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***Citicorp Industrial Credit, Inc. v. Brock*: Enjoinment Under the "Hot Goods" Ban-- The Supreme Court Turns Up the Heat on Secured Creditors**

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CASENOTE

***Citicorp Industrial Credit, Inc. v. Brock:* Enjoinder Under the “Hot Goods” Ban— The Supreme Court Turns Up the Heat on Secured Creditors**

I. INTRODUCTION	419
II. PERSPECTIVE	424
A. <i>Judicial Interpretation of Section 15(a)(1)</i>	424
B. <i>The Powell Knitting Decision</i>	427
III. <i>Citicorp Industrial Credit, Inc. v. Brock</i> : SECURED CREDITORS ARE SUBJECT TO THE “HOT GOODS” BAN	430
IV. <i>Citicorp</i> IS INCONSISTENT WITH CONGRESS’ INTENT	434
V. THE ADJUSTMENT OF CREDIT PRACTICES AFTER <i>Citicorp</i>	435
VI. FUTURE LITIGATION UNDER SECTION 15(a)(1)	438
VII. CONCLUSION	444

I. INTRODUCTION

The Fair Labor Standards Act (FLSA)¹ requires that employers pay their employees a specified minimum wage² and overtime wages for all hours worked in excess of forty hours per week.³ The FLSA, in

1. 29 U.S.C.A. §§ 201-219 (West 1965 & Supp. 1987) (original version at ch. 676, 52 Stat. 1068 (1938)) [hereinafter FLSA].

2. Section 6(a)(1) of the FLSA mandates that employers pay their hourly employees at a rate at least equal to the rate specified by the statute. At present, the hourly wage rate is \$3.35. 29 U.S.C. § 206(a)(1) (1982). Employers who employ certain categories of employees, however, are exempt from the minimum wage requirement. FLSA § 13(a), 29 U.S.C.A. § 213(a) (West 1965 & Supp. 1987).

3. Section 7(a)(1) of the FLSA provides that employers who employ hourly workers for more than forty hours in any workweek pay such employees, for all hours worked in excess of forty, at a rate “not less than one and one-half times” their hourly wage rate. 29 U.S.C.A. § 207(a)(1) (West Supp. 1987). Employers who employ certain specified classes of employees, however, are exempt from the overtime provision. FLSA § 13(b), 29 U.S.C.A. § 213(b) (West 1965 & Supp. 1987).

The FLSA’s overtime provisions were designed to decrease unemployment by increasing the cost of having employees work overtime hours. It was hoped that the overtime penalty would encourage employers to employ additional employees rather than employ their current workers for longer hours. Stamas, *Long Hours and Premium Pay*, MONTHLY LAB. REV., May 1979, at 41; see R. EHRENBURG & P. SCHUMANN, *LONGER HOURS OR MORE JOBS?* (1982) (analyzing the effect on employment levels of an increase in the rate of overtime pay from time and one-half to double time); Carr, *Overtime Work: An Expanded View*, MONTHLY LAB. REV., Nov. 1986, at 36 (1986) (surveying the patterns of overtime work).

addition, prohibits any person from shipping or selling in interstate commerce goods produced in violation of these provisions.⁴ One difficult question that courts have faced is whether this prohibition should operate without regard to the manner in which the goods were acquired. Because of this uncertainty, a conflict developed among the federal courts over whether Congress intended to extend the prohibition to a secured creditor who, through foreclosure, owns goods that were manufactured in violation of the FLSA's minimum wage and overtime provisions.⁵ The Supreme Court of the United States addressed this conflict in *Citicorp Industrial Credit, Inc. v. Brock*.⁶

In December 1983, Citicorp Industrial Credit entered into a "zero balance" financing arrangement with Qualitex Corporation, a Tennessee textile manufacturer.⁷ Subsequently, the Ely Group became the successor to Qualitex.⁸ Pursuant to the original agreement between Citicorp and Qualitex, Citicorp agreed to loan Ely up to \$11 million for general working capital, including wages.⁹ Ely granted Citicorp a "floating lien" security interest in both its inventory and accounts receivable,¹⁰ and Citicorp perfected its security interest by

4. Section 15(a)(1) of the FLSA provides in relevant part:

[I]t shall be unlawful for any person . . . to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of [the minimum wage and overtime provisions] of this title.

29 U.S.C. § 215(a)(1) (1982). Section 3(i) of the FLSA provides that the term "goods" does not include "goods after their delivery into the actual physical possession of the ultimate consumer . . . other than a producer, manufacturer, or processor." 29 U.S.C. § 203(i) (1982).

5. See *infra* notes 47-69 and accompanying text.

6. 107 S. Ct. 2694 (1987); see *infra* notes 70-100 and accompanying text.

7. *Ford v. Ely Group, Inc.*, 621 F. Supp. 22, 23 (W.D. Tenn. 1985) (Ely manufactured "hosiery, apparel and other textiles and goods through its subsidiaries Rockford Textiles, Inc., and Ely & Walker, Inc."), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987). In *Brock v. Ely Group, Inc.*, the Sixth Circuit described the parties' "zero balance" financing agreement, under which "the creditor transfers funds, on a daily or 'as needed' basis into the debtor's 'zero balance' bank account to meet the debtor's operating expenses." 788 F.2d 1200, 1201 n.1 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

8. *Citicorp*, 107 S. Ct. at 2696.

9. *Brock v. Ely Group, Inc.*, 788 F.2d 1200, 1201 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

10. Brief for Petitioner at 4, *Citicorp*, 107 S. Ct. 2694 (1987) (No. 86-88).

A lien on inventory is termed a floating lien because it covers collateral that is "continually being replaced. . . . Such collateral has been likened to the water flowing through a stream. [It is] a lien . . . structured to float upon the surface of such a flowing body of collateral." E. RILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 8.08(2) (1987); see also Coogan, *Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien,"* 72 HARV. L. REV. 838 (1959) (discussing the desirability of floating liens under article 9); Weeks, *"Floating Liens" in Inventory Financing,*

filing the financing statements required under state law.¹¹ The parties' agreement obligated Ely to provide Citicorp with daily, weekly, and monthly reports outlining its financial status.¹²

Citicorp monitored Ely's operations through systematic audits and on-site inspections.¹³ In February 1985, after Ely's financial condition deteriorated markedly, Citicorp ceased providing Ely with funds.¹⁴ Ely, despite Citicorp's refusal to provide additional funding, continued to operate its plants until Citicorp took possession of its assets through a foreclosure proceeding approximately one week later.¹⁵

A subsequent investigation by the Wage and Hour Division of the United States Department of Labor revealed that Ely had not paid its employees during the three weeks preceding its shut-down, and thereby had violated the minimum wage and overtime provisions of the FLSA.¹⁶ As a result, the Department of Labor determined that the goods produced by Ely's employees during this period were "hot" because Ely had manufactured the goods in violation of the FLSA.¹⁷

1956 U. ILL. L. F. 557, 557 (Inventory financing is "an essential source of working capital for small business."). Article 9 of the Uniform Commercial Code (UCC) permits security agreements to cover after-acquired property. See U.C.C. § 9-204 (1978). For a discussion of article 9 of the UCC, see *infra* notes 111-20 and accompanying text.

11. *Citicorp*, 107 S. Ct. at 2696. For the provisions of the UCC pertaining to the establishment and perfection of security interests, see *infra* notes 111-19. The agreement between Ely and Citicorp provided that Georgia law governed "the rights and obligations of the parties." Brief for Petitioner, *supra* note 10, at 4. For the corresponding provisions of Georgia law governing secured transactions, see GA. CODE ANN. §§ 11-9-101 to -507 (1982 & Supp. 1987).

12. *Citicorp*, 107 S. Ct. at 2696.

13. *Id.* The United States District Court for the Western District of Tennessee noted that "Citicorp conducted an ongoing monitoring system through auditors and/or field examiners who verified collateral upon which it made cash advances to Ely Group, Inc. . . . While these representatives did not verify wages paid to employees, they did check to see if Ely Group, Inc. paid all employee taxes." *Ford v. Ely Group, Inc.*, 621 F. Supp. 22, 23-24 (W.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

14. *Citicorp*, 107 S. Ct. at 2696 (1987).

15. *Id.* at 2697. See generally U.C.C. §§ 9-501 to -507 (1978) (describing the rights and obligations of creditors regarding liquidation of loan collateral upon a debtor's default); *infra* notes 111-19 (describing the relevant UCC provisions). Under Georgia law, Citicorp's interest in the goods was superior to the lien of Ely's employees against the goods for the payment of their back wages. Brief for Petitioner, *supra* note 10, at 4-5; see GA. CODE ANN. §§ 11-9-310, 44-14-320 (1982 & Supp. 1987).

16. Brief for Respondent Opposing Petition for a Writ of Certiorari at 3, *Citicorp*, 107 S. Ct. 2694 (1987) (No. 86-88). Section 11(a) of the FLSA provides that the Administrator of the Department of Labor's Wage and Hour Division is authorized to "enter and inspect [places of employment subject to the Act], question such employees, and investigate such facts, conditions, practices, or matters as he may deem necessary or appropriate to determine whether any person has violated any provision of this chapter." 29 U.S.C. § 211(a) (1982).

17. *Citicorp*, 107 S. Ct. at 2697.

