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**HIDDEN LIENS**

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Conflicting security interests in property have been a major source of litigation in the lending industry since common law times. With respect to real estate, early recording statutes went a long way towards eliminating the uncertainties of non-possessory interests in real property, but issues continue to plague those who lend against the security of personalty and intangibles. It became increasingly apparent that some effort to provide a uniform registry for personalty liens was needed and such a registry was formalized in the various state adoptions Article 9 of the Uniform Commercial Code, as introduced in 1952. Even today, with the recent amendments to Article 8 of the UCC with respect to security interests in securities and financial assets, we continue to see fine tuning in the efforts to establish a workable registry for non-possessory interest in personalty and intangibles.

But there is another body of personalty liens outside that of Articles 9 and 8 of the UCC. Many of these liens are hidden, that is, not contained in any registry, and pose potential conflicts with asset based lenders. The following is a partial list and discussion of some of the hidden liens which may be encountered by lenders.

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## **LIENS OUTSIDE ARTICLES 8 AND 9 OF THE UNIFORM COMMERCIAL CODE**

Liens which arise either by statute or as a common law consequence outside of the traditional Articles 9 and 8 consensual liens given as security for loans generally fall into three categories. The first group is protection for persons who are extending credit on account, as in the case of repairmen, mechanics, sellers of goods, or banking account providers. The second group is governmental liens for taxes or for the recovery of fines, such as successor liability for sales taxes or business taxes, and labor law violation fines. The final group is liens created by judgment or administrative action. In most instances, the surprises will come in connection with conflicts with the first group. The following discussion is focused on those hidden liens, with a brief discussion of some of the more important “forgotten” liens under the other categories.

### Protections of Sellers on account.

Whether we realize it or not, a great deal of day to day transactions involves credit, even if for no more than an hour or less. Payment for services at both the consumer and commercial level as well as for commercial goods in shipment often is delayed until after performance, in which case credit is “automatically” extended. The following provisions of Article 2 of the Uniform Commercial Code generally cover these liens with respect to delivery of goods:

#### Sale of Goods

2-502 (TCA 47-2-502, Miss. Code 1972 75-2-502) In general, a buyer who has made partial or complete payment for goods which have been identified has a right to recover the same upon tender of the remainder of the purchase price. Such a right might conflict and possibly prevail over a lien on inventory under Article 9.

2-505 (TCA 47-2-505, Miss. Code 1972 75-2-505) Shipment under a bill of lading which is negotiable but in the name of the Seller (and not negotiated) can create a security interest for the payment of the shipment until the goods are delivered to the buyer. The only way to avoid such a lien is to require that all shipments to the buyer be made by non-negotiable bill of lading naming

the Buyer as consignee.

2-702 (TCA 47-2-702, Miss. Code 1972 75-2-702) Shipments made to an insolvent Buyer on credit may be reclaimed. The seller’s right to make such reclamation may be made within 10 days of delivery, or later if the buyer has misrepresented its solvency in the three months preceding the delivery. However, this right is subordinate to bona fide purchasers for value, and as such should be subordinate to Article 9 liens.

2-711 (TCA 47-2-711, Miss. Code 1972 75-2-711) A buyer may retain possession of rejected goods in order to recover his purchase price. The lien also covers the costs of inspection as well. Normally, this lien will come into conflict with an Article 9 lien where the lender has a blanket lien of the seller’s inventory, and in such event, section 9-110 of the Tennessee and Mississippi enactment of the UCC provides that the lien will be superior to a prior perfected lien on the seller’s inventory.

