Priority of Federal Non-Tax Liens: Alternatives to an Archaic Doctrine

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Traditionally the federal government, as a lienholder, has been favored by the courts over competing state and local lienholders. Absent federal statutes to the contrary, it has been the beneficiary of a federal common law rule which makes the priority of federal liens a virtual certainty. The federal common law rule simply states that “the first in time is the first in right.”\(^1\) However, for a state or local lien to be “first in time,” it must be perfected in the sense that it is definite and not merely ascertainable in the future.\(^2\) Whether such a lien is definite is determined by a three-part test known as the choate lien doctrine.\(^3\) The test requires that the identity of the lienor must be known, the property subject to the lien must be known, and the amount payable must be fixed beyond any possibility of change.\(^4\) The fact that individual states have created a different set of priorities for liens, more protective of non-federal lienholders, is of little significance. The presence of a federal lien creates a federal question and federal law is determinative.\(^5\)

The federal priority has not escaped criticism. Federal courts which have ultimately upheld the common law rule have recognized the inequities that result from its application.\(^6\) Other courts have completely rejected the rule.\(^7\) Commentators applauded the changes made in the priority system of federal tax liens through the Tax Lien Act of 1966.\(^8\) However, one commentator referred also to “the unfinished

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4. 329 U.S. at 375.
6. See Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc., 572 F.2d 588 (7th Cir. 1978); Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978).
business, the problem areas . . . .\textsuperscript{9} Many of the problem areas concerned federal non-tax liens, against which competing state and local liens found little if any statutory relief.\textsuperscript{10} The commentator recommended that the federal common law rule should be modified at least to the same extent that the common law of tax liens had been changed by the Tax Lien Act.\textsuperscript{11}

Today the business remains unfinished. Congress has failed to act, and the United States Supreme Court has not decided a case in the area. Further, although the inequities of that rule are obvious, the majority of federal courts of appeals continue to follow the federal common law rule.\textsuperscript{12}

This note will begin by examining the federal common law rule. The development of the rule will be traced from its initial application in the area of tax liens to its more recent application in the area of non-tax liens. A discussion will follow of a particular problem in the non-tax lien area, namely liens arising out of federally insured mortgages. The discussion will examine the policy reasons behind protecting those liens at the expense of competing mechanic's liens, and will conclude with recommendations for a more equitable rule.

**THE FEDERAL COMMON LAW RULE**

The priority of federal liens is determined by a simple rule, and a more troublesome corollary. The rule is stated as, "The first in time is the first in right."\textsuperscript{13} It was adopted from the early common law by the United States Supreme Court in the case of Rankin v. Scott.\textsuperscript{14} The case

\textsuperscript{9} Plumb, Federal Liens and Priorities—Agenda for the Next Decade, 77 Yale L.J. 228, 228 (1967).
\textsuperscript{10} Id.
\textsuperscript{11} Id. at 294.
\textsuperscript{12} Six federal circuit courts of appeals continue to retain the federal common law rule. See Willow Creek Lumber Co. v. Porter County Plumbing \& Heating, Inc., 572 F.2d 588 (7th Cir. 1978); Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978); United States v. General MacArthur Senior Village, Inc., 470 F.2d 675 (2d Cir. 1972); T.H. Rogers Lumber Co. v. Apel, 468 F.2d 14 (10th Cir. 1972); In re Lehigh Valley Mills, Inc., 341 F.2d 398 (3d Cir. 1965); United States v. Latrobe Constr. Co., 246 F.2d 357 (8th Cir. 1957).

Two federal circuit courts of appeals have rejected the rule. See United States v. Crittenden, 563 F.2d 678 (5th Cir. 1977); Ault v. Harris, 317 F. Supp. 373 (D. Alas. 1968), aff'd sub nom. Ault v. United States, 432 F.2d 441 (9th Cir. 1970) (per curiam). The federal district court in South Carolina has rejected the rule. See Hayden v. Prevatt, 327 F. Supp. 635 (D.S.C. 1971). The Court of Appeals for the Fourth Circuit has retained the rule, but it has decided only cases where the debtor, upon whose property the liens attached, was insolvent. See H.B. Agsten \& Sons, Inc. v. Huntington Trust \& Sav. Bank, 388 F.2d 156 (4th Cir. 1967), cert. denied, 390 U.S. 1025 (1968). In all other cases cited herein the debtor was solvent. This may make a meaningful difference in the rule which is applied. See text accompanying notes 103-23 infra. The Circuit Courts of Appeals for the District of Columbia and the Sixth Circuit have never decided a case in the area.

\textsuperscript{13} United States v. City of New Britain, 347 U.S. 81, 85 (1954).
\textsuperscript{14} 25 U.S. (12 Wheat.) 177 (1827).
was an action of ejectment brought by Scott, who had purchased property at a judicial sale. The property had been sold to satisfy a judgment entered in March, 1822, against the estate of Little. Prior to that, in April, 1821, a judgment had been rendered against the estate of Little in favor of Schatzell, the landlord of Rankin. At the time of the second judgment and the sale to Scott, execution had not yet issued on Schatzell's judgment. Shortly thereafter the same premises were sold to Schatzell. The question before the Court was whether the second judgment in favor of Scott and subsequent execution divested the lien of the first judgment. Mr. Chief Justice Marshall responded:

> The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a Court of law or equity to a subsequent claimant.\(^1\)

Thus Schatzell's lien was entitled to priority notwithstanding the fact that Scott was the first to perfect his lien.\(^2\)

In a contest where the first in time prevails, the date on which a lien arises is crucial. A problem exists where that date may be chosen from one of several possibilities. Mechanic's liens provide a good example. In the state of Washington the lien of a mechanic attaches when he begins his particular work.\(^4\) In California, all mechanic's liens date back to the beginning of the particular construction job.\(^5\) In Illinois, mechanic's liens attach as of the date on which the construction contract is signed.\(^6\) Thus a lien competing with a mechanic's lien could be entitled to priority in Washington but not in California and Illinois under the same set of facts.

Where one of the competing liens is a federal lien this problem is avoided by a judicially created corollary to the first in time rule. The corollary is applied uniformly regardless of the state in which the property interest is located, and requires that a state or local lien must satisfy certain prerequisites before it is recognized as having arisen for purposes of the first in time rule. When a lien meets these requirements, it is considered to be perfected\(^9\) or choate.\(^10\) This test, referred

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1. *Id.* at 179.
2. *Id.* at 180.
5. *ILL. REV. STAT.* ch. 82, § 16 (1977).
7. The word choate was derived from the word inchoate which means incomplete. It is used
to as the choate lien doctrine,\textsuperscript{22} requires: (1) the identity of the lienor must be known,\textsuperscript{23} (2) the property subject to the lien must be known,\textsuperscript{24} and (3) the amount payable must be fixed beyond any possibility of change.\textsuperscript{25} A state or local lien prevails only if it meets the three requirements before the federal lien arises.\textsuperscript{26}

The identity of the lienor is not difficult to ascertain since the lienor is usually a party to the contest. The identity of the property subject to the lien and the amount of the lien present far greater problems. The United States Supreme Court's analysis of the final two requirements in \textit{United States v. Texas}\textsuperscript{27} serves as a good example of the obstacle to choateness that they provide.

In \textit{United States v. Texas},\textsuperscript{28} a manufacturer and distributor of fuel oil became insolvent and a receiver was appointed. Among his creditors were the United States to whom he owed federal gasoline taxes, and the state of Texas, to whom he owed state gasoline taxes. The amount of the federal lien was great enough so that if the United States was given priority, nothing would be left to apply to the Texas claim. The lien of the United States attached on the day the debtor went into receivership. Texas argued that according to state law its lien was perfected on the day the state gasoline taxes became due, making its lien prior in time.\textsuperscript{29} The Supreme Court noted that Texas had made no move to assert its statutory lien prior to the appointment of the receiver. Thus the Court had to decide whether the statutory lien standing alone, without any further action on the part of the state, created a perfected lien. The statute provided that the state lien would attach only to prop-

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\textsuperscript{22} The name is taken from Burroughs, \textit{The Choate Lien Doctrine}, 1963 \textit{DUKE L.J.} 429.
\textsuperscript{24} United States v. Waddill, Holland & Flinn, Inc., 323 U.S. 353 (1945).
\textsuperscript{25} United States v. Texas, 314 U.S. 480 (1941).
\textsuperscript{27} 314 U.S. 480 (1941).
\textsuperscript{28} \textit{Id.}
\textsuperscript{29} The statute in question read:

\begin{quote}
All taxes, fines, penalties and interest due by any distributor to the State shall be a preferred lien, first and prior to any and all other existing liens, upon all of the property of any distributor, devoted to or used in his business as a distributor, which property shall include refinery, blending plants, storage tanks, warehouses, office buildings and equipment, tank trucks or other motor vehicles, or any other property devoted to such use, and each tract of land on which such refinery, blending plant, tanks or other property is located, or which is used in carrying on such business.
\end{quote}

\textit{TEX. CIV. STAT. ANN.} art. 7065a-7 (Vernon 1933) (current version at \textit{TEX. TAX-GEN. ANN.} art. 10.17 (Vernon 1969)).
erty used in the insolvent's business. Texas contended that the statute determined the identity of the property affected by the lien with sufficient specificity. The Court disagreed. It held that property devoted to the insolvent's business was "neither specific nor constant." Thus the lien failed to fulfill the second requirement.

Texas' lien also failed to satisfy the third requirement, that the amount of the lien must be definite. The Court reached this conclusion in spite of the fact that the tax reports of the debtor himself showed that he was $40,312.51 in arrears on his state gasoline tax. In addition a Texas statute provided that tax reports were prima facie evidence as to the amount of taxes owed. The Court held that this was not sufficient to fix the amount payable beyond any possibility of change since the statute also provided that any inaccuracy in the tax reports could be shown, thereby defeating the presumption of their validity. Therefore, the Court in effect said that the amount of the lien could not be definite until it had been reduced to judgment.

The choate lien doctrine has presented extraordinary difficulties for lienors. In order to fix the amount payable, a lienor, with a few exceptions, must have pursued the lien to judgment before the United States established its lien. Such was the case in United States v. Texas. Even if a lien is fully perfected under state law, it will be junior to a federal lien if it fails to meet the rigorous standards of the choate lien doctrine. This is because federal priority is a federal question. In the absence of federal statutes, priority is governed by the federal common law.

The Rise of the Choate Lien Doctrine

The choate lien doctrine evolved through the judicial interpreta-

30. 314 U.S. at 487.
31. TEX. CIV. STAT. ANN. art. 7065a-8(d) (Vernon 1933) (current version at TEX. TAX-GEN. ANN. art. 10.16 (Vernon 1969)).
32. 314 U.S. at 488.
33. Certain possessory liens such as the artisan's lien are fixed or specific. See United States v. Toys of the World Club, Inc., 288 F.2d 89 (2d Cir. 1961). Unlike a materialman's lien, the amount of the artisan's lien need not be litigated since the amount is fixed as the value of the property possessed. This difference is recognized in section 9-310 of the Uniform Commercial Code. Certain state and local tax liens assessed for a particular amount and attached to particular property might also satisfy the standard. See United States v. City of New Britain, 347 U.S. 81 (1954). However, where the tax lien does not attach to particular property it remains a general or inchoate lien. Such was the case in Illinois ex rel. Gordon v. Campbell, 329 U.S. 362 (1946) (insolvent company owed the state unemployment compensation contributions; the amount owed was fixed, but since the debtor had not filed a schedule of assets, the lien could not attach to specific property).
34. 314 U.S. 480 (1941).
tion of an insolvency priority statute, Revised Statute 3466,36 enacted during the early years of our nation’s history.37 The statute provides that “[w]henever any person indebted to the United States is insolvent . . . the debts due to the United States shall be first satisfied.”38 On its face Revised Statute 3466 creates an absolute priority in favor of debts owed to the United States. It is to be contrasted with bankruptcy insolvency proceedings under the bankruptcy provisions of the United States Code.39 There a different set of priorities, much less federally oriented, governs.40

The United States Supreme Court first addressed the issue of priority under Revised Statute 3466 in Thelusson v. Smith,41 in 1817. In that case a creditor had obtained a judgment against the debtor prior to the time when the debtor declared his insolvency. The debtor was also in debt to the United States. The Court, by applying the statute, determined that the right of preference in favor of the United States accrued on the date that the debtor declared his insolvency. At that point debts owed to the United States were to be first satisfied, since the statute made no exception for prior judgment creditors or any other type of creditor.42 However, the Court did note that the United States could only be satisfied out of the debtor’s estate. This gave rise to certain exceptions in later cases where, prior to the accrual of the right of preference, the debtor had made a bona fide conveyance of his property to a third person, had mortgaged the real estate, or had had his property seized on a writ of execution. In such cases, the debtor would be divested of the property, and it would be immune from the priority of the United States.43

The Court in Thelusson did not consider whether a specific and perfected lien, not reduced to possession, could defeat the priority of the United States since the creditor’s lien was not perfected. The answer was by no means obvious. Though the holder of a perfected lien

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41. 15 U.S. (2 Wheat.) 396 (1817).
42. Id. at 425.
43. Id. at 426. Several decisions decided subsequent to Thelusson specifically extended the exception to a previously executed mortgage on the theory that the mortgaged property had passed to the mortgagee and was no longer in possession of the mortgagor. See Brent v. Bank of Washington, 35 U.S. (10 Pet.) 596 (1836); Conrad v. Atlantic Ins. Co., 26 U.S. (1 Pet.) 386 (1828).
did not have possession, he did have a right to possession of specific property. Thus in subsequent cases the Court was obliged to consider whether liens on the property of an insolvent were perfected since, if such a lien were found, it might defeat the priority of the United States. It was through this search, and through the attempt to define the requirements of a perfected lien, that the Court developed the three-part test for choateness, namely, that the identity of the lienor must be known, the property subject to the lien must be known, and the amount payable must be fixed beyond any possibility of change.

