CHAPTER 55
UNIFORM COMMERCIAL CODE

Pamphlet 79 - Uniform Commercial Code - Articles 1 through 2A - General Provisions, Sales and Leases

Pamphlet 80 - Uniform Commercial Code - Articles 3 through 6 - Negotiable Instruments, Bank Deposits, Funds Transfers and Letters of Credit

Pamphlet 81 - Uniform Commercial Code - Articles 7 through 12 - Warehouse Receipts, Investment Securities and Secured Transactions

ARTICLE 1
GENERAL PROVISIONS

Part 1

Short Title, Construction, Application and Subject Matter of the Act.

Part 2

General Definitions and Principles of Interpretation.

ANNOTATIONS

Compiler's notes. - Laws 1961, ch. 96 enacted New Mexico's version of the Uniform Commercial Code. The 1972 revision of the code, which revised primarily Article 9, was adopted by Laws 1985, ch. 193, effective January 1, 1986. The 1977 revision of the code, which revised primarily Article 8, was adopted by Laws 1987, ch. 248, effective June 19, 1987. The 1987 and 1989 additions of Articles 2A and 4A, respectively, and the 1990 revisions of Articles 3 and 4, were adopted by Laws 1992, Chapter 114. Citations within the official commentary may be found within this compilation by prefacing the section number given with Chapter 55.

PART 1
SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT

55-1-101. Short title.

Chapter 55 NMSA 1978 shall be known and may be cited as the "Uniform Commercial Code".

History: 1953 Comp., § 50A-1-101, enacted by Laws 1961, ch. 96, § 1-101; 1992, ch. 114, § 1.

ANNOTATIONS

OFFICIAL COMMENT

Each article of the code (except this article and Article 10) may also be cited by its own short title. See Sections 2-101, 3-101, 4-101, 5-101, 6-101, 7-101, 8-101 and 9-101.

The 1992 amendment, effective July 1, 1992, substituted "Chapter 55 NMSA 1978" for "This act" and inserted "the".

Purpose of comments is to explain provisions of the code itself, in effect to promote uniformity of interpretation. Burchett v. Allied Concord Fin. Corp., 74 N.M. 575, 396 P.2d 186 (1964).

And comments deemed persuasive. - Official comments appearing as part of the Uniform Commercial Code are not direct authority for construction to be placed upon a section of the code, nevertheless they are persuasive and represent the opinion of the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Burchett v. Allied Concord Fin. Corp., 74 N.M. 575, 396 P.2d 186 (1964).

The court recognizes official comments to the code as persuasive, but not controlling, authority. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Fixtures and the Uniform Commercial Code in New Mexico," see 4 Nat. Resources J. 109 (1964).

Graham v. Stoneham, 73 N.M. 382, 388 P.2d 389 (1963), commented on in 4 Nat. Resources J. 175 (1964).

For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision' " see 4 Nat. Resources J. 398 (1964).

For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966), commented on in 8 Nat. Resources J. 169 (1968).

For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967), commented on in 8 Nat. Resources J. 713 (1968).

For comment, "The Miller Act in New Mexico - Materialman's Right to Recover on Prime's Surety Bond in Public Works Contracts - Notice as Condition Precedent to Action," see 9 Nat. Resources J. 295 (1969).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Survey of New Mexico Law, 1982-83: Commercial Law," see 14 N.M.L. Rev. 45 (1984).

For article, "Lender Recourse in Indian Country: A Navajo Case Study," see 21 N.M.L. Rev. 275 (1991).

For survey of 1990-91 commercial law, see 22 N.M.L. Rev. 661 (1992).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 42; 67 Am. Jur. 2d Sales § 1 et seq.; 68A Am. Jur. 2d Secured Transactions § 163 et seq.

Excessiveness or inadequacy of attorney's fees in matters involving commercial and general business activities, 23 A.L.R.5th 241.

82 C.J.S. Statutes § 221.

55-1-102. Purposes; rules of construction; variation by agreement.