Section 15(a)(1) of the FLSA, the "hot goods" provision, prohibits any person from transporting or selling such goods in interstate commerce.¹⁸

After discovering that Citicorp intended to sell the goods in interstate commerce, the United States Department of Labor, pursuant to section 17 of the FLSA,¹⁹ sought temporary restraining orders and preliminary injunctions to prevent either Ely or Citicorp from shipping, selling, or transporting the goods in interstate commerce.²⁰ The Department of Labor brought two separate actions in the United States District Courts for the Eastern and Western Districts of Tennessee, because Ely operated plants within both jurisdictions.²¹

The Department of Labor asserted that Citicorp's planned sale of the goods would violate section 15(a)(1) of the Act.²² Even though

18. *Id.* For the relevant text of section 15(a)(1) of the FLSA, see *supra* note 4. The Department of Labor guidelines for complying with section 15(a)(1) are set out in 29 C.F.R. §§ 789.0 - .5 (1987).

The hot goods ban also applies to goods manufactured in violation of section 12(a) of the Act, which establishes standards for the employment of child labor. 29 U.S.C. § 212(a) (1982). Unlike section 15(a)(1), which is directed at "any person," section 12(a) applies only to any "producer, manufacturer or dealer." *Id.*; see also FLSA § 15(a)(4), 29 U.S.C. § 215(a)(4) (It is unlawful "to violate any of the provisions of section [12].").

19. Section 17 of the FLSA provides in relevant part that "the district courts . . . have jurisdiction, for cause shown, to restrain violations of [section 15], including . . . the restraint of any withholding of payment of minimum wages or overtime compensation." 29 U.S.C. § 217 (1982).

Section 17 of the FLSA does not expressly provide a private cause of action to enforce section 15(a)(1). The Supreme Court, however, in *Martino v. Michigan Window Cleaning Co.*, 327 U.S. 173 (1946), allowed a private citizen to bring such an action without discussion. Furthermore, although section 12(b) of the FLSA permits only the Secretary of Labor to bring an action pursuant to section 17 to restrain violations of the Act's child labor provisions, section 15 contains no such restriction. See 29 U.S.C. § 212(b) (1982).

20. *Citicorp*, 107 S. Ct. at 2597. The Department of Labor alleged "actual and potential violations of section 15(a)(1) . . . and sought to enjoin [from placement] in interstate commerce goods that had been produced from February 3 through February 19, 1985." Brief for Respondent at 8, *Citicorp*, 107 S. Ct. 2694 (1987) (No. 86-88). In addition, the Department of Labor "sought back pay and liquidated damages from Ely under Sections 16(c) and 17 of the FLSA." *Id.* at n.3. Section 16(c) of the FLSA authorizes the Secretary of Labor to "bring an action in any court of competent jurisdiction to recover the amount of unpaid minimum wages or overtime compensation and an equal amount as liquidated damages." 29 U.S.C. § 216(c) (1982). For the relevant text of section 17 of the FLSA, see *supra* note 19. For a discussion of the purposes behind section 17, see *Wirtz v. Jones*, 340 F.2d 901, 904 (5th Cir. 1965) ("[T]he purpose of the injunction [under section 17] to restrain the withholding of wages due is not to collect a debt owed by an employer to his employee but to correct a continuing offense against the public interest.").

21. See *Ford v. Ely Group, Inc.*, 621 F. Supp. 22 (W.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987); *Donovan v. Rockford Textile Mills, Inc.*, 608 F. Supp. 215 (E.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

22. Brief for Respondent Opposing Petition for a Writ of Certiorari, *supra* note 16, at 3.

Citicorp had no liability under the FLSA for the back wages of Ely's employees, the Department of Labor argued that the goods were "tainted."²³ Payment of the back wages, however, would remove the taint from the goods and permit Citicorp to introduce the goods into interstate commerce. In response, Citicorp argued that because Ely, the employer, was bankrupt and unable to pay back wages to its employees, the Department of Labor, in reality, was seeking to establish a secret employees' lien on the goods to coerce Citicorp into paying the back wages.²⁴

The United States District Court for the Eastern District of Tennessee denied the Department of Labor's application for a temporary restraining order.²⁵ In contrast, the United States District Court for the Western District of Tennessee issued the temporary restraining order sought by the Department of Labor in that court.²⁶ Both courts, however, subsequently granted the Department of Labor's applications for preliminary injunctions.²⁷ Citicorp appealed these orders to the United States Court of Appeals for the Sixth Circuit.²⁸ The Sixth Circuit affirmed both orders, holding that Citicorp was subject to the section 15(a)(1) prohibition on the sale or transportation of hot goods in interstate commerce.²⁹ In so ruling, the Sixth Circuit considered *Wirtz v. Powell Knitting Mills Co.*,³⁰ in which the Second

23. *Ford v. Ely Group, Inc.*, 621 F. Supp. 22, 25-26 (W.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

24. Reply Brief of Petitioner on Petition for a Writ of Certiorari at 5, *Citicorp*, 107 S. Ct. 2694 (1987) (No. 86-88).

25. *Donovan v. Rockford Textile Mills, Inc.*, 608 F. Supp. 215 (E.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

26. *Ford v. Ely Group, Inc.*, 621 F. Supp. 22, 23 (W.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

27. See *Ford v. Ely Group, Inc.*, 621 F. Supp. 22, 25-27 (W.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987); *Donovan v. Rockford Textile Mills, Inc.*, 608 F. Supp. 215, 217-19 (E.D. Tenn. 1985), *aff'd sub nom. Brock v. Ely Group, Inc.*, 788 F.2d 1200 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

28. *Brock v. Ely Group*, 788 F.2d 1200, 1202 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987). Ely ceased operations and, therefore, did not appeal the district courts' orders. *Id.* at 1201. Notwithstanding these orders, Citicorp was permitted to dispose of the goods "on the condition that petitioner place the proceeds in a separate interest-bearing account to be used to pay the wages of Ely's former employees in the event that, on appeal, § 15(a)(1) was held to apply to petitioner." *Citicorp*, 107 S. Ct. at 2697-98 n.2.

29. *Brock v. Ely Group, Inc.*, 788 F.2d 1200, 1206 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

30. 360 F.2d 730 (2d Cir. 1966).

Circuit had held that secured creditors were exempt from the prohibitions of section 15(a)(1). The Sixth Circuit, however, after concluding that the *Powell Knitting* court misconstrued the purpose of the section, rejected the decision as erroneous.³¹ On certiorari, the Supreme Court of the United States, *held*, affirmed: Secured creditors who own hot goods pursuant to a foreclosed security interest are subject to section 15(a)(1), and therefore are prohibited from selling or transporting those goods in interstate commerce. *Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987).

This Note examines the conflict between the rights and interests of creditors who have a security interest in hot goods and the section 15(a)(1) prohibition on the sale or transportation of such goods in interstate commerce. Section II describes the judicial interpretation of section 15(a)(1) prior to *Citicorp*. Section III discusses the soundness of the Supreme Court's reasoning in *Citicorp*, and Section IV analyzes whether the decision can in fact be reconciled with the FLSA's legislative history. Section V describes the decision's impact on credit practices and considers the possibility that the decision will increase the cost of secured lending. Section VI examines the impact of *Citicorp* on future litigation of disputes under section 15(a)(1). Finally, Section VII concludes that the policies underlying Congress' adoption of the hot goods ban do not support the Supreme Court's *Citicorp* ruling.

II. PERSPECTIVE

A. Judicial Interpretation of Section 15(a)(1)

A fundamental issue in *Citicorp* is whether legislative intent mandates the extension of the hot goods ban to goods held by a creditor as collateral.³² In *United States v. Darby*,³³ the Supreme Court first addressed the issue of the underlying purpose of section 15(a)(1).³⁴ In

31. For a discussion of the *Powell Knitting* decision, see *infra* notes 47-63 and accompanying text.

32. For a discussion of the *Citicorp* decision, see *infra* notes 70-100 and accompanying text.

33. 312 U.S. 100 (1941).

34. *Darby*, 312 U.S. at 108. Darby was indicted for violating sections 15(a)(1), 15(a)(2), and 15(a)(5) of the FLSA. *Id.* Darby was charged with "employ[ing] workmen at less than the prescribed minimum wage, or more than the prescribed maximum hours without payment to them of any wage for overtime." *Id.* at 111. (citations omitted). Darby was also charged with violating the FLSA's record keeping requirements. *Id.* For the relevant text of section 15(a)(1), see *supra* note 4. Section 15(a)(2) of the FLSA provides that it shall be unlawful to violate the Act's minimum wage and overtime provisions. 29 U.S.C. § 215(a)(2) (1982). Section 15(a)(5) of the FLSA provides in pertinent part that "it shall be unlawful for any person . . . to violate any of the provisions of section 211(c) of this title." 29 U.S.C. § 215(a)(5)

upholding independently both the FLSA's minimum wage and overtime provisions, as well as the section 15(a)(1) ban on the shipment of hot goods as within Congress' commerce powers, the *Darby* Court described the purpose of section 15(a)(1):

The motive and purpose of the present regulation are plainly to make effective the Congressional conception of public policy that interstate commerce should not be made the instrument of competition in the distribution of goods produced under substandard labor conditions, which competition is injurious to the commerce and to the states from and to which the commerce flows.³⁵

Moreover, the Court noted that this injurious competition occurred to the detriment of employers who abided by the FLSA's minimum

(1982). The following is a list of other relevant FLSA provisions: FLSA § 11(c), 29 U.S.C.A. § 211(c) (West Supp. 1987) (imposing record keeping requirements upon employers); FLSA § 11(d), 29 U.S.C. § 211(d) (1982) (authorizing the Department of Labor to promulgate regulations restricting or prohibiting homework); FLSA § 16(a), 29 U.S.C. 216(a) (1982) (providing criminal sanctions for persons who violate section 15); FLSA § 16(b), 29 U.S.C. § 216(b) (1982) (establishing a private right of action for employees against employers to recover back wages and damages for violation of the FLSA's minimum wage and overtime provisions); FLSA § 16(c), 29 U.S.C. § 216(c) (1982) (authorizing the Secretary of Labor to commence actions on behalf of employees to recover back wages and damages from employers).

