic value of the collateral.

   By contrast, real property law has been less clear regarding the mortgagee’s interest in
rents. Under the title theory of mortgages, the mortgagee’s title to the real property automatically
included the right to collect and apply rents arising from the real property to the mortgage debt
(unless the mortgage itself provided otherwise). By contrast, under the lien theory of mortgages,
the mortgagee did not automatically acquire the right to collect and apply rents as an incident of
the mortgage. For this reason, most commercial real property mortgage lenders require the
mortgagor to make an assignment of rents in order to give the mortgagee an unquestioned
interest in rents that accrue prior to the completion of a foreclosure.

   Particularly with respect to commercial real property, rents reflect the economic return
received by the owner in exchange for a temporal disposition of the right to possess and occupy
the real property. In this regard, rents from real property should be viewed as proceeds of the
property — and should receive treatment comparable to the treatment Article 9 accords to
proceeds of personal property collateral. In order to promote desirable consistency between
Article 9 and real property law, the Act establishes that a mortgage creates a security interest in
rents by default (e.g., unless the mortgage provides otherwise), even if the mortgage does not by
its express terms create an assignment of rents. For further background, see Act § 4(a),
Preliminary Comment 1.
**Expenses of Operating and Preserving the Real Property.** Often, commercial leases obligate the tenant to pay a sum characterized as “additional rent.” This sum is typically based upon the tenant’s pro rata share of the cost of real property taxes, insurance, and maintenance expenses (or the increase in such costs or expenses beyond an established baseline amount), and serves to reimburse the landlord for the payment of these expenses. Leases customarily characterize the tenant’s obligation to pay these sums as “rent,” and assignments of leases and rents typically require the landlord/assignor to grant a security interest in these sums. Based upon these customary practices, the Act treats such sums as “rents.”

California’s comprehensive assignment of rents statute places an affirmative obligation on the assignee to use whatever rents it collects to pay the reasonable expenses of operating and maintaining the real property. By contrast, under the traditional rule prevailing in most states, the landlord’s obligation to pay these expenses — even if the obligation is expressed or implied into its tenant leases — does not bind the lender as a successor until the lender acquires possession or ownership of the real property (by becoming a mortgagee in possession or purchasing the premises at foreclosure). A prudent lender may choose to apply collected rents to the payment of real property taxes, insurance, and project maintenance in order to protect its own security. Nevertheless, under the traditional view, a lender that collect rents without taking actual or constructive possession of the real property may apply those rents to the mortgage debt without any obligation to apply such sums to the payment of taxes, insurance, or property maintenance.

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

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

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

SECTION 2. DEFINITIONS. In this [act]:

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

(2) “Assignment of rents” means a transfer of an interest in rents made in connection with an obligation secured by real property located in this state and from which the rents arise.

(3) “Assignor” means a person that makes an assignment of rents or the successor owner of the real property from which the rents arise.

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

(5) “Day” means calendar day.

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

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

(8) “Notification” means a document containing information that this [act] requires a person to provide to another and signed by the person required to provide the information.
(9) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government, or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(10) “Proceeds” means personal property that is received or collected on account of a tenant’s obligation to pay rents.

(11) “Purchase” means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(12) “Rents” means:

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

(B) sums payable to an assignor under a policy of rental interruption insurance covering real property;

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

(D) sums payable to terminate an agreement to possess or occupy real property;

(E) sums payable to an assignor for payment or reimbursement of expenses incurred in owning, operating and maintaining, or in constructing or installing improvements on, real property; or

(F) any other sums payable under an agreement relating to the real property of another person that constitute rents under the law of this state other than this [act].
(13) “Secured obligation” means an obligation the performance of which is
secured by an assignment of rents.

(14) “Security instrument” means a document, however denominated, that creates
or provides for a security interest in real property, whether or not it also creates or provides for a
lien on personal property.

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

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

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

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

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

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

(19) “Tenant” means a person that holds a right to possess or occupy, or who
actually possesses or occupies, the real property of another person and has a corresponding
obligation to pay rents.

Preliminary Comments

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

2. “Assignment of rents.” The Act uses the term “assignment of rents” to mean the transfer of an interest in rents, rather than the document by which the transfer is made. Any document sufficient to effect a transfer of a security interest in rents constitutes an assignment of rents under the Act. As a result, a mortgagee need not use a separate document to create an assignment of rents, but can merely incorporate into the mortgage document language that creates an assignment of rents. See Act § 4, Comment 4.

For sake of simplicity, the Act uses the term “assignment of rents” even though the document creating such an assignment is usually termed “assignment of leases and rents” and effectively transfers to the assignee an interest in the leases covering the real property (as well as an interest in the rents payable under those leases). The focus of the Act is to govern the creation, perfection, and enforcement of security interests in rents. By using the term “assignment of rents,” the Act is not intended to bifurcate a tenant’s obligation to pay rents from the lease under which the tenant’s obligation to pay rents arises.

3. “Assignor.” The term “assignor” means a person that makes an assignment of rents or the successor owner of the real property subject to the assignment.

4. “Cash proceeds.” The term “proceeds” means personal property that is collected on account of a tenant’s obligation to pay rents covered by this Act. See Comment 10. The term “cash proceeds” means proceeds that are in the form of cash, checks, funds in a deposit account, and the like.

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

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

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

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

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

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

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

12. “Rents.” In many commercial real property developments (e.g., office buildings, industrial parks, retail shopping centers, and apartment complexes), the owner stands in a landlord-tenant relationship with the occupiers of the development, based upon the execution of leases covering portions of the development. Because the common law has treated unaccrued rents as an interest in real property (an incorporeal hereditament), the right to collect sums paid by tenant occupiers undoubtedly constitutes “rent” in the nature of real property. Thus, a mortgage lender taking a security interest in “rents” must comply with the provisions of real property law in order to obtain and enforce that security interest. In other words, the mortgage lender must have the mortgagor execute and deliver an instrument sufficient to convey an interest in “rents” and must record that instrument in the appropriate real property records.

In many other developments, however, the owner does not stand in a landlord-tenant relationship with the user/occupier of real property because that user/occupier is 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. If the development’s occupier is a licensee and not a tenant, a significant classification problem arises. Is the right to collect sums from project occupiers “rent” governed by real property law (such that the lender would obtain and record an assignment of rents in the real property records), or an “account” governed by Article 9 of the Uniform Commercial Code (such that the lender would create a security interest in present and after-acquired accounts and perfect that interest by filing a financing statement covering accounts in the Article 9 filing system)?

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

Unfortunately, Bankruptcy Code § 552(a) complicates this analysis. Section 552(a)
generally provides that any pre-petition security agreement covering after-acquired property does
not affect property that the bankruptcy estate acquires post-petition. By itself, section 552(a)
would suggest that a lender’s security interest in pre-petition revenues would not attach to post-
petition revenues (which would, in turn, mean that those revenues would not constitute the
lender’s cash collateral). Congress drew a careful distinction, however, between property
received by the debtor post-petition and post-petition proceeds of pre-petition collateral. This
distinction is reflected in section 552(b), which provides that a valid and properly perfected pre-
petition security interest in collateral will attach to any rents, profits, and proceeds of that
collateral that are received by the debtor post-petition. The protection accorded to secured
creditors by section 552(b) makes the resolution of the “what revenues are ‘rents’?” question
critical for the commercial real property mortgage lender. If post-petition project revenues are
“rents,” “profits,” or “proceeds” of the real property, the lender’s security interest attaches to
those revenues. If not, then section 552(a) extinguishes the lender’s interest in post-petition
project revenues.

