

Uncovering Hidden Liens: Overview & Best Practices to Ensure Senior Priority Lien Status¹

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¹ The alternative title is *But I Thought I Was First*, which is what the banker will reflexively say when the lawyer first raises the specter of a hidden lien.

Introduction.

The topic of “hidden liens” provokes fear for lenders and stokes paranoia for their attorneys, notwithstanding the casual familiarity that one obtains with it merely by being in the financial services industry. Because of the breadth and diversity of the subject matter, this manuscript can’t possibly address each instance in which it arises. However, this manuscript does provide a framework for understanding such “liens,” focuses on several examples – both well-worn and novel – and briefly suggests some ways to underwrite the attendant risks along with how to mitigate them.

This manuscript is not a scholarly dissertation, but rather a structured-yet-informal discussion with citations sprinkled in for credibility. So, this has been drafted with the intended audience being a relationship banker with a broad mandate that is hungry for a deal and in need of a few cautionary tales to create enough scruples that will, in turn, facilitate a thoughtful conversation with the underwriter. I hope that it helps that banker’s lawyer, too.

Defining the Concept and Why You Should Care About It.

The term “hidden liens” is a colloquial reference for senior interests that other creditors may have in collateral that are not readily apparent to a lender. Three basic observations. First, the operative term is “senior interests” because many of the “liens” are not liens at all – they are claims or other legal structures that practically function like priming liens. (So, going forward the term “liens” is used in a technically imprecise and overbroad, but very convenient, manner.) Second, certain liens are not readily apparent because they cannot be identified with a simple search of the public record. Finally, other liens might not even exist at the time the lender is making the loan and may even arise from conduct unrelated to a traditional debtor-creditor relationship.

What, exactly, are we talking about? Well, a broad spectrum. The hidden lien can be a statutory lien created by state statute other than Article 8 or Article 9 of the Uniform Commercial Code (UCC) to protect the interest of a specific creditor (*e.g.*, mechanics’ liens), or arise under federal statute or regulation (*e.g.*, federal tax liens). It could also emerge from the application of common law principles, such as the equitable subrogation rights of a surety. Or the hidden lien could take the form of a trust concept that arises under state or federal law that is not readily evidenced in any public record or searchable database (*e.g.*, Perishable Agricultural Commodities Act trust provisions). Or it could take the form of a federal statute or regulation that prohibits a lender from taking commercial activity with respect to property that reduces the value thereof (*e.g.*, Fair Labor Standards Act “hot goods” provision). This cornucopia of hidden liens means that a lender has ample fodder to consider when underwriting and monitoring the performance of any loan.

Why should you care about it? Rudimentary underwriting assumes an understanding of a borrower’s ability to create cash flow as well as the value of the borrower’s assets. Upon the occurrence of financial distress, most creditors will seek to improve their position in the capital structure. (And a cash flow lender immediately thinks of how it can become an asset-based lender.) Depending on the industry, certain classes of creditors can, and do, obtain statutory and equitable rights that protect them, sometimes elevating their claims above those of a senior secured lender. An unwary lender may find its claims or liens subordinated to those of a third party. Said differently, if you as a banker or lawyer do not properly spot these issues, then you may be in for the cold sweat of a “should I polish my resume” moment. You don’t want that, so let’s focus on several examples and address how to best prepare for the appearance of any hidden lien.

Example One: Perishable Agricultural Commodities Act of 1930 – an Oldie but a Goodie.

Anyone that has any experience in the agriculture industry (or any industry related to it) is aware that transactions involving fruits and vegetables may be affected by the statutory trust arising under the Perishable Agricultural Commodities Act of 1930 (PACA).² This Depression-era legislation is primarily designed to ensure that “dealers of fresh and frozen fruits and vegetables get what they pay for and get paid for what they sell, including when their customers go out of business, declare bankruptcy, or simply refuse to pay for the fruits and vegetables received.”³ In 1984, Congress amended the statute to create a “floating trust” in favor of suppliers of certain perishable commodities (“PACA Creditors”) on (i) the PACA goods sold and (ii) the proceeds thereof (collectively, the “PACA Assets”).⁴

PACA does not create a priming lien in favor of PACA Creditors on PACA Assets that would otherwise be encumbered by a lender’s lien. However, the practical impact to the lender of the PACA trust’s creation is the same – the PACA Assets are removed from the scope of the lender’s lien until the obligations owed to the PACA Creditors are repaid. In essence, the PACA trust “primes” the lender’s lien by making some portion of the lender’s collateral “disappear.” Because PACA Creditors’ claims can arise at any time, lenders must understand how such claims arise and be wary for signs that suggest such claims are going unpaid.