35. *Darby*, 312 U.S. at 115. Under the commerce clause, Congress is empowered "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. CONST. art. I, § 8, cl. 3.

Darby involved a constitutional challenge to Congress' powers under the commerce clause to regulate the compensation of employees. The Court, in an opinion authored by Justice Stone, dismissed the argument that the regulation of employees' wages and hours encroached upon powers reserved to the states:

The power of Congress over interstate commerce "is complete in itself, may be exercised to its utmost extent, and acknowledges no limitations other than are prescribed in the Constitution." That power can neither be enlarged nor diminished by the exercise or non-exercise of state power. Congress, following its own conception of public policy concerning the restrictions which may appropriately be imposed on interstate commerce, is free to exclude from the commerce articles whose use in the states for which they are destined it may conceive to be injurious to the public health, morals or welfare, even though the state had not sought to regulate their use.

Darby, 312 U.S. at 114 (citations omitted).

In addition, the Court rejected *Darby*'s contention that the tenth amendment restricted the exercise of Congress' powers under the commerce clause. In dismissing this argument, the Court stated, "The amendment states but a truism that all is retained which has not been surrendered. There is nothing in the history of its adoption to suggest that it was more than declaratory of the relationship between the national and state governments." *Id.* at 123-24 (citations omitted).

The Court also overruled its decision in *Hammer v. Dagenhart*, 247 U.S. 251 (1918) (Congress is incompetent to exclude goods manufactured by child labor from the channels of interstate commerce), because it "was a departure from the principles which have prevailed in the interpretation of the Commerce Clause both before and since the decision and that such vitality, as a precedent, as it then had has long since be exhausted." *Darby*, 312 U.S. at 116-17.

wage and overtime provisions. The FLSA was aimed at preventing the dislocation of commerce that resulted from the "impairment or destruction of local businesses by competition made effective through interstate commerce."³⁶ Thus, the Court concluded that Congress intended the Act as a tool to deter "a method or kind of competition in interstate commerce which it [had] in effect condemned as 'unfair.'"³⁷

Darby involved the criminal prosecution of a solvent employer for refusing to employ and compensate his workers according to the FLSA's minimum wage and overtime provisions.³⁸ The Court's analysis, therefore, focused upon an employer who had intentionally violated the Act, notwithstanding the fact that he had been capable of conforming to its requirements.³⁹

Prior to *Citicorp*, the Supreme Court had not addressed the circumstances under which courts were permitted to enjoin third parties under section 15(a)(1). The courts of appeals, however, had held section 15(a)(1) applicable to third parties.⁴⁰ In *Southern Advance Bag & Paper Co. v. United States*,⁴¹ for example, the Fifth Circuit upheld the conviction of a paper manufacturer for shipping hot goods in interstate commerce.⁴² The manufacturer in that case purchased lumber

36. *Id.* at 122.

37. *Id.* Congress declared the purposes of the FLSA in section 2(a) of the Act:

The Congress finds that the existence, in industries engaged in commerce or in the production of goods for commerce, of labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers (1) causes commerce and the channels and instrumentalities of commerce to be used to spread and perpetuate such labor conditions among the workers of the several States; (2) burdens commerce and the free flow of goods in commerce; (3) constitutes an unfair method of competition in commerce; (4) leads to labor disputes burdening and obstructing commerce and the free flow of goods in commerce; and (5) interferes with the orderly and fair marketing of goods in commerce.

29 U.S.C. § 202(a) (1982).

38. *Darby*, 312 U.S. at 111.

39. In contrast, *Citicorp* involved an insolvent employer who did not intend to violate the minimum wage provision. See *infra* notes 105-07 and accompanying text.

40. See, e.g., *Wirtz v. Lone Star Steel Co.*, 405 F.2d 668 (5th Cir. 1968) (third party, who failed to qualify as a good faith purchaser, adjudged in violation of section 15(a)(1)); *Walling v. Gulf States Paper Corp.*, 143 F.2d 301 (5th Cir. 1942) (third party violated section 15(a)(1) by purchasing goods from producers who had violated the FLSA's minimum wage and overtime provisions). But see *Sun Pub. Co. v. Walling*, 140 F.2d 445 (6th Cir. 1944) (holding that an injunction against the interstate distribution of newspapers produced in violation of the FLSA violates the guarantees of the first amendment). *Lone Star* is discussed *infra* notes 131-33 and accompanying text.

41. 133 F.2d 449 (5th Cir. 1943). In *Southern Advance*, the third party was prosecuted under section 16(a) of the FLSA, which provides criminal sanctions for the violation of section 15. *Id.* at 450.

42. *Id.* at 451.

from independent producers in order to make paper products that were then shipped in interstate commerce.⁴³ The court found that the manufacturer had purchased the lumber with knowledge that the independent producers had violated the minimum wage requirements of the Act.⁴⁴

The independent producers in *Southern Advance* arguably had an agency relationship with the manufacturer, who played the role of principal and stood to benefit from its agent's violation of the FLSA.⁴⁵ The *Southern Advance* decision therefore established that the nature of the relationship between the employer who violates the FLSA and the third party who comes into possession of the employer's hot goods is an important factor in determining whether to enjoin the third party under section 15(a)(1).⁴⁶

B. *The Powell Knitting Decision*

Twenty-five years after the Supreme Court upheld the constitutionality of the FLSA in *Darby*, the Second Circuit became the first federal appellate court to consider the applicability of section 15(a)(1) to secured creditors. In *Wirtz v. Powell Knitting Mills Co.*,⁴⁷ the court held that a factor,⁴⁸ who had foreclosed its perfected lien on an insol-

43. *Id.* at 450.

44. *Id.* Similarly, in *Walling v. Acosta*, 140 F.2d 892 (1st Cir. 1944), the district court had entered a judgment against sixty-six persons, including Acosta, who were engaged in the needlework trade, enjoining them from violating the FLSA. *Id.* at 893. Subsequently, employees who worked under the supervision of an individual, alleged to have been employed by Acosta, received less than the statutorily mandated minimum wage. *Id.* In response, the Department of Labor moved that the district court adjudge Acosta in contempt for violating the judgment and that he be required to show cause why he should not be held in contempt. *Id.* In reversing the district court's discharge of the rule to show cause, the First Circuit stated that Acosta could be held in violation of section 15(a)(1) even if he were not the employer of the employees who received less than the minimum wage. *Id.* at 894.

45. See RESTATEMENT (SECOND) OF AGENCY § 1 (1958) (defining agency as a fiduciary relationship between a principal and an agent); *id.* § 2 (defining master, servant, and independent contractor); *id.* § 94 ("An affirmation of an unauthorized transaction can be inferred from a failure to repudiate it."); *id.* § 263 ("[A] principal whose . . . agent has fraudulently acquired property for him, holds it subject to the interests of the defrauded person.").

46. "[I]n determining whether a permanent injunction should be granted," courts should consider the actor's "previous conduct and the dependability of his promises for future compliance." *Dunlop v. Davis*, 524 F.2d 1278, 1281 (5th Cir. 1975). In addition, "the granting or denial of an injunction under Section 17 of the Act is addressed to the sound discretion of the district court." *Hodgson v. American Can Co.*, 440 F.2d 916, 920 (8th Cir. 1971). For the text of section 17 of the FLSA, see *supra* note 19.

47. 360 F.2d 730 (2d Cir. 1966).

48. A factor is one who purchases accounts receivable from a business enterprise for immediate cash. See Moore, *Factoring—A Unique and Important Form of Financing and Service*, 14 BUS. LAW. 703, 706-07 (1959). He then performs the various bookkeeping

vent sweater manufacturer, could not be enjoined under section 15(a)(1) from shipping or selling in interstate commerce the hot goods it had taken as collateral.⁴⁹ Like the creditor in *Citicorp*, the factor in *Powell Knitting* had extended large amounts of credit to the employer and had received a security interest in the employer's present and future inventory.⁵⁰

The Second Circuit noted that courts could enjoin the sale or shipment of hot goods by a secured creditor under a literal interpretation of section 15(a)(1).⁵¹ The court argued, however, that such an application would conflict with the purpose behind the hot goods ban. The court stated that "one purpose of making the sale [of hot goods] illegal was to prevent adverse competitive effects on those who comply with the Act. Here there can be no connection between the asserted violation and any effects on competition."⁵² Although the court did not discuss *Darby*,⁵³ the Second Circuit's description of the purpose behind the FLSA's prohibition on the sale or transportation of hot goods in interstate commerce echoed the reasoning of the *Darby* Court.⁵⁴

Moreover, the court stated that another motive for the hot goods ban was to ensure that "wage earners would be paid."⁵⁵ Because the employer in *Powell Knitting* was insolvent and had assigned its assets for the benefit of its creditors, it was unable to pay the back wages of its employees.⁵⁶ As a result, the court reasoned that having the factor pay the employees was the only way to accomplish Congress' goal that employees be paid according to the FLSA.⁵⁷ The Second Circuit, however, concluded that such an outcome would be untoward because Congress never considered the question of overriding the priorities of creditors established by state law.⁵⁸ In addition, the court stated that although "those priorities would fall before § 15 if applicable, we are unable to conclude that Congress intended such a result

functions related to the accounts. *Id.* at 706. The factor therefore must assume any losses that may result from a customer's refusal or inability to pay. *Id.*

49. *Powell Knitting*, 360 F.2d at 732-33.