In Illinois ex rel. Gordon v. Campbell, decided in 1946, the Court for the first time enunciated its three-part test, though it had on several prior occasions noted the various requirements individually. In that case the state of Illinois was the holder of a statutory lien on the property of an insolvent company for unpaid unemployment compensation. Subsequently the Commissioner of Internal Revenue filed a claim for unpaid federal income tax. The federal tax lien alone was greater than the liquidated value of the debtor's property. After determining that the debtor was indeed insolvent, the Court considered the issue of priority. It recognized that previous decisions had never decided whether the priority of the United States under Revised Statute 3466 could be overcome by a fully perfected lien. But once again the issue escaped review, since the lien was not found to be perfected. Illinois' lien failed on two counts. First, though the filing of a notice of lien was recorded for a specific amount, the amount was not fixed beyond any possibility of change since the state might have erred as to the amount of taxes owed to it. Second, the state had no information concerning the nature of the property belonging to the debtor company at the time it went into receivership. Thus the state lien could not possibly have attached to specific property prior to the accrual of the Commissioner's right of preference under Revised Statute 3466. The Court, while

48. A federal tax lien has been defined as a secret lien arising at the time the tax is assessed. Overman, Federal Tax Liens: A Guide to the Priority System of Section 6323 of the Internal Revenue Code, 16 B.C. INDUS. & COM. L. REV. 729, 729 (1975). By secret lien it is meant that no notice of the lien is recorded. Thus another creditor could not be aware that such an encumbrance on a person's assets existed until it was recorded.
49. 329 U.S. at 376.
50. Id. at 375.
51. Id.
bringing together in one opinion the three parts of the choate lien doctrine for the first time, recognized that it was "long established,"52 under earlier cases enunciating individual parts of the doctrine.

Revised Statute 3466 has been criticized in recent years, chiefly because it is overprotective of the interests of the United States. In 1969, the American Bar Association's Committee on Relative Priority of Government and Private Liens recommended that the federal priority be limited to tax claims. In arguing for an amendment to the statute the Committee stated:

In the beginning years of our nation, when this statute was enacted, the activities in which the federal government engaged which could give rise to claims against third parties were relatively restricted. Today, there are few areas of activity in which the federal government is not involved. While the needs of the federal government for tax revenues arguably require priority for the government to function effectively, no such priority is imperative when the government has a nontax claim against an insolvent. Rather, fairness to other creditors seems to require that if the government undertakes activities in the private sector, its claims in connection with such activities be treated the same as those of any other creditor operating in the private sector. If the result is a loss of revenue to the government, the burden should be met by tax revenues rather than being imposed arbitrarily on hapless creditors of an insolvent.53

Yet the statute has not been amended since 1799,54 and it remains binding law.55

*The Choate Lien Doctrine—Its Initial Application in Non-Insolvency Proceedings*

In *United States v. Security Trust & Savings Bank,*56 decided in 1950, the Supreme Court, for the first time, applied the test for choate-ness to a competing lien in a non-insolvency tax proceeding. Prior to that time, lower courts generally assumed that the principles governing Revised Statute 3466 and section 3670 of the Internal Revenue Code,57 the statute giving rise to liens for unpaid federal income taxes,58 were

52. *Id.*
54. Act of March 2, 1799, ch. 22, § 65, 1 Stat. 676.
55. See *United States v. Moore,* 423 U.S. 77 (1975) (United States given priority over the assets of an insolvent company which had defaulted on a government contract).
58. Code section 3670 created a lien for unpaid taxes. See Int. Rev. Code of 1939, § 3670, 53 Stat. 448 (current version at I.R.C. § 6321). The current version which is the same in significant part as Code section 3670 provides:
distinct and independent of each other.\textsuperscript{59} It was reasoned that while Revised Statute 3466 created a priority, Code section 3670 merely created a lien. As a lien it was subject to the unmodified "first in time is the first in right"\textsuperscript{60} rule because the correlative choate lien doctrine had never been applied in such a situation. If an inchoate non-federal lien existed prior to an assessment for unpaid taxes by the Internal Revenue Service,\textsuperscript{61} the federal tax lien would take second. The holding in \textit{Security Trust} changed this result. By applying the choateness test to non-federal liens, it gave federal tax liens in non-insolvency cases the same practically insurmountable advantage enjoyed by the United States under Revised Statute 3466.

In \textit{Security Trust}, the issue was the priority between a federal tax lien and an attachment lien "where the federal tax lien was recorded subsequent to the date of the attachment lien but prior to the date the attaching creditor obtained judgment."\textsuperscript{62} The case began when Morrison, seeking to enforce payment on an unsecured note, brought suit against the owners of several parcels of land. In accordance with California law, he attached the parcels of land. After the attachment but before Morrison obtained judgment, the IRS filed a notice of federal tax liens. The trial court ruled that Morrison's judgment lien was entitled to priority. The California District Court of Appeal affirmed on the basis of what it presumed to be the prevailing rule:

The liens created by Sections 3670 and 3671 of the Internal Revenue Code are general and not priority liens. . . . There is no provision in either section indicating that the liens for taxes have a priority over attachment liens placed on the property prior to the time when the tax liens arise.\textsuperscript{63}

The United States Supreme Court reversed,\textsuperscript{64} assuming that only a perfected lien could defeat a federal tax lien. It found that even under state law the federal lien would prevail since according to California cases an attachment creditor could not proceed against the property of

\begin{itemize}
\item If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
\end{itemize}

\textit{I.R.C. § 6321.}


\textsuperscript{60} United States v. City of New Britain, 347 U.S. 81, 85 (1954).

\textsuperscript{61} Hereinafter referred to as the IRS.

\textsuperscript{62} 340 U.S. at 48.


a debtor until he obtained a judgment. The brief rationale at the end of the opinion stated why, for the first time, the Court was applying the stringent priority rules under Revised Statute 3466 to a non-insolvency proceeding. The Court stated:

In cases involving a kindred matter, i.e., the federal priority under Rev. Stat. § 3466, it has never been held sufficient to defeat the federal priority merely to show a lien effective to protect the lienor against others than the Government, but contingent upon taking subsequent steps for enforcing it. If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due the United States from tax delinquents is to be fulfilled, a similar rule must prevail here.

The reasoning of the Court is curious for two reasons. First, because it overlooks several statutory considerations, it is wholly inadequate, given the precedential effect of the decision. The Court failed to note that Revised Statute 3466 clearly establishes a priority while Code section 3670 merely establishes a lien and is absolutely devoid of any mention of priority. There is no mention of Code section 3672 which codifies the priority of federal tax liens. The Court also failed to recognize the different purposes behind the statutes. Revised Statute 3466 applies to any debt owed to the United States, but only where the debtor is insolvent, while Code section 3670 applies only to tax debts, though the debtor may be solvent or insolvent. Second, the Court’s only reasoning for the extension, that it is necessary “to insure prompt and certain collection of taxes due the United States from tax delinquents,” seems questionable. Since the debtor is solvent, his assets presumably are greater than his debts. Add to this the fact that a federal tax lien is a general lien which can be satisfied from all the debtor’s assets, and there seems to be no reason to extend the priority. The federal tax lien will most likely be satisfied whether it is paid first or last.

66. 340 U.S. at 50.
67. Id. at 51 (citation omitted).
71. 340 U.S. at 51.
73. The occasion may arise where the outstanding debts of a solvent debtor are not entirely satisfied. If the debtor does not have liquid assets available to pay his debts, a creditor’s only remedy may be a forced sale of the debtor’s property. Though the fair market value of the property is enough to satisfy all the debts, the proceeds realized from a forced sale are often less than
Though the reasoning for extending the doctrine to non-insolvency cases seems suspect, at least in terms of federal tax liens, the Supreme Court has continued to apply the extension. However, decisions since *Security Trust* leave some doubt as to whether the choate-ness test applies with the same degree of rigor where the debtor is solvent.

In *United States v. White Bear Brewing Co.*, the Court gave a stringent interpretation to the choate lien doctrine. It was reminiscent of the Court's rigid application of the doctrine in *Illinois ex rel. Gordon v. Campbell* and *United States v. Texas*. The case arose out of a contest between a federal tax lien and a mechanic's lien. The mechanic's lienor had completed his work, recorded his lien for a specific amount, and instituted a suit to enforce his lien—all prior to the assessment of federal income taxes. He had done everything but reduce his lien to judgment. This was accomplished by the time the IRS had filed an action to foreclose its tax lien. Nonetheless, the Court found the federal tax lien to be prior in time. The Court held, in effect, that in order for the mechanic's lienor to have prevailed, he would have had to reduce his lien to judgment before the federal taxes were assessed. A similar burden for establishing choateness was placed on the non-federal lienor in *United States v. Texas*, an insolvency case. Thus it seems that the Court applied the same rigorous standard found in

the fair market value. Thus a creditor such as the federal government cannot be assured of full payment in every case. However, even granting this exception, the court's rationale for extending the priority rules under Revised Statute 3466 is still unsound. Where the debtor is insolvent at least one debt will always remain unsatisfied. Where the debtor is solvent a debt will remain unsatisfied only in exceptional cases.


75. 350 U.S. 1010 (1956). The decision was entered per curiam and the facts were stated by Mr. Justice Douglas in dissent.

76. 329 U.S. 362 (1946).

77. 314 U.S. 480 (1941).

78. 350 U.S. at 1010.

79. If one accepts the premise that the choate lien doctrine applies with equal force where the debtor is solvent, the result is logical. In *United States v. Texas* the Court found the lien inchoate because, *inter alia*, the amount of the lien had not been ascertained beyond any possibility of change. The amount of taxes had been assessed precisely, but because the taxpayer could rebut the presumption that the taxes were computed correctly, there existed a possibility of change. In *White Bear*, though the lien was for a specific amount, presumably a court could find, with the proper evidence, that the amount of the lien was incorrect. Only a judgment could eliminate all possibility of change.

80. 314 U.S. 480 (1941).

81. *See* text accompanying notes 28-32 *supra.*
solvency cases to this case involving a solvent debtor. *White Bear* represents the Court's most stringent application of the doctrine.

Other decisions have exhibited a more relaxed application. *United States v. City of New Britain* involved a contest between federal tax liens and several municipal liens for the funds of a solvent corporation. There were also two mortgage liens, a judgment of record, and expenses of a judgment sale foreclosing the two mortgages. The United States did not assert its priority against these latter claims. The Supreme Court found that both the municipal and federal liens were perfected—the city's because it attached to specific pieces of property, and the federal government's because it was general and perfected upon assessment. The Court, given the facts before it and the finding that all liens were perfected, did not determine the order of priority among the competing liens. The case was remanded to the lower court for a determination of the priorities.

The language used by the Court in describing the nature of a perfected non-federal lien indicates a more relaxed attitude than comparable descriptions found in cases applying Revised Statute 3466. In referring to the city's lien the Court stated that "[t]he liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." This language is less exacting than that found in insolvency cases where the courts, in referring to the amount of the lien, consistently required that it be fixed beyond any possibility of change. It is not surprising that Mr. Justice Douglas, dissenting in *United States v. White Bear Brewing Co.*, cited New Britain's language in arguing that the *White Bear* Court had departed from its prior decisions.