The PACA trust is created when four key elements are met. First, the PACA Creditor must have sold unprocessed or minimally processed fruits and vegetables.⁵ The extent of acceptable processing is subject to interpretation and has changed over time.⁶ Second, the PACA Creditor must have transacted with a commission merchant, dealer, or broker.⁷ The definitions of those terms are interpreted liberally to provide coverage to a PACA Creditor.⁸ Third, the PACA Creditor’s payment terms must be less than 30 days from receipt of the covered goods, although post-default payment plans are permitted in certain circumstances.⁹ Finally, the PACA Creditor must have provided timely written notice of its intent to preserve rights under

² 7 U.S.C. § 499a *et seq.*

³ U.S. Department of Agriculture, *Common Questions & Answers, USFA Agricultural Marketing Service*, <https://www.ams.usda.gov/rules-regulations/paca/common-questions> (last visited February 26, 2023).

⁴ Pub. L. No. 98-273.

⁵ Applicable federal regulations clarify that PACA’s protections only extend to unprocessed or minimally processed fruits and vegetables. 7 C.F.R. § 46.2(u). The U.S. Department of Agriculture identifies qualifying produce in the following publication: <https://www.ams.usda.gov/sites/default/files/media/CommoditiesCoveredbyPACA.pdf>.

⁶ The U.S. Bankruptcy Court for the District of Delaware’s decision in *In re Ameriserve Food Distribution Inc.*, 267 B.R. 668 (D. Del. 2001), is one example of how standards have been applied by a court and later revised by Congress. The bankruptcy court held that the PACA Creditor’s claim against the bankruptcy estate for the sale of “battered and coated” frozen potatoes was ineligible for PACA protections because of such processing. Thereafter, due to industry group lobbying, the U.S. Department of Agriculture clarified that battering and coating constitutes acceptable processing that did not change the character of the food. 68 Fed. Reg. 23377 (May 2, 2003). Subsequent decisions on the same facts have resulted in PACA protections to PACA Creditors.

⁷ Each term is defined in 7 C.F.R. § 46.2.

⁸ For example, prior to 2000, the U.S. Department of Agriculture interpreted the PACA rules not to apply to sales to restaurants under the theory that restaurants were not in the business of buying or selling perishable agricultural commodities. In the case of *In re Magic Restaurants, Inc.*, 205 F.3d 108 (3d Cir. 2000), the Third Circuit held that the plain language made restaurants “dealers” under the law notwithstanding such interpretation. Other courts have followed suit.

⁹ 7 C.F.R. § 46.46(e). Prior to 2011, any extension of the 30-day period would terminate PACA protection. In 2011, the U.S. Department of Agriculture amended its regulations interpreting PACA to, among other things, permit a PACA Creditor to provide for *post*-default extensions of the 30-day period. 76 Fed. Reg. 20217-01 (Apr. 12, 2011).

PACA, which requirement may be, and often is, satisfied by the inclusion of a statement on the invoice or billing statement.¹⁰

There is ample case law that illustrates how buyers of PACA goods, and their lenders, defend against PACA liability by successfully challenging one or more of the four key elements necessary to establish a PACA trust. Let's assume that the lender is not successful in its challenge and that a PACA Creditor has a viable claim. In that situation, the concerns for the lender are that: (i) the scope of PACA Assets is potentially large, and independently acquired assets can arguably become PACA Assets if proceeds of other PACA Assets are used to make such acquisition;¹¹ and (ii) the burden to prove that an asset is not a PACA Asset falls on the buyer of the PACA goods (or its lender).¹² In certain circumstances, lenders can be forced to disgorge funds received as payment in respect of valid loan obligations because those funds are held to constitute PACA Assets.¹³ To avoid that fate, a lender must constitute a bona fide purchaser for value – a party that received the asset or payment for value and without notice of the breach of the trust.¹⁴ The factual circumstances will vary and therefore so will any legal conclusion as to status as a bona fide purchaser for value. Speaking very generally, the receipt of an ordinary course loan payment may constitute value, while the foreclosure or seizure of collateral does not.¹⁵ Even if the lender is not definitively aware that the payment it received breached the PACA trust, courts will assess whether the lender should have known about the non-payment of PACA claims, in which case it will be deemed to have knowledge of such breach.¹⁶