50. *Id.* at 732.

51. *Id.*

52. *Id.* at 733. For a discussion of Congress' intent in enacting the hot goods ban, see *supra* notes 101-10 and accompanying text.

53. 312 U.S. 100 (1941).

54. *Powell Knitting*, 360 F.2d at 733; see *supra* notes 32-38 and accompanying text.

55. *Powell Knitting*, 360 F.2d at 733.

56. *Id.*

57. *Id.*

58. *Id.*

here.”⁵⁹ Hence, a creditor who advanced funds to an employer/debtor long before he defaulted on his payroll should not be forced to pay the back wages owed to the defunct debtor’s employees.⁶⁰ The court suggested that if section 15(a)(1) were applied, it would be a “backhanded” attempt to alter the priorities of the secured creditor.⁶¹

The Second Circuit reasoned that the presence of express exclusions under section 15(a)(1) did not foreclose the creation of a judicial exemption for secured creditors because the “problem of the foreclosing secured creditor had [not] been brought to the attention of the Congress” when it amended the FLSA to include an express exemption for good faith purchasers in 1949.⁶² Finally, the Department of Labor’s apparent failure to apply section 15(a)(1) to secured creditors in previous cases weakened its argument for such an application in *Powell Knitting*.⁶³

The Fourth Circuit subsequently addressed the applicability of section 15(a)(1) to secured creditors in *Schultz v. Factors, Inc.*⁶⁴ In *Factors*, the Department of Labor, pursuant to section 15(a)(1), sought to enjoin a factor who had loaned funds to a furniture manufacturer subject to a valid security agreement. During the period covered by the financing agreement, the manufacturer became insolvent and consequently defaulted on its payroll. The factor took possession of the insolvent manufacturer’s finished goods through a foreclosure proceeding.⁶⁵ The Fourth Circuit adopted the Second Circuit’s holding in *Powell Knitting* and therefore refused to enjoin the factor under section 15(a)(1).⁶⁶ The court, however, narrowed its application of *Powell Knitting* by adding a “proviso” that no collusion could exist between the secured creditor and the insolvent employer.⁶⁷

59. *Id.* For a discussion of the Supreme Court’s interpretation of Congress’ powers under the commerce clause, see *supra* note 35.

60. *Powell Knitting*, 360 F.2d at 733.

61. *Id.*

62. *Id.* For the text of the good faith purchaser exemption, see *infra* note 73. For a discussion of the good faith purchaser exemption, see *infra* notes 127-47 and accompanying text.

63. 360 F.2d at 733.

64. 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971).

65. *Id.*

66. *Id.* at 32,488.

67. *Id.* In fact, the court adopted the *Powell Knitting* holding without discussion, stating that “[t]he admirable clarity of the opinion [of the Second Circuit in *Powell Knitting*] spares us the task of delimiting the Act.” *Id.* With regard to the relationship between the secured creditor and the insolvent employer, the Fourth Circuit stated:

The reservation is that there be no collusion between the manufacturer and his financier permitting the introduction into the market of goods produced in violation of the Act. Because [the employer/manufacturer] had suffered sanctions for violation of section 15(a)(1) and further because [the factor] had for

In addressing Citicorp's claim that it was not subject to the hot goods ban, the Sixth Circuit rejected the judicial exception to section 15(a)(1) created by the Second Circuit in *Powell Knitting* and modified by the Fourth Circuit in *Factors*.⁶⁸ The Supreme Court granted Citicorp's petition for certiorari to resolve the conflict between the circuits.⁶⁹

III. *Citicorp Industrial Credit, Inc. v. Brock*: SECURED CREDITORS ARE SUBJECT TO THE "HOT GOODS" BAN

In *Citicorp*, the Supreme Court rejected *Powell Knitting's* exception for secured creditors and therefore affirmed the Sixth Circuit's decision.⁷⁰ In an opinion written by Justice Marshall, the Court held that Citicorp, a secured creditor who had obtained possession of hot goods through foreclosure, was not exempt from the prohibitions contained in section 15(a)(1).⁷¹ In addition, the Court stated that the two exceptions that Congress provided in section 15(a)(1)⁷²—common carriers who accept hot goods for interstate transit and purchasers who in good faith buy hot goods without knowledge that they were produced in violation of the FLSA⁷³—constituted the only exceptions

its protection from time to time "monitored" the operations of [the employer/manufacturer], we scrutinize the relationship of the two for any complicity of [the factor] in the infractions by [the employer/manufacturer].

Id. (citations omitted). The court concluded that the "evidence [did] not justify a finding that they did collude in withholding compensation" or in "exact[ing] added labor" from the manufacturer's employees. *Id.*

68. *Brock v. Ely Group, Inc.*, 788 F.2d 1200, 1206 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987). Subsequent to *Factors*, the district courts decided cases involving the applicability of section 15(a)(1) to secured creditors. Compare *Brock v. Kentucky Ridge Mining Co.*, 635 F.2d 444 (W.D. Ky. 1985) (enjoining secured creditors under the hot goods ban is consistent with congressional intent.) with *Dunlop v. Sportsmaster, Inc.*, 77 Lab. Cas. (CCH) ¶ 33,293 (E.D. Tenn. 1975) (adopting *Powell Knitting's* judicial exemption for secured creditors under section 15(a)(1)). For an example of a case holding that federal bankruptcy law does not bar injunction under section 15(a)(1), see *Donovan v. TMC Industries, Ltd.*, 20 Bankr. 997 (N.D. Ga. 1982).

69. *Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 397 (1986) (granting petition for certiorari).

70. *Citicorp*, 107 S. Ct. at 2698. Although the FLSA applies only to "persons," the Court noted that the Act's definition of a "person" includes a corporation. The Court concluded that Citicorp's status as a corporation therefore made it subject to the prohibitions of section 15(a)(1). *Id.* at 2698-99. Section 3(a) of the FLSA defines a "person" as "an individual, partnership, association, corporation, business trust, legal representative, or any other organized group of persons." 29 U.S.C. § 203(a) (1982).

71. *Citicorp*, 107 S. Ct. at 2698.

72. *Id.* at 2699.

73. *Id.* With regard to common carriers and good faith purchasers, section 15(a)(1) of the FLSA provides:

[N]o provision of this chapter shall impose any liability upon any common carrier . . . and no provision of this chapter shall excuse any common carrier

to section 15(a)(1) and were not applicable to Citicorp.⁷⁴

Although the Court acknowledged that there was “no indication that Congress actually considered application of the ‘hot goods’ provision to secured creditors when it enacted the FLSA,”⁷⁵ it dismissed Citicorp’s contention that *Powell Knitting’s* judicially-created exemption for innocent secured creditors should be upheld because Congress intended that section 15(a)(1) apply only to culpable parties.⁷⁶ According to the Court, “That Congress identified only two narrow categories of ‘innocent’ persons who were not subject to the ‘hot goods’ provision suggests that all other persons, innocent or not, *are* subject to section 15(a)(1).”⁷⁷

The Court indicated that granting creditors a “general exemption” from the operation of section 15(a)(1), “without any duty to ascertain compliance with the FLSA,” would confer upon creditors greater protection than good faith purchasers “for whom Congress specifically added an exemption.”⁷⁸ Furthermore, the Court stated, “In the past, the Court has refused ‘[t]o extend an exemption to other than those plainly and unmistakably within [the FLSA’s] terms and spirit,’ ”⁷⁹ and that “enlargement” of the Act by implication was foreclosed “where the FLSA provides exemptions ‘in detail and with particularity.’ ”⁸⁰

Citicorp asserted that even if the common carrier and good faith purchaser exemptions were the sole exceptions to the hot goods ban, the Court should look beyond the plain language of section 15(a)(1). Because the sole aim of the FLSA was to improve the employment terms of workers, enjoinder of secured creditors who were not responsible for violating the Act’s minimum wage and overtime provi-

from its obligation to accept any goods for transportation; and . . . any such transportation, offer, shipment, delivery, or sale of such goods by a purchaser who acquired them in good faith in reliance on written assurance from the producer that the goods were produced in compliance with the requirements of this chapter, and who acquired such goods for value without notice of any such violation, shall not be deemed unlawful.

29 U.S.C. § 215(a)(1) (1982). For a discussion of the purposes behind the common carrier and good faith purchaser exemptions, see *infra* notes 127-47 and accompanying text.

74. *Citicorp*, 107 S. Ct. at 2699.

75. *Id.*

76. *Id.*

77. *Id.* (emphasis supplied by Court).

