

Absolute Assignment Of Rents: Maybe Yes, Maybe No

Law360, New York (May 13, 2011) -- For many years, if not decades, lenders have been trying to persuade courts that the lenders' rights to rents received by the borrower are not affected by a borrower's bankruptcy. See *In re Ventura-Louis Properties*, 490 F.2d 1141 (9th Cir. 1994). Some courts have ruled that if the language of the assignment clearly indicates that the parties intended the assignment of the rents to be absolute, then such rents do not become property of the estate. *Sovereign Bank v. Schwab*, 414 F.3d 450 (3rd Cir. 2005).

Other courts, however, look to the underlying economic substance of the transaction and if they find that the debtor retains some interest in the rents (such as the right to receive rents upon the payment of the loan), then such rents are property of the estate of the debtor. *In re Ventura-Louis Properties*, supra; *Cavros v. Fleet National Bank*, 262 B.R. 206 (Bankr. D. Conn.. 2001); *Lyons v. Federal Savings Bank*, 193 B.R. 637 (Bankr. D. Mass. 1996).

Earlier this year, the Bankruptcy Court for the Southern District of Tennessee fell in line with the latter, "substance over form" courts. *In re Senior Housing Alternatives*, 444 B.R. 386 (Bank. ED Ten 2011).

In *Senior Housing*, the loan documents contained various clauses in support of the "absolute" nature of the assignment. The assignment stated:

- "The purpose of [borrower] in making this assignment is [to] assign to lender the right of [borrower] to collect and enjoy the rents in partial payment of the outstanding debt.
- "This assignment is a present, absolute and unconditional assignment to lender to both the rents and the leases. This assignment presently gives lender the right to collect the rents and to apply the rents in partial payment of the debt ... This assignment is not intended by [borrower] to be an assignment as security for the performance of the debt ... [borrower] intends that the rents absolutely assigned as provided in this assignment are no longer, during the terms of this assignment, property of [borrower] or property of any estate of [borrower] as defined by 11 U.S.C. § 541 of the Bankruptcy Code and will not constitute collateral, cash or otherwise, of [borrower] ... This assignment is intended by [borrower] to create, and will be construed to create, a present transfer of an interest or interests in real estate ... If despite this specifically expressed intention of [borrower], any law exists requiring lender to take actual possession of the property (or some action equivalent to taking possession of the property, such as securing the appointment of a receiver) in order for lender to "perfect" or "activate" the rights and remedies of lender as provided in this assignment, [borrower] waives the benefits of such law and agrees that such law will be satisfied solely by ...

- Lender grants to [Borrower] a revocable license to collect, as agent of Lender and subject to this Assignment, the Rents, as the Rents become due, and to enforce the Leases, so long as no default by Owner exists in payment or performance of the Debt or Obligations, the Deed of Trust, or this Assignment. The revocable license will automatically terminate without further action by Lender, except for notice to [Borrower], if a default occurs . . .
- Lender may apply the Rents and any sums recovered by Lender as provided in this Assignment to the outstanding Debt, as well as to charges for taxes, insurance, improvements, repairs, replacement, maintenance, and other items with respect to the operation of the Property.

The Senior Housing court agreed that a determination of whether an assignment is an absolute assignment effective upon execution or a pledge of security begins with an examination of the language used. The court, however, then went on to note that sometimes the “usual, natural and ordinary meaning” of the words do not reflect the “true nature of the contract.” It is in those situations that the court has the responsibility to ascertain the “true essence of the parties’ agreement, not what labels have been assigned to it.”

The court cites to a 2007 law review article by Julia Patterson Forrester, "Still Crazy After All These Years: The Absolute Assignment of Rents in Mortgage Loan Transactions," 59 Fla. L.Rev 487 (2007) which isolated six factors which courts have identified as reasons to hold that an assignment is one intended for security. These factors are:

1. The assignment is given in connection with (and only because of) a related real estate loan.
2. The borrower is typically permitted to collect rents before default although the borrower may be required to apply the rents for property expenses and debt service but excess rents are freely at borrower’s disposal.
3. The lender is not entitled to collect rents before default.
4. The rents lender collects must be used for property expenses or debt service and are not at lender’s general disposal.
5. The borrower retains the risk of nonpayment of rents by tenants.
6. The assignment of rents terminates upon the full payment of the debt.

The assignment in the Senior Housing case contained a provision that “[u]pon payment to lender of the full amount of the debt ... this assignment will be void and of no further effect.” The Senior Housing court, therefore, concluded that since under the assignment the borrower retained an interest in the rents upon payment of the underlying debt, such interest was sufficient to make the rents property of the estate within the meaning of 11 U.S.C. § 541.

The court referred to various decisions from other courts which have held that a conveyance even if absolute on its face but given in: 1) connection with a loan transaction; and 2) not in exchange for present consideration; and 3) to be reconveyed upon satisfaction of the debt, is a conveyance for security and not absolute.

Moreover, the court correctly observed that in none of the cases concluding that the assignment was for security was there any basis to believe that the borrower had assigned its right to rents “ad infinitum.” Quoting *In re 5822 Poplar LP*, 268 B.R. 140 (Bank. W.D. Tenn. 2001). In fact if there were such a transfer, one would expect that the borrower would receive some consideration for such transfer. In the absence of such consideration, such transfer might well be a fraudulent transfer if the other elements of a fraudulent transfer were satisfied.

The circuits are not united on the issue, See *Sovereign Bank v. Schwab*, supra., and certain courts have held that language stating that an assignment is absolute will take the rents out of the bankruptcy estate at least where the lender prepetition has revoked the borrower's license to collect rents, has moved for the appointment of a receiver and has notified tenants to pay it. *In re Soho 25 Retail*, 2011 WL 133084 (Bank. S.D.N.Y. March 31, 2011).

Consequently, until this issue is resolved in some uniform way either by statute or unity of the circuits or the Supreme Court, absolute assignments in loan documents will continue to be included and litigation as to whether they are in fact absolute will continue to require bankruptcy court resolution.

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