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83. See CONN. GEN. STAT. § 1853 (1949) (current version at CONN. GEN. STAT. ANN. § 12-172 (West 1972)); CONN. GEN. STAT. § 758 (1949) (current version at CONN. GEN. STAT. ANN. § 7-239 (West 1972)).
84. 347 U.S. at 84. Code section 3671 determined the point at which the federal lien arose. See Int. Rev. Code of 1939, § 3671, 53 Stat. 449 (current version at I.R.C. § 6322). The current version, which is the same in significant part as Code section 3671, provides that: "Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time."
85. 347 U.S. at 88.
86. Id. at 84.
88. 350 U.S. 1010 (1956) (per curiam).
89. Id. at 1010-11 (Douglas, J., dissenting).
Another indication of the Court's more relaxed attitude was its reliance on the state court for its finding that the city's lien attached to specific pieces of property.90 Prior cases had relied upon the opinions of state courts to the detriment of the non-federal lienor.91 In *United States v. Security Trust & Savings Bank*92 the Court had stated that "although a state court's classification of a lien as specific and perfected is entitled to weight, it is subject to reexamination by this Court. On the other hand, if the state court itself describes the lien as inchoate, this classification is 'practically conclusive.'"93 In all prior cases the Court had rejected upon reexamination94 the state court's classification, except where the lien was described as inchoate.95 Where the lien was described as inchoate, the state court's classification was conclusive. In *New Britain* the Court broke with its one-sided trend and upheld the state court's classification although the lien was held by the state court to be choate.96

In the 1964 case, *United States v. Vermont*,97 the Court, for the first and only time, found a non-federal lien prior in right where the result was governed by the choate lien doctrine. The case involved a contest between a federal lien arising under sections 6321 and 6322 of the Internal Revenue Code,98 and a Vermont tax lien statute "worded in terms virtually identical to the provisions of those federal statutes."99 The delinquent taxpayer was a solvent Vermont corporation. Vermont made its tax assessment in 1958, and in 1959 a judgment was entered for taxes owed. The IRS made its assessment in 1959, prior to the judgment in favor of the state, and brought suit to foreclose its lien in 1961. The state argued that its lien, like that of the United States, was general in that it attached to all the property of the delinquent taxpayer. Thus the requirement that a lien must attach to specifically identified prop-

90. 347 U.S. at 84.
91. *See*, e.g., County of Spokane v. United States, 279 U.S. 80, 93-95 (1929).
93. *Id.* at 49-50.
96. 347 U.S. at 84. For purposes of priority, a federal tax lien arises at the time of assessment (at the time the taxpayer is found to be liable to the Internal Revenue Service). *See* note 84 supra. Thus for the municipal lien to have prevailed in *New Britain*, the municipal lien would have had to become choate before the Internal Revenue Service processed the taxpayer's tax return. There are statutory exceptions to this rigorous standard. *See* text accompanying notes 159-72 infra.
98. I.R.C. §§ 6321, 6322.
erty was inapplicable, and the fact that Vermont's lien was a general lien was not an obstacle to choateness. The United States argued that a competing state lien had to attach to specific portions of property, much as did the municipal liens in *New Britain*. It urged the Court to apply the federal priority created by Revised Statute 3466 to this non-insolvency case, arguing that the Court had already done so in *United States v. Security Trust & Savings Bank.*

The Court rejected these arguments, and held that Vermont's lien was "sufficiently choate to obtain priority over the later federal lien. . . ." The Court reasoned that "it is as true of Vermont's lien here as it was of the federal lien in *New Britain* that 'The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt.'"

Though the holding in *Vermont* is sound, some of the reasoning is questionable. The Court, in rejecting the argument that the priority under Revised Statute 3466 applies to cases where the debtor is solvent, stated, "This argument fails to discriminate between the standards applicable under the federal tax lien provisions and those applicable to an insolvent debtor under R.S. § 3466." The Court indicated that under Revised Statute 3466 a non-federal lien was perfected only if the property to which the lien attached was reduced to possession. On the other hand, where the debtor was solvent, the three-part test for choateness was the proper standard. To support its conclusion, the Court referred to *United States v. Gilbert Associates,* an insolvency case decided by the Supreme Court in 1953. The *Vermont* Court noted that *Gilbert* had applied the possession test for determining whether a lien was perfected. Further, *Gilbert* had failed to mention specifically the three-part test for choateness. From this the *Vermont* Court inferred that only liens reduced to possession could defeat the federal priority in insolvency proceedings, and that the three-part test was only proper in non-insolvency proceedings.

These conclusions are not supported by prior case law. First, the

101. 377 U.S. at 359.
102. *Id.* (footnote and citation omitted).
103. *Id.* at 357.
104. *Id.*
105. *Id.* at 358.
106. 345 U.S. 361 (1953).
107. 377 U.S. at 357.
108. *Id.*
109. *Id.* at 357-58.
Court's reliance on Gilbert is misplaced. Though the Gilbert Court did not specifically mention the three-part test, it did consider the possibility that a perfected lien not reduced to possession might defeat the federal priority.\textsuperscript{110} The Court stated, "This Court has never actually held that there is such an exception. Once again, we find it unnecessary to meet this issue because the lien asserted here does not raise the question."\textsuperscript{111} This statement not only indicates such a possibility but it also indicates that some test, presumably the three-part test used in prior cases, was used to determine that the non-federal lien was not perfected.

Second, the Vermont Court ignored the fact that the three-part test was first applied in Illinois ex rel. Gordon v. Campbell,\textsuperscript{112} an insolvency case. It also ignored the fact that the three-part test had been applied, in part, in a number of earlier cases.\textsuperscript{113} In those cases, the Court carefully analyzed the nature of the non-federal lien in order to be sure that the lien was not perfected. If the only inquiry in an insolvency case was whether a lien was reduced to possession before the debtor declared his insolvency, a priority contest under Revised Statute 3466 would be decided quite simply. This was not the case in the more recent Supreme Court insolvency cases.\textsuperscript{114} If it had been the case, a careful analysis of the non-federal lien would have been unnecessary.

After Vermont, the relative stringency of the federal rule in insolvency and non-insolvency proceedings remains confusing. If Vermont is taken at face value the difference between the two is clear. Where the debtor is insolvent, the test is based on possession. This reverts to the test in Thelusson v. Smith.\textsuperscript{115} On the other hand, where the debtor is solvent, the test is based on choateness. But Vermont cannot be reconciled with earlier cases. Illinois ex rel. Gordon v. Campbell\textsuperscript{116} is inconsistent with Vermont because Gordon requires that choateness be a basis for determining lien perfection in insolvency cases.\textsuperscript{117} United States v. White Bear Brewing Co.\textsuperscript{118} and United States v. Security Trust & Savings Bank\textsuperscript{119} indicate that the choateness test should be applied

\textsuperscript{110} 345 U.S. at 365.
\textsuperscript{111} Id.
\textsuperscript{112} 329 U.S. 362 (1946). See text accompanying notes 48-52 supra.
\textsuperscript{115} 15 U.S. (2 Wheat.) 396 (1817).
\textsuperscript{116} 329 U.S. 362 (1946).
\textsuperscript{117} Id. at 375.
\textsuperscript{118} 350 U.S. 1010 (1956) (per curiam).
\textsuperscript{119} 340 U.S. 47 (1950).
most stringently in both instances.\textsuperscript{120} The application of the test in \textit{United States v. City of New Britain}\textsuperscript{121} is similar to that found in \textit{Vermont}, but \textit{New Britain} does not go so far as to hold that possession is the only test under Revised Statute 3466.\textsuperscript{122} In spite of the confusion, one conclusion in \textit{Vermont} is clear: If choateness is the basis for measuring perfection of liens in both instances, it should not be applied with the same degree of rigor where the debtor is solvent.\textsuperscript{123}

Developments since 1964 have neither clarified nor expanded the position of the Supreme Court.\textsuperscript{124} The Court has never considered a case where the priority of a federal lien other than a tax lien was at issue. Finally, the importance of its decisions in the tax lien area has been greatly reduced by the passage of the Tax Lien Act of 1966,\textsuperscript{125} an Act which created a new, less protective set of priorities for federal tax liens.\textsuperscript{126}

\textbf{THE TAX LIEN ACT OF 1966—A TURNING POINT}

The statutory priorities created by the Tax Lien Act of 1966\textsuperscript{127} supercede those priorities which otherwise would be established under the federal common law rule—the rule that "first in time is first in right"\textsuperscript{128} and its corollary, the choate lien doctrine. However, the Act has also proved to be important with regard to federal non-tax liens. After 1966 courts began to reject the federal common law rule.\textsuperscript{129} They reasoned that if Congress considered the rule inappropriate in its application to tax liens, it was likewise inappropriate in instances of non-tax liens.\textsuperscript{130} The provisions of the Act also provided guidance when courts were faced with the problem of fashioning a new federal common law rule.\textsuperscript{131}

\begin{thebibliography}{99}
\bibitem{120} See text accompanying notes 75-81 \textit{supra}.
\bibitem{121} 347 U.S. 81 (1954).
\bibitem{122} \textit{Id.} at 85.
\bibitem{124} The only Supreme Court case since 1964 in which the priority of a federal lien against the assets of a solvent debtor was in issue was \textit{United States v. Equitable Life Assurance Soc'y of the United States}, 384 U.S. 323 (1966). The decision added little to existing law.
\bibitem{126} See text accompanying notes 159-72 \textit{infra}.
\bibitem{128} \textit{United States v. City of New Britain}, 347 U.S. 81, 85 (1954).
\bibitem{129} See text accompanying notes 184-226 \textit{infra}.
\bibitem{130} See text accompanying notes 186-89, 199 \& 213-19 \textit{infra}.
\bibitem{131} See text accompanying notes 186-88 \& 213-19 \textit{infra}.
\end{thebibliography}
Background of the Act—Growing Discontent

The first statute creating the federal tax lien was passed in 1866.\textsuperscript{132} It did not specify the priorities by which it was to be governed. Neither did it provide for any procedure by which notice of the lien would be recorded. Thus the federal tax lien acted as a secret lien upon the property of the delinquent taxpayer.\textsuperscript{133} Its presence as an encumbrance upon property could not be detected. In \textit{United States v. Snyder},\textsuperscript{134} the United States Supreme Court upheld the concept of the secret lien by concluding that the federal tax lien was not subject to a state constitution's compulsory recordation provision.\textsuperscript{135} The Court found that a purchaser of property encumbered by a secret federal tax lien took the property subject to the lien, although he was ignorant of its presence.\textsuperscript{136}

Congress remedied this inequitable situation in 1913 when it amended the statute which gave rise to the federal tax lien.\textsuperscript{137} The amendment provided that "such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated. . . ."\textsuperscript{138} The statute further provided for recordation with the recorder of deeds of the appropriate county if required by state law.\textsuperscript{139} This amendment effectively reversed the holding in \textit{United States v. Snyder}.\textsuperscript{140} In 1939, the list of protected lienors was expanded to include pledgees.\textsuperscript{141} One court, explaining the statute, stated that "after the notice of lien has been filed such lien is enforceable against any mortgagee, pledgee, purchaser, or judgment creditor of the tax delinquent whose interest in the property and right to property belonging to such tax delinquent arises, or is created, subsequent to the recording of

\begin{itemize}
\item \textsuperscript{132} Act of July 13, 1866, ch. 184, § 9, 14 Stat. 107. The statute's wording was much like the present statute, Code section 6321, but it applied to all taxes assessed by the United States:
\begin{quote}
[I]f any person, bank, association, company, or corporation, liable to pay any tax, shall neglect or refuse to pay the same after demand, the amount shall be a lien in favor of the United States from the time it was due until paid, with the interest, penalties, and costs that may accru in addition thereto, upon all property and rights to property belonging to such person, bank, association, company, or corporation. . . .
\end{quote}

\item \textsuperscript{133} See note 48 supra.
\item \textsuperscript{134} 149 U.S. 210 (1893).
\item \textsuperscript{135} \textit{Id.} at 214.
\item \textsuperscript{136} \textit{Id.}
\item \textsuperscript{137} Act of March 4, 1913, ch. 166, 37 Stat. 1016.
\item \textsuperscript{138} \textit{Id.}
\item \textsuperscript{139} \textit{Id.}
\item \textsuperscript{140} 149 U.S. 210 (1893).
\item \textsuperscript{141} Act of June 29, 1939, § 401, 53 Stat. 882 (current version at I.R.C. § 6323(a)). This amendment was passed in response to the holding in \textit{United States v. Rosenfield}, 26 F. Supp. 433 (E.D. Mich. 1938) (federal lien had priority over securities subsequently acquired by broker without actual notice of the lien).
\end{itemize}
the tax lien . . . .”142 But the statute did not state, nor did that court explain, at what point an interest arises, or whether the interest must be perfected before the federal tax lien is recorded. The issue was addressed in 1963 by the United States Supreme Court in United States v. Pioneer American Insurance Co.143

In Pioneer a delinquent taxpayer had acquired an interest in a parcel of land and had assumed liability on a note and a mortgage securing it. The mortgage included an arrangement whereby the delinquent taxpayer and mortgagor promised to pay reasonable attorney’s fees to the mortgagee, Pioneer, in case he defaulted on the mortgage. The taxpayer defaulted and Pioneer filed suit to foreclose its mortgage, seeking in addition, reasonable attorney’s fees. Several federal tax liens also attached to the parcel of land before the decree of foreclosure was entered. The chancery court hearing the suit held that the tax liens were junior to the mortgage lien including the attorney’s fees. The state court of review affirmed.144 As a result, some of the federal tax liens remained unsatisfied.