78. *Id.*

79. *Id.* at 2699-2700 (brackets supplied by Court) (quoting *A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945)).

80. *Id.* at 2700 (quoting *Addison v. Holly Hill Fruit Products, Inc.*, 332 U.S. 607, 617 (1944)).

sions would not further this objective.⁸¹ Thus, it was neither within the spirit of the FLSA, nor within the intention of the drafters of the Act to hold secured creditors subject to section 15(a)(1).⁸²

The Court, in finding Citicorp's argument unpersuasive, stated that the "legislative intent fully supports the result achieved by application of the plain language."⁸³ According to the Court, the two primary goals of the FLSA were to improve working conditions and "eliminate the [unfair] competitive advantage enjoyed by goods produced under substandard conditions."⁸⁴ Citing its own opinion in *Darby*,⁸⁵ the Court concluded that preventing the shipment of hot goods in interstate commerce furthered Congress' desire to eliminate unfair competition.⁸⁶ Consequently, the Court determined that enjoining Citicorp under section 15(a)(1) from shipping or selling the hot goods, formerly owned by the Ely Group, would further this purpose.⁸⁷

Furthermore, the Court reasoned that its holding did not affect Citicorp's ownership of the goods, even though it could not ship or sell them in interstate commerce. The Court insisted that the decision did not grant Ely's employees a "possessory interest" in the goods⁸⁸ and that the Department of Labor's motive in seeking to enjoin

81. *Id.*

82. *Id.* (citing *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892) ("[A] thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers.")). In *Holy Trinity*, the Court addressed the validity of applying a federal statute that prohibited the "importation or migration of any alien or aliens . . . under contract or agreement . . . to perform labor or service of any kind," to a contract between a religious society and a pastor. 143 U.S. at 458. The Court stated that although the contract in question fell within the "letter" of the statute, there was no indication that Congress intended it to apply to an agreement "for the employment of ministers, rectors and pastors." *Id.* at 458-63. The Court concluded that applying the statute in the instant case would be contrary to Congress' purpose. *Id.*; see *United States v. Missouri Pac. Ry.*, 278 U.S. 269, 278 (1929) ("Where the language of an enactment is clear and construction according to its terms does not lead to absurd or impracticable consequences, the words employed are to be taken as the final expression of the meaning intended [and] legislative history may not be used to support a construction that adds to or takes from the significance of the words employed.").

83. *Citicorp*, 107 S. Ct. at 2700.

84. *Id.*

85. 312 U.S. 100 (1941). For a discussion of *Darby*, see *supra* notes 32-38 and accompanying text.

86. *Citicorp*, 107 S. Ct. at 2701.

87. *Id.* In a terse concurrence, Justice Scalia commented:

While I would affirm the Court of Appeals even if I agreed with [Citicorp] that "the sole aim of the FLSA was to establish decent wages and hours for American workers," and that this goal "is not furthered by application of § 15(a)(1)" to secured creditors, I do not disagree with the Court's conclusions [regarding the purposes of the FLSA], and therefore join its opinion in full.

Id. at 2702 (citations omitted) (Scalia, J., concurring).

88. *Id.* at 2701.

Citicorp from shipping or selling the goods in interstate commerce was not to coerce it into paying the back wages of Ely's employees; rather, it was to prevent "tainted goods from entering the channels of interstate commerce."⁸⁹ Merely because the "petitioner can cure the employer's violation of the FLSA by paying the employees the statutorily required wages does not give the employees a 'lien' on the assets superior to that of a secured creditor."⁹⁰

The Court, in addition, argued that there was no difference between the hot goods ban and other regulatory measures that Congress had enacted to prevent the interstate transportation of harmful goods that fail to conform to "specified standards."⁹¹ The Court stated that "secured creditors take their security interest subject to the laws of the land."⁹² In analogizing the hot goods ban to other statutory prohibitions that Congress had enacted to exclude hazardous goods from interstate commerce,⁹³ the Court stated:

If, for example, the goods at issue in this case were fabrics that failed to meet federal flammability standards and were therefore banned from interstate commerce under the Flammable Fabrics Act, surely petitioner could not argue that it had a right to sell the inventory merely by virtue of its status as a secured creditor. "Hot goods" are not inherently hazardous, but Congress has determined that they are contraband nonetheless. We see no reason for a different result merely because a different form of contraband is involved.⁹⁴

Justice Stevens, in a dissenting opinion joined by Justice White, argued that the Court's construction of section 15(a)(1) conflicted with Congress' intent in enacting the FLSA.⁹⁵ Congress did not consider the applicability of section 15(a)(1) to secured creditors when it enacted the provision,⁹⁶ and "nothing in the language or history of the [FLSA] suggests that Congress intended that Act to [apply] when an employer is unable to pay his employees for the final days of work that produced the inventory at hand when the plant was forced to close."⁹⁷ Furthermore, Justice Stevens argued that the Court's decision would have a negative impact on the operation of federal bankruptcy law and state law regulating secured lending, noting that these

89. *Id.*

90. *Id.* (footnote omitted).

91. *Id.*

92. *Id.* at 2702.

93. *Id.* at 2701.

94. *Id.*; see Flammable Fabrics Act, 15 U.S.C. §§ 1191-1204 (1982).

95. *Citicorp*, 107 S. Ct. at 2702 n.1 (Stevens, J., dissenting).

96. *Id.* (Stevens, J., dissenting).

97. *Id.* (Stevens, J., dissenting).

areas "constitute discrete bodies of law."⁹⁸ Because the purposes of the FLSA "do not fit nicely into [the] contexts [of federal bankruptcy law and state law governing secured transactions], Congress never intended to apply the FLSA to these unique areas of the law."⁹⁹ Thus Justice Stevens concluded that the Supreme Court should have adopted the Second Circuit's holding in *Powell Knitting*.¹⁰⁰

IV. *Citicorp* Is INCONSISTENT WITH CONGRESS' INTENT

The Supreme Court's decision in *Citicorp* is problematic. After concluding that it was uncertain whether Congress had intended section 15(a)(1) to apply to secured creditors, the Court's opinion focused primarily upon one narrow issue: Whether enjoinder of *Citicorp* furthered the purposes of the FLSA? Because one purpose of the FLSA was to prevent the shipment or sale of hot goods in interstate commerce,¹⁰¹ the Court concluded that enjoining *Citicorp* would achieve this goal.¹⁰²

Although this syllogism is appealing, the court neglected to ask this most pertinent question: Why did Congress intend to prohibit the shipment or sale of hot goods in interstate commerce? Both the *Darby* Court's opinion¹⁰³ and the FLSA's legislative history indicate that in 1938, Congress foresaw that some employers would violate the Act to gain an advantage over competitors who complied with the Act.¹⁰⁴ Thus, one objective of the hot goods ban was to remove the incentive to violate the FLSA as a means of undercutting competitors in the area of labor costs.

Enjoining *Citicorp* does not further this purpose. Ely is defunct and is in no position to benefit from its violations of the FLSA. Also, Ely did not violate the minimum wage and overtime provisions of the FLSA in order to gain an unfair competitive advantage, but did so as the result of its insolvency.¹⁰⁵ Ely is therefore quite unlike the employer in *Darby*, who consciously violated the FLSA.¹⁰⁶ Furthermore, *Citicorp* did not place itself in Ely's shoes and attempt to act as

98. *Id.* (Stevens, J., dissenting). The majority did not discuss the impact of its decision upon federal bankruptcy law because Ely had not filed for bankruptcy and thus the issue was not before the Court. *Id.* at 2701 n.10. A consideration of *Citicorp*'s impact on federal bankruptcy law is beyond the scope of this Note.

99. *Id.* at 2702-03 (Stevens, J., dissenting).

100. *Id.* at 2704 (Stevens, J., dissenting).

101. *Id.* at 2700.

102. *Id.* at 2701.

103. 312 U.S. 100 (1941).

104. See *Darby*, 312 U.S. at 122.

105. *Citicorp*, 107 S. Ct. at 2697.

106. *Darby*, 312 U.S. at 111; see *supra* notes 32-38 and accompanying text.

its successor. Hence, there is no danger that Citicorp will reap an unfair advantage. Consequently, applying section 15(a)(1) to Citicorp does not advance Congress' goal of suppressing unfair competition.¹⁰⁷

There is, however, justification for applying section 15(a)(1) to secured creditors when the collusion described by the Fourth Circuit in *Factors* is present.¹⁰⁸ If an insolvent employer and a secured creditor collude to deny employees the statutorily mandated benefits provided by the FLSA, the problem of unfair competition exists. In such circumstances, both parties may reap an unfair advantage by having reduced the employer's labor costs. Moreover, when such collusion is present, the creditor and the employer would appear to have an agency relationship of the type described by the Fifth Circuit in *Southern Advance*.¹⁰⁹ As a result, the creditor would be in the position of a principal who stands to benefit from the statutory violations of his agent.¹¹⁰

Applying section 15(a)(1)'s ban to secured creditors when there is no risk of collusion is more troubling. Although this policy insures the payment of employees, which is one purpose of the FLSA, it coerces the secured creditor into paying back wages to employees of defunct debtors. Such a policy could adversely affect the cost and availability of credit—a result that Congress never intended. It is important, therefore, to analyze the impact of the *Citicorp* decision on credit practices.

