

Turning the Screws: Enhanced Rights Under the Michigan Special Tools Lien Act

By Dennis W. Loughlin

Introduction

A longstanding problem that plagued metal fabricating firms was remedied this past summer when Governor John Engler signed 2002 PA 481, creating the Special Tools Lien Act (Act), on June 27, 2002. As the House Legislative Analysis Section noted in describing the arguments in favor of passing the Act:

Essentially, the bills would provide the same protections to special tool builders and end users of special tools in the metal fabrication sector as currently exist in state law for their counterparts in the plastic fabrication sector. Among other things, they provide protection by allowing liens to be imposed upon valuable and specially designed and created products used in manufacturing in order to help collect amounts owed for the creation or use of the so-called special tools.¹

The preamble to the Act states that its purpose is to “provide for and establish possession and ownership rights in special tools for use in the fabrication of metal parts under certain conditions; to require procedures to establish a lien; and to establish and maintain a lien on certain special tools.”² This article will briefly describe the scope of the Act and its provisions and note some of its shortcomings.

Scope of the Act

The Act covers many tools that fall within the scope of the definition of a special tool. A “[s]pecial tool” means any tools, dies, jigs, gauges, gauging fixtures, special machinery, cutting tools, or metal castings manufactured by a special tool builder.³ The Act does not further describe or define what objects could fall within the scope of these definitional items. Based on feedback from those in the metal fabrication industry, there would appear to be numerous items that could fall within the definition items of a special tool.

The Act covers and defines three main parties. A *special tool builder* is “a person who designs, develops, manufactures, or assembles special tools for sale.”⁴ An *end user* is a person who uses a special tool as part of his or her manufacturing process.⁵ A *customer* is (1) “a person who causes a special tool builder to design, develop, manufacture, assemble for sale, or otherwise make a special tool for use in the design, development, manufacture, assembly, or fabrication of metal parts” or (2) “a person who causes an end user to use a special tool to design, develop, manufacture, assemble, or fabricate a metal product.”⁶ A “person” as used in these definitions “means an individual, firm, partnership, association, corporation, limited liability company, or other legal entity.”⁷

While the legislative history does not give any indication on how the terms *special tool builder*, *end user*, and *customer* were chosen, early feedback from those involved in the industry indicates confusion over the terms end user and customer. According to the terms of the statute, an end user would be the party that would be using the special tool to manufacture parts to sell to the customer. However, industry types generally use the term end user to mean the same party that the Act defines as a customer. The same problem does not exist with the Michigan Mold Lien Act because the terms used to define the parties in that statute more accurately and clearly reflect the terms used in the industry. The equivalent to a special tool builder under the Michigan Mold Lien Act is a *moldbuilder*. The equivalent to end user is a *molder*, and the definitions of a customer are virtually identical in both statutes.⁸ There is no confusion over what party is a molder and what party is the customer in the Michigan Mold Lien Act, like there is between end user and customer in the Special Tools Lien Act. Perhaps a better choice would have been to use the term *metal part manufacturer* rather than end user.

Obtaining a Special Tool Builder's Lien Under the Act

The Act protects end users and special tool builders by giving them liens on special tools in certain circumstances. To gain these protections, the Act requires that a Special Tool Builder comply with two main statutory provisions.

First, a Special Tool Builder must permanently record its name, street address, city, and state on every special tool that the special tool builder fabricates, repairs, or modifies.⁹

Second, a special tool builder must file a financing statement in accordance with MCL 440.9502.¹⁰ In most cases, such a financing statement is only required to include the name of the end user or customer, the name of the special tool builder or its representative, and a description of the special tool covered by the financing statement.

These two requirements present many issues for discussion. First, with respect to the requirement for the special tool builder to permanently record its name on the special tool, the Act does not define what constitutes a permanent recordation on the special tool. If the special tool builder's name and address is etched onto the special tool itself, it can be ground off. If a plaque with a name and address is adhered or screwed to the special tool, it could be pried or unscrewed off. It is likely that case law will help to define what constitutes a permanent recordation. As an extra form of protection, some special tool builders are taking digital pictures of the special tools with specific focus on the area where its name and address are recorded to protect against removal of the recordation once it leaves the special tool builder's possession.