PACA's implication for a lender is that the lender must underwrite its loans assuming that PACA Creditors' claims will prime all liens. In the asset-based lending context, legal documents should include appropriate reserves and procedures for adequate monitoring. In the cash flow lending context, the lender must be prepared to extend further credit to its borrower for the payment of PACA Creditors' claims to preserve enterprise value. In any context, the lender must be mindful that the taint of the PACA trust can theoretically extend to all assets.¹⁷ Accordingly, a lender should adjust financial covenants to specifically account for PACA Creditors' claims and may desire language that establishes a lower cross-default threshold for such claims that allows it to cease funding following its borrower's default thereon (to avoid double exposure).

PACA is sufficiently well-understood and a common example of a trust concept that operates as a hidden lien. Lenders should be mindful of other industry specific trust concepts that have a similar impact from an

¹⁰ 7 C.F.R. § 46.46(f)(3)-(4).

¹¹ *In re Kornblum & Co., Inc.*, 81 F.3d 280, 284 n.2 (2d Cir. 1996). (“Throughout this opinion, we refer to assets acquired with the cash proceeds of trust property as being included among the ‘proceeds’ of that property. The same result follows, however, whether one views an asset purchased with the cash proceeds of a trust property as a second-generation ‘proceed’ (thereby falling within the statutory definition of trust property), or as the product of a wrongful dissipation of trust assets (thereby becoming a part of the trust by operation of law).”)

¹² *Sanzone-Palmisano Co. v. M. Seaman Enters., Inc.*, 986 F.2d 1010, 1014 (6th Cir. 1993).

¹³ *See, e.g., Endico Potatoes, Inc. v. CIT Group/Factoring*, 67 F.3d 1063 (2d Cir. 1995) (requiring the lender to disgorge funds arising from its collection of accounts receivable that was its collateral).

¹⁴ *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1382 (3rd Cir. 1994).

¹⁵ *See, e.g., C.H. Robinson Co. v. Trust Co. Bank, N.A.*, 952 F.2d 1311, 1315 (11th Cir. 1992) (explaining that ordinary loan payments may be retained, but that payments received from the enforcement of a lien must be disgorged).

¹⁶ *See, e.g., Nickey Gregory Co., LLC v. Agricap, LLC*, 597 F.3d 591, 605–06 (4th Cir. 2010) (determining that the lender could not claim to be without notice of the breach of the PACA trust when it had knowledge of the borrower's excessive aging of PACA receivables).

¹⁷ If the lender is underwriting an acquisition loan, it should confirm the source of proceeds for such acquisition and the resulting debt service payments.

underwriting perspective, such as the Packers and Stockyards Act of 1921 for livestock, meat, and poultry,¹⁸ and the patchwork quilt of state laws governing the payment of certain agricultural products (most notably, milk).¹⁹

Example Two: Equitable Subrogation in the Suretyship Context.

Lenders that finance borrowers that post payment or performance surety bonds to conduct business must be mindful of surety companies' rights of equitable subrogation. In brief, the surety guarantees the performance of an obligation of its principal (*i.e.*, the borrower) to a third party (*i.e.*, the borrower's customer). These performance obligations often include payments to vendors or the completion of performance under a contract. For a fee, the surety provides a bond to a beneficiary (the "obligee") who requires its contractual counterparty (*i.e.*, the borrower) to obtain such bond.²⁰ The surety's obligation is limited to the "notional" amount of the bond that it has issued. The surety and the borrower enter into a contractual agreement pursuant to which, among other things, the borrower agrees to indemnify the surety for any loss the surety sustains in connection with the corresponding bond.