V. THE ADJUSTMENT OF CREDIT PRACTICES AFTER *Citicorp*

The practice of secured lending is regulated by state law. In particular, article 9 of the Uniform Commercial Code (UCC), as enacted by the states in its several versions, establishes uniform rules and terminology to govern secured transactions.¹¹¹ Under a typical security agreement,¹¹² a lender,¹¹³ in return for extending credit to a borrower,

107. See *supra* notes 32-38 and accompanying text.

108. 65 Lab. Cas. (CCH) ¶ 32,487 (4th Cir. 1971); see *supra* notes 64-67 and accompanying text.

109. 133 F.2d 449 (5th Cir. 1943); see *supra* notes 40-46 and accompanying text.

110. See *supra* notes 40-46 and accompanying text.

111. U.C.C. §§ 9-101 to -507 (1978). Article 9 has been adopted by every state except Louisiana. It also has been adopted by the District of Columbia and the United States Virgin Islands. See generally Braucher, *Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798 (1958) (describing the UCC's origin and highlighting some of its major provisions). For a detailed treatment of article 9, see J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 873-1135 (1980).

112. U.C.C. § 9-105(1)(l) (1978) ("Security Agreement" means an agreement which creates or provides for a security interest.").

113. *Id.* § 9-105(1)(m) ("Secured party" means a lender, seller or other person in whose

receives an interest¹¹⁴ in particular assets of the debtor.¹¹⁵ The creditor must then "perfect" his security interest to make it fully effective.¹¹⁶ The secured creditor's interest is "secured" because the assets held as secured collateral,¹¹⁷ upon the borrower's default, must be used to satisfy the secured creditor's claims before they can be used to satisfy the claims of the debtor's other creditors.¹¹⁸ Security agreements thus mitigate the effects of debtor default for the creditor with a perfected security interest by placing certain secured assets (such as inventories) out of the reach of all unsecured creditors, including the debtor's employees, as well as all creditors who subsequently acquire a security interest in the same goods.¹¹⁹ Thus, secured transactions reduce the risk inherent in lending. As a result, all other things being equal, creditors will furnish credit that is secured in greater amounts and at a cheaper price than credit that is not secured. Secured lending, therefore, promotes the availability of credit over and above the amount that would exist in its absence.¹²⁰

favor there is a security interest, including a person to whom accounts or chattel paper have been sold.").

114. *Id.* §§ 9-306 to -316.

115. *Id.* § 9-105(1)(d) (" 'Debtor' means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper.").

116. *Id.* § 9-302. The UCC provides that a secured party may perfect his security interest by filing a financing statement with the state, or by taking possession of the collateral. *Id.* §§ 9-302 to -305. Article 9 also provides for "certain limited classifications of property, an automatic perfection upon attachment of the security interest without the taking of any action by the secured party." D. CAMPBELL & D. LYNN, CREDITORS' RIGHTS HANDBOOK 29 (1985); see J. WHITE & R. SUMMERS, *supra* note 111, at 918-92; see also U.C.C. §§ 9-401 to -408 (describing the process of filing).

117. *Id.* § 9-105(c) (" 'Collateral' means the property subject to a security interest, and includes accounts receivable and chattel paper which have been sold.").

118. *Id.* § 9-306.

119. *Id.* § 9-312 (governing priority where there are conflicting security interests in the same collateral). Moreover, for the security interest to be enforceable against the debtor or third parties, the secured party must "either keep possession of the collateral . . . [or obtain] a security agreement which contains a description of the personal property or fixtures that are to serve as collateral for the loan." In addition, the secured party must "give value for the loan, [and] the debtor must have rights in the collateral which secures the loan." Squillante, *The Security Agreement: Part I*, 1981 COM. L.J. 99, 100 (footnote omitted) (describing the requirements of attachment under U.C.C. § 9-203(1)); see B. MANNING, LEGAL CAPITAL 3 (1981) (A secured creditor has "the opportunity to claim those assets for the full and complete payment of the debt owing to him, even if they are the only assets so that the dedication of the lien assets to his debt means that other creditors will receive nothing at all."); J. WHITE & R. SUMMERS, *supra* note 111, at 901-17.

120. For a discussion of the workings of article 9, see Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979). There is an ongoing debate concerning the function and utility of secured credit. See, e.g., Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49 (1982) (Secured creditors monitor management's behavior to the benefit of shareholders.); Schwartz, *The Continuing*

The Supreme Court's decision in *Citicorp* undoubtedly will affect the price and availability of credit because a secured creditor who is unable to transport or liquidate his secured collateral faces a significant devaluation of his security interest.¹²¹ The possibility that courts would enjoin a secured creditor from liquidating the assets of a borrower in default will likely raise the cost of secured lending as a reflection of this uncertainty.¹²² In addition, the cost of credit could rise to reflect the risk that the secured lender would pay the back wages of the defunct borrower's employees in order to remove the taint from the collateral. The secured creditor who has an interest in hot goods, like any rational actor, surely would pay the back wages if they do not exceed the value of the collateral. Such action is the only way a creditor could salvage a portion of the funds that he provided to the defunct borrower.¹²³ At the same time, creditors could reduce the availability of credit because at higher interest rates, creditors can earn the same amount of money by providing a diminished supply of credit, and the money otherwise lent as credit would be placed in investments that would generate the highest possible return.¹²⁴

Furthermore, a number of companies could face bankruptcy if credit became too expensive or too scarce. Other businesses could

Puzzle of Secured Debt, 37 VAND. L. REV. 1587 (1984) (The reasons supporting the issuance of secured debt are not known.); Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981) (Traditional justifications for the issuance of secured debt are unsupportable.); White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473 (1984) (Secured credit exists because it is more efficient than unsecured credit.).

121. This diminution in the value of the security interest would be keyed to the likelihood of the debtor producing goods subject to the hot goods ban.

122. This increase in price would be reflected in a higher rate of interest charged debtors for credit.

123. The secured creditor might, however, choose not to pay the back wages if the value of the collateral is only marginally greater than the value of the employees' wage claims. In such a case, the transaction costs involved in removing the "taint" from the goods might be greater than the value of the collateral minus the wage claims. See, e.g., *Donovan v. TMC Industries, Ltd.*, 20 Bankr. 997, 1006-07 (N.D. Ga. 1982) (describing the steps necessary to remove "taint" from "hot goods").

124. The increase in the cost of secured lending caused by the *Citicorp* decision might make unsecured loans more attractive. The *Citicorp* decision thus could affect the mix of secured and unsecured debt instruments. For example, as the differential between the costs of secured and unsecured lending narrows, some borrowers might choose the costlier unsecured loan in order to avoid encumbering assets. The demand for unsecured credit would thereby increase. In response to this demand, creditors would increase their supply of unsecured credit.

Secured creditors might also lower their exposure to the increased riskiness of secured lending by reducing or eliminating inventory as an item of collateral. Thus, for example, secured creditors would substitute debtor assets, such as accounts receivable, which are not subject to the hot goods ban, for inventory. The rate of substitution would depend upon the relative weights that the creditor attributed to riskiness of the noninventory assets and inventory exclusive of the risk of enjoinder under section 15(a)(1).

respond to the higher cost of credit by decreasing their borrowing or delaying plans for expansion. In either case, employees are likely to suffer. The issues in *Citicorp* concern more than stopping the shipment of hot goods by secured creditors. The practice of secured lending depends upon a creditor's ability to liquidate a defaulted debtor's assets. Finally, *Citicorp* gives creditors the incentive to structure future security agreements in order to qualify for exempt status under section 15(a)(1)'s good faith purchaser exception.¹²⁵ The Supreme Court in *Citicorp* in fact indicated that creditors could protect themselves from "unwitting" violations of the FLSA if they met the criteria of the good faith purchaser exemption.¹²⁶ Thus, the federal district courts and the courts of appeals will have to grapple with one of the questions that the *Citicorp* Court failed to address: Is it feasible for a secured creditor to qualify as a good faith purchaser under section 15(a)(1)?

VI. FUTURE LITIGATION UNDER SECTION 15(a)(1)

Section 15(a)(1) of the FLSA provides that the hot goods ban will not operate if goods were acquired "by a purchaser . . . in good faith in reliance on *written assurance* from the producer that the goods were produced in compliance with the requirements of this chapter, and . . . for value *without notice* of any such violation [of the Act]".¹²⁷

The Report of the House Managers of the FLSA stated that good faith is "what a reasonable, prudent man, acting with due diligence, would have done in the circumstances."¹²⁸ The House report also

125. See *infra* notes 127-47 and accompanying text.

126. *Citicorp*, 107 S. Ct. at 2699. Under the parties' financing agreement, Ely agreed to act in accordance with applicable governmental statutes and regulations. *Brock v. Ely Group, Inc.*, 788 F.2d 1200, 1206 n.11 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987). The Sixth Circuit concluded that this "representation" did not constitute the written assurance necessary to qualify Citicorp as a good faith purchaser under section 15(a)(1). *Id.*

127. 29 U.S.C. § 215(a)(1) (1982) (emphasis added). For the relevant text of this statute, see *supra* note 73. Congress inserted the common carrier exemption into the FLSA in order to forestall a challenge to the constitutionality of section 15(a)(1). See H.R. REP. NO. 2182, 75th Cong., 3d Sess. 14 (1938). *But see* *Walling v. Griffin Cartage Co.*, 62 F. Supp. 396, 399-400 (E.D. Mich. 1945) (common carrier exemption does not apply where transportation of goods is an incident to their production).

