Testimony of Barry C. Hawkins
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In Support of Committee Bill 597
An Act Adopting the Uniform Assignment of Rents Act
Committee on Judiciary
March 12, 2007

Senator McDonald, Representative Lawlor, Members of the Judiciary Committee, thank you for the opportunity to comment in support of Bill 597, An Act Adopting the Uniform Assignment of Rents Act. My name is Barry C. Hawkins of 15 Armitage Drive in Bridgeport, Connecticut. I am a Partner in the firm of Shipman & Goodwin, LLP resident in its Stamford office. Since 1999 I have served as one of the Commissioners of Uniform Laws for the State of Connecticut. In that capacity I serve as one of the commissioners from Connecticut in the National Conference of Commissioners on Uniform State Laws which is often referred to as "NCCUSL".

In October 2002 I was asked by NCCUSL to serve on a Study Committee to determine whether NCCUSL should undertake the drafting of an act to provide laws governing assignments of rent. At that time only California had adopted comprehensive statutory guidance for this important subject matter.

To address the problems which had become increasingly apparent, the Study Committee recommended that a revised version of UMIFA be drafted. In August 2003 a national drafting committee was appointed which worked for two years in drafting a new act which was adopted in final form by NCCUSL in July 2005. It was my privilege to serve as a Member of the Drafting Committee and as National Enactment Coordinator.

The Uniform Assignment of Rents Act (UARA), provides a comprehensive framework to govern the creation, perfection, and enforcement of security interests in rents arising from mortgaged real property. Without such a comprehensive statutory framework, courts (particularly bankruptcy courts) have struggled to establish clear and consistent rules governing security interests in rents – thereby encouraging needless and wasteful litigation over control of rents arising from mortgaged real property.

Enactment of UARA in Connecticut will provide much-needed clarity by establishing the following rules:

- *"Rents" include sums payable for the right to possess or occupy the real property of another person, even if the occupant does not technically constitute a "tenant" under real property law.* In some commercial real estate developments (such as hotels and marinas), the occupants or "end-users" are not tenants under real property law, because their occupancy agreement does not create a sufficiently "exclusive" or "possessory" right. For this reason, some courts have refused to

treat hotel room charges as "rents" and have thus concluded that hotel room charges would not be covered by an assignment of rents – even though such charges are functionally analogous to rents and parties often executed an assignment of rents believing that it covered such charges. UARA helps to resolve this documentary "trap," by providing that "rents" includes any sums payable for the right to possess or occupy the real property of another person.

- *A security interest in rents is perfected (and thus enforceable against creditors and purchasers) upon recording of the document creating an assignment of rents.* Under Article 9 of the Uniform Commercial Code, the filing of a financing statement is sufficient to perfect a security interest in most forms of personal property. By contrast, some courts have held that even if a creditor held a recorded assignment of rents, the creditor held only an "inchoate" lien until the creditor actually collected the rents after default. Many of these courts further held that if the debtor filed for bankruptcy before the creditor took effective steps to collect the rent after default, the creditor's interest was unperfected and the bankruptcy trustee could set aside the creditor's interest in rents using the trustee's strong-arm power. UARA overrules these decisions, providing that the recording of a document creating an assignment of rents is sufficient to perfect the creditor's security interest in rents and thereby make that interest enforceable against subsequent creditors and purchasers.

- *A security interest in rents is separate and distinct from a security interest in the underlying real property.* The primary purpose of an assignment of rents is to create an effective security interest in rents that accrue after the assignor's default and prior to the assignee's completion of a foreclosure sale of the mortgaged real property. Most courts have treated these rents as a source of collateral that is separate and distinct from the underlying land. A few notorious bankruptcy court decisions, however, have held that rents are "subsumed within the land" such that a debtor need not provide adequate protection of the assignee's security interest in rents. UARA would overrule these decisions (to the extent that they rely upon state law), providing that a security interest in rents is an additional source of collateral that is distinct from the underlying real estate.

- *There is no such thing as an "absolute assignment of rents' in the context of a mortgage transaction; an assignment of rents creates only a security interest in the rents.* Properly understood, an assignment of rents creates only a security interest in rents as collateral for the mortgage debt. Courts in some states, however, have held (and continue to hold) that an assignment of rents that purports to be an "absolute assignment" passes full title to the rents to the assignee, even prior to the assignor's default. UARA would overrule these decisions, providing that any assignment of rents granted in the context of a mortgage transaction creates only a security interest in rents (regardless of its form).

