

Who's on First? Nothing Funny About Liens for Lenders

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Federal Bar Association – Bankruptcy Section Newsletter

Unlike the classic baseball comedy sketch "Who's on First?" by the duo Abbott and Costello, there's nothing funny about lien priority for lenders!

When making loans, lenders assume that if the mortgage or financing statement is filed before anyone else's, the lender has priority. Although that time-honored principle may generally be true, there are liens that can prime the secured creditor's position. Even worse, some of these liens may be "hidden." This article will highlight some of the ways a secured creditor's priority position may be at risk.

TAX LIENS

Michigan

MCL 205.29 provides that State of Michigan tax liens take precedence over all other liens and encumbrances, except bona fide liens recorded before the state tax lien is recorded. However, bona fide liens recorded before the tax lien is recorded shall take precedence only to the extent of disbursements made under a financing arrangement before the 46th day after the date of the tax lien recording, or before the date the person making the disbursement had actual knowledge of a tax lien recording, whichever is earlier. To the extent the creditor makes advances more than 46 days after the date of recording of state tax liens, the state tax liens will have priority.

MCL 211.40 provides that personal property tax liens assessed for county, village, or township taxes are a first lien, prior, superior, and paramount on all personal property. The tax liens take precedence over all other claims, encumbrances, and liens on that personal property. The transfer of personal property assessed for taxes does not divest or destroy the lien, except where the personal property is actually sold in the regular course of retail trade. The local taxing authority needs to be contacted to determine if personal property taxes are owing.

MCL 421.15(e) provides that except for liens and encumbrances recorded before the filing of the notice of the lien, all contributions, interest, and penalties payable to the Michigan Unemployment Insurance Agency from a party that neglects to pay the same when due are a first and prior lien upon all property and rights to real and personal property belonging to the party. Notice of the lien shall be recorded with the Register of Deeds of the county in which the real property subject to the lien is situated. Notice of the lien may also be filed with the Michigan Secretary of State in regard to personal property.

Federal

Section 6321 of the Internal Revenue Code grants the United States a lien upon a taxpayer's real and personal property when the taxpayer fails to pay any tax due. In order for the federal tax lien to have priority over the secured creditor's perfected interest, the IRS must record a notice of the federal tax lien. With respect to real property, the notice of federal tax lien must be filed with the Register of Deeds for the county where the real property is located. With respect to personal property, the notice of federal tax lien must be filed with the Michigan Secretary of State. In regard to assets such as accounts receivable or inventory, the secured creditor's lien takes priority over the federal tax lien only to the extent of advances made during the 45 days immediately following the filing of the federal tax lien and only as to receivables arising during that same period. 26 USC §6323(c).

The IRS unfortunately is not required to use the taxpayer's exact legal name on a notice of federal tax lien. In *United States v. Crestmark Bank*, 412 F.3d 653 (6th Cir. 2005), the debtor's correct name was "Spearing Tool and Manufacturing Co." The notice of federal tax lien was filed under "Spearing Tool & Mfg. Company Inc." Although UCC searches under the debtor's correct legal name did not indicate the existence of the federal tax lien, the Sixth Circuit Court of Appeals found that the notice of federal tax lien would have been disclosed by a reasonable and diligent search.

CONSTRUCTION LIENS

The Michigan Construction Lien Act, MCL 570.1101 *et seq.*, creates construction lien rights for persons who provide improvements to privately owned real property. The rights created under the Act cover privately owned construction projects only. The remedies for collection of funds due to those who provide improvements on public projects are covered by the Contractor's Bond for Public Buildings or Works Act, MCL 129.201 *et seq.*

If the construction lien is recorded before a mortgage, the construction lien has priority. However, if the mortgage is recorded before the construction lien, whether the mortgage has priority depends upon whether the mortgage was also recorded before the first "actual physical improvement" on the project.

"Actual physical improvement" means the actual physical change in, or alteration of, real property as a result of labor provided, pursuant to a contract, by a contractor, subcontractor, or laborer which is readily visible and of a kind that would alert a person upon reasonable inspection of the existence of an improvement. Actual physical improvement does not include that labor which is provided in preparation for that change or alteration, such as surveying, soil boring and testing, architectural or engineering planning, or the preparation of other plans or drawings of any kind or nature. Actual physical improvement does not include supplies delivered to or stored at the real

property. MCL 570.1103(1).

If the mortgage was recorded prior to the first actual physical improvement on the project, then the mortgage has priority. If not, then all of the claims of lien recorded for that project have priority over the mortgage. Additionally, it is possible for a mortgage which is recorded before the first actual physical improvement, but which is not fully disbursed at the time of recording, to lose its priority as to those funds disbursed after the first actual physical improvement.

STATUTORY TRUSTS

Michigan Builders' Trust Fund Act

The Michigan Building Contract Fund Act, MCL 570.151 *et seq.*, commonly known as the Michigan Builders' Trust Fund Act, was adopted to protect both subcontractors and owners from financially irresponsible general contractors. The Act imposes a trust on monies paid to a contractor for the benefit of other contractors, subcontractors, laborers, suppliers, and the person making the payment. The Act also prohibits a contractor from keeping or using construction payments from a particular project until all laborers, subcontractors, and materialmen who worked on the project are paid. The Act does not impose a trust on funds held by the owner, nor does it apply to public construction contracts.

A secured creditor will not necessarily prevail over an unsecured beneficiary under the Act. The secured creditor will have priority only if the security interest was obtained in return for funds actually used to pay for laborers, subcontractors or materialmen on the specific project for which the funds were obtained. *Bishop Distributing Co. v. Safeco Title Ins. Co.*, 130Mich. App. 791 (1983).