Most of the bankruptcy cases addressing this characterization question involved hotels
and security interests in hotel room revenues. Before 1994, a few decisions sensibly treated hotel
room revenues as the functional equivalent of tenant rents and concluded that § 552(b)’s
protection for “rents” preserved a lender’s properly perfected interest in post-petition hotel room
revenues. See, e.g., In re S.F. Drake Hotel Assocs., 131 B.R. 156, 158-61 (Bankr. N.D. Cal.
1991), aff’d, 147 B.R. 538 (N.D. Cal. 1992); In re Mid-City Hotel Assocs., 114 B.R. 634, 638-
642 (Bankr. D. Minn. 1990). Most courts, however, concluded that post-petition hotel room
revenues were accounts (personal property) and were neither “rents,” “profits,” nor “proceeds” of
the real property. See, e.g., In re Northview Corp., 130 Bankr. 543, 548 (9th Cir. BAP 1991); In
re Investment Hotel Properties, Ltd., 109 Bankr. 990, 994-97 (Bankr. D. Colo. 1990). These
courts typically applied the formalistic reasoning that room revenues could not be “rents”
because hotel guests were not “tenants.” As a result, many bankruptcy courts routinely
invalidated lenders’ claimed interests in post-petition hotel revenues. The formalistic
invalidation of a hotel lender’s interest in post-petition room revenues was particularly
inappropriate, as hotel room revenues are economically identical to the “rents” paid by tenants
under apartment, office, or industrial leases. See, e.g., R. Wilson Freyermuth, Of Hotel
Revenues, Rents, and Formalism in the Bankruptcy Courts: Implications for Reforming
Commercial Real Estate Finance, 40 UCLA L. Rev. 1461 (1993). Recognizing the absurdity of
these decisions, Congress amended section 552(b) in 1994 to preserve the lender’s interest in
post-petition “fees, charges, accounts, or other payments for the use or occupancy of rooms and
other public facilities in hotels, motels, or other lodging properties.”

This amendment provided a practical solution to the classification problem with respect
to hotels and other “lodging properties,” but it did not address a wide variety of other income-

In Section 2(12)(A), the Act takes the view that “rents” should include all sums payable for the right to possess or occupy the real property of another. A person “possesses” the real property of another if that person has a possessory interest in that real property (e.g., the interest of a tenant under a lease). A person “occupies” the real property of another if that person has a contractual right that permits them to occupy the real property of another to the exclusion of persons other than the owner. Thus, the Act defines the term “rents” to include all sums paid by a person in order to acquire the right to possess or occupy the real property of another.

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

The application of subsection (12)(A) is demonstrated by the following illustrations:

Illustration 1. ABC Life Insurance Company holds an assignment of rents on the Friendly Shopping Center. Grocer signs a 20-year lease for an anchor tenancy within the Friendly Shopping Center. The lease provides that Grocer will pay base rent and (depending upon sales) percentage rent. Sums payable from Grocer under the terms of the lease (whether for base rent or percentage rent) constitute “rents” within the meaning of the Act.

Illustration 2. ABC Life Insurance Company holds an assignment of rents on the Friendly Hotel. Heinz is a guest of Friendly Hotel for three nights. Although Heinz has no possessory interest in a particular hotel room vis-a-vis the owner of Friendly Hotel,
Heinsz does “occupy” the room in a fashion that essentially excludes third persons. Sums payable for the room occupancy charges that Heinsz incurs for his stay are “rents.” Sums payable for charges that Heinsz incurs for additional hotel-related services (such as room service meals, dry cleaning or laundry services, or the like) would not constitute “rents,” as they are not incurred in exchange for the right to occupy the room.

Illustration 3. ABC Life Insurance Company holds an assignment of rents on the Friendly Nursing Home, where Davis is a resident. Although Davis may not have a possessory interest in the room vis-a-vis the owner of Friendly Nursing Home, Davis does “occupy” the room in a fashion that essentially excludes third persons. Sums payable for the room occupancy charges that Davis incurs for his stay are “rents.” Sums payable for medical treatment, medication, physical therapy, or the like would not constitute “rents,” as they are not incurred in exchange for the right to occupy the room.

Illustration 4. First Bank holds an assignment of rents on the Friendly Marina. Smith has a contract with Friendly Marina pursuant to which he pays a monthly fee for a slip at which he may dock his yacht. The monthly fees payable by Smith under this agreement are “rents.”

Illustration 5. First Bank holds an assignment of rents on Friendly Parking Garage. Smith has a contract with Friendly Parking Garage pursuant to which he pays $150 per month for a reserved parking space. Sums payable by Smith for this parking space constitute “rents.”

Illustration 6. First Bank holds an assignment of rents on Friendly Golf Course. Smith pays greens fees to play at Friendly Golf Course. Sums payable on account of Smith’s greens fees are not right “rents,” as Smith does not “occupy” the real property but is merely using it in a temporary and essentially nonexclusive fashion.

In jurisdictions adopting this Act, there will remain certain developments for which the definition of “rents” does not unambiguously resolve the classification dilemma. For example, consider a stadium that stages athletic or entertainment events. On the one hand, one might characterize as “rents” the right to collect admission fees from patrons, on the ground that while patrons do not have a possessory interest, they may “occupy” a stadium seat in a more or less exclusive fashion (as two persons cannot literally occupy the same seat simultaneously). On the other hand, one might characterize the right to collect admission fees as “accounts” governed by Uniform Commercial Code Article 9, on the ground that patrons have merely a temporary interest that is more appropriately characterized as “use” rather than “occupancy.” In such cases, a prudent lender may choose to follow the “belt and suspenders” approach — taking both an assignment of rents (and recording it in the real property records) and an Article 9 security interest in present and after-acquired accounts (and perfecting it by filing an Article 9 financing statement) — in order to assure that it has a perfected security interest in the revenues generated by the project.
Subsections (12)(B) through (E) define rents to include sums payable that leases or occupancy agreements often characterize as “rents,” as well as the right to collect sums that constitute an economic substitute for rents that might otherwise have accrued or been collected. These include the sums payable under a policy of rental interruption insurance; claims arising out of a default in the payment of rents (e.g., liquidated damages); sums payable in order to terminate a lease or occupancy agreement; and sums payable for the purpose of paying or reimbursing the assignor’s payment of expenses incurred in owning, operating and maintaining the real property (such as taxes or insurance) or in constructing or installing improvements.

In any particular state, a court or legislature might choose to define particular sums payable as “rents” even though such sums would not be covered by subsection (12)(A) through (E). Under subsection 12(F), such sums would constitute “rents” under this Act.

13. “Secured obligation.” The term “secured obligation” covers any obligation the performance of which is secured by an assignment of rents.

14. “Security instrument.” This definition is similar 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 in real property. The definition thus covers a mortgage, deed of trust, deed to secure debt, or any other document used by the parties to create a security interest in real property.

