

BILL ANALYSIS

S.B. 889
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Business & Industry
Committee Report (Unamended)

BACKGROUND AND PURPOSE

A lien against collateral is perfected when a person's security interest in that collateral is established with respect to third party creditors. With most types of security interest, perfecting a lien is a standardized process that is clearly defined in statute, which provides lenders confidence that a loan is secured in the event of a default by a borrower. In a commercial lease transaction, a lender will obtain a security interest in both the property being purchased and the rents and other proceeds that the property may generate. Such an interest, known as a collateral assignment of rents, provides a lender only a security interest in those proceeds.

A Texas Supreme Court case in the early 1980s complicated this process by holding that a lender does not have a perfected security interest in a property's proceeds until the lender takes some proactive action to collect those proceeds directly from the property tenant following a default by the borrower. As a result of this holding, a lender's security interest may become subordinate to another party's security interest if that other party is able to perfect its lien before the lender perfects its security interest.

To resolve this issue, lenders have for decades required parties to a commercial real estate loan to execute an absolute assignment of rents, which states that a lender owns all proceeds from the subject property and will allow the property owner to use those rents until a default occurs. However, the use of absolute assignment of rents agreements has caused a separate problem for lenders. In some bankruptcy cases, it has been argued that rents collected and kept by the property owner should be credited against the owner's debt to the lender, even if the lender did not actually receive those funds, an argument based on the fact that the lender owns all proceeds paid on the property, regardless of whether any of those funds are actually applied against the debt.

While Texas law does not adequately address the perfection of a lien on rents, the Uniform Assignment of Rents Act developed by the National Conference of Commissioners on Uniform State Laws serves as a basis for enacting corresponding law in Texas. S.B. 889 seeks to adopt a version of the national model legislation that conforms to Texas law, clarify the process for perfecting a lien on rent proceeds from property subject to a lien, and exempt residential estates so as not to put an unnecessary burden on homeowners and residential tenants.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

S.B. 889 amends the Property Code to establish provisions relating to assignment of rents to a lienholder. The bill establishes that an enforceable security instrument creates an assignment of rents arising from real property securing an obligation under the security instrument, unless the security instrument provides otherwise or the security instrument is governed by a provision of

the Texas Constitution protecting a homestead from forced sale for payment of debt with certain exceptions. The bill establishes that 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, regardless of whether the document is in the form of an absolute assignment, an absolute assignment conditioned on default or another event, an assignment as additional security, or any other form. The bill establishes that the security interest in rents is separate and distinct from any security interest held by the assignee in the real property from which the rents arise. The bill establishes that an assignment of rents does not reduce the secured obligation except to the extent the assignee collects rents and applies, or is obligated to apply, the collected rents to payment of the secured obligation.

S.B. 889 authorizes the recording of a document creating an assignment of rents in the county in which any part of the real property is located. The bill establishes that the security interest in the rents is perfected on recordation of a document creating an assignment of rents and that the bill's provision regarding the perfection of the security interest in the rents prevails over a conflicting provision in the document creating the assignment of rents or another state law that prohibits or deters enforcement of the security interest until the occurrence of a subsequent event. The bill establishes that a perfected security interest has priority over the rights of a person who, after the security interest is perfected, acquires a lien on or other security interest in the rents or the real property from which the rents arise or an interest in the rents or the real property from which the rents arise. The bill grants an assignee of a perfected security interest in rents the same priority over the rights of a person who subsequently acquires a lien, other security interest, or interest in the rents or real property with respect to future advance as the assignee has with respect to the assignee's security interest in the real property from which the rents arise.

S.B. 889 authorizes an assignee to enforce an assignment of rents using one or more of the methods provided by the bill's provisions or another method sufficient to enforce the assignment under state law. The bill entitles the assignee, on and after the date on which an assignee begins to enforce an assignment of rents, to collect all rents that accrued before but remain unpaid on that date and accrue on or after that date.

S.B. 889 authorizes the assignee, after default or as otherwise agreed by the assignor, to provide the assignor a notice demanding that the assignor pay the assignee the proceeds of any rents that the assignee is entitled to collect under the bill's provisions. The bill establishes that the assignee begins enforcement on the date on which the assignee provides such notice to the assignor in the manner specified by the bill's provisions. The bill prohibits an assignee from enforcing an assignment of rents if, on the date the security instrument was signed and the date of prospective enforcement, the real property constitutes the assignor's homestead on which is located a one-family to four-family dwelling.

