Welcome to this podcast on Priority Between a Secured Party and a Party with a Lien brought to you by CALI. I am Professor Scott J. Burnham.

Other CALI podcasts explore the priority between a secured party and a buyer and between two secured parties. The topic of this podcast is to determine priority between a secured party and a party with a lien, including a judicial lien creditor, a creditor with a lien arising by operation of law, a creditor with an agricultural lien, and the IRS with a tax lien.

1. A judicial lien creditor. A judgment creditor is a creditor who gets a judgment against the debtor. Note that when a creditor gets a judgment, the judgment does not attach to any particular property until it is executed, usually by having the sheriff levy on property of the debtor. At that point the creditor becomes a judicial lien creditor. If that property is subject to a security interest, the judicial lien creditor takes priority over a secured party that has not perfected its security interest but loses to a secured party who has perfected. However, if that security interest is a PMSI, then the secured party has 20 days from the date of delivery of the collateral to perfect its security interest and the perfection is effective retroactively to the time of attachment.

For example, a creditor gets a judgment against a debtor and has the sheriff levy on the debtor’s car to satisfy the judgment. If a secured creditor has a perfected security interest in the car, the judicial lien creditor loses priority to the secured creditor. Note also that judicial lien creditors are subject to exemption statutes that bar judgment creditors from levying on certain property of the debtor. These exemption statutes vary from state to state, but they do not apply to secured creditors.

By the way, for those of you with some knowledge of the significance of security interests in bankruptcy, Bankruptcy Code § 544(a), often referred to as “the strong arm clause,” provides that the bankruptcy trustee has the status of a hypothetical judicial lien creditor at the time of the filing of the bankruptcy petition. That means that the trustee, like the lien creditor, has priority over unperfected security interests. In other words, an unperfected security interest is not effective once the debtor declares bankruptcy. However, the exception for a PMSI applies in bankruptcy as well, and as an exception to the automatic stay on actions by creditors, the secured party with a PMSI may effectively file within 20 days of delivery even if the filing of the financing statement comes after the filing of the bankruptcy petition.

2. A creditor with a lien arising by operation of law. Recall that a security interest arises consensually, by the agreement of the debtor and the secured party. As described in § 9-333, lien arising by operation of law is created by statute. It secures payment for services or materials furnished to goods by a person in the ordinary course of their business. The creditor claiming this lien must have possession of the goods for the lien to be effective. Common examples are state statutes providing for a “mechanic’s lien,” such as a statute that allows an automobile repair shop to have a lien on the car to secure payment for repairs to the car. If a secured party also has a security interest in the car, the default rule under Article 9 is that the lien arising by operation of law has priority over the security interest. The statute, however, can change the default rule.

For example, a business takes a computer to a repair shop. When the business does not pay the bill, the shop says it will keep the computer until payment is made. A state statute provides:

Every person who while lawfully in possession of an article of personal property, renders any service to the owner of the article by labor or skill employed for the repairing or storage of the article has a special lien on it. The lien is dependent on possession and is for the compensation that is due to the person from the owner for the service and for material furnished in connection with the service. The lien hereby created shall not take precedence over perfected security interests under the UCC.

This lien satisfies the elements of a lien arising by operation of law under § 9-333: it is created by statute, it secures payment for services or materials furnished with respect to goods, and it is dependent on possession. Note that this statute changes the default rule by providing that a perfected security interest has priority over the lien.

3. A creditor with an agricultural lien. An agricultural lien is a special category of liens arising by operation of law. Don’t confuse it with a security interest in farm products. The security interest is created consensually while the ag lien arises by statute. You may have noticed that many provisions of Article 9 state that they apply to “security interests and agricultural liens.” This language indicates that while ag liens are not security interests, many provisions of Article 9 apply to them.

As defined in § 9-102(a)(5), an ag lien is a state statute that, like the lien arising by operation of law, grants an interest in farm products to a person who provides services to a farming operation. However, the interest is unlike the lien arising by operation of law in that it is not dependent on possession. This lien is somewhat like the security interests that have superpriority under § 9-324 in that it enables a debtor whose goods are subject to a security interest to get additional credit.

For example, a farmer has granted a security interest in her farm products to a bank and the bank has properly filed a financing statement. The farmer does not have enough cash to buy seeds for planting. A seed seller is willing to sell the farmer seed on credit. A statute in the jurisdiction provides:

Any person who furnishes to another seed to be planted in the production of crops on the lands owned by him, upon filing a financing statement, has a lien not exceeding the purchase price of the seed furnished upon the crop produced from the seed furnished to secure the payment of the value of the seed furnished. The lien provided shall, as to the crop covered thereby, have priority over all other liens thereon.

Assume that after the crop is harvested, the farmer defaults as to the bank and the bank forecloses on the crop. This ag lien provides that the seed seller will be paid first from the proceeds, as long as the seller complied with the statute by filing a financing statement.

4. The IRS with a tax lien. When businesses can’t pay their bills as they come due, they often don’t pay their taxes, and don’t send to the IRS the money they have withheld from payroll for taxes. If the IRS determines that there has been nonpayment of taxes, it can assess a tax lien on all the property of the debtor. However, Internal Revenue Code § 6323(a) provides that the filed tax lien loses priority to an earlier filed security interest. The IRS has also ruled that a later PMSI that would have priority over a security interest also has priority over a tax lien.

At this point you should be able to identify a judicial lien creditor, a creditor with a lien arising by operation of law, a creditor with an agricultural lien, and the IRS with a tax lien, and you should be able to determine whether the lien or a security interest has priority in the collateral.

I hope you’ve enjoyed this podcast on Priority Between a Secured Party and a Party with a Lien.

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