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

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

17. “Submit for recording.” This definition is comparable to that contained in Section 102(21) of the Uniform Residential Mortgage Satisfaction Act. To “submit for recording” means that the person has submitted a document that has complied with the appropriate legal requirements for the document submitted, along with required fees and taxes, to the appropriate recording official. Whether an assignment of rents that is submitted for recording is actually recorded or otherwise binds third parties is determined by the state’s recording act.

18. “State.” This definition is the boilerplate definition of the term as used in uniform acts.
19. “Tenant.” For purposes of this Act, a “tenant” is any person that holds a right to possess or occupy the real property of another, or who actually possesses or occupies that real property, and is thereby obligated to pay rents. The Act defines “rents” to include sums payable by certain occupants of real property that do not have a possessory interest in the real property and thus do not stand in a landlord-tenant relationship with the assignor. Although the Act treats such a licensee as a “tenant” for the purposes of this Act, it does not render such a licensee a tenant within the meaning of the state’s landlord-tenant law. Thus, for example, nothing in this Act would grant a licensee the benefit of the state’s forcible entry and detainer statutes, the benefit of an implied warranty of habitability, or any other right recognized under the state’s general law of landlord and tenant.

SECTION 3. MANNER OF GIVING NOTIFICATION.

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

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

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

(2) A person giving a notification to an assignor shall use the address for notices to the assignor provided in the document creating the assignment of rents, but if the assignor has provided the person giving the notification with a more recent address for notices, the person giving the notification shall use that address.
(3) If a tenant’s agreement with an assignor provides an address for notices to the tenant and the person giving notification has received a copy of the agreement or knows the address for notices specified in the agreement, the person giving the notification shall use that address in giving a notification to the tenant. Otherwise, the person shall use the address of the premises covered by the agreement.

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

(d) If a notification is received by the recipient, it is effective even though it was not given in accordance with subsection (a) or (c).

Preliminary Comments

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

Subsection (c) provides that if an agreement between the person giving a notification and the recipient dictates a method of notification other than the methods permitted under subsection (a), any notification must be given by the agreed-upon method. Subsection (c) would thus permit the giving of a notification by electronic mail or other form of electronic communication, but only where the recipient had agreed to receive notifications by that manner of delivery. Such an agreement may arise either by express written provisions or by virtue of an established course of conduct between the giver and recipient of the notification (such as the consistent delivery and receipt of previous formal notices).

Under subsection (d), a notification actually given in a manner not authorized by subsection (a) or (c), but received by the recipient, is nevertheless effective under this Act.

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

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

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

**SECTION 4. SECURITY INSTRUMENT CREATES ASSIGNMENT OF RENTS; ASSIGNMENT OF RENTS CREATES SECURITY INTEREST.**

(a) An enforceable security instrument creates an assignment of rents arising from the real property described in the security instrument, unless the security instrument provides otherwise.

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

**Preliminary Comments**
1. **Security instrument creates an assignment of rents.** Under subsection (a), a security instrument that creates a security interest in real property automatically creates a security interest in the rents arising from that real property, unless the security instrument expressly provides otherwise. In this regard, the Act adopts a default rule comparable to the rule existing under Uniform Commercial Code Article 9, under which a security agreement covering collateral automatically covers the proceeds of that collateral (including rents from the collateral) unless the agreement provides otherwise. U.C.C. §§ 9-203(f), 9-315(a)(2).

In nearly all commercial mortgage transactions covering income-producing real property, the loan documentation will create an express assignment of rents. Thus, subsection (a) should not impact in any meaningful way upon the negotiation and documentation of commercial mortgage transactions. However, in residential mortgage transactions in “lien theory” states, current mortgage documents often do not contain an assignment of rents. Current mortgages that do not contain an assignment of rents are not covered by subsection (a). *See* Section 20(c).

Under subsection (a), a mortgage that is signed and delivered after this Act takes effect would, by default, create an assignment of any rents arising from the mortgaged real property, unless the mortgage document provided otherwise. This should not significantly affect the negotiation and documentation of residential mortgage transactions, however, as rents will rarely arise in the circumstances where the borrower occupies the mortgaged real property as its primary residence. Further, the Act’s remedial mechanism for enforcing the assignee’s interest in rents by notification (either to the assignor or to tenants) is not available to an assignee that holds a security interest in rents solely by virtue of subsection (a). *See* Sections 8(d) and 9(g).

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

Traditionally, state law has governed the creation and enforcement of security interests in rents. Most frequently, however, disagreements regarding security interests in rents arise in the federal bankruptcy courts. On its face, the Bankruptcy Code appears to recognize that state law has traditionally treated “rents” that accrue between default and foreclosure as a source of collateral that is separate and distinct from the real property that generated those rents. The Bankruptcy Code characterizes rents from mortgaged real property as “cash collateral,” 11 U.S.C. § 363(a), and preserves a secured creditor’s pre-bankruptcy lien on rents that the debtor receives after it files a bankruptcy petition, *id.* § 552(b). These provisions appear to acknowledge that a pre-bankruptcy assignment of rents creates a separate security interest in the rents (*i.e.*, ...
Most bankruptcy court decisions have treated post-petition rents as a separate and distinct source of collateral, but a few bankruptcy court decisions have instead concluded that post-petition rents do not constitute separate collateral because the post-petition rent stream is in fact “subsumed” within the valuation of the real property itself. See, e.g., In re Wrecclsham Grange, Inc., 221 B.R. 978 (Bankr. M.D. Fla. 1997); In re Embassy Properties N. Ltd. Partnership, 196 B.R. 172 (Bankr. D. Kan. 1996); In re Citicorp Park Assocs., 180 B.R. 15 (Bankr. D. Me. 1995); In re Barkley 3A Investors, Ltd., 175 B.R. 755 (Bankr. D. Kan. 1994); In re Mullen, 172 B.R. 473 (Bankr. D. Mass. 1994). These courts have thus concluded that a debtor can use post-petition rents without regard to a pre-bankruptcy assignment of rents as long as the mortgage lender’s interest in the mortgaged real property is adequately protected (i.e., as long as the real property itself is not declining in value), even if the real property was worth less than the mortgage debt.

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

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

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

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

The Restatement (Third) of Property — Mortgages and most commentators have rejected
this view. In the typical transaction, the assignor executes an assignment of rents and leases
temporaneously with its execution of the mortgage. The assignee does not immediately begin
collecting rents from tenants as soon as it takes the assignment, and typically has no intention to
do so at any time before the assignor’s default — indeed, the typical assignment expressly
acknowledges the assignor’s right to collect and expend the rents before default. Under such an
“assignment,” the circumstances demonstrate that the parties intend the rents to secure the
repayment of the mortgage debt. In other words, the “absolute” assignment is merely a security
device, regardless of its “absolute” characterization. Mortgage law has long established that
instruments purporting absolutely to convey an interest in real property nevertheless constitute
 equitable mortgages when the circumstances demonstrate that the parties are using title to real
property to secure a debt. See, e.g., Restatement of Property (Third) — Mortgages § 3.2
(absolute deed intended to secure an obligation constitutes a mortgage); accord Smith v. Player,
601 So.2d 946 (Ala. 1992); Steckelberg v. Randolph, 404 N.W.2d 144 (Iowa 1987). Under this
same principle, courts should treat a typical “absolute” assignment of rents as an assignment for
security purposes, and the weight of modern judicial authority so provides. See, e.g., In re
Cavros, 262 B.R. 206 (Bankr. D. Conn. 2001); In re 5877 Poplar, L.P., 268 B.R. 140 (Bankr.
W.D. Tenn. 2001); National Operating, L.P. v. Mutual Life Ins. Co. of New York, 630 N.W.2d
116 (Wis. 2001); In re Guardian Realty Group, L.L.C., 205 B.R. 1 (Bankr. D.D.C. 1997); In re
RV Centennial Partnership, 202 B.R. 774 (Bankr. D. Colo. 1996); In re Lyons, 193 B.R. 637,
644 (Bankr. D. Mass. 1996). Under this view, where the underlying real property is property of
the estate, post-petition rents would likewise constitute property of the estate. The assignee of
those rents, however, would continue to have a security interest in those rents by virtue of
Bankruptcy Code § 552(b), and the debtor/assignor would be obligated to provide adequate
protection of the assignee’s interest in those rents under Bankruptcy Code § 363.