In addition to the surety's rights under the indemnity contract with the borrower, the surety can avail itself of the (quite powerful) common law principles of equitable subrogation. These principles provide that when a person who is secondarily liable pays the debt of another, who is primarily liable, the secondarily liable party will be substituted to the rights and remedies of the creditor whose debts the secondarily liable party discharged. So, if the borrower defaults on its bonded contract with its customer (the obligee), then the surety will perform the borrower's obligations pursuant to the terms of the bond and step into the shoes of: (i) the borrower to, among other things, receive payment for work performed; (ii) the obligee to, among other things, pay laborers out of funds retained from progress payments and apply earned but unpaid progress payments in the hands of the obligee as a credit to the cost of completion; and (iii) any other creditor whose debts the surety satisfies, such as a subcontractor of the borrower.²¹

What makes the concept of equitable subrogation a hidden lien is that the interaction between the surety's equitable subrogation rights and the lender's rights against its borrower and/or collateral is not a question of lien priority. Article 9 of the UCC does not apply; the surety need not file a UCC-1 financing statement; and the underlying bond may not predate the lender's extensions of credit or filed UCC-1 financing statement.²² By virtue of the right of equitable subrogation, the borrower's right to payment under the contract from the obligee becomes the surety's asset and, as such, the lender's liens do not attach to the asset.²³ In addition to losing collateral, the lender risks disbursement of receivables payments (that became

¹⁸ 7 U.S.C. § 181 *et seq.*

¹⁹ See, *e.g.*, NY Agric. & Mkts. Law ch. 69, art. 20; Tex. Agric. Code Ann. § 103.002.

²⁰ These come in all shapes and sizes, including payment and performance bonds, bid bonds, supply bonds, maintenance bonds, fidelity bonds, and license and permit bonds. (Say that sentence again in a Forrest Gump voice.)

²¹ The extent of equitable subrogation to retainage, unearned progress payments, and earned and unpaid progress payments is specific to state law. Further, the cross-application of receivables between progress is generally not automatic.

²² The scope of Article 9 of the UCC extends to a transaction that "creates a security interest in personal property or fixtures *by contract.*" UCC § 9-109 (emphasis added). The surety's rights arise by operation of law under the equitable doctrine of subrogation, and not by contract. Further, the UCC does not displace equitable principles, except to the extent expressly displaced by a specific provision therein. UCC § 1-103.

²³ Moreover, the surety's subrogation rights relate back to the date of the issuance of the bonds for the borrower's underlying contract. *Western Casualty and Surety Co. v. Brooks*, 362 F.2d 486, 489–90 (4th Cir. 1966) ("[S]ince this

the surety's asset) applied to the debt or worse – double exposure if it applies such payment to a revolving facility and readvances credit thereunder. Yikes.

Lenders need not panic but must keep several simple principles in mind. First – and imagine Captain Obvious saying this – the risk of equitable subrogation only practically exists when the borrower is insolvent or in serious financial distress. Those situations are rare.²⁴ Second, the “notional” amount of the bond may overstate the actual exposure, because the borrower may be well down the path of completing the corresponding project. Third, the spectrum of surety risk can be appropriately mitigated depending on how great it is. If the risk is relatively small, then perhaps a simple carve-out in the loan documents from the indebtedness and lien covenants specifically relating to the surety bond exposure will suffice. If the risk is greater, then the loan documents may need to include numerous provisions to address the potential for a material surety default.²⁵ If the risk is sufficiently great, then a properly documented intercreditor agreement with the surety is likely necessary.

Examples Three Through Six: Statutory Liens.

There are numerous examples of statutory priming liens that could be addressed in this manuscript, though for obvious reasons – you're still reading, and I'd love for you to read all of it! – I'll gloss over many and focus more specifically on a few. Let's dispense with two brief summaries of generic concepts. First, mechanics' liens arise in all jurisdictions, provide credit protection to contractors and suppliers, and have diverse eligibility standards and enforcement mechanisms (although require a county-level filing and some form of notice to the property owner).²⁶ Second, every state has at least one statute establishing a possessory lien in favor of an artisan, warehouseman, or landlord that allows the provider of such service to recover unpaid amounts from the possessed property.²⁷ The UCC provides that a possessory lien on goods has priority over a security interest in the goods unless state law specifically provides otherwise.²⁸ Both concepts have enough nuance and state-specific quirks to keep lenders on their toes. Now, a deeper dive on four specific examples.

Federal Tax Lien Act of 1966. Liens arising under the Federal Tax Lien Act of 1966 provide the Internal Revenue Service (IRS) with powerful rights to collect unpaid taxes, namely a lien on all property belonging to a taxpayer who has failed to pay their taxes. The lien arises automatically when the tax is assessed, continues until the tax is paid or the lien is released and – here's the wrinkle – is filed in the state where the borrower's principal place of business exists (*not* where the borrower is

‘equitable right’ of the surety to the fund relates back to the date of the surety bond, it entitles the surety to priority in payment over all subsequent lienholders and general creditors.”).