#### Provision of services

Probably even more common are conflicts which might occur with hidden liens for services, as opposed to goods, in that the value of services and the conformity to the contract cannot be determined until those services are irrevocably delivered (performed). Consequently the law has long given protection to artisans, mechanics, landlords and warehousemen. A few of these hidden liens would be as follows:

#### Warehouseman’s liens

While some crop-specific liens are still on the books, these are generally vestiges of past economies (e.g. Tobacco Warehouseman’s lien. TCA 43-19-217). Most of the potential conflict among lenders and warehousemen will arise under the generic UCC established warehouseman’s lien (TCA 47-7-209, Miss Code 1972 75-7-209). Under this lien, a warehouseman automatically has a lien on goods in his possession if he is in fact a warehouseman and he issues a warehouse receipt. In that it is a statutory lien under Article 7 rather than Article 9 of the UCC, (that is, it is not a “security interest” as defined

in Article 8 of the UCC), its priority is governed by Section 9-333, (TCA 47-9-333, Miss Code 1972 75-9-333) which provides that such possessory lien will have priority over any Article 9 security interest (unless otherwise provided by the statute).

However, Section 7-209 (c) of the UCC (TCA 47-7-209 (c), Miss Code 1972 75-7-209 (c)) provides that absent the entrustment of goods to a bailor with certain powers of disposition and other situations in which the owner or lender has granted certain powers or indicia of ownership to the bailor, the warehouseman's lien attaches only to such interest as the bailor had at the time, and should not defeat a prior perfected security interest in the goods. Therefore, the most common conflict will be in the instance that the Lender takes a security interest in goods which are already in warehouse storage. In such situations, it would appear that absent some agreement on the part of the Warehouseman, the Lender is going to be subordinate to storage charges which accrue in connection with such goods, and should address the issue accordingly. Normally, in perfecting one's security interest in goods held at a warehouse where the same is evidenced by a negotiable warehouse receipt, possession and negotiates of the receipt is required for perfection. In obtaining the receipt, one should also check to see if the lien of the warehouseman is duly noted on the document itself and whether such notation claims a lien in goods other than those evidenced by the warehouse receipt.

Long after the creation of the statutory warehouseman's lien, a new industry providing additional storage focused at consumers arose. The growth of the self storage facility reached the point where some of the provisions of the warehouseman lien no longer applied. For example, the warehouse receipt is not issued, as the bailor is responsible for depositing and drawing the goods which may be stored. For that reason among others the self storage lien has been adopted by statute in many jurisdictions (TCA 66-31-104, Miss Code 1972 85-7-123). In general, these statutes operate in a version of real estate trust deed foreclosures, and there is little direction on the treatment of conflicting interests. The rules for warehousemen will generally not apply as the "Owner" as set forth in these statutes exclude anyone issuing a

document of title (e.g. bill of lading or warehouse receipt). In such event, the statute by definition will revert to Article 7 of the UCC. However, the lack of guidance on conflicting interests is more academic, since in general, the goods involved are consumer goods handled by statutes (including provisions of the UCC) outside the scope of this discussion.

#### Artisan's Liens

In addition to storage charges, there arise charges incident to the protection or repair of goods which may be serving as collateral. These generally come into play in the commercial area with respect to "big ticket" items, such as vehicles and rolling stock, aircraft, barges, and similar items. Usually termed a "garageman's lien", "jeweler's lien" or the like, it is helpful to group these in one general category of artisan's liens. However, as a possessory lien, the artisan's lien will not be applicable to machinery permanently situated at the Debtor's location, which will be more akin to a fixture and which may be subject to a mechanic's or materialmen's lien under the real estate provisions of state law. Some examples of statutory artisans liens would be garagemen and towing liens, (TCA 66-19-101, 66-19-103 Miss Code 1972 85-7-107, 85-7-251) (towing), the statutory codification of the long time common law jeweler's lien (TCA 66-14-101 Miss Code 1972 85-7-73), and relatively new codifications of liens for repair to water and air craft ([watercraft] Miss Code 1972 85-7-7 TCA 66-19-201 [aircraft] TCA 66-19-301).