In addition to complying with the recordation requirement, the special tool builder should file its UCC-1 financing statement in accordance with Article 9 as soon as practicable, but in any case ideally before delivery of the special tool from the special tool builder to the end user.¹¹ The filing of the financing statement should be accomplished in this manner primarily for priority reasons under Article 9 of the Uniform Commercial Code. The filing of the financing statement is a necessary step in the process of having the lien attach to the collateral, and the order of attachment determines the order of priority between competing liens that are created under this Act.¹² A special tool builder's lien attaches when actual or constructive notice is received. The special tool builder retains the lien even if the special tool builder is not

in possession of the special tool for which the special tool builder's lien is claimed. The information that the special tool builder is required to record on the special tool and the filing of the financing statement constitute actual and constructive notice of the special tool builder's lien on the special tool.¹³

Accordingly, if a special tool builder has filed a financing statement for the special tool and has already permanently recorded its name and address on the special tool before delivery of the special tool to the end user, the special tool builder has provided the end user with actual and constructive notice of the special tool builder's lien, and its lien will be in the best priority position on the special tool as against other creditors or lenders of the end user that have liens against the assets of the end user. If the special tool builder waits to file the financing statement until some time after delivery of the special tool, title will have passed from the special tool builder, resulting in the risk of another creditor or lender's lien attaching to the special tool prior to the special tool builder's lien. It should be noted for those special tool builders who have not been in the practice of filing financing statements recently that the debtor's signature is no longer required on the financing statement as a prerequisite to filing it under the UCC Revised Article 9. Therefore, a financing statement may be filed before the required recordation is made on the special tool. By completing these requirements under the Act, the special tool builder has a lien on any special tool in the amount that a customer or end user owes the special tool builder for the fabrication, repair, or modification of the special tool.¹⁴

There are three ways to terminate a special tool builder's lien. A special tool builder's lien is valid until (1) the customer or end user pays the special tool builder the amount owed, (2) the customer receives a verified statement from the end user that the end user has paid the amount for which the lien is claimed, or (3) the financing statement is terminated.¹⁵ A special tool builder may run into a conflict over the termination of its lien on the special tool when an end user has provided the customer with a verified statement that the end user has paid the amount for which the lien is claimed but there is still a dispute or nonpayment between the special tool builder and the end user. The Act does not address what to do in the event of such a termination during a dispute.

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Enforcement of a Lien by the Special Tool Builder

To enforce a special tool builder's lien, the special tool builder needs to give written notice of the lien to the customer and the end user.¹⁶ The notice must state that a lien is claimed; the amount that the special tool builder claims is owed for fabrication, repair, or modification of the special tool; and a demand for payment.¹⁷ The notice must be delivered by hand or by certified mail with return receipt requested to the last known addresses of the customer and the end user.¹⁸ After receiving written notice of the lien, the customer and the end user have 90 days to pay the amount claimed in the notice to the special tool builder. If they do not pay within 90 days, the special tool builder has a right to possession of the special tool.¹⁹ The special tool builder may use self-help by taking possession of the Special Tool without judicial process if this can be done without a breach of the peace. If this cannot be achieved, the special tool builder may enforce the right to possession through judgment, foreclosure, or any available judicial procedure such as claim and delivery. The special tool builder may also sell the special tool at a public auction.²⁰

If the special tool builder desires to sell the special tool, the special tool builder must send an additional notice to the end user, the customer, and all others who have a perfected security interest in the special tool.²¹ The notice must include the special tool builder's intention to sell the special tool 60 days after the receipt of the notice, a description of the special tool, the last known location of the special tool, the time and place of the sale, an itemized statement of the amount due, and a statement that the special tool was accepted and acceptance was not subsequently rejected.²²

The notice must be sent by certified mail with return receipt requested. If there is no return of the receipt of the mailing or if the postal service returns the notice as being nondeliverable, the special tool builder must publish a notice of his or her intent to sell the special tool in a newspaper of general circulation in a place where the special tool is last known to be located, in the place of the customer's last known address, and in the place of the end user's last known address.²³ The published notice must include a description of the special tool and the name of the customer and the end user.