S.B. 889 authorizes the assignee, after default or as otherwise agreed by the assignor, to provide to a tenant of real property that is subject to an assignment of rents a notice demanding that the tenant pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrue. The bill requires the assignee to provide a copy of the notice to the assignor in the manner specified by the bill's provisions. The bill requires the notice to substantially comply with the form prescribed by the bill's provisions and be signed by the assignee or the assignee's authorized agent or representative. The bill establishes that the assignee begins enforcement under these provisions on the date on which the tenant receives notice demanding payment of unpaid accrued rents and subsequent rents as they accrue. The bill establishes that after a tenant receives a notice, the tenant is obligated to pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrue, unless the tenant has previously received a notice from another assignee of rents provided by that assignee and the other assignee has not canceled that notice; that the tenant is not obligated to pay to an assignee rent that was prepaid to the assignor before the tenant received the notice; that the tenant is not discharged from the obligation to pay rents to the assignee if the tenant pays rents to the assignor, unless the tenant occupies the premises as the tenant's primary residence; that the 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 that the tenant's obligation to pay rents to the assignee continues until the earliest date on which the tenant receives one of the following: a court order directing the tenant to pay the rents in a different manner, a signed notice that a perfected security instrument that has priority over the assignee's security interest has been foreclosed, or a signed document from the assignee canceling the assignee's notice. The bill establishes that a tenant who has received a notice demanding payment is not in default for nonpayment of rents that accrue during the 30 days after the date the tenant receives the notice until the earlier of the 10th day after the date the next regularly scheduled rental payment would be due or the 30th day after the date the tenant receives the notice.

S.B. 889 requires an assignee that has provided a notice to a tenant demanding payment to provide another notice immediately to the tenant canceling the earlier notice on receiving a notice from another creditor who has priority on the basis of a perfected security interest in rents that the creditor with priority has conducted a foreclosure sale of the real property from which the rents arise or is enforcing the creditor's interest in rents by notice to the tenant. The bill sets out the content and form for providing notice to a tenant that satisfies the requirements for enforcement of a security interest by notice to a tenant when properly completed.

S.B. 889 establishes that the enforcement of an assignment of rents by notice to tenant or to assignor, the application of proceeds to expenses of protecting or maintaining real property subject to an assignment of rents by the assignee after enforcement, the payment of expenses under provisions relating to the application of proceeds generally, or an action under provisions relating to turnover of rents and the assignor's liability, does not make the assignee a mortgagee in possession of the real property from which the rents arise; does not make the assignee an agent of the assignor; does not constitute an election of remedies that precludes a later action to enforce the secured obligation; does not make the secured obligation unenforceable; does not limit any right available to the assignee with respect to the secured obligation; or does not bar a deficiency judgment under any state law governing or relating to deficiency judgments following the enforcement of any encumbrance, lien, or security interest.

S.B. 889 requires an assignee who collects rents under the bill's provisions or collects on a judgment in an action relating to turnover of rents and the assignor's liability, unless otherwise agreed by the assignor, to apply the sums collected to the following, in order: reimbursement of the assignee's expenses of enforcing the assignee's assignment of rents, including, under certain conditions, reasonable attorney's fees and costs incurred by the assignee; reimbursement of any expenses incurred by the assignee to protect or maintain the real property that is subject to the assignment of rents if the assignee elects or is required to apply the proceeds to those expenses; payment of the secured obligation; payment of any obligation secured by a subordinate security interest or other lien on the rents if, before distribution of the proceeds, the assignee receives a signed notice from the holder of the interest or lien demanding payment of the proceeds; and payment of any excess proceeds to the assignor.

S.B. 889 establishes that, unless otherwise agreed by the assignee, an assignee that collects rents following enforcement is not obligated to apply the collected rents to the payment of expenses of protecting or maintaining the real property subject to an assignment of rents. The bill establishes that, unless otherwise agreed by a tenant, the right of the assignee to collect rents from the tenant is subject to the terms of any agreement between the assignor and tenant and any claim or defense of the tenant arising from the assignor's nonperformance of that agreement.