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

4. Conveyancing formalities. The Act is not intended to effect any change in the underlying law of states adopting the Act with respect to the formalities necessary to effect a conveyance of an interest in real property. If a document entitled “Assignment of Rents” is not executed in accordance with the formal requirements for an effective conveyance of an interest in real property, it does not effect a “transfer” of an interest in rents and thus the document would not constitute an “assignment of rents” as defined in Section 2(2). The Act does not specify precisely what formalities are necessary for a document to constitute an effective assignment of rents, but leaves this question to other state law. For example, if an assignor has signed and delivered a document entitled “Assignment of Rents,” but the assignee has not yet extended credit to the assignor and state law provides that no transfer of rents occurs until such credit is actually extended, the document would not effect an “assignment of rents” until the credit is actually extended.

The Act uses the term “assignment of rents” to mean the transfer of an interest in rents, rather than the document by which the transfer is made. This definition serves an important purpose in promoting document simplification and transactional efficiency. In many commercial transactions, it has become customary for the lender to require the borrower to execute multiple documents, including both a “mortgage” or “deed of trust” covering the real property and an “assignment of rents and leases” which assigns to the lender all leases covering the mortgaged real property and all rents accruing under those leases. By contrast, in some transactions, lenders have simply incorporated into the mortgage language sufficient to assign to the lender all leases covering the mortgaged real property and rents accruing under such leases, without a separate assignment document. Under this Act, either approach is sufficient to create an assignment of rents. As a result, there is no need to use a separate document to create an assignment of rents. Mortgage lenders may achieve efficiencies in transactional drafting and negotiation merely by incorporating into the mortgage document language that creates an assignment of rents.

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

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

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

(c) Except as otherwise provided in subsection (d), a perfected security interest in
rents takes priority over the rights of a person that, after the security interest is perfected:

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

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

(d) A perfected security interest in rents has priority over the rights of a person
listed in subsection (c) with respect to future advances to the same extent as the assignee’s
security interest in the real property has priority over the rights of that person with respect to
future advances.

Preliminary Comment

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

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

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

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

If a mortgagee claims a security interest in rents by virtue of a separate assignment of rents, however, any legal constraints on the mortgagee’s right to collect rents by virtue of the mortgage itself should be irrelevant. Nevertheless, a number of older state court decisions conflated these two situations, holding that even a separate assignment of rents was not effective until the mortgagee took affirmative steps after default to enforce that assignment, such as by obtaining the appointment of a receiver, becoming a mortgagee in possession, or impounding the rents. See, e.g., Taylor v. Brennan, 621 S.W.2d 592, 593-94 (Tex. 1981); Bevins v. Peoples Bank & Trust Co., 671 P.2d 875, 879 (Alaska 1983), Martinez v. Continental Enters., 730 P.2d 308, 316 (Colo. 1986); Sullivan v. Rosson, 119 N.E. 405 (N.Y. 1918). Based upon these decisions, numerous bankruptcy courts concluded that an assignment of leases and rents created only an “inchoate” lien upon rents that was ineffective against third parties if the mortgagee had not taken affirmative steps before bankruptcy to activate that lien. These courts concluded that if a mortgagee had not taken action to divest the mortgagor of control over the property and its rents before bankruptcy — such as by obtaining the appointment of a receiver, taking possession of the real property, or notifying tenants to pay rents directly to the mortgagee — the mortgagee’s security interest in post-petition rents was “unperfected” and subject to avoidance under § 544(a).


These diverse interpretations of state mortgage law produced substantial nonuniformity in the treatment of security interests in rents, both from state to state and even from district to district within a particular state. This nonuniformity produced significant criticism among academics, real property practitioners, and commercial mortgage lenders. See, e.g., 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, 118 (1997); Julia Patterson Forrester, A Uniform and More Rational Approach to Rents as Security for the Mortgage Loan, 46 Rutgers L. Rev. 349 (1993); Patrick A. Randolph, Jr., Recognizing Lenders’ Rents Interests in Bankruptcy, 27 Real Prop., Prob. & Trust J. 281 (1992).
In response to this criticism, Congress amended Bankruptcy Code § 552(b) in 1994 in an
apparent attempt to provide more uniform treatment of assignments of rents. Before 1994, §
552(b) provided that a pre-petition security interest in real property and rents from that real
property extended to post-petition rents “to the extent provided by [the] security agreement and
by applicable nonbankruptcy law.” By focusing upon the term “applicable nonbankruptcy law,”
many courts (as noted above) concluded that § 552(b) did not permit the mortgagee to claim a
security interest in post-petition rents where the mortgagee had failed to take the necessary steps
to obtain actual or constructive possession of the real property and its rents before bankruptcy. In
1994, however, Congress amended § 552(b) to remove this reference to “applicable
nonbankruptcy law.” Some commentators concluded that the amended § 552(b) established a
federal standard for the enforcement of an assignment of rents, thus rendering state rent
assignment law irrelevant. See, e.g., 5 Collier on Bankruptcy ¶ 552.03[1], at 552-17 (“[Section
552(b)(2)] does not refer to applicable nonbankruptcy law and is intended to provide a creditor
with a valid post-petition interest in rents notwithstanding the creditor’s failure to perfect its
security interest in rents under applicable state law ....”). But while legislative history suggests
that Congress intended to preempt contrary state laws limiting the post-petition effectiveness of
an assignment of rents, the text itself provides no express statement of pre-emptive intent.
Further, § 552(b)’s protection for a security interest in post-petition rents is expressly subject to §
544’s strong-arm clause — which implicitly incorporates underlying state law regarding the
enforceability of a security interest versus third parties. Under § 544(a), there is no question that
the debtor-in-possession may avoid a security interest in rents if a bona fide purchaser of the real
property 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 in rents — notwithstanding
the amendment to § 552(b) — if the mortgagee failed to take such action before bankruptcy.

Roughly one-third of the states have enacted statutes making clear that an assignment of
rents is “perfected,” without regard to whether the mortgagee has taken any steps to “activate” or
Gen. Stat. § 47-20(c); Or. Rev. Stat. § 93.806; S.C. Code § 29-3-100; Tenn. Code Ann. § 66-26-
The Act adopts this approach, and provides that a perfected security interest in rents cannot be
avoided by a person that thereafter becomes a judgment lien creditor or a purchaser of the rents
or the real property from which they arise.