On appeal before the Supreme Court, the federal government did not contest the priority of the mortgage, but it did argue that its liens were superior to that part of the mortgage lien devoted to attorney’s fees. The Court agreed, and clarified the status of the liens protected under Internal Revenue Code section 6323(a), the successor to Code section 3672. The decision analyzed the legislative history behind the original predecessor to Code section 6323(a)145 and concluded that:

The section dealt with the federal lien only and it did not purport to affect the time at which local liens were deemed to arise or to become choate or to subordinate the tax lien to tentative, conditional or imperfect state liens. Rather, we believe Congress intended that if out of the whole spectrum of state-created liens, certain liens are to enjoy the preferred status granted by § 6323, they should at least have attained the degree of perfection required of other liens and be choate for the purposes of the federal rule.146

The Court held that since the decree of the chancery court fixing the amount of reasonable attorney’s fees was not entered until after the filing of the federal tax lien, the lien for attorney’s fees was perfected subsequent to the recording of the tax lien and was junior to the tax lien.147

142. United States v. Phillips, 198 F.2d 634, 636 (5th Cir. 1952). See also Grand Prairie State Bank v. United States, 206 F.2d 217 (5th Cir. 1953).
143. 374 U.S. 84 (1963).
144. 235 Ark. 267, 357 S.W.2d 653 (1962).
146. 374 U.S. at 89.
147. Id. at 91.
In light of this decision it is clear that Code section 6323(a) gave very little additional protection to the liens enumerated in it. Prior to 1913, to be assured of priority, liens listed had to be perfected before the tax deficiencies were assessed.\footnote{See United States v. Snyder, 149 U.S. 210 (1893).} After 1913, they had to be perfected before the deficiencies were recorded.\footnote{See Act of March 4, 1913, ch. 166, 37 Stat. 1016 (current version at I.R.C. § 6323 (a)).} If the IRS recorded its liens as they arose, the enumerated local liens were given no extra time in which to become perfected. Even the stated purpose of the notice requirement—to give notice to the specified interest holders of federal tax liens attaching to the property in which the local lienors have an interest or intend to purchase or otherwise obtain an interest\footnote{H.R. REP. No. 1802, 62d Cong., 3d Sess. (1913).}—is sometimes circumvented. If one of these lienholders has an unperfected lien on real property before the recordation of a federal tax lien on that property, the notice requirement affords no protection. This was the case in \textit{United States v. Pioneer American Insurance Co.}\footnote{374 U.S. 84 (1963).}

Prior to 1966, Congress was soundly rebuked by many commentators for its inaction in the tax lien area.\footnote{Kennedy, \textit{From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien}, 50 IOWA L. REV. 724 (1965); McNally, \textit{Federal Lien Priority: An Injustice to Creditors}, 14 HASTINGS L.J. 52 (1962); Mitchell, \textit{The Choateness Doctrine—Both Unconscionable and Unconstitutional}, 38 CONN. B.J. 252 (1964); Note, \textit{Federal Priorities and Tax Liens}, 63 COLUM. L. REV. 1259 (1963).} These writers were alarmed by the extension of federal priorities at the expense of private creditors in a number of United States Supreme Court decisions. As early as 1959, the Special Committee on Federal Liens of the American Bar Association recommended a comprehensive revision of the law regarding federal tax liens, priorities and procedures.\footnote{Special Committee on Federal Liens, \textit{Report}, 84 A.B.A. REP. 645 (1959).} The Committee declared, “This extension of the scope of the federal tax lien and the uncertainties the decisions have created have had a severe impact on innumerable business and commercial transactions, and have caused increasing concern on the part of many lawyers throughout the country.”\footnote{Plumb, \textit{What Ever Happened to the A.B.A. Federal Tax Lien Legislation?}, 18 BUS. LAW 1103, 1103 (1963).}

\textbf{The Tax Lien Act of 1966: New Status for Mechanic’s Lienors}

The passage of the Tax Lien Act of 1966\footnote{Pub. L. No. 89-719, 80 Stat. 1125 (1966) (codified at scattered sections of 26 U.S.C.).} was greeted with warm
approval.\textsuperscript{156} The Act totally revised the system of priorities where one of the competing liens was a federal tax lien. One of its major objectives was to reform the choate lien doctrine and eliminate or minimize the inequities and impediments to business transactions which it created.\textsuperscript{157} One commentator, in referring to the passage of the act stated:

"Now is the winter of our discontent
Made glorious summer by this sun . . . ."

Shakespeare, I am sure, was not thinking of federal tax lien reform, but his words serve as a suitable text for this discussion. For we have known 16 winters of growing discontent since the Supreme Court began the parade of decisions which expanded the priority of federal tax liens and eroded the protections on which the business and banking community rely for their security. The American Bar Association worked for many of those years to bring about an accommodation between the legitimate necessities of revenue collection and the practicalities of modern credit transactions. Now at last those efforts have borne fruit in the enactment of the first comprehensive revision of the law of federal tax liens in over half a century. Truly, the summer sun is shining!\textsuperscript{158}

The Tax Lien Act\textsuperscript{159} included provisions improving the position of many previously unprotected or less protected interests. First, it created a category of interests given so-called "superpriority" status.\textsuperscript{160} These interests were given priority even though they might arise subsequent to the filing of the tax lien.\textsuperscript{161} Second, the Act protected dis-


\textsuperscript{160} One reason for giving superpriority status to certain liens was to remedy the problem of circular priority. See Plumb, Federal Liens and Priorities—Agenda for the Next Decade, 77 Yale L.J. 228, 231-32 (1967). Such a circular priority problem arose in United States v. City of New Britain, 347 U.S. 81 (1954). The Court had before it the following competing liens: a federal tax lien, a municipal lien arising out of property taxes, and a judgment lien. According to section 6323 of the Internal Revenue Code as in force at that time, the federal tax lien was superior to municipal liens, but inferior to judgment liens. According to state law the municipal liens were superior to all other liens. The following circuitous situation resulted: Under federal law the federal tax lien could not be paid until the judgment lien had been paid, and the municipal lien could not be paid until the federal tax lien had been paid. But under state law, which governed the relationship between the municipal lien and the judgment lien since no federal question existed, the judgment lien could not be paid until the municipal lien was paid. Each interest's payment was contingent upon the prior payment of another interest. The inevitable loser in such a situation was the judgment lienor, whose interest, ironically, was the most protected under federal law.

bursements of funds made under certain types of financing agreements which created a security interest in the taxpayer's property even though the disbursements might be made after the notice of the tax lien was filed.\(^\text{162}\) To be protected under this provision the financing agreement itself had to be entered into before the notice was filed. Third, the Act gave limited protection to other security interests which came into being as a result of disbursements made after the filing.\(^\text{163}\) Again the agreement had to be entered into before the date of filing, but these interests were protected only when the disbursements were made within forty-five days of the date of filing or before actual notice of filing, whichever occurred sooner. Fourth, the Act significantly amended the provisions found in the earlier version of Code section 6323(a).\(^\text{164}\) It replaced the terms "mortgagee" and "pledgee" with the all-inclusive term "security interests," thereby embracing all forms of commercial security.\(^\text{165}\) It defined the term "purchaser" to include optionees, lessees, and parties to executory contracts for the purchase of property.\(^\text{166}\) But the most dramatic change was the inclusion of mechanic's lienors within this protected category.

Prior to 1966, mechanic's lienors were afforded no statutory protection. Thus they were subject to the full force of the choate lien doctrine.\(^\text{167}\) This produced especially inequitable results since the person who improved the taxpayer's property, in reliance on a lien perfected under local law, lost the benefit of his labor or materials to the federal government because of a secret federal tax lien. The Act changed this result by requiring that a mechanic's lienor must have notice of the tax lien.\(^\text{168}\) Thus the mechanic's lienor was protected to the same extent as the other secured creditors enumerated in Code section 6323(a). But the Act went further. It defined mechanic's lienors so as to protect them even after notice-filing was accomplished.\(^\text{169}\) The Senate Finance Committee Report described the mechanic's lienor and the nature of his priority as follows:

\(^{163}\) Id.
\(^{165}\) Id. Compare the definition of security interest found in the Uniform Commercial Code, U.C.C. § 1-201(37), with that found in Code section 6323(h)(1).
\(^{166}\) Tax Lien Act of 1966, Pub. L. No. 89-719, § 101, 80 Stat. 1125, 1131. However, some courts have indicated that judgment creditors, purchasers, and holders of security interests must perfect their interests before notice of the federal tax lien is given. See Dugan v. Missouri Neon & Plastic Advertising Co., 472 F.2d 944, 950-51 (8th Cir. 1973); United States v. Trigg, 465 F.2d 1264 (8th Cir. 1972).
Under the bill a "mechanic's lienor" is a person who, under local law, has a lien on real property (or on the proceeds of a contract relating to real property) for furnishing services, labor, or materials in connection with the construction or improvement of the property. A mechanic is considered to have this lien under the bill as of the time the mechanic begins to furnish services, labor or materials, or, if later, the time when his lien is effective under local law. This protects mechanics under most State laws, where the mechanic's lien arises as of the time when the mechanic commences his labor or begins supplying materials, even though he does not perfect his lien (such as by filing or by securing a judgment) until long after this time.170

According to the Act, as long as the mechanic's lienor begins to furnish services, labor, or materials before the filing of the competing tax lien, and the lien is perfected at some point in the future (not necessarily before the filing), the mechanic's lien is entitled to priority, unless state law provides a later point in time when the lien becomes effective.171 The subsequent perfection of the mechanic's lien is said to relate back to the time when services were initially provided.172 This, in effect, negates all influence of the choate lien doctrine on mechanic's lienors. They are, practically speaking, given superpriority status since, in most states, their liens can only be defeated if the federal tax lien is filed before they begin work.

The Tax Lien Act silenced most of the criticism surrounding the priority of federal tax liens. In general commentators were pleased with the changes it made.173 Those liens not specifically addressed by the Act were still subject to the federal common law rule. However, this was not considered unfair because the holders of those liens generally had not advanced credit in reliance on the property subject to the tax lien.174 One commentator summarized his response to the Act:

Nobody—not even the Treasury—got everything he wanted in the new legislation. Some no doubt would have preferred a sweeping rule that state law shall govern in all respects the priorities of federal taxes. Others surely wish that the law might have granted relief in specific situations which it failed to cover, or which it covered in less favorable ways. But legislation, like all matters political, is the art of the possible, and the accommodation of conflicting views and interests is its essence. The law which has finally emerged after years of study and negotiation is, if imperfect, "pretty good" from everyone's

171. In most states a mechanic's lien arises on or before the date on which he commences work. See generally text accompanying notes 278-95 infra.
173. See text accompanying notes 155-58 supra.
standpoint. In fact, in my opinion, it is a very good law.175

THE APPLICATION OF THE FEDERAL COMMON LAW RULE TO NON-TAX CASES

Following the codification of priorities in the tax lien area, there still remained "the unfinished business, the problem areas. . . ."176 The priority of federal non-tax liens was and is still one of those areas. Since the system of priorities for federal non-tax liens is virtually uncodified, the federal common law rule—i.e., "the first in time is the first in right,"177 and its corollary, the choate lien doctrine—governs in most cases. A non-federal lien must meet the three-part test for choateness at the time the federal lien arises or it is junior to the federal lien.178

Most lower federal courts have found the federal common law rule applicable in determining whether the federal government has priority in collecting on its non-tax liens.179 Prior to 1966, the courts supported this conclusion by citing United States Supreme Court cases which had applied the rule for the benefit of federal tax liens.180 They assumed that the rule was equally valid in cases involving federal non-tax liens. After the passage of the Tax Lien Act,181 courts could no longer be certain. Since Congress had seen fit to rewrite the law of priorities regarding federal tax liens, perhaps the reasoning behind the changes was relevant to the priority of non-tax liens. Courts have recognized the necessity for change, yet most of them have refused to act, reasoning

176. Plumb, Federal Liens and Priorities—Agenda for the Next Decade, 77 Yale L.J. 228, 228 (1967).
178. See text accompanying notes 20-26 supra.
179. See note 12 supra.
that any change in the law should be initiated by Congress.\textsuperscript{182} A few courts have rejected the rule either in part or in whole.\textsuperscript{183} Inequities persist, yet the rule as it relates to non-tax liens, remains binding authority in most jurisdictions.

\textit{Opposition to the Federal Common Law Rule—A Strong Minority}

The \textit{Ault} Opinion

In \textit{Ault v. Harris},\textsuperscript{184} the United States District Court for Alaska rejected the federal common law rule. It determined that a mechanic's lien was entitled to priority over a mortgage lien held by the Small Business Administration.\textsuperscript{185} The SBA lien was executed prior to the performance of services by the mechanic's lienor but was not recorded until after the mechanic's lienor commenced work. Unquestionably the SBA lien would have prevailed under the federal common law rule.

After finding no evidence of insolvency, the court considered the applicability of the federal common law rule. The United States argued that the rule was necessary to protect the public treasury. The court responded that the SBA should disburse its funds with greater vigilance or withhold sufficient funds from its loan to pay a lien if one is established. The court then noted that if this case had been decided under the Tax Lien Act\textsuperscript{186} the mechanic's lien would have prevailed. It found no reason to adopt a more stringent rule for the SBA. The court further noted that the Tax Lien Act intended that local law be applied to the situation before it. Accordingly it adopted local law\textsuperscript{187} as its federal rule. Since under local law, the mechanic's lien was entitled to priority over other types of liens which were unrecorded at the time the mechanic's lienor began supplying labor or materials,\textsuperscript{188} the mechanic's lien prevailed.