Perishable Agricultural Commodities Act

The Perishable Agricultural Commodities Act, 7 USC §499a *et seq.* ("PACA"), establishes a statutory trust for the benefit of persons who sell perishable agricultural commodities to commission merchants, dealers and brokers, and are not paid. "Perishable agricultural commodity" means any of the following, whether or not frozen or packed in ice: fresh fruits and fresh vegetables of every kind and character, and cherries in brine. 7 USC §499a(4).

PACA creates a non-segregated floating trust which permits the commingling of trust assets. Therefore, all of the purchaser's produce-related inventory, proceeds and receivables from the sale thereof are included in the assets of the trust, to the extent of the amount that sellers remain unpaid.

MICHIGAN STATUTORY LIENS

Mechanic's and Artisan's Liens / Keeping of Animals

MCL 570.185 *et seq.* provides mechanics, artisans, and tradespersons with possessory liens for the manufacture, repair, or alteration of goods. The validity of these liens depends on possession. A lien is also provided for the care or keeping of animals. MCL 570.185. The lien of a mechanic, artisan, or tradesperson who maintains possession will take priority over prior liens asserted on the property. MCL 440.9333

Tools, Dies, Molds and Special Equipment Liens

Michigan law provides protections for the builders and end users of tools, molds, and other specially made equipment by granting those parties liens under the Michigan Special Tools Lien Act, MCL 570.541 *et seq.*, and the Michigan Ownership Rights in Dies, Molds, and Forms Act, MCL 445.611 *et seq.*

For a tool builder to hold a valid lien on a tool, the tool builder must permanently record, on each special tool that the builder fabricates, repairs, or modifies, the builder's name, street address, and city and state. MCL 570.563(1). A second requirement for perfection to occur is the filing of a financing statement. *In re Plastech Engineered Products*, 418 B.R. 235, 247 (Bankr. E.D. Mich. 2009). A tool builder's valid lien will take priority over all other liens, including those of a secured lender. MCL 570.563(6); MCL 440.9201(2)(u).

Garage Keeper's Liens

The Michigan Garage Keeper's Lien Act, MCL 570.301 *et seq.*, provides a lien to garage keepers who furnish labor or material for storing, repairing, maintaining, keeping, or otherwise supplying automobiles or other vehicles. The validity of a garage keeper's lien under the Act depends on possession. MCL 570.303(1). A garage keeper's lien for labor and material furnished in making repairs to a vehicle has priority over all other liens on the vehicle. MCL 570.303(3).

However, if a security interest attached to the vehicle before a garage keeper's lien, the prior lienholder may pay the garage keeper pursuant to a formula set forth in MCL 570.303(4) and MCL 570.304(2) to subordinate the garage keeper's lien.

Boatyard Liens

The Michigan Marina and Boatyard Storage Lien Act, MCL 570.371 *et seq.*, provides protections for marinas, boatyards, and marine repair facilities that repair, service, and store marine property. To assert a valid lien, a facility owner must maintain possession of the property.

The lien is entitled to priority over any prior lien on the property unless the prior lienholder pays to the facility owner the lesser of (1) the amount of the lien attributable to storage, labor, materials, supplies, or other charges reasonably incurred in the sale of the property under the Act or (2) the amount calculated pursuant to the formula set forth in MCL 570.373(1)–(4). In the event the prior lienholder provides payment to the facility owner, the prior lienholder's lien increases in an amount commensurate to the payment, and the facility owner's lien is decreased in a commensurate amount. MCL 570.373(5).

Self-Service Storage Facility Liens

The Michigan Self-Service Storage Facility Act, MCL 570.521 *et seq.*, provides owners of self-service storage facilities with a lien on personal property located at their facilities, regardless of whether the personal property is owned by the tenant. MCL 570.523(1). The validity of a lien arising under this Act depends on possession. A lienholder with a prior lien on a motor vehicle, aircraft, mobile home, moped, motorcycle, snowmobile, trailer, or watercraft may pay the storage facility owner the amount of the owner's lien and reasonable expenses. MCL 570.525(12). However, this amount shall not exceed the equivalent of four months' rent. Any such payment is then added to the amount of the lien of the prior lienholder and subtracted from the amount of the owner's lien.

Threshing and Hulling Liens

Owners of hay presses, threshing machines and hullers who press, thresh, or hull any hay, grain, corn, beans, peas or other vegetable products for another, shall, upon the filing of a sworn statement with the Register of Deeds within 20 days of such services, have a lien for the value of such services, or in case there is an agreed price, then for such agreed price upon the hay, grain or other products so pressed, threshed or hulled. Such lien shall not attach where the hay, grain or other products, shall have passed to an innocent purchaser or dealer in the usual course of trade. MCL 570.331.

Commercial Real Estate Broker's Lien

The Commercial Real Estate Broker's Lien Act, MCL 570.581 *et seq.*, provides that a commercial real estate broker's lien for a commission attaches to commercial real estate if the broker has a written commission agreement and the broker records a sworn statement with the Register of Deeds pursuant to the Act.

Environmental Liens

The State of Michigan may impose a lien on real or personal property of a person or a business where there is environmental "response activity" resulting in loss and damages incurred by the state. MCL 324.20138. The lien has priority over any liens filed after the environmental lien is

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filed.

For violations of the Michigan Natural Resources and Environmental Protection Act, the civil fine or other award constitutes a lien on any of the defendant's property. MCL 324.3115 (7)(b). The lien has priority over any other liens filed after the environmental lien is filed.

CONCLUSION

A secured creditor should not assume it has first priority. Its priority position may be at risk from a number of liens. The prudent lender will be on the lookout for competing liens and take steps to preserve its priority position.