3. Priority versus purchasers and lien creditors. Under subsection (c), a perfected
security interest in rents takes priority over the rights of a judgment lien creditor that
contemporaneously or thereafter acquires a lien against the rents or the real property from which
they arise. Likewise, a perfected security interest in rents takes priority over the rights of a
person that contemporaneously or thereafter purchases an interest in the rents or the real property
from which they arise. “Purchaser” includes both buyers and other secured creditors (such as a subsequent assignee of rents).

Under subsection (d), a perfected security interest in rents has priority over a purchaser or lien creditor with respect to future advances to the same extent as the assignee’s security interest in the real property has priority over the rights of that purchaser or lien creditor with respect to future advances. In this regard, the Act is neutral with regard to existing state law regarding priority with respect to future advances.

SECTION 6. ENFORCEMENT OF SECURITY INTEREST IN RENTS.

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

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

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

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

Preliminary Comments

1. Nonexclusive method of enforcement. Section 6 provides that the assignee may enforce an assignment of rents in accordance with its terms. The Act specifies several methods of enforcement of an assignment of rents in Sections 7 (appointment of a receiver), 8 (notification to the assignor), and 9 (notification to tenants). If the assignee enforces an assignment of rents under Section 7 or 8, the enforcement is effective with respect to all accrued but unpaid rents and all rents accruing thereafter. By contrast, if the assignee enforces an assignment of rents by notifying tenants under Section 9, that enforcement is effective only with respect to tenants actually notified.

The Act also permits enforcement of an assignment of rents by any other method recognized under other law of this state. Thus, for example, this Act would not prevent an assignee holding a mortgage on the real property from taking possession of the real property and thus becoming a “mortgagee in possession.” Generally speaking, mortgage lenders are loathe to assume the status of a mortgagee in possession for a variety of reasons, including potential tort liability to third parties, the obligation to account for rentals collected, and the assumption of a
duty to maintain the physical condition of the premises. See, e.g., 1 Grant S. Nelson & Dale A. Whisman, Real Estate Finance Law §§ 4.24 - 4.29, at 213-230 (3d ed. 1993). Still, in rare cases a mortgagee may voluntarily choose to become a mortgagee in possession, and the Act is not intended (either explicitly or implicitly) to eliminate the mortgagee-in-possession doctrine. Thus, to the extent that becoming a mortgagee in possession under the law of this state would be sufficient to enforce a security interest in rents, this Act would permit an assignee to enforce its interest in this manner.

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

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

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

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

The date of enforcement will depend upon the method of enforcement used by the assignee. If the assignee enforces the assignment by appointment of a receiver, the date of enforcement will be the date that the court appoints the receiver. Section 7(c). If the assignee enforces the assignment by notification to the assignor, the date of enforcement will be the date that the assignor receives the notification. Section 8(b). If the assignee enforces the assignment by notification to a tenant, the date of enforcement with respect to rents payable by that tenant is the date that the tenant receives the notification. Section 9(b).
SECTION 7. ENFORCEMENT BY APPOINTMENT OF RECEIVER.

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

(1) the assignor is in default as defined in the document creating the assignment and:

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

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

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

(D) a subordinate assignee of rents obtains the appointment of a receiver for the real property; or

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

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

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

(2) for specific performance of the assignment;

(3) seeking a remedy on account of waste or threatened waste of the real property subject to the assignment; or
(4) otherwise to enforce the secured obligation or the assignee’s remedies arising from the assignment.

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

(d) From the date of its appointment, a receiver has the authority provided in Section 6(b), the order of appointment, and law of this state other than this act.

(e) The following rules govern priority among receivers:

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

(2) If a subordinate assignee obtains the appointment of a receiver, the receiver may collect the rents and apply the proceeds in the manner specified in the order appointing the receiver until a receiver is appointed under a senior assignment of rents.

Preliminary Comments

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

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

2. Traditional standards for appointment of a receiver. Traditionally, courts have appointed a receiver for mortgaged real property if the value of the real property was insufficient to satisfy the mortgage debt (i.e., where the mortgagee’s security was inadequate) or whether the owner of the mortgaged real property 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 7(a)(1)(B) authorizes the appointment of a receiver if the real property appears insufficient to satisfy the secured obligation. Likewise, Section 7(a)(2) authorizes the appointment of a receiver where “other circumstances” justify the appointment of a receiver under the law of this state other than this Act. Such “other circumstances” could include waste as defined under state law other than this Act. Thus, for example, if the law of this state other than this Act treats nonpayment of real property taxes as actionable waste and allows appointment of a receiver in the event of waste, the assignor’s nonpayment of taxes would provide a justification for the appointment of a receiver.

A few court decisions have required a mortgagee seeking appointment of a receiver to show that the mortgagor was insolvent. See, e.g., Mutual Benefit Life Ins. Co. v. Frantz 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. The Act does not require the assignee to demonstrate the assignor’s insolvency as a predicate to obtaining the appointment of a receiver, but Section 7(a)(2) would permit an assignee to use the assignor’s insolvency as grounds for appointment of a receiver where other state law has recognized the assignor’s insolvency as sufficient grounds for a receivership.

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

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

Consistent with the position adopted by Restatement (Third) of Property — Mortgages §
4.3(b) and significant recent judicial authority, the Act establishes that a receivership clause
alone provides a sufficient basis to appoint a receiver after the mortgagor’s default. See, e.g.,
Bank of America Nat’l Trust & Sav. Ass’n v. Denver Hotel Ass’n Ltd. Partnership, 830 P.2d
1138 (Colo. App. 1992) (upholding appointment of receiver under receivership clause, without
regard to adequacy of security or solvency of mortgagor, under abuse of discretion standard);
Fleet Bank v. Zimelman, 575 A.2d 731 (Me. 1990) (freely bargained-for receivership clause
should be enforced); Metropolitan Life Ins. Co. v. Liberty Center Venture, 650 A.2d 887 (Pa.

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

4. Priority between conflicting receivers. Subsection (e), which is modeled upon § 4.5 of
the Restatement (Third) of Property — Mortgages, provides a priority rule in the event where
multiple rents assignees obtain the appointment of a receiver. As a threshold matter, conflicting
security interests in rents are resolved based upon the priorities established by the state’s
recording act, and thus an assignee holding a recorded assignment of rents would be entitled to
priority over the interest of a later assignee of the same rents. Section 5(c). Consistent with this
approach, if the senior assignee is entitled to the appointment of a receiver under Section 7, the
court’s appointment of that receiver will take priority over and displace a prior receivership
obtained by a subordinate assignee. Any proceeds 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 must apply those sums in the manner specified in its order of appointment.

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

6. Receiver’s power to terminate or disaffirm existing leases. In many states, statutory or case law regarding receiverships has generally established (or limited) the receiver’s power to terminate leases in default or to disaffirm leases not in default. Likewise, the court order appointing a receiver will often specify the extent to which a receiver can take these steps with or without the approval of the court and/or the assignee. As a result, subsection (d) addresses the receiver’s power to terminate and/or disaffirm leases by leaving this question to the terms of the court order appointing the receiver and other state law.