- *In a mortgage or assignment of rents, a provision granting the assignee the right to obtain a receiver following the assignor's default is enforceable.* In many states, statutes provide few (if any) standards to inform a court's exercise of discretion whether to appoint a receiver to collect rents from mortgaged real property. UARA established consistent standards to govern the appointment of a receiver for mortgaged real property.

- *Upon default by the assignor (or as otherwise agreed by the assignor), the assignee may collect all rents that have accrued but remain unpaid and all rents that accrue thereafter.* By its terms, UARA does not allow the assignee to require the assignor to turn over sums already collected from its tenants prior to enforcement by the assignee. However, an assignee could create, perfect, and enforce a security interest in such monies under the provisions of UCC Article 9.

- *The assignee may enforce an assignment of rents by obtaining the appointment of a receiver, by notification to the assignor, by notification to the assignor's tenants, or by any other method permitted by law.* UARA provides specific rules governing the collection of rents by receivership, by notification to the assignor, and by notification to tenants. UARA also provides that an assignee could collect rents by any other method permitted by law (including by becoming a mortgagee-in-possession).

- *The assignee's enforcement of its rights and remedies under UARA does not render the assignee as a "mortgagee in possession" or trigger other adverse statutory consequences.* At common law, a creditor that collected rents after default risked a possible argument that the creditor had become a "mortgagee in possession" – thereby triggering fiduciary obligations to the assignor and potential tort liability to third parties. UARA provides that the assignee's mere exercise of UARA's statutory remedies does not render the assignee as a mortgagee in possession.

- *An assignor that collects rents after it received notification that the assignee has enforced its security interest in rents must turn over to the assignee the rents collected; if the assignor fails to do so, it is liable to the assignee for the amount not turned over.* At common law, an assignor that refused to turn over rents to the assignee despite proper demand by the assignee could beheld liable for "waste" (or conversion) of rents. The amount of such liability, however, varied depending upon whether the jurisdiction followed the lien theory of mortgages (damages recoverable only to the extent assignee was harmed) or the title theory of mortgages (damages measured by the amount of rents collected and not turned over). UARA provides that the assignor that fails to turn over collected rents following a proper demand by the assignee is liable to the assignee for all sums collected by the assignor. Any damages recovered by the assignee in an action under § 14, however, constitute security for the mortgage debt and must therefore be applied to the mortgage debt.

- *Most tenants that receive notification to make rent payments to the assignee cannot thereafter discharge their rental obligation by paying the assignor.* Under the common law of contracts, the obligor can discharge its obligation by payment to the obligee until the obligor receives notification that the obligee has assigned the right to payment and the assignee directs the obligor to make payment to the assignee. UARA primarily tracks existing common law, providing that a tenant that receives notification to pay the assignee can only discharge its obligation by paying the assignee. UARA does provide an exception for a tenant that occupies the premises as its primary residence, permitting such a tenant to satisfy its rental obligation by payment to either the assignee or the assignor.

- *An assignee that collects rents from the tenants or the assignor can apply the collected sums to the mortgage debt and need not apply the rents to the payment of expenses of maintaining the mortgaged real property (unless otherwise agreed by the mortgagee).* Tenants under commercial leases often pay sums called "rent" or "additional rent" based upon the tenant's proportionate share of real property taxes, insurance and maintenance. An assignment of rents typically assigns the assignor's right to collect these payments to the assignee as security for the mortgage debt. Under prevailing law, an assignee that collects such rents can apply them to the debt, without obligation to use those sums for the payment of property-related expenses (unless the assignee has so agreed). UARA follows this prevailing view. UARA preserves any claims or defenses that a tenant may have by virtue of the landlord's nonperformance of the lease, and also permits a tenant to seek appointment of a receiver if the assignee's nonpayment of property-related expenses causes or threatens harm to the tenant's interest in the mortgaged real property.

- *UARA establishes priority rules that govern disputes between interests created by real property law (a security interest in the cash proceeds of rents) and interests in the same property created under Article 9.* A perfected security interest in rents extends to the identifiable proceeds of those rents – typically, cash collections. Because cash monies – and the deposit accounts in which cash is typically maintained – are personal property in which a competing security interest can be created under Article 9, UARA provides coordinating priority rules to govern such priority disputes.

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