128. H.R. CONF. REP. NO. 1453, 81st Cong., 1st Sess. 31, *reprinted in* 1949 U.S. CODE CONG. & ADMIN. NEWS 2241, 2271. The House report also commented:

This provision protects an innocent purchaser from an unwitting violation and also protects him from having goods which he has purchased in good faith ordered to be withheld from shipment in commerce by a "hot goods" injunction. . . . The requirement that he must have made the purchase in good

noted, "An affirmative duty is imposed upon [the third party purchaser] to assure himself that the goods in question were produced in compliance with the act, and he must have secured written assurance to that effect from the producer of the goods."¹²⁹ Congress decided that notice under the good faith purchaser exemption must be reasonable: A purchaser must not be aware of the existence of any violations of the Act by the employer/debtor, and the absence of knowledge of any violations must be reasonable under the circumstances.¹³⁰

The Fifth Circuit applied this subjective-objective standard in *Wirtz v. Lone Star Steel Co.*,¹³¹ which held that a mill owner, whose independent contractors violated the FLSA's minimum wage and overtime provisions, violated section 15(a)(1).¹³² The Fifth Circuit rejected the mill owner's attempt to qualify as a good faith purchaser under section 15(a)(1), stating that Lone Star knew or should have known that its contractors were violating the FLSA:

The person who had sole responsibility for keeping Lone Star Steel Company in compliance with the Act also had hearsay evidence that the "hot goods" section was being violated. . . . "Good faith" under the Act does not include ignoring the obvious. Lone Star Steel Company had the contractual right to inspect the records of the contractors at any time. A good faith effort to comply with the Act would have included checking their records and any further investigation necessary to ascertain the facts. A person or a corporation cannot take an "ostrich-like attitude" and still be in good faith under the Fair Labor Standards Act.¹³³

The rationale for this subjective-objective standard is that notice under the FLSA cannot be exclusively dependent on the subjective belief of the purchaser, because he would then have the incentive to

faith is comparable to similar requirements imposed on purchasers in other fields of law.

Id.

129. *Id.*

130. *Id.*

131. 405 F.2d 668 (5th Cir. 1968).

132. *Id.* at 670. *Lone Star* involved an action for an injunction. Lone Star operated a steel mill and various iron ore mines. Lone Star contracted with independent contractors to haul ore mined at its mines to its processing plant. *Id.* at 671-73. The court stated that "the contract between the company and the contractors provided for the contractors' compliance with the [FLSA] and written certification of compliance." *Id.* at 670. The court added that although "such written assurances were given," Lone Star was aware that the Department of Labor had previously "conducted an investigation of the wages paid to the contractors' employees and [had] thereafter filed actions alleging Wage and Hour violations by the contractors." *Id.*

133. *Id.*

consciously avoid obtaining information that would place a reasonable person on notice.

To minimize the risk of falling victim to the hot goods prohibition, creditors who plan to take a security interest in a debtor's future inventory may seek to qualify as good faith purchasers.¹³⁴ There are three possible scenarios under which secured creditors could seek written assurance of compliance with the FLSA with regard to future inventory. First, prior to establishing his security interest, the secured creditor could ask the employer/debtor for written assurance that the subject goods, to be produced at some future time, would be manufactured in compliance with the Act. Second, when he forecloses on collateral held by the employer/debtor, the secured creditor could seek assurance that the goods subject to the security interest were made in compliance with the Act. The third scenario would require the secured creditor to seek continual assurance from the employer/debtor as each batch of goods is manufactured.

Under either of the first two scenarios, the secured creditor could not qualify as a good faith purchaser if that term is to have any substantive meaning. Under the first hypothetical, for example, the creditor would seek assurance that goods produced at some future time would be manufactured in compliance with the FLSA. Assurance as to the occurrence of a speculative event—the production of goods at some future time—is not the good faith assurance contemplated by the Act.¹³⁵ The good faith purchaser exception would certainly eviscerate the hot goods ban as applied to secured creditors if employers could assure creditors that goods to be manufactured in the future would be made in compliance with the Act; the secured creditor could

134. The Court in *Citicorp* never discussed whether a secured creditor could successfully qualify as a good faith purchaser under section 15(a)(1). The Court merely noted that Citicorp did not claim standing as either a common carrier or a good faith purchaser. *Citicorp*, 107 S. Ct. at 2699. The Sixth Circuit, however, observed that "although the extension of credit might qualify as a 'purchase,'" Citicorp was not a good faith purchaser because it had not received written assurance that the goods were produced in compliance with the FLSA. *Brock v. Ely Group, Inc.*, 788 F.2d 1200, 1205-06 (6th Cir. 1986), *aff'd sub nom. Citicorp Industrial Credit, Inc. v. Brock*, 107 S. Ct. 2694 (1987); see U.C.C. § 1-201(32) (1978) ("Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.").

135. 29 C.F.R. § 789.3 (1987). The regulation states:

A so-called "general and continuing" assurance or "blanket guarantee" stating, for instance, that all goods to be shipped to the purchaser during a twelve-month period following a certain date "will be or were produced" in compliance with applicable provisions of the Act would not afford the purchaser the statutory protection with respect to any production of such goods after the assurance is given.

Id.

only hope that the goods subject to his security interest would be produced in accordance with the Act. He therefore could not rely upon such an assurance in good faith.

The second scenario also presents analytical difficulties. Under this hypothetical, the secured creditor would request written assurance from the employer/debtor at the time of foreclosure. Even assuming that the employer/debtor would be willing or available to give such assurance at the time the creditor took possession of the goods, no reasonable secured creditor could rely in good faith upon such a guarantee: The fact that the secured creditor himself is foreclosing on the assets of the employer/debtor should invalidate any assurances from the employer/debtor that the secured goods were produced in compliance with the FLSA. Rather, if the employer/debtor defaulted on his obligation to the secured creditor, it is likely that he also was unable to pay his employees. As a result, no reasonable creditor could claim that he had no notice of FLSA violations if he knew that the employer/debtor had been unable to meet his debts.

In contrast, it is possible for a secured creditor to qualify as a good faith purchaser under the third scenario. The secured creditor could seek assurance from the employer/debtor as the goods are produced. This would necessitate, however, that the creditor closely monitor the employer/debtor's operations.¹³⁶ The *Citicorp* Court in fact argued that a secured creditor had a "duty" to insure that the employer/debtor produced the collateral in conformity with the Act: The Court noted that under the Citicorp-Ely Group financing agreement, Citicorp was permitted and did in fact monitor Ely's operations.¹³⁷

Analyzing a creditor's attempt to qualify for good faith purchaser status under the third scenario shifts the focus of the inquiry under section 15(a)(1). Because of the complexities involved in determining whether a secured creditor acted in good faith and received written assurance as to each batch of goods produced, courts will have to analyze the reasonableness of the creditor's conduct in monitoring the operations of the debtor. The exercise of due care in monitoring the employer/debtor's operations would create a presumption that the creditor acted in good faith by seeking assurance that the goods were produced in accordance with the FLSA.¹³⁸

136. The court in *Lone Star* imposed a similar requirement. *See supra* notes 131-33 and accompanying text. *Lone Star*, however, is distinguishable from the instant case. In *Lone Star*, the third party producer was aware that the employers (independent contractors) had previously violated the FLSA. *Lone Star*, 405 F.2d at 670.

137. *Citicorp*, 107 S. Ct. at 2696.

138. Given the volume of transactions arising during the course of a financing agreement,

Logic justifies the focus upon the care exercised by creditors in monitoring the employer/debtor's activities as a proxy for good faith assurance. If creditors are not held to a standard of reasonableness, then any assurance pertaining to compliance with the requirements of the FLSA is suspect—a creditor's negligence in supervising the employer/debtor's operations casts doubt as to whether the creditor used due care in obtaining assurance from the employer/debtor. Moreover, requiring a secured creditor to monitor the employer/debtor's business continually is seemingly consistent with *Lone Star*. The *Lone Star* court emphasized that Lone Star, prior to its purchase of goods, should have monitored the wage practices of its independent producers.

Nonetheless, a duty to oversee a debtor's business continually during the life of a loan agreement is qualitatively much more burdensome than the corresponding burden placed on an ordinary one-time purchaser under section 15(a)(1). There is no indication that when Congress amended the FLSA in 1949 to include an exemption for good faith purchasers under section 15(a)(1), it intended to place a heavier burden on secured creditors than other third party purchasers.¹³⁹ For that matter, there is no reason to believe that Congress even considered applying section 15(a)(1) to secured creditors, because secured transactions in 1949 were far less common than today—article 9 of the UCC, which spurred the growth of secured transactions, did not become a reality until the late 1950's.¹⁴⁰ Thus, it is doubtful that Congress intended to differentiate among third parties in this regard.

There is, however, another problem associated with this approach. Assuming that a secured creditor determines that the employer/debtor is violating the Act, there is nothing that the creditor can do to compel the employer/debtor to comply with the Act, unless the violations constitute a breach of the parties' loan agreement.¹⁴¹ The creditor, unlike the ordinary purchaser, cannot condition his purchase of the goods on the employer/debtor's compliance with the Act: He previously "purchased" the goods when he pro-

the validity and reliability of the creditor's system for monitoring the debtor's business is the only realistic method for a court to gauge the reasonableness of the creditor's conduct vis-a-vis the good faith purchaser exemption.