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

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

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

(c) An assignee’s failure to give a notification under subsection (a) to any person holding a recorded assignment of rents does not affect the effectiveness of the notification as to the assignor, but the other person is entitled to any relief permitted under law of this state other than this [act].
(d) An assignee that holds a security interest in rents solely by virtue of Section 4(a) may not enforce the security interest under subsection (a) as long as the assignor occupies the real property as the assignor’s primary residence.

Preliminary Comments

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

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

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

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

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

4. Limitation on remedy where mortgage does not contain express assignment of rents. Under Section 4(a) of the Act, the signing and delivery of a mortgage creates an assignment of rents automatically, even without express language creating an assignment of rents, unless the mortgage provides otherwise. However, an assignee that claims a security interest in rents solely by virtue of Section 4(a) — i.e., by virtue of a mortgage that does not expressly create an assignment of rents and without any other document that grants the assignee a security interest in rents — cannot enforce its security interest by notification under subsection (a), as long as the assignor occupies the real property as its primary residence.

SECTION 9. ENFORCEMENT BY NOTIFICATION TO TENANT.

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

(1) identify the tenant, assignor, assignee, premises covered by the agreement between the tenant and the assignor, and assignment of rents being enforced;

(2) provide the recording data for the document creating the assignment or other reasonable proof that the assignment has been made;
(3) state that the assignee has the right to collect rents in accordance with
the assignment;

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

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

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

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

(8) be signed by the assignee.

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

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

(1) a tenant is obligated to pay to the assignee all unpaid accrued rents and
all unaccrued rents as they come due, unless the tenant has previously received a notification
from another assignee of rents given by that assignee in accordance with this section and the
other assignee has not canceled that notification;
(2) a tenant that pays rents to the assignor is not discharged from the
obligation to pay rents to the assignee, unless the tenant occupies the premises as the tenant’s
primary residence;

(3) a tenant’s payment to the assignee of rents then due satisfies the
tenant’s obligation under the tenant’s agreement with the assignor to the extent of the payment
made; and

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

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

(1) 10 days after the date that the next regularly scheduled rental payment
would be due; or

(2) 30 days after the date the tenant receives the notification.

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

(f) An assignee’s failure to give a notification under subsection (a) to any person
holding a recorded assignment of rents does not affect the effectiveness of the notification as to
the assignor and those tenants receiving the notification. However, the person entitled to the
notification is entitled to any relief permitted by law of this state other than this [act].
(g) An assignee that holds a security interest in rents solely by virtue of Section 4(a) may not enforce the security interest under subsection (a) as long as the assignor occupies the real property as the assignor’s primary residence.

**Preliminary Comments**

1. *Enforcement by notification to tenants.* Section 9 provides that an assignee may enforce its security interest in rents by notification to tenants either following default or otherwise in accordance with the assignment. Because many assignments of rents do not authorize the assignee to collect rents before the assignor’s default, enforcement by Section 9 will usually arise only after the assignor’s default. Nevertheless, this Act would permit the assignee to collect rents directly from the tenants even before default if the assignor so agrees.

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

2. *Effect of notification.* Once the tenant receives notification from the assignee demanding payment of rents pursuant to the assignment, the tenant must pay accrued but unpaid rents and rents accruing in the future to the assignee in order to satisfy its rental obligation. In this respect, the Act’s provisions generally operate comparably to Uniform Commercial Code Section 9-406(a), which governs the circumstances under which an account debtor can discharge its obligation following notification and demand by an assignee of that account. Following receipt of a notification, a tenant cannot discharge its rental obligations by payment to the assignor. Thus, a tenant that pays its landlord following receipt of a notification under this section faces the risk of having to make double payment of the sums necessary to discharge its rental obligation.

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

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

3. Notification to other rents assignees. Subsection (a) requires that the enforcing
assignee give notification to the assignor and to any person that, 10 days prior to the notification
date, held a recorded assignment of rents on the real property. Under this provision, an enforcing
assignee must search the public records to identify any other creditors holding a recorded
assignment of rents (whether junior or senior to the assignee’s interest) and provide notification
of enforcement to such creditors. Notification will alert another person holding a recorded
assignment of rents as to the pending enforcement effort and permit that person to protect its
secured position with respect to the rents. See Act § 8, Preliminary Comment 2.

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

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

5. Extension of time for payment of next rental payment following notification. If a tenant
receives a notification directing payment of rents to an assignee, the tenant reasonably may wish
to obtain counsel regarding the effect of the notification. If the notification arrives shortly before
the tenant’s rental due date, however, the tenant may find it difficult to obtain that advice before
its rental obligation would become past due.

To give the tenant a reasonable opportunity to obtain counsel, subsection (d) provides that
neither the assignor nor the assignee may hold a tenant in default solely for nonpayment of rents
that accrue after the notification is given until the earlier of 10 days after the next regularly
scheduled rental payment would be due under the lease or 30 days after the date the tenant
receives the notification. Subsection (d) would not in any way protect a tenant from the
consequences of a breach of the lease on grounds other than nonpayment of rent, or for
nonpayment of rents that accrued before the notification.

The application of subsection (d) is demonstrated by the following illustrations:
Illustration 1. Tenant’s rent is due and payable to Assignor monthly, on the first
of each month. On March 28, Tenant receives a notification from Assignee
demanding that Tenant pay future rents to Assignee. Neither Assignor nor
Assignee may declare Tenant in default of the April 1 rent payment until after
April 11.

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

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

Illustration 4. Tenant’s lease provides that base rental is due and payable to
Assignor monthly, on the first of each month. Tenant’s lease also provides a
percentage rental clause by which percentage rental is payable on an annual basis
on September 25. On September 15, Tenant receives a notification from Assignee
demanding that Tenant pay future rents to Assignee. Neither Assignor nor
Assignee may declare Tenant in default for failure to pay the October 1 base rent
payment until after October 11. Neither Assignor nor Assignee may declare
 Tenant in default for failure to pay the September 15 percentage rental payment
until after October 15.

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

7. Limitation on remedy where mortgage does not contain express assignment of rents.
Under Section 4(a) of the Act, the signing and delivery of a mortgage creates an assignment of
rents automatically, even without express language creating an assignment of rents, unless the
mortgage provides otherwise. However, an assignee that claims a security interest in rents solely
by virtue of Section 4(a) — *i.e.*, by virtue of a mortgage that does not expressly create an assignment of rents and without any other document that grants the assignee a security interest in rents — cannot enforce its security interest by notification under subsection (a), as long as the assignor occupies the real property as its primary residence.

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

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

Tenant: [Name of tenant]

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

Landlord: [Name of landlord]

Assignee: [Name of assignee]

Address of Assignee and Telephone Number of Contact Person: [Address for payment of rents to assignee and telephone number of contact person for further information]:

1. The Assignee named above is the assignee of rents under [name of document] (the “Assignment of Rents”) dated __________, and recorded at [recording data] in the [appropriate governmental office under the recording act of this State]. You may obtain additional information about the Assignment of Rents and the Assignee’s right to enforce it at the address listed above.