²⁴ Says the restructure attorney whose workload has recently increased... ha!

²⁵ Such provisions could include a borrowing base definition that addresses eligibility criteria to remove affected accounts receivable; financial covenant calculations that pick up the notional amount of defaulted bonds; reporting requirements specifically catered to the surety relationship; covenants requiring the segregation of proceeds from defaulted projects; and a cross-default provision specific to surety bonds on material projects.

²⁶ A decision highlighting the morass of conflicts of law principles and interplay between a secured lender's security interest (perfected pursuant to the UCC) and state-specific mechanics' liens protecting participants in a local cottage industry is *In the Matter of First River Energy, L.L.C.*, 986 F.3d 914 (5th Cir. 2021). In that case, the Fifth Circuit determined that (i) a non-uniform provision of the Texas UCC was insufficient to protect Texas producers' rights in the proceeds of the sale of crude oil, (ii) a non-uniform provision of the Oklahoma UCC was sufficient to protect Oklahoma producers' rights, and (iii) the Oklahoma producers' liens trumped those of the senior secured lender.

²⁷ In lieu of conducting an exhausting and unnecessary 50-state survey, I have assumed that every state has this type of lien. I'll be a “homer” and reference, as one example, N.C. Gen. Stat. § 44A-1 *et seq.* (establishing various types of possessory liens for persons who improve or store personal property).

²⁸ UCC § 9-333(b).

organized/formed/resides).²⁹ Although the statute provides that the IRS' lien generally follows the common priority rule of "first in time, first in right," a lender must be aware of an exception known as the "twin 45-day rules." This exception has two applications. First, a lender has priority as to future advances for the earlier of 45 days after the federal tax lien filing or actual knowledge of such filing.³⁰ However, such priority pertains to collateral the taxpayer/borrower owned on the date of the federal tax lien filing and "Qualified Property" (namely, accounts and inventory) acquired during that 45-day period, but not thereafter.³¹ In the second application, a lender's security interest is senior to the federal tax lien as to any after-acquired collateral constituting "Qualified Property" that the taxpayer acquires within 45 days after the date of the federal tax lien. The lender's actual knowledge of the tax lien is irrelevant.³² The twin 45-day rules encourage lenders to check the federal tax lien records – in the borrower's state where its principal place of business is located! – periodically even after making loans.

Comprehensive Environmental Resource, Compensation and Liability Act. The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA)³³ allows, among other things, the federal government to assert claims against a potentially responsible parties³⁴ of property for remediation costs incurred by the government arising from the release of hazardous substances. The federal government has three ways it can impose such liability on property: (i) "superfund" liens on any remediated property where the government has spent any money doing such remediation; (ii) maritime liens on a vessel that releases or threatens to release hazardous material; and (iii) "windfall" liens on the remediated property (even if there was a limited exception to the imposition of a "superfund" lien) to the extent that unrecovered remediation costs increased the fair market value of such property. Courts have universally held that the liability of potentially responsible parties is joint and several,³⁵ so lenders are keen to avoid being labeled an owner of the property that serves as collateral and therefore a potentially responsible party. Fortunately, Congress has included in CERCLA certain safe harbors for secured creditors, including that post-foreclosure ownership of property followed by divestiture thereof "at the earliest practicable, commercially reasonable time, on commercially reasonable terms" will generally not result in liability.³⁶ How a court will interpret that standard is, of course, a matter of fact. In addition to doing diligence regarding the environmental conditions of the property – which lender doesn't do these days? – the lender will want to make sure that it manages any exercise of remedies, especially post-foreclosure property management, with appropriate caution to be within the applicable safe harbors.

Commercial Instruments and Maritime Liens Act (CIMLA). Federal law grants suppliers of certain goods or services to a vessel, otherwise referred to as "necessaries," a super-priority lien on such vessel.³⁷ Courts often interpret the term "necessary" broadly within the context of the purpose for which the specific vessel was operating.³⁸ Such liens do not have to be recorded or filed to be valid. Unlike

²⁹ 26 U.S.C. § 6321 *et seq.* A decision highlighting the extent of the IRS' federal tax lien is *United States v. Craft*, 535 U.S. 274 (2002), in which the Supreme Court of the United States held that the husband's interest in a tenancy by entirety property constitutes an asset to which a federal tax lien may attach.

