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WATCH OUT FOR UNINTENDED LIENS

Business owners are aware that a bank or other lender extending credit to a business will often take a lien on their equipment, inventory, accounts receivable or other assets. It is a very standard lending arrangement for most small and medium sized businesses. However, many business owners are surprised to find that they may have unintentionally granted similar liens in other contracts and written documents. Those unintended liens can cause major headaches.

Several times a year while reviewing contracts, we will come across either a commercial lease, or sometimes even a supplier/purchase agreement type contract that contains language granting a lien on a specific asset, and occasionally, on all of the assets of one of the parties. The provision is usually buried in small print, near the end of a form contract. In many cases even the party proposing the contract may not even realize the language is there or what the significance of the language might be.

Regardless of what the parties intended, when that language is found in a written contract, it can pose real problems for the party that has unintentionally granted the lien. First, most of the time lender loan documents say that no other liens can be granted by the borrower. Such a lien can constitute an unintentional violation of the loan. Lenders do not always call a loan for this kind of violation, but generally they have that right, and it is an unpleasant surprise for a borrower to find out about an unintended lien after it has already been granted. Second, of course, granting a lien means that someone holds a lien on the business's assets. If you get in a dispute with that other party and they pull out the lien language, now they not only have a claim against your company, but they can assert the right to take your business assets. The obvious problems this causes for a business are only compounded by the fact that if someone starts trying to take the business assets, the lender is virtually certain to become interested in what is going on. Now the business has two problems.

Reviewing contracts is always a challenge for businesses because it is expensive and so much of the language is boilerplate. Nevertheless, this is an area for care. When you enter into contracts, whether they are leases, master services agreements, or another type of agreement, read the document carefully to make sure that it does not have lien language; or that if it does, it is lien language you understand and have agreed to. And, make sure that any lien language that you agree to does not put you into covenant default with your lender. A quick call to your lender is often the best way to be sure that you will not create a default with the lender.

Peter Tiede practices law in White Bear Lake, Minnesota and River Falls, Wisconsin, concentrating in commercial matters, lending, real estate, and local government.