2. The Landlord is in default under the Assignment of Rents. Under the Assignment of Rents, the Assignee is entitled to collect rents from the Premises.
3. This notification affects your rights and obligations under the agreement under which you occupy the Premises (the “Agreement”). In order to provide you with an opportunity to consult with an attorney, neither the Assignee nor the Landlord can hold you in default under the Agreement for nonpayment of your next scheduled rental payment until 10 days after the due date of that payment or 30 days following the date you receive this notification, whichever occurs first. You may consult an attorney concerning your rights and obligations under the Agreement and the effect of this notification.

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

5. If you pay any rents to the Landlord after receiving this notification, your payment to the Landlord will not discharge your rental obligation, and the Assignee may hold you liable for that rental obligation notwithstanding your payment to the Landlord, unless you occupy the Premises as your primary residence.

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

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

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

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

[Name of assignee]

By: [Officer/authorized agent of assignee]

SECTION 11. EFFECT OF ENFORCEMENT. The enforcement of an assignment of rents by one or more of the methods identified in Sections 7, 8, and 9, the application of proceeds by the assignee under Section 12 after enforcement, the payment of expenses under Section 13, or a civil action under Section 14(d) does not:

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

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

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

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

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

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

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

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

Preliminary Comments

1. Mere enforcement of security interest in rents does not trigger mortgagee-in-
   possession status. A number of common law decisions suggest that a mortgagee can become a
   “mortgagee in possession” — with the legal responsibilities attendant to that status — without
   physical occupation of the mortgaged premises. See, e.g., 1 GRANT S. NELSON & DALE A.
   cases). This result is not surprising, given the factual and legal uncertainty attendant to the term
   “possession.” This ambiguity can produce concern for the assignee that wishes to protect its
   security interest in rents without assuming the duties and liabilities attendant to mortgagee-in-
   possession status. Consistent with commentary to the Restatement (Third) of Property —
   Mortgages, the Act provides that the mere collection of rents does not render the mortgagee a
   “mortgagee in possession” with the duties and liabilities attendant to that status. Cf. Restatement
   (Third) of Property — Mortgages § 4.2 cmt. c.

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

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

3. “One action” rules and anti-deficiency provisions. In some states, “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 bars 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 over 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 interest in rents:

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

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

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

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

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

(2) payment of expenses incurred by the assignee to protect or maintain the real property subject to the assignment;

(3) payment of the secured obligation;

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

(5) the assignor.

Preliminary Comments

The term “reasonable attorneys’ fees and costs” in Section 12(1) includes those fees and costs the assignee incurs in enforcing its assignment of rents. This would include, for example, 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 9. Unlike U.C.C. § 9-607(d) — under which an assignee’s right to recover these expenses from collected receivables arises automatically — the assignee may recover reasonable attorneys’ fees under this Act only to the extent such fees are provided for in the assignment of rents and are not prohibited by applicable law other than this Act. This limitation is consistent with the expectations of mortgagors and mortgagees.

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

SECTION 13. APPLICATION OF PROCEEDS TO EXPENSES OF
PROTECTING REAL PROPERTY; CLAIMS AND DEFENSES OF TENANT.

(a) Unless otherwise agreed by the assignee, an assignee that collects rents following enforcement under Section 8 or 9 may apply the proceeds in accordance with Section 12 and need not apply them to the payment of expenses of protecting or maintaining the real property subject to the assignment.

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

(c) This [act] does not limit the standing of a tenant to request a court to appoint a receiver for the real property subject to the assignment on the ground that the assignee’s nonpayment of expenses of protecting or maintaining the real property has caused or threatened harm to the tenant’s interest in the property. Whether the tenant is entitled to the appointment of a receiver is governed by law of this state other than this [act].

Preliminary Comments

1. Expenses of operation and preservation of the real property. Typically, a tenant’s payment of rents enables the assignor to pay the expenses of operating and preserving the real property (such as real property taxes, insurance, and maintenance). In many commercial leases, the tenant pays a sum designated as “additional rent,” specifically to reimburse the assignor for the tenant’s pro rata share of real property taxes, insurance, and maintenance expenses, or for any increases in these items above a defined baseline.

If an assignor defaults and an assignee enforces its assignment of rents, the assignor may be unable to collect rents that it needs to pay the expenses of operating and preserving the real property. Potentially, the assignor’s nonpayment of these expenses or the nonperformance of its obligation to maintain the real property threatens the interests of the tenants.

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

The assignor’s obligation to pay taxes, insurance, or maintenance expenses (whether
expressed or implied in tenant leases), however, does not generally bind the assignee as a
successor if the lender has not yet acquired possession or ownership of the real property. If a
lender purchases mortgaged real property at foreclosure, the lender becomes obligated to fulfill
the assignor’s responsibilities under the tenant leases, as the landlord’s covenants in those leases
then run with the real property to bind the lender. By contrast, if the lender collects rents prior to
completing foreclosure, but without taking either actual or constructive possession of the real
property, the lender may collect those sums and apply them to the mortgage debt with no legal
obligation to pay taxes, insurance, or maintenance expenses. Such a lender is not a successor that
is bound to perform the landlord’s covenants under tenant leases; further, courts have not
generally treated such sums as being impressed with a “trust” that obligates the lender to apply
such sums to the payment of taxes, insurance, or maintenance.

As a result, if the assignee enforces its assignment of rents by means of Section 8
(notification to the assignor) or Section 9 (notification to tenants), the assignor effectively
remains in day-to-day possession and control of the real property. In such a case, the assignee’s
collection of rents and payment of property-related expenses does not place day-to-day
operational and management responsibility upon the assignee. Instead, that responsibility
remains upon the assignor. Such an assignee may apply the collected rents to the mortgage debt
in accordance with Section 12, and need not apply such rents to property-related expenses (such
as taxes, insurance, and/or maintenance), absent a contrary agreement by the assignee. A prudent
assignee may choose, however, to apply collected rents to the payment of such expenses, both to
protect its own interest in (and the value of) the real property and to avoid any possible claim or
defense that a tenant might have to payment of rent based upon the assignor’s nonperformance of
the lease agreement.

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

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

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

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

SECTION 14. TURNOVER OF RENTS; COMMINGLING AND
IDENTIFIABILITY OF RENTS; LIABILITY OF ASSIGNOR.

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

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

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

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

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

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

(1) the proceeds, or an amount equal to the proceeds, that the assignor was obligated to turn over under subsection (b); and

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

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

(f) Unless otherwise agreed, if an assignee entitled to priority under Section 5(c) enforces its interest in rents after another creditor holding a subordinate security interest in rents has enforced its interest under Section 8 or 9, the creditor holding the subordinate security interest in rents is not obligated to turn over any proceeds that it collects in good faith before the creditor receives notification that the senior assignee has enforced its interest in rents, but shall turn over to the senior assignee any proceeds that it collects after it receives the notification.

Preliminary Comments

1. “Milking” of rents and existing law. The owner of distressed income-producing real property may sometimes engage in “milking” of rents — i.e., collecting rents and using them for purposes unrelated to the mortgage debt. 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 divest the mortgagor of control over rents.

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

All authorities agree that the mortgagee has no basis for recovering cash proceeds of rents
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. See Act § 15, Comment 4, Illustrations 6 and 7. 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 real 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.]