A limitation on the special tool builder's ability to sell the special tool arises when the customer or the end user can assert that the

special tool was not accepted or that the acceptance was subsequently rejected.²⁴ In such a case, the customer or the end user must notify the special tool builder. The notice must be in writing and sent by certified mail with return receipt requested and state that the special tool was not accepted or that the acceptance was subsequently rejected. A special tool builder who receives this notice may not sell the special tool until the dispute is resolved.²⁵

Another limitation on the special tool builder's ability to sell or take possession of a special tool that is subject to a special tool builder's lien is if the action would violate any right of the customer or the end user under federal patent, bankruptcy, or copyright law.²⁶

If none of the limitations on sale of the special tool apply to the special tool builder, the special tool builder may sell it at an auction. If the proceeds of the sale are greater than the amount of the lien, the special tool builder takes the amount of his or her lien. The excess proceeds are paid to any junior lienholders and to the customer.

End User's Lien on a Special Tool

The characteristics of an end user's lien on a special tool differ from a special tool builder's lien. The Act protects end users by giving them the ability to destroy special tools. An end user has a lien on any special tool in his or her possession that belongs to the customer in an amount due to the end user by the customer for metal fabrication work performed with the special tool.²⁷ An end user has a right to retain possession of the special tool until the amount due is paid. An end user must be careful not to release possession of the special tool if any amount is owed for parts the end user has manufactured for the customer.

Enforcement of a Lien by the End User

To enforce the lien, the end user must give a written notice to the customer.²⁸ The notice may be delivered personally or sent by registered mail to the last known address of the customer. The notice needs to include a demand for payment and a statement that a lien is claimed for the amount due for metal fabrication work or for making or improving the special tool.²⁹

If the customer does not pay the amount due to the end user within 90 days after the customer receives the notice, the end user may sell the special tool at a public auction.³⁰ To sell the special tool at a public auc-

An end user has a right to retain possession of the special tool until the amount due is paid.

tion, it must still be in the end user's possession. Before selling the special tool, the end user must notify the customer and any person who has a filed perfected security interest in the tool of the end user's intention to sell the special tool 60 days after the customer's receipt of the notice.³¹ The notice must also include a description of the special tool to be sold, the time and place of the sale, an itemized statement of the amount due, and a statement that the product produced by the special tool complies with the quality and quantity ordered.³²

The end user must send a notice of intent to sell to the customer by registered mail with return receipt requested. If there is not a return of the receipt of the mailing or if the postal service returns the notice as nondeliverable, the end user must publish a notice of intent to sell in a newspaper of general circulation in the place where the special tool is being held for sale and in the place of the customer's last known address. The published notice must include a description of the special tool and the name of the customer.³³

A limitation on the end user's ability to sell the special tool arises if a customer asserts in response to the end user's written notice to the customer that the product produced by the special tool did not meet the quality or quantity ordered. The customer's notice must be a written notice and sent by registered mail with return receipt requested. If the customer sends this type of notice, the end user may not sell the special tool until the dispute is resolved.³⁴

Another limitation on the end user's ability to sell the special tool to enforce a lien exists if the sale would violate a customer's rights under federal patent or copyright law.³⁵ If there are no limitations on the end user selling the special tool, the end user may sell the special tool at an auction. If the sale exceeds the amount of the lien, the proceeds are first paid to any prior perfected lienholder in an amount to extinguish the lien.³⁶ The end user who has a lien under the Act takes the amount of the lien out of the proceeds. Any remaining amount is paid to the customer.³⁷

Lien Priority Under the Special Tools Lien Act

Although the Act does not explicitly address priorities in detail, a few things are clear. There will never be two competing end users with liens on the same special tool under the Act because such a lien requires possession. The priority between an end

user's lien under the Act and a special tool builder's lien under the Act is determined by the order in which the liens attach. The first lien to attach has priority.³⁸ An end user's lien under the Act is a possessory lien and thus has priority over security interests in the special tool.³⁹

Ability of an End User to Destroy A Customer's Special Tool

The end user can also take action under the Act to destroy a special tool that has been abandoned by the customer. Unless otherwise agreed in writing, the Act's provisions apply when a customer does not claim possession of the special tool within three years from when the end user last used the special tool.⁴⁰ This provision applies retroactively from the effective date of the Act if the end user was in possession of the special tool on the effective date of the Act.⁴¹ Therefore, an end user who has satisfied the requirements of the three-year waiting period described above may take appropriate steps under the Act to destroy the special tool.