139. See H.R. CONF. REP. NO. 1453, *supra* note 128, at 10, 31.

140. Note, "Hot Goods" Liability: Secured Creditors and the Fair Labor Standards Act, 87 COLUM. L. REV. 644, 652-53 (1987); see also Braucher, *supra* note 111, at 798 (tracing the origins of the UCC).

141. See Brief for the National Commercial Finance Association as Amicus Curiae in Support of Petitioner at 14-15, *Citicorp*, 107 S. Ct. 2694 (1987) (No. 86-88).

vided the employer/debtor with the loan proceeds, and in return, he took a security interest in the future inventory of the employer/debtor.¹⁴²

In addition, even assuming that creditors modify security agreements so that an employer/debtor's violation of the FLSA constitutes a breach of the parties' loan agreement, the creditor is still in a weak bargaining position vis-a-vis the employer/debtor. The value of a secured creditor's security interest is dependent upon the value of the collateral. If the collateral consists of inventory to be produced at a future date, the value of the creditor's collateral is dependent upon inventory being produced to replace inventory sold. Thus, preventing the employer/debtor from producing hot goods works to the detriment of the creditor because it reduces the value of his security interest. Furthermore, it might be economically advantageous for the employer/debtor to halt production rather than comply with the requirements of the FLSA. This situation would arise in the event that the cost of FLSA compliance was greater than the value of the collateral held pursuant to the creditor's lien.¹⁴³

The *Citicorp* Court did not address the extra burdens inhering in a secured creditor's attempt to qualify as a good faith purchaser. The Court did not consider whether compelling a secured creditor to oversee the operations of an employer/debtor in order to qualify as a good faith purchaser was consistent with the FLSA's limited goals—i.e., preventing unfair competition and insuring that workers receive compensation according to the Act's minimum wage and overtime provisions.¹⁴⁴ In addition, the *Citicorp* Court did not address the potential liability associated with a creditor's oversight of a debtor's operations. If a secured creditor exercises too much control over a debtor's business, he might be held liable for the acts and obligations of the debtor.¹⁴⁵

The Court also failed to consider whether the extra burden of monitoring the employer/debtor's operations placed upon secured

142. The creditor could also require as a part of the financing arrangement that he have access to the wage and hour records that the employer is required to keep pursuant to section 11(c) of the FLSA. 29 U.S.C.A. § 211(c) (West Supp. 1987). The creditor might also apply pressure to the employer/debtor by indicating to him that violations of the FLSA will result in a more stringent attitude on his part in assessing the debtor's adherence to his obligations under the financing agreement.

143. See *supra* note 123 and accompanying text.

144. See *supra* notes 34-37 and accompanying text.

145. The creditor might even be held liable as an employer under the FLSA for the employer/debtor's violations of the Act. See generally Douglas-Hamilton, *When are Creditors in Control of Debtor Companies?*, PRAC. LAW., Oct. 15, 1980, at 61-74 (Lenders who oversee debtors' affairs may be held liable for the claims of other creditors.).

creditors, as compared with the obligations placed upon other third parties seeking good faith purchaser status, is consistent with Congress' intent.¹⁴⁶ In fact, the Court did not even discuss the time period during which Citicorp could have received good faith assurance that the goods were being produced in compliance with the Act.

The "timing issue" and the additional burdens associated with monitoring the operations of the employer/debtor under the third scenario indicate that a secured creditor's ability to take advantage of the good faith purchaser exception is inherently limited. In essence, the Court's ruling establishes two different classes of third parties in relation to their abilities to qualify as good faith purchasers. Because there is no indication that Congress intended to distinguish among classes of potential good faith purchasers, the *Citicorp* Court's holding is not consistent with the intent of Congress.¹⁴⁷

VII. CONCLUSION

In enacting section 15(a)(1) of the FLSA, Congress did not consider its application to secured creditors. In fact, security agreements were uncommon at the time of the FLSA's adoption in 1938 and subsequent amendment in 1949.¹⁴⁸ Despite these factors, the Supreme Court in *Citicorp* decided that the legislative intent behind the FLSA mandated the extension of the hot goods ban to secured creditors.¹⁴⁹

The Supreme Court's decision is thus questionable. The Court's analysis of Congress' intent amounted to nothing more than a mechanistic recitation of the FLSA's purpose and was divorced from the realities of the situation at hand. The Court focused on Congress' desire to stop the sale or transportation of hot goods in interstate commerce without giving full consideration to Congress' underlying motives. Moreover, the Court failed to address the impact on credit practices that would result from the application of section 15(a)(1) to secured creditors.¹⁵⁰ Furthermore, the Court's decision provides no guidance to the lower courts on how to deal with a secured creditor's attempt to qualify as a good faith purchaser.¹⁵¹ Finally, the difficulties inhering in a secured creditor's ability to qualify as a good faith purchaser under section 15(a)(1) demonstrate that the *Citicorp* decision is inconsistent with Congress' intent. This Note therefore sug-

146. See *supra* note 72 and accompanying text.

147. See H.R. CONF. REP. NO. 1453, *supra* note 128, at 10, 31.

148. Note, *supra* note 140, at 652-53.

149. See *supra* notes 75-87 and accompanying text.

150. For a discussion of *Citicorp*, see *supra* notes 70-100 and accompanying text.

151. For a discussion of the good faith purchaser exemption, see *supra* notes 127-47 and accompanying text.

gests that the Supreme Court's decision in *Citicorp* was ill-considered and that Congress should amend section 15(a)(1) to override the Supreme Court's decision. The *Powell Knitting-Factors* rule furthers the FLSA's goals and would be an appropriate substitute for the *Citicorp* holding.

As the Second Circuit noted in *Powell Knitting*,¹⁵² Congress has the power to affect the priorities of creditors indirectly as an incident of its commerce powers.¹⁵³ Thus, Congress could have altered the priorities of secured creditors when it enacted the FLSA and provided for the section 15(a)(1) ban.¹⁵⁴ The legislative history of the FLSA, however, does not indicate that Congress ever considered the effect

152. 360 F.2d 730 (2d Cir. 1966); see *supra* notes 47-63 and accompanying text.

153. See L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 239-42 (1978). Citicorp argued that enjoining secured creditors under the hot goods ban would undermine the "safeguards for federalism inherent in the structure of the national government" by overriding the state-established priorities of secured creditors. Reply Brief of Petitioner on Petition for a Writ of Certiorari, *supra* note 24, at 6 (citing *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 556 (1985), *overruling* *National League of Cities v. Usery*, 426 U.S. 833 (1976)). It also contended that "generally-worded provisions of a federal statute," such as section 15(a)(1) of the FLSA, should be construed to avoid superseding the policy judgments of the states "on matters of primarily local concern" when there is no indication that Congress "ever considered, much less intended such a result." *Id.* at 6 n.7. Citicorp further stated that failure to adopt such a construction would nullify those "safeguards." *Id.*

In *National League of Cities v. Usery*, 426 U.S. 833 (1976), Congress' amendment of the FLSA to extend its coverage to state and local government employees was challenged as an unconstitutional interference with the sovereignty of the states *qua* states. *Id.* at 836. The Court, in a five to four decision, struck down the FLSA amendments and thereby created a narrow exception to Congress' powers under the commerce clause in areas, such as public employment, where traditional state and local governmental operations are involved. *Id.* at 855. The Court stated that "Congress may not exercise [its commerce] power so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made." *Id.*

In *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 556 (1985), the Court again considered the application of the FLSA to the states and their political subdivisions. In *overruling National League of Cities*, the Court, in a five to four decision, held that state sovereignty would be best protected through the political framework of the federal system. *Id.* at 546-55. Moreover, no member of the *Garcia* Court questioned the broad power of Congress under the commerce clause. See *id.* at 584 (O'Connor, J., dissenting) ("Even if a particular individual's activity has no perceptible effect, it can be reached by Congress . . . as long as that [class of activity] affects interstate commerce.").

Citicorp's reliance upon *Garcia* is therefore misplaced. Regulation of secured transactions is not a traditional governmental function of the type held immune from the reach of the commerce power in *National League of Cities*. Moreover, not even the *Garcia* dissenters suggested that Congress' commerce powers could be restricted in an area not involving traditional governmental activities. See generally Comment, *Garcia: The Preservation of Federalism Values is Best Left to the Political Process Rather than the Courts*, 15 CAP. U.L. REV. 515 (1986) (arguing that state sovereignty is better protected through state participation in the federal system, rather than through judicial oversight). For the text of the commerce clause, see *supra* note 35.

154. See *supra* notes 35, 59 & 60 and accompanying text.

section 15(a)(1) would have on secured lenders. Notwithstanding the likely adverse impact on credit, extension of the section 15(a)(1) ban to secured creditors will not achieve Congress' goal of eliminating unfair competition. In *Citicorp*, the only purpose served by applying the section 15(a)(1) ban is to coerce Citicorp into paying the back wages of Ely's employees. Although ensuring the payment of Ely's employees furthers one of the central purposes of the Act, it is doubtful whether Congress intended the secured creditor to be responsible for employers' arrearages. Only when there is a collusive relationship or agency between the employer and the secured creditor does application of section 15(a)(1) to the secured creditor effectuate Congress' intent. The unfair competition problem foreseen by Congress would arise only in such a case.

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