Once again, the priorities of these liens will be governed by 9-333 of the UCC (state enactments referred to above). Again, the general rule is that so long as the lien remains effective by continued possession, the statutory lien has priority over any security interest (regardless of the time of perfection). Unlike the savings provision of 7-209 (c) of the UCC which grants to the warehouseman only such rights as the bailor may have had, no such provision exists with respect to these liens, and it is most likely that a court would find them to be superior to the lien of the Lender. This would make some sense, as value is added in the preservation or repair of the collateral, but the Lender should always be aware of advances made for the repair or accession to rolling stock, aircraft or watercraft and take precautions to insure that advances

are properly applied to the payment for such services.

#### Carrier's Liens (TCA 47-7-307 Miss Code 1972 75-7-307)

Where financed goods are shipped by regulated carrier, once again the UCC provides lien rights in the carrier for cartage. As with warehousemen's and artisan's liens, it is a possessory lien established by statute, the priority of which is governed by UCC 9-333. However, unlike the savings provision of 7-209 (c), 7-307 (b) upholds the priority of the carrier's lien against any other party unless the carrier is given direct knowledge of a "lack of authority" on the part of the bailor. Note that a showing of the knowledge of the prior security interest may not satisfy this requirement, as financed goods are often shipped, and done so with no question regarding the authority of the Seller/Debtor to do so. In the event of the carrier's lien, rather than basing the priority on an act by the prior lien holder which might have given rise to the inference of the warehouseman's lien, the carrier's lien requires no such culpability on the part of the prior secured party. Only actual knowledge of the carrier's part defeats his priority. In this regard, the carrier's lien sits somewhere between the artisan's lien and the warehouseman's lien in terms of the strength of the priority of its possessory interest.

#### Landlord liens

The grant of real estate interests in the form of a leasehold estate has dramatically changed over the past century. Under the common law, an estate for years was granted, as any other estate (fee simple, fee tail, fee simple determinable) might be granted, and payment in full or fealty offered in return. The modern lease has become an estate for years conditional, where the payment is not made simultaneously with the grant, but under a contract for payment (including maintenance, taxes, or utilities as applicable). Because of the common law origins of the leasehold grant, the removal of tenants requires a bit more than the self help provisions of the UCC. The actual estate in land must be terminated, and the common law forcible entry and detainer action remains to this date the means of dispossessing a tenant. However, in applying this to the tenant's personal property located on the leased property, various jurisdictions have provided statutory liens for the benefit of the landlord in order to enforce

the obligations for rent.

Relatively uncommon in the South, a lien on personalty for the payment of rent sometimes appears as a statutory right. (e.g. Virginia Code Sections 55-227, 231 and 233). However, in both Tennessee and Mississippi, no such lien exists (except where an action might be brought for distress of rent, and the resulting judgment registered as a lien - see Judgment Liens). Such liens may be established by agreement within the provisions of Article 9 of the UCC, but outside of such an express grant of a security interest in the tenant's personalty, none exists.

There is one common-law based exception however, in the form of the agricultural landlord's lien, which exists by statute in both Tennessee and Mississippi. TCA 66-12-101, Miss. Code 1972 89-7-51. It is important to note that this lien is very strong, being superior to any other interest in crops which might be grown upon land owned or controlled by the landlord. As a result, they often have priority over production loan liens, warehousemen's liens, liens for suppliers of seed and fertilizer, and other consensual (Article 9) and statutory liens. It should also be noted that the new enactment of Article 9 was specifically intended to cover agricultural liens but it is clear that the favored priorities continue notwithstanding the inclusion of agricultural liens in the revised Article 9. (See 9-334 (i)). While this lien cannot be defeated by a security interest in the crops, it is important to note that the lien is subject to avoidance in the bankruptcy situation. 11 U.S.C. Section 545 (3) allows a trustee in bankruptcy to avoid a statutory lien for rent, and while it has not often been so applied, it is a potent tool for the trustee in the event some marshalling of assets may become necessary.