If an end user wants to destroy a special tool under the Act, the end user must send a written notice to the customer by registered mail with a return receipt requested.⁴² The notice must be sent to an address designated in writing by the customer or, if none has been designated, to the customer's last known address. The notice should indicate the end user's intent to terminate the customer's rights, title, and interest in the special tool by transferring all such rights, title, and interest to the end user.⁴³

The customer has 120 days to claim possession or make arrangements with the end user for storage of the special tool after the end user receives the return receipt of the notice.⁴⁴ If the customer does not take such action, all rights, title, and interest of the customer in the special tool are transferred to the end user for the purpose of destruction.⁴⁵

A limitation on an end user's ability to destroy a customer's special tool applies when the necessary transfer of rights, title, and interest would violate federal patent law, copyright law, or laws regarding unfair competition.⁴⁶

Application of the Act to Persons and Tools Outside of Michigan

One of the issues that is not discussed in the Act itself or its legislative history or analysis is to what extent it applies to special tool builders, end users, and customers who are not all located within Michigan or are not

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organized in Michigan. It is clear that the Act applies to certain situations. For example, if all entities and special tools covered under the Act are located in Michigan, it is fairly certain that the Act applies. If the parties have a choice of law provision within a governing contract, most courts will defer to the language of the contract.

Some uncertainty arises because the Act does not address how its provisions apply to covered persons, special tools, or relationships outside of Michigan. In this day and age, it is very typical to have a Michigan special tool builder build a special tool that is going to be used by an end user located in a different state (or country) to manufacture parts for a customer located in yet a different state.

In another public act that was tie-barred to the Act, the Michigan Legislature amended MCL 440.9201, which governs secured transactions.⁴⁷ MCL 440.9201(2) specifies that a transaction under the article be subject to any applicable rule of law that establishes a different rule for consumers, as well as specified state laws. The amendment of MCL 440.9201 added the Act to the list of laws to which security interests are subject.

Provisions addressing this conflict of laws issue within Article 9 of the Uniform Commercial Code may not apply to the liens created under the Act, but the issue is unclear. Determining how the Act applies in an interstate context requires the application of conflict of laws rules from other sources. It appears, at this point, that conclusions can only be developed case by case. The analysis will depend on the specific facts and the applicable laws.

Conclusion

Regardless of these ambiguities, it is clear that the enactment of the Special Tools Lien Act has created a bundle of rights and protections for special tool builders and end users that will greatly enhance their ability to get paid and protect their interests in the sometimes unstable tool and die industry.

NOTES

1. House Legislative Analysis Section, HB5993 (May 8, 2002).
2. 2002 PA 481.
3. MCL 570.542(c).
4. MCL 570.542(d).
5. MCL 570.542(b).
6. MCL 570.542(a).
7. MCL 570.542(e).
8. *See* MCL 445.611.
9. MCL 570.563(1).
10. MCL 570.563(2).

11. MCL 570.563(4). MCL 570.563(4) does not require the UCC-1 financing statement to be filed prior to delivery of the special tool. However, because the special tool builder's lien attaches when actual or constructive notice is received by the end user, which will typically occur at delivery of the special tool, those special tool builders that have satisfied the statutory requirements to obtain a lien on a special tool prior to delivery will be in an optimal priority position vis-à-vis the end user's other lien holders.

12. MCL 570.563(6).
13. MCL 570.563(3).
14. *Id.*
15. MCL 570.563(5).
16. MCL 570.565.
17. *Id.*
18. *Id.*
19. MCL 570.567.
20. *Id.*
21. MCL 570.569(1).
22. *Id.*
23. MCL 570.569(2).
24. MCL 570.569(3).
25. *Id.*
26. MCL 570.561(2).
27. MCL 570.553.
28. MCL 570.555.
29. *Id.*
30. MCL 570.557.
31. *Id.*
32. MCL 570.559(1).
33. MCL 570.559(2).
34. MCL 570.559(3).
35. MCL 570.561(2).
36. MCL 570.561(1).
37. *Id.*
38. *See* MCL 550.563(4).
39. *See* MCL 440.9333.
40. MCL 570.543.
41. MCL 570.549.
42. MCL 570.545.
43. *Id.*
44. MCL 570.547.
45. *Id.*
46. *Id.*
47. 2002 PA 481.



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