S.B. 889 requires an assignor, if the assignor collects rents that the assignee is entitled to collect, to turn over the proceeds to the assignee not later than the 30th day after the date the assignor receives notice from the assignee or within another period prescribed by a security instrument or other document signed by the assignor and approved by the assignee, less any amount representing payment of expenses authorized by a security instrument or other document signed by the assignee. The bill authorizes an assignee, if an assignor does not turn over proceeds to the

assignee, to recover from the assignor in a civil action the proceeds, or an amount equal to the proceeds, that the assignor was obligated to turn over and reasonable attorney's fees and costs incurred by the assignee to the extent provided for by an agreement between the assignor and assignee and not prohibited by a law of this state, in addition to any other remedy available to the assignee under state law. The bill authorizes the assignee to maintain such an action with or without taking action to foreclose any security interest that the assignee has in the real property.

S.B. 889 establishes that unless otherwise agreed by an assignee that has priority, a subordinate creditor that has enforced the subordinate creditor's interest before the priority assignee enforces the priority assignee's interests in rents is not obligated to turn over any proceeds that the subordinate creditor collects before the subordinate creditor receives a signed notice from the priority assignee informing the subordinate creditor that the priority assignee is enforcing the priority assignee's interest in rents. The bill requires the subordinate creditor to turn over to a priority assignee any proceeds that the subordinate creditor collects after the subordinate creditor receives the notice from the priority assignee that the priority assignee is enforcing the priority assignee's interest in rents not later than the 30th day after the date the subordinate creditor receives the notice or as otherwise agreed between the priority assignee and the subordinate creditor. The bill requires any proceeds subsequently collected by the subordinate creditor to be turned over to the priority assignee not later than the 10th day after the date the proceeds are collected or as otherwise agreed between the priority assignee and the subordinate creditor.

S.B. 889 establishes that an assignee's security interest in rents attaches to identifiable proceeds and that if an assignee's security interest in rents is perfected, the assignee's security interest in identifiable cash proceeds is perfected. The bill establishes that Business & Commerce Code provisions relating to secured transactions, or the comparable Uniform Commercial Code provisions of another applicable jurisdiction, determine the following: whether an assignee's security interest in proceeds is perfected; the effect of perfection or nonperfection; the priority of an interest in proceeds; and the law governing perfection, the effect of perfection or nonperfection, and the priority of an interest in proceeds.

S.B. 889 establishes that for purposes of the bill's provisions, cash proceeds are identifiable if they are maintained in a segregated deposit account or, if commingled with other funds, to the extent they can be identified by a method of tracing, including application of equitable principles, that is permitted under state law with respect to commingled funds. The bill establishes that its provisions do not preclude subordination by agreement by a person entitled to priority.

S.B. 889 authorizes a person to provide notice under the bill's provisions by transmitting the notice in the manner described in provisions relating to sale of real property under contract lien; by depositing the notice with the United States Postal Service or a commercially reasonable delivery service, properly addressed to the intended recipient's address with first class postage or other cost of delivery paid; or by transmitting the notice to the intended recipient by any means agreed to by the intended recipient. The bill sets out provisions relating to the appropriate address for delivery of notice to the assignor, assignee, and tenant, respectively, and establishes that notice is considered received on the earliest of the date the notice is received by the person to whom the notice is provided; the fifth day after the date the notice is provided by depositing with the United States Postal Service or a commercially reasonable delivery service; or the date on which the notice is considered provided in accordance with an agreement made by the person to whom the notice is provided for the purposes of the bill's provisions.

S.B. 889 establishes that, except as otherwise provided, the bill's provisions govern the enforcement of an assignment of rents, the perfection and priority of a security interest in rents, and the attachment and perfection of a security interest in proceeds regardless of whether the document creating the assignment of rents was signed and delivered before the bill's effective date. The bill establishes that its provisions do not affect the enforceability or perfection of an assignee's security interest in rents or proceeds if, immediately before the bill's effective date,

that security interest was enforceable or was perfected, nor do they affect the priority of an assignee's security interest in rents or proceeds with respect to the interest of another person, if immediately before the bill's effective date, the interest of the other person was enforceable and perfected and that priority was established.

S.B. 889 defines "assignee," "assignment of rents," "assignor," "cash proceeds," "day," "deposit account," "document," "proceeds," "rents," "secured obligation," "security instrument," "security interest," "sign," and "tenant."

S.B. 889 makes a conforming change in a provision of the Business & Commerce Code relating to secured transactions.

EFFECTIVE DATE

On passage, or, if the bill does not receive the necessary vote, September 1, 2011.