The court relied heavily on the passage of the Tax Lien Act. It

\textsuperscript{182} Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc., 572 F.2d 588 (7th Cir. 1978); Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978); United States v. General Douglas MacArthur Senior Village, Inc., 470 F.2d 675 (2d Cir. 1972); T.H. Rogers Lumber Co. v. Apel, 468 F.2d 14 (10th Cir. 1972).


\textsuperscript{184} 317 F. Supp. 373 (D. Alas. 1968), \textit{aff'd} \textit{sub nom.} Ault v. United States, 432 F.2d 441 (9th Cir. 1970).

\textsuperscript{185} Hereinafter abbreviated as SBA.


\textsuperscript{187} \textit{ALASKA STAT.} § 34.35.060 (1977).

\textsuperscript{188} 317 F. Supp. at 376. The reasoning of the court in \textit{Ault} was cited with approval in United States v. California-Oregon Plywood, Inc., 527 F.2d 687 (9th Cir. 1975), but the holding, that an SBA lien was inferior to a local tax lien, rested on a federal statute. \textit{See} 15 U.S.C. § 646 (1976).
reasoned that if a mechanic's lien prevails over a tax lien, it should, a fortiori, prevail over an SBA mortgage lien. This argument has some merit. Certainly the act of raising revenue by income tax is fundamental to the welfare of our country. A large percentage of our revenue is raised in this manner.\textsuperscript{189} In addition, the IRS, as involuntary creditor, is not able to pick and choose its debtors. The SBA, on the other hand, may choose its debtors. However, the court, by encouraging greater vigilance, may be asking the SBA to act contrary to its mandate. The declared policy of the SBA requires it to lend money to small businesses which are likely to be rejected by private lending institutions.\textsuperscript{190} Though greater vigilance may be possible, SBA loans necessarily include a high risk factor. The court's alternative—that the SBA withhold sufficient funds to pay a lien if one is established—seems more plausible and far less detrimental to the goal of helping business concerns in high risk situations.\textsuperscript{191}

The Kimbell Opinion

In \textit{Kimbell Foods, Inc. v. Republic National Bank},\textsuperscript{192} the United States Court of Appeals for the Fifth Circuit reached a result similar to that in \textit{Ault}. Once again the SBA was involved, but this time it was a guarantor of a private loan for $300,000 made by Republic National Bank to O.K. Supermarkets, Inc. Under an agreement entered into in 1969, the SBA guaranteed ninety percent of the loan. The loan was secured by O.K.'s "machinery, fixtures, equipment, inventory and all additions and accessions thereto,"\textsuperscript{193} and the security agreement was duly filed. However, in 1966, O.K. had executed the first of several loan security agreements to Kimbell Foods, Inc. These loans also were secured by items such as O.K.'s machinery, fixtures and equipment. The loans were paid off with part of the funds received from Republic, but new debts were constantly accruing because O.K. was buying from Kimbell on open account. O.K. defaulted on its note to Republic and the SBA paid Republic ninety percent of the outstanding indebtedness, more than $252,000. On January 21, 1971, Republic, in turn, assigned ninety percent of its interest in the debt to the SBA. Meanwhile, on January 15, 1971, Kimbell filed suit to recover on its debt, and on Janu-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{189} According to the United States Treasury Department, Office of Management and Budget, receipts from individual and corporate income taxes totaled approximately sixty percent of all receipts for fiscal year 1977. [1978] \textit{The World Almanac & Book of Facts} 75.
\item \textsuperscript{190} \textit{See} 15 U.S.C. § 631 (1976).
\item \textsuperscript{191} This practice also is carried on to some extent by the Federal Housing Authority. \textit{See} text accompanying notes 276-77 \textit{infra}.
\item \textsuperscript{192} 557 F.2d 491 (5th Cir. 1977).
\item \textsuperscript{193} \textit{Id.} at 493-94.
\end{itemize}
\end{footnotesize}
ary 31, 1972, obtained a judgment for $24,000. Thus both Kimbell and the SBA were competing for their share of approximately $86,000, which represented the proceeds from the sale of O.K.'s equipment and other assets.

The district court, following the choate lien doctrine, ruled that the lien of the SBA had priority because Kimbell had not reduced its claim to judgment before the SBA either guaranteed Republic's note or made good on its guarantee. The Court of Appeals for the Fifth Circuit reversed. It initially determined that the security agreements between Kimbell and O.K. covered O.K.'s subsequent purchases on open account, and that Kimbell's lien would be entitled to priority under state law. However, the United States argued that its priority should be determined by the choate lien doctrine. The court gave four policy reasons for rejecting the choate lien doctrine on the facts before it. First, the court noted that the reasons for extending the priority under Revised Statute 3466 to tax liens are not present where the SBA is a quasi-commercial lender. The United States as the holder of a tax lien is an involuntary creditor and is often not aware of its status until after other creditors have made their claims on the debtor's property. The SBA on the other hand, as a voluntary creditor, can examine the interests of other creditors and can require whatever security it feels is necessary. Second, the court stated that the collection of taxes is central to the functioning of government. The SBA as a supplement to commercial loan operations is less central to governmental functioning. Third, the court said that allowing the SBA priority in the collection of its debt would discourage potential creditors of small businesses. Potential creditors would fear that the collateral for their loans would be used as security for a future SBA loan. Finally, the court stated that the Tax Lien Act greatly restricted the priority of federal tax liens. An SBA lien, which is less worthy of protection than a federal tax lien, should not be the beneficiary of an expanded priority.

The United States next argued that other federal courts had applied the federal common law rule where the federal priority was at stake. The court responded by noting that all other non-tax lien cases decided by the federal courts, with the exception of those decided by the United States Court of Appeals for the Third Circuit, were "not

195. Id. at 328.
196. 557 F.2d at 500.
197. Id.
198. Id.
199. Id. at 501.
necessarily authority for adoption of the choateness doctrine. . . for in each case the application of the ‘first in time, first in right’ doctrine, without using the concept of choateness, could have given priority to the federal liens because each competing state lien arose after the federal lien.”

The court acknowledged that the Third Circuit had applied the choate lien doctrine per se, but the Fifth Circuit held the doctrine to be inappropriate on the Kimbell facts.

With the choate lien doctrine cast aside, the court had to formulate a new standard for the perfection of Kimbell’s lien. This was necessary because Kimbell’s lien could only compete under the “first in time is the first in right” priority rule if it was held to be perfected, regardless of the standard applied. The court solved its dilemma in the following manner:

"In the context of competing state security interests arising under the U.C.C., we conclude that liens perfected under the UCC qualify to compete against federal liens under the federal ‘first in time, first in right’ priority rules. The UCC carefully prescribed the steps necessary to perfect a security interest. Perfection under the UCC provides many of the assurances of the existence of a lien required by the choateness doctrine—identity of the debtor, identity of the lienholder, and identity of the property serving as collateral. Further, the UCC embodies rules of nationwide applicability—all states but Louisiana have adopted it—assuring that federal contractual liens will not be subject to the idiosyncracies of particular state laws. The context provides our final reason: perfection under the UCC provides protection to the secured creditor against later-filed claims of other creditors; in the absence of congressional mandate or persuasive policy reasons to the contrary, it should similarly protect secured creditors against later arising federal contractual liens."

Applying the rule for perfection of liens under the Uniform Commercial Code, the court held Kimbell’s lien to be “first in time” and therefore “first in right.”

Kimbell provides convincing reasons for rejecting the choate lien doctrine. It then fashions a rule which is more equitable than the choate lien doctrine, and capable of being applied uniformly among all but one of the fifty states. However the rule, because it relies on the U.C.C., does present one important disadvantage. The rules for

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200. Id. at 502.
201. See United States v. Oswald & Hess Co., 345 F.2d 886 (3d Cir. 1965); In re Lehigh Valley Mills, Inc., 341 F.2d 398 (3d Cir. 1965).
203. 557 F.2d at 503 (footnotes and citations omitted). The court does not cite the sections of the U.C.C. to which it is referring. Presumably it is referring to sections 9-302 through 9-306.
204. Hereinafter abbreviated as U.C.C.
205. U.C.C. Article Nine covering secured transactions has been adopted by every state except Louisiana.
perfecting a lien under the U.C.C. apply only where interests are secured by personalty. Therefore, the rule in Kimbell is applicable only where the competing liens are attached to personalty. This significantly narrows the number of instances where the Kimbell rule might be applied because the rule will have no precedential value where the competing liens are secured by realty. As Kimbell demonstrates, there are a number of strong arguments for abandoning the choate lien doctrine; the more difficult inquiry concerns its replacement.

The Crittenden Opinion

In United States v. Crittenden, the Court of Appeals for the Fifth Circuit carried its reasoning in Kimbell one step further by rejecting "the first in time is the first in right" rule as well as the choate lien doctrine. Again the court had facts before it which facilitated the adoption of an alternative to the federal common law rule. From 1970 to 1972, Bridges, "the imppecunious one," had received several loans from the Farmers Home Administration. Under the terms of an agreement executed on February 2, 1972, the loans were secured by an interest in Bridge's crops and certain personalty, including a tractor. Notice of the security agreement was filed on that date. On several occasions between December 29, 1972, and December 21, 1973, Bridges took his tractor to Crittenden for repairs. On December 21, after Bridges failed to pay his earlier bills, Crittenden retained possession of the tractor. In March, 1974, when Bridges filed a petition in bankruptcy, Crittenden took possession of the tractor as bailee by writ of execution. At the time of Bridges' discharge in bankruptcy, he owed more than $7,000 to the FmHA and more than $2,000 to Crittenden. The tractor was valued at $5,000.

The facts in Crittenden allowed the court to consider two important factors not present in Kimbell. First, since the FmHA lien was perfected before Crittenden's lien came into existence, and would necessarily be first in time no matter what standard was used for perfecting Crittenden's interest, Crittenden's interest could not be superior unless both the choate lien doctrine and "the first in time, first in right" rule were rejected. Second, Crittenden's lien was possessory, placing it

206. See U.C.C. § 1-201(37). This definition of security interest is confined to personalty.
207. See text accompanying notes 298-329 infra.
208. See text accompanying notes 331-33 infra.
209. 563 F.2d 678 (5th Cir. 1977).
211. 563 F.2d at 680.
212. Hereinafter referred to as FmHA.
squarely within one of the superpriority exceptions of section 6323(b) of the Internal Revenue Code.213

The United States, in support of its interest, argued that the priorities should be measured by the federal common law rule. It further argued that any reference by analogy to the Tax Lien Act214 was misconceived since Congress did not intend that the Act be applied to federal non-tax liens. The court rejected the government’s arguments. It reasoned that the Act was applicable by analogy since the Act had a “consanguinity”215 with the problem under discussion. The court stated, “In the creativity of law we are not forbidden, in fact we are encouraged, to look to statutes in the area of discussion in order to flesh out congressional attitude and philosophy . . . .”216 The court then noted that if the federal lien had been a tax lien, Crittenden’s lien would have been entitled to superpriority status under Code section 6323(b)(5).217 Therefore, it concluded that the Act removed the “jurisprudential underpinnings”218 for any argument that the first in time rule was applicable in protecting the federal government’s non-tax lien under the facts in the case.219

Having rejected the common law rule, the court was free to fashion its own federal rule. It analyzed two alternative sources, state law220 and the Uniform Commercial Code.221 State law was attractive because a person holding a security interest in property might be justified in thinking that state law governed his rights. It would be unfair if he subsequently learned that his lien was junior to a competing federal lien because the priority was not controlled by state law. The court was sensitive to this policy consideration. Nonetheless it chose U.C.C. § 9-310 as its “model for the creation of an analogous federal common law rule . . . .”222 because it would not thwart the reasonable expectation

213. I.R.C. § 6323(b)(5).
215. 563 F.2d at 686.
216. Id. at 686-87.
217. I.R.C. § 6323(b)(5) provides:
   Even though notice of a lien . . . has been filed, such lien shall not be valid—
   (5) With respect to tangible personal property subject to a lien under local law securing the reasonable price of the repair or improvement of such property, as against a holder of such a lien, if such holder is, and has been, continuously in possession of such property from the time such lien arose.
218. 563 F.2d at 687.
219. Id. at 688.
220. GA. CODE ANN. § 109A-9-310 (1963). The court noted that because of inconsistencies in the applicable Georgia law, it could not determine whether Crittenden’s lien was entitled to superpriority status under state law. See 563 F.2d at 688 n.17.
221. U.C.C. § 9-310.
222. 563 F.2d at 689. U.C.C. § 9-310 provides:
of mechanic's lienors, it was generally uniform among the states, and it was appropriately protective of mechanic's lienors.\textsuperscript{223} The court reasoned that "the prior secured creditor's interests are not prejudiced by granting the mechanic's lien superpriority status because the value of the secured party's collateral is usually enhanced by at least the amount of the lien."\textsuperscript{224}

As in the case of \textit{Kimbell Foods, Inc. v. Republic National Bank},\textsuperscript{225} the court was fortunate to have a ready-made alternative available under the U.C.C.\textsuperscript{226} Like \textit{Kimbell}, \textit{Crittenden} is helpful only where the competing interests are in personalty. If the mechanic's lien had been attached to realty, the court would have had to construct its own rule, since there is no uniform law regarding the priority of interests in realty.