#### Banker's liens

It is instructive to look at the banker's lien which arises as a result of common law. More commonly called a "right of set-off" the implicit liens of a creditor bank in the general (as opposed to special, e.g. trust) deposits of the debtor may defeat the interest of a secured creditor taking the deposit as security. Again it is a lien created by operation of law and it is possessory. The Revised Article 9 sought to add some certainty to this conflicting interest when it initiated the concept of "control" with respect to deposit accounts. Under

section 9-104 as enacted in both Tennessee and Mississippi, the secured party “controls” an account (very generally) when the bank, the secured party and the debtor have agreed that the secured party may direct the payment of funds in the account without the consent of the debtor. The issue arises when such direction is made to a bank to which money is owed by the debtor. Section 9-340 of the Revised UCC would seem to directly disallow the right of set-off where the proper steps for control have been met under 9-104. (TCA 47-9-340 (c), Miss Code 1972 75-9-340 (c)). In addition, the ABA has prepared as disseminated in Model Deposit Account Control Agreement (“DACA”), which should be used in any instance in which a lender seeks to obtain a security interest in an account. Under DACA, paragraph 5 (both in the basic and securitization forms) is an explicit subordination on the part of the depository bank of any interest in the account (with certain exceptions, e.g. reimbursement for honored checks), including the right of set-off. Copies of the model forms are available at:

<http://www.abanet.org/dch/committee.cfm?com=CL710060>

### Forgotten Governmental Liens

Most lenders prudently check a borrower’s background for filed tax liens, generally for income and payroll taxes. However, other liens may be applicable to the assets of the borrower which are imposed as a result of an enforcement of governmental policy or which may arise under successor liability statutes in the case of a foreclosure of an entire business.

### Hot Goods in Manufacturing

The “lien” for “Hot Goods” imposed by 29 USC Section 215 (a) (1) (Fair Labor Standards Act) can be superior to the fixed asset financing of a manufacturer. In an injunction action against Citicorp in connection with goods manufactured in violation of the overtime and minimum wage standards of the Department of Labor, Citicorp was prohibited from placing the goods in Interstate Commerce without first remedying the violation of the labor laws. Note that this is not necessarily a lien, and as such can come as a surprise to the lender in a manufacturing setting. The only defense to such a claim is the express representation of the borrower that it is in compliance with the statutes, and

a covenant that it will remain so, in the hope that the exception for a good faith purchaser might be upheld (though the Citibank decision did not treat the holder of a security interest as a bona fide purchaser.)

Another surprise can be the successor liability statutes of the State. For example, in Tennessee, the following statutes specifically impose upon the “buyer” of a business the obligation to set aside a portion of the purchase price or become personally responsible for the payment of the taxes not discharged by the withholding:

Personalty – (TCA 67-5-513).

Business taxes -- (TCA 67-4-721)

Sales -- Buyer may be liable for sales taxes in addition to those generated by the sale. (TCA 67-6-513)

In Bank of Commerce v. Woods (585 SW2d 577), the court applied the sales tax successor liability statute above to a bank which took property and operated a business (food store) in lieu of foreclosure. Note that this is not merely a superior lien. This statute imposes personal liability on the purchaser/lender in possession. The same reasoning could apply to the other statutes above under Tennessee law (though there is no case law on the issue as of yet), and Mississippi has a similar successor liability law with respect to sales taxes (Miss Code 1972 27-65-55).

### Litigation and Judgment Liens

With respect to judgment liens, most lenders are familiar with the requirement to search for judgments which might have been rendered against the borrower or renewed during the last ten years. A review of the local court records with respect to pending litigation is also necessary because certain types of liens, called attachments, may be placed on property before the final judgment is rendered. (Miss Code 1972 11-33-1, TCA 29-6-101). Consequently, with regard to personalty, it is important to know the status of any lawsuit against the borrower prior to the advance of funds.

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Financing and Creditors Rights



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