Daily Development for Friday, September 10, 2010
by: Patrick A. Randolph, Jr.
Elmer F. Pierson Professor of Law
UMKC School of Law
Of Counsel: Husch Blackwell Sanders
Kansas City, Missouri
dirt@umkc.edu

MORTGAGES; ASSIGNMENTS OF RENTS; FORECLOSURE PURCHASERS: Purchaser of property at a foreclosure sale must disgorge to prior mortgagee rental income generated by the property, even though there is no privity of contract between the purchaser and such prior lender

Higdon v. Regions Bank, ___ S.W.3d ___ , 2010 Westlaw 1924019 (Tenn. Ct. App. 5/13/10). (Another aspect of this case was the subject of yesterday's DD)

Stinnetts refinanced an existing deed of trust loan on their Property with a loan obtained from ORNL. On September 9, 1999, Weather Tamer advanced additional money to the Stinnetts, secured by a deed of trust that subsequently was assigned to KeyBank USA, N.A. Finally, on September 20, 1999, the Stinnetts obtained another loan from ENM, Inc. Such loan was secured by a third deed of trust which was subsequently assigned to Regions Bank ("Regions").

While the Regions deed of trust was executed after the KeyBank deed of trust, Regions recorded its deed of trust prior to KeyBank, thereby making the Regions lien prior to the KeyBank lien.

The Regions deed of trust included a mortgage acceleration clause that could be executed upon the borrower's breach of the terms of the applicable loan agreement. It also contained standard assignment of rents language providing that "Borrower . . . assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration [of the deed of trust] . . . or abandonment of the Property, have the right to collect and retain such rents as they become due and payable."

Later Key Bank foreclosed and Higdon purchased. Higdon made no effort before purchasing to discover the Regions claim (which remained unaffected by the KeyBank foreclosure). Later a court awarded Regions the principal owned on the loan and amounts Regions had paid on a prior lien it had paid, and also required that Higdon disgorge rents he had received on the property following his acquisition that related to the period prior to the KeyBank foreclosure.

Higdon argued on appeal that he was not liable for rent payments made to him because of his absence of contractual privity with Regions. (The court does not tell us whether the rent payments were for periods before or after the foreclosure. Apparently the court, correctly, saw no distinction for purposes of its analysis.)

The court noted that "it was Mr. Higdon's responsibility to inquire about the status of any mortgage liens or encumbrances with respect to the Property prior to purchasing it at a foreclosure auction." Because the Regions deed of trust contained an express assignment of rents "which it enforced in good faith

following proper notice and the mortgagor's subsequent failure to cure the default" and because "the Property purchased by Mr. Higdon at the foreclosure sale is subject to [Regions'] security interest in the hand of any subsequent purchaser," the lack of contractual privity between Higdon and Regions was irrelevant and the trial court's judgment was affirmed..

Comment 1: Because of the wording of the assignment of rents clause, the court appeared to view the mortgagee's right to rents to arise immediately upon notice of acceleration. The lender had sent Higdon notice of acceleration. There is no indication that it sent a separate notice of activation of its security interest in the rents. Most modern cases, and the Restatement, view it necessary for a mortgagee to "activate" its rents interest before it has a right to claim the rents, even if the lender has accelerated and notwithstanding "automatic" language such as that which appears in the mortgage here. The Tennessee court did not discuss the fact that its upholding of an automatic activation went beyond most other jurisdictions, perhaps because Higdon was resisting the mortgagee's claim on another ground and the court simply didn't focus on the issue.

Comment 2: Other courts are reluctant to enforce boiler plate "automatic activation" clauses because the parties often act without regard to them, causing great confusion later. The wording is an accidental byproduct of a bankruptcy problem since corrected.

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