³⁰ 26 U.S.C. § 6323(d).

³¹ *Id.*

³² 26 U.S.C. § 6323(c).

³³ 42 U.S.C. § 9601 *et seq.*

³⁴ Recovery may be obtained from "potentially responsible parties," which is broad and includes, among others, current owners and prior owners of the property at the time of disposal. 42 U.S.C. § 9607(a)(1)–(4).

³⁵ *See Burlington N. & Santa Fe Ry. Co. v. United States*, 556 U.S. 599, 613–14 (2009) (discussing case law establishing joint and several liability).

³⁶ 42 U.S.C. § 9601(20)(F).

³⁷ 46 U.S.C. § 31301 *et seq.* The vessel itself is the obligor.

³⁸ *See, e.g., Equilease Corp. v. M/V SAMPSON*, 793 F.2d 598, 603 (5th Cir.) (*en banc*), cert. denied, 479 U.S. 984 (1986) ("What is a 'necessary' is to be determined relative to the requirements of the ship."). Note that necessities

traditional secured lending rules, maritime law gives priority to the most recent claim (as opposed to the first claim) filed or asserted against the vessel on the theory that the most recent supplier has preserved the operating value of the vessel for all parties (including the immediately preceding supplier). If you are a lender with a vessel as collateral, then assume that priming liens will exist under the unique U.S. maritime law theory of “last in time, first in right.”³⁹

Health and Human Services “Head Start” Program. The U.S. Department of Health and Human Services (HHS) operates the “Head Start” funding program that provides grants to eligible organizations to operate comprehensive child development programs that serve low-income families. Grant funds used to fund acquisition or major renovations of real property for “Head Start” facilities gives rise to a “federal interest,” which is also a self-effectuating lien known as a “notice of federal interest” (NFI).⁴⁰ The NFI is not a priming lien, but rather a mechanics’ lien that will relate back to (and have priority over anything after) the date that HHS extends grant funds. However, diligence may be difficult because the borrower (and *not* the government as a creditor) is required to post the NFI both at the property and local registry, but the borrower’s failure to do so does *not* destroy either the federal interest or the NFI.⁴¹ Although a borrower is prohibited from mortgaging real property purchased, constructed, or renovated with grant funds without HHS permission, it’s possible that an unwary lender making what it believes is a run-of-the-mill mortgage loan is not informed of, or required by the borrower to address, the NFI prior to closing.⁴² This unique lien reminds us that, when extending credit to entities supported by government programs, lenders should be mindful of the rights such programs may establish in favor of the government.

Bonus Round: Law That May Reduce the Value of the Underlying Property (and the Lien Thereon).

The Fair Labor Standards Act of 1939 (FLSA) is a federal law that establishes minimum wage and overtime requirements for employees.⁴³ Section 15(a) of the FLSA prohibits the transportation, sale, or shipment of goods produced in violation of the FLSA’s minimum wage or overtime provisions. This provision is often referred to as the “hot goods” provision. When the Department of Labor (DOL) determines that goods are “hot goods,” it can issue an order prohibiting their shipment or sale until the employer remedies the FLSA violation. Courts have extended the DOL’s injunction authority to secured creditors. For example, in *Citicorp Indus. Credit v. Brock*, 483 U.S. 27 (1987), the Supreme Court of the United States held that the DOL could enjoin a lender from conducting a foreclosure sale of inventory manufactured in violation of the FLSA. The practical effect of such decision is that if the secured creditor’s collateral constitutes “hot goods,” then wages owed to the employees will “prime” the secured creditor’s lien on the proceeds of such collateral. Said differently, if a foreclosing creditor wants to consummate a sale of the “hot goods,” then it needs to pay the wages that arose in connection with the creation of such goods (from the proceeds of sale or otherwise). Since *Brock*, at least one federal court has articulated that a foreclosing lender must pay the straight time and overtime based on contract rates, and not merely minimum wage rates, owed to employees whose wages FLSA protects.⁴⁴ These cases illustrate that courts broadly interpret the government’s interest

provided to a supply vessel for the benefit of *another* vessel do not entitle the supplier to priority lien status as against the supply vessel. See *Martin Energy Services, LLC v. Bourbon Petrel M/V*, 962 F.3d 827 (5th Cir. 2020).