The weight of available authority suggests that the mortgagor’s diversion of rents would
constitute legal waste, at least where the mortgagee had taken sufficient steps to enforce its
security interest in rents. See, e.g., Taylor v. Brennan, 621 S.W.2d 592 (Tex. 1981) (mortgagor’s
collection and disposition of rents following mortgagee’s enforcement of security interest in rents
would constitute waste, but holding that no waste occurred because mortgagee had not taken
sufficient steps post-default to enforce its security interest in rents); Ginsberg v. Lennar Florida
Holdings, 645 So.2d 490 (Fla. App. 1994). The Restatement (Third) of Property — Mortgages
adopts this view in § 4.6(a)(5), which provides that “[w]aste occurs when, without the
mortgagee’s consent, the mortgagor … retains possession of rents to which the mortgagee has the
right to possession.”

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

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

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

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

3. **Commingling.** An assignor that collects rents following enforcement of an assignment
of rents may commingle those funds with other funds that are not rents or the proceeds of rents.
For example, an assignor hotel operator might receive a notification of enforcement from the
assignee under Section 8, and thereafter might generate a day’s worth of revenues consisting in
part of rents (room revenues) and in part of nonrents (food and beverage revenues). Subsections
(b) and (c) make clear that the assignor’s commingling of these funds does not automatically
deprive the assignee of its security interest in the rents. As long as the proceeds of the rents are
“identifiable,” the assignee’s interest remains enforceable against those proceeds. In this context,
“identifiable” has the same meaning as it does in U.C.C. § 9-315(a). 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
4. Collection of rents by subordinate assignee. Subsection (f) provides that a person holding a subordinate assignment of rents generally may enforce that assignment, collect rents, and apply any proceeds collected in good faith to its debt without having any obligation to turn over those proceeds to a senior assignee. This protection is subject to two limitations, however. First, once the junior assignee receives a notification from the senior assignee that the senior assignee has enforced its assignment of rents, the junior assignee must turn over any proceeds that it collects after receiving that notification. Second, if the junior assignee has entered into an intercreditor agreement that obligates it to turn over any collected proceeds to the senior assignee, the senior assignee may enforce that agreement. Furthermore, the protection extends only to rents collected by the subordinate assignee in good faith. If the subordinate assignee collects rents under Sections 8 or 9 of this Act without having given notification of its enforcement to the senior assignee as required by the Act, the subordinate assignee would not be collecting rents in good faith and would not be protected by subsection (f).

SECTION 15. PERFECTION AND PRIORITY OF ASSIGNEE’S SECURITY INTEREST IN PROCEEDS.

(a) In this section:

(1) “Article 9” means [Article 9 of the Uniform Commercial Code as adopted in this state] or, to the extent applicable to any particular issue, Article 9 as adopted by the state whose laws govern that issue under the choice-of-laws rules contained in Article 9 as adopted by this state; and

(2) “Conflicting interest” means an interest in proceeds, held by a person other than an assignee, that is:

(A) a security interest arising under Article 9; or

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

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

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

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

Preliminary Comments

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

Section 15 applies to any priority conflict as to proceeds between an assignee of rents and
the holder of a “conflicting interest.” A “conflicting interest” is a security interest in the
proceeds that arises under Article 9, or any other interest in the proceeds if Article 9’s priority
rules resolve a conflict between that interest and a conflicting Article 9 security interest.

2. Perfection and priority of assignee’s security interest in cash proceeds. In the typical
case, a tenant’s payment of rent will result in cash proceeds. An assignee of rents would have a
security interest in cash proceeds of rents as long as the assignee could satisfy the tracing burden
imposed by Section 14’s “identifiability” standard. See Sections 14(a), (b). Further, Section
15(b) makes clear that the assignee’s security interest in cash proceeds is perfected so long as the
assignee’s security interest in rents was perfected. Cf. U.C.C. § 9-315(c), (d) (continuous
perfection of Article 9 security interest in identifiable cash proceeds where security interest in
original collateral was perfected).
Generally speaking, priority between an assignee’s security interest in identifiable proceeds and a conflicting interest is governed by the priority rules expressed in Article 9. However, an assignee’s perfected security interest in identifiable cash proceeds has priority over a conflicting interest that is perfected under Article 9 by a means other than by control.

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

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

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

Illustration 1. In year 1, Debtor grants to Secured Party an effective security interest in all of Debtor’s existing and after-acquired assets, and Secured Party perfects this security interest by filing. In year 2, Debtor makes an assignment of rents to Assignee, and Assignee promptly records. In year 3, Debtor receives a rent check from Tenant. Assignee has a perfected security interest in the check as identifiable cash proceeds of rents. Secured Party has a perfected security interest in the check, but Secured Party’s security interest is perfected only by filing. Thus, Assignee has priority as to the check under subsection (d).
Illustration 2. Same as Illustration 1, except Debtor deposits the check into a deposit account maintained at Bank. Secured Party has not established control over the deposit account in accordance with U.C.C. § 9-104. Assignee has a perfected security interest in the deposited funds as identifiable cash proceeds of rents. Secured Party also has an Article 9 security interest in the deposited funds as proceeds of the check, but that security interest is perfected only by virtue of Article 9’s continuous perfection as to identifiable cash proceeds under U.C.C. § 9-315(c), (d)(2). Thus, Assignee has priority as to the deposited funds under subsection (d).

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

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

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

Illustration 6. Assignor makes an assignment of rents to Assignee promptly records. The following month, Assignor receives a rent check from Tenant, and deposits the check into a bank account containing only proceeds of rents. Assignor then write a check drawn on that bank account to Supplier in payment of an account incurred by Assignor to purchase office equipment and supplies. In good faith, Supplier accepts the check and presents it for payment and the check is paid. Even though Assignee had a perfected security interest in the proceeds of rents deposited into the bank account, Supplier takes the funds paid from the bank account free and clear of the Assignee’s security interest in those funds. Cf. U.C.C. § 9-332(b) (transferee of funds from deposit account takes them free of a security interest in the deposit account unless the transferee acts in collusion with debtor in violating rights of secured party).

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

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

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

**Preliminary Comments**

Section 16 makes it clear that a person entitled to priority under this Act may effectively agree to subordinate its claim. Contractual subordination of a security interest in rents and/or proceeds may occur in the context of an intercreditor agreement between persons holding conflicting security interests in rents. The enforceability of such agreements is governed by state law other than this Act.

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

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

**SECTION 19. REPEALS.** The following acts are repealed: [List statutes to be repealed.]
SECTION 20. APPLICATION TO EXISTING RELATIONSHIPS.

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

(b) This [act] does not affect an action or proceeding commenced before the effective date of this [act].

(c) Section 4(a) of this [act] does not apply to any security instrument signed and delivered before the effective date of this [act].

(d) This [act] does not affect:

(1) the enforceability of an assignee’s security interest in rents or proceeds if immediately before the effective date of this [act] that security interest was enforceable;

(2) the perfection of an assignee’s security interest in rents or proceeds if immediately before the effective date of this [act] that security interest was perfected; or

(3) the priority of an assignee’s security interest in rents or proceeds with respect to the interest of another person if immediately before the effective date of this [act] the interest of the other person was enforceable and perfected, and that priority was established.

SECTION 21. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. Section 7001, et. seq.) but does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c)) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15
U.S.C. Section 7003(b).