\textit{The Majority Position—Chicago Title Insurance Co. v. Sherred Village Associates}

Since 1966 several federal courts of appeals—the First,\textsuperscript{227} Second,\textsuperscript{228} Fourth,\textsuperscript{229} Seventh,\textsuperscript{230} and Tenth\textsuperscript{231} Circuits—have held that the federal common law rule still governs the priority of federal nontax liens. A recent First Circuit case, \textit{Chicago Title Insurance Co. v. Sherred Village Associates},\textsuperscript{232} restates most of the arguments raised in favor of its retention.

In \textit{Sherred Village}, the court of appeals adjudicated the priority between a mortgage lien held by the Department of Housing and Ur-

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  \item When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.
  \item 563 F.2d at 687. The court quoted U.C.C. § 9-310, Comment 1, which states that "liens securing claims arising from work intended to enhance or preserve the value of the collateral take priority over an earlier security interest even though perfected."
  \item 563 F.2d at 687.
  \item See text accompanying notes 192-208 supra.
  \item See text accompanying notes 205-08 supra.
  \item Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978).
  \item United States v. General Douglas MacArthur Senior Village, Inc., 470 F.2d 675 (2d Cir. 1972).
  \item H.B. Agsten & Sons, Inc. v. Huntington Trust & Sav. Bank, 388 F.2d 156 (4th Cir. 1967). This case concerned competing liens attached to the property of an insolvent debtor. Thus the court applied a stricter test in determining choateness. \textit{Id.} at 168. \textit{See also} text accompanying notes 103-23 supra.
  \item Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc., 572 F.2d 588 (7th Cir. 1978).
  \item T.H. Rogers Lumber Co. v. Apel, 468 F.2d 14 (10th Cir. 1972).
  \item 568 F.2d 217 (1st Cir. 1978).
\end{itemize}
ban Development\textsuperscript{233} and a mechanic's lien. In 1971, Hercoform, Inc. had contracted to supply materials and labor to the developer of a moderate income residential housing project. In 1972, the developer had obtained mortgage financing for the project from the New England Merchants Bank. The loan was insured by HUD in accordance with its authority under section 236 of the National Housing Act.\textsuperscript{234} Chicago Title Insurance insured the developer's title in the mortgaged property for the benefit of the mortgagee bank. Hercoform recorded its mechanic's lien upon completion of its work in 1973, and immediately filed suit on its claim. In 1974, the developer defaulted on its note to the mortgagee bank, and the bank, pursuant to its rights under the agreement with HUD, assigned the mortgage to HUD. The bank warranted to HUD that the mortgage would have priority over all liens filed subsequent to the date on which the mortgage was initially executed. Chicago Title also insured the bank's warranty to HUD. Under state law Hercoform clearly had priority over HUD's mortgage since its contract with the developer had been executed before the bank's mortgage.\textsuperscript{235} In anticipation of the state court judgment foreclosing Hercoform's lien, Chicago Title sought a declaratory judgment\textsuperscript{236} stating that HUD's lien was entitled to priority.

The court began its inquiry by noting that the federal courts of appeals were "split on the issue of whether the doctrine of choateness should continue to be applied in priority disputes involving non-tax federal liens."\textsuperscript{237} It listed the reasons given by previous courts for upholding the doctrine:

(1) [T]he Tax Act on its face and in its legislative history is limited in scope to federal tax liens, (2) Congress was aware of lower federal court decisions extending choateness to cases involving non-tax federal liens and, therefore, would have acted in these other areas too if it had intended that choateness no longer be applied there, (3) the Tax Act of 1966 is merely the latest in a series of Acts "designed to effect precisely limited expansions of categories of secured creditors protected from secret federal tax liens", and (4) Congress . . . is better equipped than the judiciary to gauge the impact of a decision to waive the priority to which federal non-tax liens are generally enti-
tled now.\textsuperscript{238}

The court then reviewed the arguments for abandoning the doctrine. Although the court admitted that the arguments were persuasive, it

\textsuperscript{233} Hereinafter referred to as HUD.
\textsuperscript{235} See ME. REV. STAT. tit. 10, § 3251 (Supp. 1978).
\textsuperscript{236} The declaratory judgment was sought pursuant to 28 U.S.C. § 2201 (1976).
\textsuperscript{237} 568 F.2d at 220.
\textsuperscript{238} Id. at 220-21.
concluded that it could not create its own rule.

The court gave several reasons for retaining the doctrine. First, it hoped that by adding another federal circuit court of appeals to the already existing majority favoring the doctrine, it would stimulate Congressional action. Second, the judges felt that there was much they did not know "about the equities, effects of various rules, and relative ability of federal and local lienors to protect themselves." Questions such as "whether priority of federal liens should be subject to the impermanent policy decisions of state legislatures" and "to what extent participation by private financial institutions . . . is dependent upon a rule favoring federal liens" the court felt could be better answered by Congress after Congressional hearings, rather than by a court after hearing a limited number of litigants. Finally, unlike the courts in *Kimbell Foods, Inc. v. Republic National Bank* and *United States v. Crittenden*, the First Circuit did not have generally recognized rules such as those found in the U.C.C. available to apply to interests in realty. The court rejected recourse to state law and criticized the result in *Ault v. Harris* for its lack of uniformity.

*Sherred Village* represents the most carefully reasoned defense of the choate lien doctrine. Nonetheless, two out of the three reasons it gives for retaining the doctrine are suspect. The first, that a decision supporting the doctrine would attract the attention of Congress, is highly speculative. The second, that the court felt incompetent to create new law in the area is equally unconvincing. The court gave two examples of questions which could be better answered by Congress. However, neither question should present much difficulty for a court. First it asked "whether priority of federal liens should be subject to the im-

239. *Id.* at 221.
240. *See* note 12 *supra.*
241. 568 F.2d at 221.
242. *Id.*
243. *Id.* n.6.
244. 557 F.2d 491 (5th Cir. 1977). *See* text accompanying notes 192-208 *supra.*
245. 563 F.2d 678 (5th Cir. 1977). *See* text accompanying notes 209-26 *supra.*
247. 568 F.2d at 222. The court stated:

Recourse to the local law governing mechanics' liens . . . would incorporate many local eccentricities. This fact led the Ninth Circuit in *Ault*, *supra.*, to adopt the rule of the Tax Act, i.e., adopting local law except where the mechanic's lienor has not commenced work prior to the recordation of the federal lien. Application of this rule, though, would not only require HUD to concern itself with the varying state laws, but would require contractors to be aware of the possible applicability of two sets of rules.

248. It hardly seems reasonable that a court should base its decision, even in part, upon the hope that the Congress might be compelled to act where the split in the circuits is 6-2 as opposed to 5-3.
permanent policy decisions of state legislatures." Other courts have not hesitated to answer this question. Most courts have been influenced by the need for uniform rules. Even the United States Court of Appeals for the Fifth Circuit, which rejected the first in time rule, was careful to substitute a rule uniform among the states. It is obvious that a federal agency such as HUD would be greatly inconvenienced if it had to contend with a different and impermanent priority rule for each state. The other question better directed to Congress was "to what extent participation by private financial institutions, a primary goal of the National Housing Act, is dependent upon a rule favoring federal liens." Again the answer seems clear. Mortgages signed pursuant to a HUD regulatory agreement are insured mortgages. A private financial institution is not concerned with the fate of its mortgage once its interest is assigned or sold to HUD. Thus there is no reason why its participation should be contingent upon a rule favoring or disfavoring federal liens. Neither of the issues proposed by the court seems particularly difficult to resolve, or in need of Congress' investigatory resources. They are issues for which the courts seem capable of formulating their own rules.

The Sherred Village court's final reason for retaining the choate lien doctrine, that it anticipated difficulties in adopting an alternative rule, is a legitimate concern. Given the nature of the competing liens in Sherred Village, there was no pre-existing uniform rule such as those existing under the U.C.C., which could be utilized to establish the priority of Hercoform's mechanic's lien. Hercoform's lien attached to realty, not personalty. This necessitated a judicially created rule. The court assumed that any rule would have to be applied uniformly regardless of the law of the state in which the secured property was located. This is a valid assumption because state laws regarding the priority of mechanic's liens vary and are always subject to change within a given state. The absence of a uniform rule would unduly burden an agency such as HUD with the need to be aware of these

249. 568 F.2d at 221 n.6.
251. See text accompanying notes 331-33 infra.
252. 568 F.2d at 221 n.6.
253. A HUD regulatory agreement is signed by the mortgagor, mortgagee and HUD. In such an agreement HUD insures the mortgage for the total amount advanced by the mortgagee. If the mortgagor defaults on his payments, the mortgagee may assign the mortgage to HUD. See 24 C.F.R. § 236.255 (1977).
254. 568 F.2d at 222.
255. See, e.g., U.C.C. § 9-310.
256. See text accompanying notes 278-95 infra.
differences and changes, and the necessity of governing its operations accordingly.

**Governing Priority Between a HUD Mortgage Lien and a Mechanic's Lien**

No court has formulated an alternative to the rule that "first in time is the first in right," and its corollary, the choate lien doctrine, where the competing interests are secured by realty, except by relying on the law of the state in which the realty is located. Such reliance results in a rule which is problematical because of its lack of uniformity. Developing a uniform alternative rule is difficult because interests in realty are not governed by a set of statutes, such as the Uniform Commercial Code, which are common to most jurisdictions. Thus, unless Congress acts, any alternative rule will be entirely judicially created. It can only be developed after a careful examination of the nature of the competing interests.

A priority contest between a HUD mortgage lien and a mechanic's lien is one example of a contest where the competing liens are attached to realty. Potentially the priority contest arises whenever HUD insures a loan secured by a mortgage that is attached to land and buildings upon which the mechanic's lienor is working. Before formulating an alternative rule, it is necessary to carefully examine how the lien interests arise, at what point in time they arise, whether the present majority rule creates a fair priority, and if not, what policy considerations and other factors must be considered in adopting a new rule.

**How the Interests of the Parties Involved Arise**

The Department of Housing and Urban Development

The Department of Housing and Urban Development was organized in 1965. However, it is comprised of agencies such as the Federal Housing Administration whose origins date back as far as 1934. One of the purposes of HUD is to provide "a decent home and a suitable living environment for every American family." One way it accomplishes this purpose is through assistance in providing adequate

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housing for low and middle income persons,262 principally through low interest loans,263 subsidies,264 and mortgage insurance for private investors.265

The FHA remains the agency responsible for administering the various mortgage insurance programs. In general they may be divided into single family266 and multifamily programs,267 one of which, section 236 of the National Housing Act,268 was under scrutiny in Chicago Title Insurance Co. v. Sherred Village Associates.269 Although the substance of particular multifamily programs is obviously different, the procedure under which the FHA operates is basically the same for most multifamily programs.270 Thus conclusions drawn regarding HUD-FHA's priority as a mortgage insurer under section 236 are applicable to its position under most multifamily mortgage insurance programs.

Section 236 is designed to provide new or rehabilitated rental housing for lower income families and for elderly or handicapped persons.271 As originally enacted, its aim was to "stimulate subsidized housing production by making private enterprise the primary vehicle for providing shelter for low- and moderate-income families.272 It includes not only mortgage insurance but a subsidy paid to the mortgagee on behalf of the mortgagor, thereby lowering the mortgagor's actual interest on his loan to one percent.273 The savings are then passed on to the tenants of the project. Eligible mortgagors are restricted to limited-dividend corporations,274 nonprofit entities, and builders who intend to ultimately sell their project to a nonprofit investor.275 The processing procedure under section 236 is complex. Its details illustrate the care with which HUD scrutinizes its allocations and show how HUD's interest arises.

A developer's first contact with HUD is a pre-feasibility confer-

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267. See, e.g., National Housing Act § 207, 12 U.S.C. § 1713 (1976). This note will only consider multifamily programs. One such program codified at section 236 of the National Housing Act, 12 U.S.C. § 1715z-1 (1976), will be analyzed.
269. 568 F.2d 217 (1st Cir. 1978).
270. HOUS. & DEV. REP. (BNA) § 20:1011.
272. HOUS. & DEV. REP. (BNA) § 20:0525.
274. A limited-dividend corporation is profit motivated but cannot earn more than six percent annually on its equity investment. See HOUS. & DEV. REP. (BNA) § 3:0004.
275. See generally C. EDSON & B. LANE, A PRACTICAL GUIDE TO LOW-MODERATE INCOME HOUSING 2.5-2.6 (1972) [hereinafter cited as EDSON & LANE].
ence. At that time the developer must have either purchased or have an option to purchase the land upon which the project will be built. He must also have such basic information as the number of units and the prospective rental income from the project. From this information HUD determines whether the project is economically feasible. The next step is an application for a letter of feasibility. The application (known as Form 2013) requires detailed information about the project such as administrative, operating and maintenance costs. HUD then analyzes carefully whether the rent and other income will cover the mortgage payments. If the project appears financially sound, a feasibility conference is held, and HUD sets forth its costs limitations and target dates for the project, which the developer must accept. At this time HUD reserves the funds necessary to complete the project.