³⁹ I wish there was some practical advice to provide for this one. Sorry.

⁴⁰ 45 C.F.R. § 1303 *et seq.*

⁴¹ 45 C.F.R. § 1303.46.

⁴² HHS is authorized to subordinate the NFI to third-party liens, but only with certain conditions, including the right to intervene and cure defaults under the loan, a standstill period applicable to the lender, and the right to unilaterally substitute a new borrower to perform the original borrower’s obligations. 45 C.F.R. § 1303.49.

⁴³ 29 U.S.C. § 201 *et seq.*

⁴⁴ *Reich v. Midwest Body Corporation*, 843 F. Supp. 1249, 1252 (N.D. IL 1994).

in enforcing the FLSA, even when such enforcement adversely impacts the recovery of a lender that otherwise has no responsibility to satisfy the ordinary course payment obligations of its borrower.

Underwriting the Risk and Best Practices.

Considering the myriad of liens (again, a loose term) that are not readily identifiable, how does a lender more successfully-than-not underwrite the associated risk of extending credit? By going a mile wide and more than an inch deep with its diligence, and then intelligently gauging materiality of any lien issues. Let's break this down into three components that any lender should implement:

First, go a “mile wide” and understand the entirety of the industry in which the borrower operates. With enough familiarity of an industry, a lender should have significant comfort that it will implement underwriting procedures that help spot any liens. Ask outside counsel to identify multiple areas of concern for any borrower in that industry, including common intercreditor disputes. For example, a lender in the agriculture industry may want to implement processes and procedures for identifying all possible lien interests on assets of a potential borrower (*e.g.*, search protocols for diligence associated with state agriculture liens filed in multiple centralized databases).⁴⁵

Second, go “more than an inch deep” by digging in to understand the unique aspects of the borrower's enterprise. A lender should ask how its proposed borrower generates value that makes it special (and worthy of financing)? If a lender (correctly) assumes that it cannot rely on the borrower to identify (or appreciate) the risk of hidden liens, then the lender will necessarily spend more time asking the right questions and collecting the necessary data.⁴⁶

Third, intelligently gauge the materiality of any lien issues within the context of the financing that is to be provided. Not everything is material even if the potential dollar amount of exposure arising from a hidden lien is significant. For example, PACA trust concepts can taint all assets of a business (and debt payments), which in theory is incredibly problematic. Yet the magnitude of the corresponding claims in the context of the broader enterprise, such as in restaurant financing, may not require any specific action. Further, materiality could be satisfactorily addressed through an intercreditor agreement that directly mitigates (most of) the concern, or through one or more financial, affirmative, or negative covenants in the loan documentation that imposes sufficient parameters.

How can lawyers help their lender clients navigate this minefield? In several ways. Educate your client about topical developments in the industry, perhaps by reading and sharing publications from trade associations that highlight them (or even better, that report on juicy public squabbles). Share a checklist of legal diligence inquiries that you'd want filled out by the borrower with the help of its advisors (*e.g.*, a “perfection” certificate) at the onset of a transaction. Incorporate concepts in the legal documents that address identified concerns, including specific reserves, appropriate cross-default concepts, bespoke reporting requirements, and periodic post-closing diligence that is active (*e.g.*, semi-annual inspections) as opposed to passive (*e.g.*, representation that previously delivered asset list is still accurate). At the first sign of financial distress, encourage your client to authorize you to obtain “bring down” lien searches. And in

⁴⁵ I didn't get to cover this issue. Sorry! I recommend The National Agricultural Law Center's handy 50-state resource guide if you're interested in it: <https://nationalaglawcenter.org/state-compilations/agricultural-liens/>.

⁴⁶ For example, a deeper dive on the practical operations of the borrower's business will focus on the following: How do you break down the borrower's trade creditors into discrete components? Does the borrower rely on a particular type of supplier? Does that supplier have special protections? Does the borrower or the supplier transact with governmental units? Are other parties routinely in possession of critical assets? Where are those assets located?

connection with any credit event – an amendment, forbearance, or waiver – force the borrower to provide the lender with an updated “perfection” certificate.

Conclusion.

I don't have a key takeaway or insightful parting thought that can concisely recap this incredibly broad topic. But I am very appreciative of your willingness to read this manuscript until the end.