Once the developer has received a letter of feasibility, he must, if he has not already done so, hire an architect and contractor, and choose a mortgagee. Using the architect's drawings and compilations, he may submit a refined Form 2013 and a conditional commitment application. Following HUD's conditional commitment, the architect must prepare final plans and specifications, and a final Form 2013 is submitted with firm figures on all items. Once HUD gives its firm commitment, the parties are ready for the initial closing.

At the initial closing the mortgage is executed and recorded. One of the many other documents signed at the closing is the regulatory agreement. This agreement declares HUD's endorsement for insurance of the mortgage. It is also recorded. Construction cannot start and the mortgagee normally will not advance any funds until after the initial closing.

Once construction begins, the mortgagee disburses funds at regular intervals; however, the reasonableness of each request by the general contractor must be verified by the architect. Any major change orders in construction must be approved by HUD. For each advance, there is a retention of ten percent of the amount requested. The money retained is not advanced until ninety percent of the project is completed. When ninety-five percent of the project is completed HUD issues a permit to occupy and tenants are selected. The final closing takes place thirty days after construction has been completed. At that time HUD issues an endorsement stating that a specific sum of money reflecting the final mortgage figure is approved for insurance.

276. Id. at 3.102.
277. See note 253 supra. See also Edson & Lane, supra note 275, at 3.160.
Mechanic's Lienors

The point at which the mechanic's lienor fits into the development chronology is related to the nature and priority of mechanic's liens. The right to a mechanic's lien, unknown at common law, is statutory.\textsuperscript{278} It is a claim which arises when labor or materials are supplied for the improvement of land, and the lien attaches to the land as well as buildings and improvements affixed to the land.\textsuperscript{279} Though the claim arises automatically, statutes generally provide for the filing of a notice of lien before the lien is entitled to priority against encumbrancers or purchasers.\textsuperscript{280} Once the required notice has been filed, the lienor may bring suit to enforce his lien.

The states are not consistent in their treatment of the priority of mechanic's liens. Among the fifty states and the District of Columbia, there are several types of statutes governing the priority between a mechanic's lienor and a mortgagee.\textsuperscript{281} They vary in the degree of protection afforded the mechanic's lienor.

The statutes of most states provide that a mechanic's lien will have priority over all liens, including a mortgage lien, which attach after a specified point in time. This point in time varies from state to state, but it is always measured in terms of the mechanic's lienor's work. The most commonly employed point is the commencement of work.\textsuperscript{282} In most states this does not necessarily mean the commencement of the particular lienor's work, but rather the start of the project as a whole. Most courts have held that work begins when there is visible excavation or construction.\textsuperscript{283}

A few states choose a different point in time. In Washington, for example, a mechanic's lienor has priority over all liens created after the commencement of his particular work.\textsuperscript{284} Thus a materialman who supplies fixtures near the end of a lengthy project enjoys legal advantages in a state such as California which will measure his priority from the day the work on the project in general commences.\textsuperscript{285} The difference in time may be many months. Illinois has a particularly liberal rule.\textsuperscript{286} It measures the priority of a lien from the day on which the

\textsuperscript{278} See, e.g., ILL. REV. STAT. ch. 82, § 1 (1977).
\textsuperscript{279} See, e.g., CAL. CIV. CODE § 3128 (West 1974).
\textsuperscript{280} See, e.g., N.Y. LIEN LAW § 13 (McKinney 1966).
\textsuperscript{281} See text accompanying notes 282-95 infra.
\textsuperscript{282} See, e.g., CAL. CIV. CODE § 3134 (West 1974).
\textsuperscript{283} See generally Annot., 1 A.L.R.3d 822 (1965).
\textsuperscript{284} WASH. REV. CODE § 60.04.050 (Supp. 1977).
\textsuperscript{285} CAL. CIV. CODE § 3134 (West 1974).
\textsuperscript{286} ILL. REV. STAT. ch. 82, § 16 (1977).
lienor enters into a contract to supply labor or materials. This could be several months before the project commences.

There are several important variations in the statutes. A few states distinguish between liens which may be satisfied from the value of the land, and those which may be satisfied from the value of buildings and other appurtenances attached to the land. The statute in Alabama, for example, provides that a mechanic's lien has priority against the value of both the land and appurtenances where the competing lien attaches after the commencement of the work. But where the competing lien attaches prior to the commencement of the work, the mechanic's lienor will have priority only as to the product of his work which is separable from the land, building, and improvements which are subject to the prior lien. Thus a mechanic's lienor may be in a better position in Alabama than he would be in California. In California, a lien competing with a mechanic's lien has absolute priority where it attaches before the commencement of work. However, in Alabama a mechanic's lienor, in the same situation, may be able to salvage some compensation if he can show that his labor or materials are somehow separable from the land, building, and improvements which existed before he began work.

A second variation singles out construction mortgage liens for special treatment. A construction mortgage lien is executed for the purpose of providing funds for making improvements on a given parcel of land. In Arkansas, for example, a general provision requires that all mechanic's liens shall have priority over other liens, mortgages or encumbrances, up to the total value of the buildings or other improvements for which the mechanic's lienor supplied work, regardless of when the mechanic's lien arises. However, construction mortgage liens are distinguished from other types of mortgages. They are given priority against the value of the buildings and other improvements where they arise before a mechanic's lien. A similar exception prevails in New York. There a construction mortgage lien has priority over a mechanic's lien to the extent that the mortgagee ad-

288. Id.
292. Id.
294. In New York a construction mortgage lien is referred to as a "building loan mortgage." Id.
advanced payments before the filing of the mechanic's lien.  

**Determining the Appropriate Rule**

In order to ascertain the rule which should be employed in determining the priority between a HUD mortgage lien and a mechanic's lien, this analysis will consider three questions:

1) Whether the HUD mortgage lien attaches when the regulatory agreement is signed or when HUD records its mortgage lien following the assignment of the mortgage to HUD by the private mortgagee;

2) Whether the priority should be determined by the federal common law rule; and,

3) If the priority should not be determined by the federal common law rule, what rule should be employed.

**When HUD's Lien Arises**

The first question, when the HUD mortgage lien attaches, establishes the position of HUD's lien in any competition for priority. The answer is found by inquiry into the nature of the assignment. An assignment of a mortgage to HUD is an assignment of the rights and obligations of the private mortgagee. HUD, in effect, steps into the shoes of the private mortgagee. As a result of this identity, it has been held that a federal mortgage lien resulting from a federally insured mortgage attaches as of the date on which the federal agency agrees to insure the mortgage. Thus HUD's interest attaches on the day on which the regulatory agreement is executed and recorded.

This rule seems to produce a fair result. It protects HUD as of the time when it assumes contractual obligations as an insurer. A contrary rule would require HUD to provide a benefit, namely its obligation as an insurer under the agreement, without any corresponding protection for the funds which it might have to advance pursuant to its obligation. On the other hand any subsequent lienor is adequately protected by the requirement that the regulatory agreement be executed and recorded. It ensures that any subsequent lienor will have notice that the rights under the mortgage might accrue at some future date to HUD.

**Applicability of the Choate Lien Doctrine**

The second question involves the applicability of the choate lien

295. A mortgage held by HUD is a construction mortgage lien.
doctrine to the priority contest between HUD and a mechanic's lienor. The question can be analyzed on several levels.

At the most basic level, some doubt exists as to whether the doctrine should ever have been extended to non-insolvency proceedings. The doctrine was originally stated for the purpose of determining the federal priority in insolvency cases. For the extension to be rational, the interest of the federal government must be as worthy of the doctrine's almost total protection where the debtor is solvent. The United States Supreme Court has stated that the two situations are "kindred" matters, but it has never stated why.

Presumably the application of the doctrine in the two instances may be reconciled to the extent that both situations require protection of the federal treasury. Where the debtor is insolvent, clearly the United States is entitled to protection. Not all creditors will have their claims satisfied in their entirety. Without a protective rule that guarantees priority, debts owed to the United States could go unsatisfied, causing a drain on the federal treasury.

Where the debtor is solvent, there is no longer the clear cut need for protection. The solvent debtor is capable of satisfying all of his creditors so long as all of his assets can be used for that purpose. If the United States holds a general lien, the claim will most likely be satisfied. A tax lien is a general lien. Therefore, where the United States has a claim against a delinquent but solvent taxpayer, there is no need for a rule which protects the federal treasury. It may be argued that the rule facilitates prompt payment since it gives the United States first priority to liquid assets. But this is a different policy consideration from that upon which the choate lien doctrine has been traditionally justified in insolvency proceedings. The policy considerations behind insuring prompt payment of debts to the federal government are far weightier than those behind insuring prompt payment where payment at some point is assured.

Given the fact that a United States tax lien may not need priority protection, it is ironic that the United States Supreme Court originally extended the choate lien doctrine to a non-insolvency situation in a tax lien case, United States v. Security Trust & Savings Bank. It is no less ironic that in every succeeding Supreme Court case the United States

300. A general lien attaches to all of the debtor's assets. See note 73 supra.
301. This was one of the reasons for the original extension in United States v. Security Trust & Sav. Bank, 340 U.S. 47, 51 (1950).
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was the holder of a tax lien. Nevertheless, every lower federal court which has extended the priority to federal non-tax liens has relied heavily upon the Supreme Court's extension in the tax lien area. No court has questioned the logic of the extension. If there are valid reasons for applying the choate lien doctrine to non-insolvency proceedings, they have not been supplied by the Supreme Court.

Another basic consideration leaves open to doubt the need for a protective rule such as the choate lien doctrine in both non-insolvency and insolvency proceedings. This concerns the continuing validity of the premise underlying the choate lien doctrine, namely that the federal treasury must be protected. In 1797 when Congress enacted Revised Statute 3466, and in 1817 when the Supreme Court strictly construed that statute, losses resulting from unpaid debts were more difficult to absorb. The United States could not afford to stand in a long line of general creditors and be paid a small percentage of its claim. The financial position of the United States has changed significantly since then. The federal treasury's dramatic growth eases any difficulty in absorbing losses, and the methods for raising revenue to cover losses to the treasury are far more sophisticated.

The more secure financial position of the United States must be juxtaposed with that of the competing private creditor. His difficulty in absorbing losses has not changed. The federal priority was detrimental to his financial status in 1797 and 1817, and it remains so today. Moreover, the federal government is engaged in a far greater number of activities which give rise to a debtor/creditor relationship than in 1817. Thus many more private creditors are affected by the federal priority. In addition many of these activities interface with the private sector and are not for the purpose of raising revenue. The fairness of giving the United States priority where it is acting just as any other private creditor is questionable.

Obviously the policy considerations supporting a protective rule in

303. See note 74 supra.
304. See note 182 supra.
308. Within the last forty-five years, Congress has created a number of administrative agencies whose purpose is to assist and stabilize various segments of the economy. The Small Business Administration, created in 1953, Pub. L. No. 83-163, 67 Stat. 232 (current version at 15 U.S.C. § 633 (1976)), is one such agency. Its activities include loans to small businesses, disaster loans, loans for water pollution control facilities, and loans to handicapped persons operating small businesses. 15 U.S.C. § 636 (1976). These activities by their nature give rise to debtor-creditor relationships. Other agencies engaged in similar programs include the Department of Housing and Urban Development and the Farmer's Home Administration.
the nation's formative years have changed or have been modified in the last 150 years. It is time to assess these changes and modifications, and redetermine whether the need for the federal priority still exists.

A second level of inquiry as to the applicability of the choate lien doctrine concerns the importance of the Tax Lien Act\(^{309}\) in assessing the doctrine's current validity. The provisions of the Act clearly reject the priority created by the doctrine in a number of different situations where the United States is the holder of a tax lien.\(^{310}\) However there is strong disagreement over the propriety of applying the reasoning behind these provisions to federal non-tax liens.

Proponents of the choate lien doctrine point to the fact that the Tax Lien Act, on its face, applies only to tax liens.\(^{311}\) They argue that if Congress had intended that the priorities apply to non-tax liens, it would have enacted statutes to that effect.\(^{312}\) Twelve years have passed and Congress has not acted.

Opponents of the choate lien doctrine counter by arguing that the Tax Lien Act removed the "jurisprudential underpinnings"\(^{313}\) of the doctrine.\(^{314}\) Though the Act applied only to tax liens, its provisions can be applied by analogy in other areas. They argue that the policy considerations behind protecting a federal tax lien are similar to those behind protecting other types of federal liens.\(^{315}\) Congress reasoned that the choate lien doctrine produced inequitable results in its protection of federal tax liens. Therefore the reasoning should apply, a fortiori, to other federal liens where the government is not raising revenue but is acting in a quasi-commercial capacity.

Neither set of arguments is sound. The proponents ignore the fact that the choate lien doctrine is a judicially created rule.\(^{316}\) As such it may be judicially and judiciously abandoned. There is no binding precedent. The Supreme Court has adjudicated only the priority of fed-

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310. \textit{See} I.R.C. \S\ 6323.
311. Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc., 572 F.2d 588 (7th Cir. 1978); Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978); United States v. General Douglas MacArthur Senior Village, Inc., 470 F.2d 675 (2d Cir. 1972); T.H. Rogers Lumber Co. v. Apel, 468 F.2d 14 (10th Cir. 1972).
313. United States v. Crittenden, 563 F.2d 678, 687 (5th Cir. 1977).
eral tax liens,317 and that priority has been eroded by the Tax Lien Act. Some courts admit that they have the power to change the rule, and that it should be changed, yet they fail to act.318 They rely instead on the faint hope that Congress will act to remedy the inequities in the not too distant future.

The arguments set forth by the opponents of the choate lien doctrine are specious. It is tempting to analogize from the Tax Lien Act, but it should not be done without greater scrutiny of the interests involved. A tax lien is a general lien which attaches to all of the property of the delinquent taxpayer.319 Therefore the fact that a federal tax lien is junior to a mechanic’s lien with regard to a particular property interest, which cannot satisfy both liens, does not leave the tax lien unsatisfied. In most cases the tax lien can be satisfied from the balance of the taxpayer’s property. If the taxpayer is insolvent, the federal government is still protected. Revised Statute 3466320 supercedes the priorities under Code section 6323321 and the United States is entitled to first priority.322 Thus a federal tax lien is protected with or without a rule that gives it first priority.

Other federal liens such as a federal mortgage lien are not so protected. They are specific liens which attach only to a specific piece of property. If the value of the property is insufficient to satisfy all the attaching liens and the federal lien is junior to the other liens, the federal lien will go unsatisfied. The purpose of the choate lien doctrine is to insure that the federal lien will be paid to the greatest extent possible. A federal mortgage lien may need this protection while a federal tax lien clearly does not.

Thus the policy considerations behind abandoning the choate lien doctrine are not the same for all federal liens. The approach of the opponents, though appealing on its face, is too simplistic. This does not mean that provisions of Code section 6323 are irrelevant in determining the priority of other federal liens, for they may help provide an adequate solution. But they should not be applied without more rigorous scrutiny than that given by courts opposing the choate lien doctrine.

The final level of inquiry concerns the validity of applying the

317. See note 74 supra.
318. See Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc., 572 F.2d 588 (7th Cir. 1978); Chicago Title Ins. Co. v. Sherred Village Assocs., 568 F.2d 217 (1st Cir. 1978).
319. See note 58 supra.
choate lien doctrine to determine the priority of a mortgage lien held by the Department of Housing and Urban Development. It has been seen that the rationale behind applying the doctrine for the benefit of any federal lien is suspect for at least two reasons. First, the United States Supreme Court has never given an adequate explanation for extending the use of the doctrine from insolvency to non-insolvency proceedings. Second, in view of the changes in the financial position of the United States during the last 150 years, the application of the doctrine in both insolvency and non-insolvency proceedings is questionable. Some courts, in determining the applicability of the choate lien doctrine to a particular federal non-tax lien, have analogized to provisions of the Tax Lien Act. However, the provisions of the Act cannot be applied without careful examination of the policy consideration behind protecting that lien. Thus it is necessary to examine the policy considerations behind protecting a HUD mortgage lien.

The need for protecting a federal tax lien provides a helpful comparison in determining the applicability of the Act. The retention of the choate lien doctrine as it applies to a HUD mortgage lien is valid to the extent that the need for protecting the HUD mortgage lien is greater than the need for protecting a federal tax lien. If the need for protecting a federal tax lien is greater, then, a fortiori, the provisions of the Act may be applied to a HUD mortgage lien. It has already been acknowledged that a HUD mortgage lien, as a specific lien, could potentially go unsatisfied, whereas a federal tax lien, under almost any set of circumstances, eventually will be satisfied. This indicates that the mortgage lien is in greater need of protection. But there are a number of other considerations which tend at least to equalize the need.

First, HUD has the opportunity to choose its debtors while the United States as a tax lienor cannot. HUD can protect itself by choosing the developer or owner of the land whose mortgage it insures. It does, in fact, take advantage of this opportunity by requiring the mortgagor to submit to an extensive and comprehensive application procedure. HUD will not insure a mortgage unless it is convinced that the project is sound. In addition HUD protects itself to some degree by requiring the mortgagee to withhold ten percent of each disbursal until

323. See text accompanying notes 298-304 supra.
324. See text accompanying notes 305-08 supra.
326. See text accompanying notes 309-22 supra.
327. See text accompanying notes 319-22 supra.
328. See text accompanying notes 276-77 supra.
the project is nearly completed. This lessens by ten percent the amount
of any lien in case the project should fail before completion.

The United States, on the other hand, cannot choose the person or
entity that fails to pay its taxes. As a result, the IRS is often forced to
collect from a delinquent taxpayer who is having financial problems.
He is solvent, but his assets are not easily liquidated. Where other par-
ties have an interest in his property, disbursement of funds from the
sale of that property must be settled through litigation. If the United
States is not given priority over other claimants, it will be entitled to a
smaller share of the property to which its lien attaches. As a result it is
likely that the United States will have to foreclose on more of the tax-
payer's property than if it were entitled to first priority. This could
require more litigation and greater expenses than would otherwise be
necessary.

Second, HUD, unlike the IRS, operates on a commercial basis,
insuring mortgages somewhat like any other commercial lender. It en-
ters into contracts and therefore can control, to some extent, its rights
and obligations. It does not insure high risk projects, but rather those
projects which it is reasonably certain will be successful. It seems un-
fair that HUD should be entitled to a priority which is unavailable to
private lending institutions acting in the same capacity.

Third, the federal priority may discourage potential creditors of
the mortgagor. A mechanic's lienor, for example, will be less likely to
contract with a developer whose mortgage is being insured by HUD,
because he knows that with the federal government as a claimant, he
will lose the priority advantages he enjoys under state law. If he does
contract to provide his services, he may charge a premium for those
services because of the additional risk involved.

Finally, the federal government's role as a collector of taxes is far
more central to the functioning of our country than is its role as an
insurer of mortgages. The raising of revenue is a function upon which
all other federal agencies rely for their funds. An obstacle to or even a
delay in the raising of revenue must necessarily have repercussions in
all areas of federal activity. The insuring of mortgages, while it is an
important part of our national housing program, does not occupy such
a central position.

Balancing the various policy considerations, it becomes clear that
if a federal tax lien is not given the protection of the choate lien doc-
trine, then a HUD mortgage lien should be denied its protection as
well. The conclusion becomes even stronger in view of the questiona-
ble reasoning behind the choate lien doctrine. 329 The question remains, however, as to whether the doctrine should apply where the competing lien is a mechanic's lien. Internal Revenue Code sections 6323(a) and 6323(h)(2) 330 specifically determine the priority between a mechanic's lien and a federal tax lien. The statute supercedes the choate lien doctrine, and the doctrine is therefore inapplicable where the federal lien is a tax lien. Since a HUD mortgage lien is no more in need of protection than a federal tax lien, it follows that the doctrine should likewise not be applied to determine the priority between a HUD mortgage lien and a mechanic's lien.

Considerations in Formulating the Proposed Alternative Rule

The problem in formulating an alternative to the federal common law rule is choosing an equitable rule which will not be too difficult to apply. An equitable rule should be considerate of the competing interests involved. It should create a rule of priority the application of which will effect a result which most closely reflects the real interests of the parties in the property. Thus the rule should consider the value of the advances made by HUD or its assignor. It should also reflect the fact that the mechanic's lienor has improved the property. The value of the improvement should not accrue solely to the benefit of HUD, a result the choate lien doctrine would compel.

Difficulty in application refers to the problem of uniformity. Ideally the rule which is proposed should be capable of application uniformly among the states. If, for example, the rule was dependent on the law of the state in which the property interest was located, HUD would be forced to concern itself with many different rules. Burdening HUD with a myriad of rules should be avoided if possible. If there are other workable alternatives which avoid adopting state law, they would be preferable.

From the standpoint of uniformity the best proposal would be the

329. See text accompanying notes 298-304 supra.
330. I.R.C. § 6323(a) provides that:
The tax lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate.

I.R.C. § 6323(h)(2) provides:
The term "mechanic's lienor" means any person who under local law has a lien on real property (or on the proceeds of a contract relating to real property) for services, labor, or materials furnished in connection with the construction or improvement of such property. For purposes of the preceding sentence, a person has a lien on the earliest date such lien becomes valid under local law against subsequent purchasers without actual notice, but not before he begins to furnish the services, labor, or materials.
uniform application of the law found in the majority of states—the mechanic's lienor has priority over all liens which arise subsequent to the commencement of work. However, this rule would do little to help the mechanic's lienor in a contest with a HUD lien since work usually is not commenced until after the signing of the regulatory agreement, which is the time when HUD's lien arises. Thus in almost every case a mechanic's lien would be junior to a HUD mortgage lien.

Any proposal which establishes a specific point in time, such as the commencement of work, after which the mechanic's lien is entitled to priority, will suffer from the same inequitable result. Depending on the point in time which is chosen, the HUD mortgage lien, which always arises when the regulatory agreement is signed, will be entitled either to absolute priority over the entire value of the project or to no priority at all. Most FHA insured multifamily projects develop according to a similar pre-planned sequence of events. Any event chosen to measure the mechanic's lienor's priority, depending on its position in the sequence of events, will always be before the signing of the regulatory agreement or always after the signing of the agreement. Such a result does not reflect, in either case, the real interest of the competing liens in the property.

Clearly the proposed rule must strike a balance between the competing interests. A rule that produces an all or nothing result is unfair to the lien that is deemed to be junior, for both liens have a stake in the property. The mechanic's lienor supplies labor or materials which increase the value of the property. HUD reimburses the private mortgagee in an amount equal to the sum of the advances made by the private mortgagee. HUD may also make advances out of its own funds. Thus each lienor should be entitled to priority over the value of some segment of the property.

The Proposed Alternative Rule

The current approach should be replaced by the following rules:

1) If a laborer or materialman contracts to supply labor or materials to a housing project prior to the signing of a HUD regulatory agreement and the owner or developer has reason to know that his mortgage may be insured by HUD, the owner or developer must notify the laborer or materialman of that possibility prior to signing of the contract. If a laborer or materialman contracts to supply labor or

332. See text accompanying notes 296-97 supra.
333. See text accompanying notes 270-77 supra.
materials after the signing of a HUD regulatory agreement, then the filing of the regulatory agreement will be sufficient notice.

2) If a laborer or materialman is not given notice pursuant to the provisions of section one, then his priority as a mechanic's lienor will be governed by state law.

3) If the laborer or materialman has received notice that the owner's or developer's mortgage may be or will be insured by HUD, then HUD has priority over the value of the property prior to the commencement of that particular laborer's or materialman's work. The mechanic's lienor has priority over the value of all improvements made upon the land subsequent to the commencement of his particular work.

The first provision insures that the mechanic's lienor is given sufficient notice that his priority will be determined by the federal common law and not state statute. With this notice he may decide to reject the contract or charge a premium if the federal common law rule provides an additional risk.

The second section provides a remedy in case the mechanic's lienor does not receive notice. In order to protect itself, HUD should require some evidence that the developer or owner has given sufficient notice to all laborers and materialmen already under contract before it signs the regulatory agreement. Otherwise HUD's priority will be governed by a state statute which is less protective of its interest.

The final provision establishes the priorities. It creates a priority in favor of HUD, to the extent of the value of the property before a particular mechanic's lienor commences his work. This is fair to the mechanic's lienor because he has no interest in the property until he commences his work. The mechanic's lienor, on the other hand, is given priority over the value of all improvements made on the land after he commences work, not just his own. This insures that his lien will be fully satisfied even when the subsequently determined value of his work is less than his actual expenses.

Under the proposed rule if any lien must go unsatisfied, it will necessarily be HUD's lien. Where one party must suffer a loss, it is preferable that the loss burden the party which can best absorb that loss. If the mechanic's lienor were to suffer the loss, it would be felt by one individual or business. Where HUD suffers the loss it is felt by a large federal agency, and eventually is spread among the millions of taxpayers whose tax dollars support the work of HUD. The loss is part of the cost of providing adequate housing at a reasonable price for thousands of American families.
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CONCLUSION

Twelve years have passed since Congress enacted the Tax Lien Act. Since then, a number of courts have had the opportunity to finish "the unfinished business" by devising more equitable and progressive rules governing the priority of federal non-tax liens. The majority of courts have chosen not to act. Instead they have applied the choate lien doctrine, often without giving adequate reasons for doing so. Thus the "business" remains "unfinished." It is time that the archaic choate lien doctrine be laid to rest, for its application produces unfair results. If Congress does not act, this should not excuse the courts, for they are fully capable of fashioning new law in the area. Alternatives to the old rule exist. The courts must be willing to use them.

SARGENT L. ABORN

AUTHOR'S NOTE

After this note went to press, the United States Supreme Court announced its decision in two consolidated cases, United States v. Kimbell Foods, Inc. (aff'g Kimbell Foods, Inc. v. Republic National Bank) and United States v. Crittenden. 47 U.S.L.W. 4342 (April 2, 1979). In Kimbell, the Court affirmed the decision of the lower court. In Crittenden, the Court vacated the decision of the lower court and remanded the case for an application of state priority rules, rejecting the special federal commercial law rule applied by the lower court.

335. Plumb, Federal Liens and Priorities—Agenda for the Next Decade, 77 Yale L.J. 228, 228 (1967).