(1) This act [this chapter] shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes of [and] policies of this act are:

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this act may be varied by agreement, except as otherwise provided in this act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

(4) The presence in certain provisions of this act of the words "unless otherwise agreed" or words of similar import does not imply that the effect of other provisions may not be varied by agreement under Subsection (3).

(5) In this act unless the context otherwise requires:

(a) words in the singular number include the plural, and in the plural include the singular;

(b) words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender.

History: 1953 Comp., § 50A-1-102, enacted by Laws 1961, ch. 96, § 1-102.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 74, Uniform Sales Act; Section 57, Uniform Warehouse Receipts Act; Section 52, Uniform Bills of Lading Act; Section 19, Uniform Stock Transfer Act and Section 18, Uniform Trust Receipts Act.

Changes. Rephrased and new material added.

Purposes of changes. - 1. Subsections (1) and (2) are intended to make it clear that:

This act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the act requires that its interpretation and application be limited to its reason.

Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope. Pacific Wool Growers v. Draper & Co., 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1-104. They have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act, Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co., 239 U.S. 520, 36 S. Ct. 194, 60 L. Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same where reason and policy so required, even where the subject matter had been intentionally excluded from the act in general. Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that act was intentionally limited to goods "other than things in action.") They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. Fiterman v. J. N. Johnson & Co., 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in this act stands in the way of the continuance of such action by the courts.

The act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. Subsection (3) states affirmatively at the outset that freedom of contract is a principle of the code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the code seeks to avoid the type of interference with evolutionary growth found in Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in this act. But an agreement can change the legal consequences which would otherwise flow from the provisions of the act. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201, 1-205 and 2-208; the effect of an agreement on the rights of third parties is left to specific provisions of this act and to supplementary principles applicable under the next section. The rights of third parties under Section 9-301 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the act and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies

enforcement to such a waiver as part of the "contract" made unenforceable; Section 9-501(3), on the other hand, is quite explicit. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by this act," provisions of the act prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1-205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

3. Subsection (4) is intended to make it clear that, as a matter of drafting, words such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to Subsection (3), but absence of such words contains no negative implication since under Subsection (3) the general and residual rule is that the effect of all provisions of the act may be varied by agreement.

4. Subsection (5) is modelled on 1 U.S.C. Section 1 and New York General Construction Law Sections 22 and 35.

Compiler's note. - Laws 1961, ch. 96, § 10-105, directs the compiler to retain article, part, section and subsection designations, headings, numbers, indentations and layout as used in Articles 1 to 9 of this act.

Applicability of former law. - It is evident that provisions of the code are not applicable as to transactions completed or entered into before the effective date of the code, but those transactions are governed by provisions of the former law even though repealed or amended by the code. 1961-62 Op. Att'y Gen. No. 62-12.

Variant meanings of "commercial paper". - "Commercial paper" in former 58-13-29H NMSA 1978 did not have a meaning identical to "commercial paper" under New Mexico's U.C.C.; although a document might have been commercial paper under both acts, the purposes of the two acts were not the same. State v. Sheets, 94 N.M. 356, 610 P.2d 760 (Ct. App. 1980).

Reasonableness of guaranty contracts. - Guaranty contracts according to which the creditor bank was not, as a prerequisite to the guarantors' liability, obliged to take any security, although it had a right to do so, no provision of which required the bank to perfect security taken or otherwise to deal with it in any particular way, and under which the guarantors waived their rights to subrogation and waived and released any claims to the security and to "any benefit of, and any right to participate in any security now or hereafter held by bank," while the bank was given the right to "waive and release" the security at any time without the waiver or release affecting the guarantors' obligation to pay, are not inherently unreasonable. American Bank of Commerce v. Covolo, 88 N.M. 405, 540 P.2d 1294 (1975).

An agreement by the guarantor of a note to waive any right to require the lending bank to proceed against the maker, exhaust any security, or pursue any other remedy, did not constitute waiver of the defenses of breach of duty of good faith and reasonableness. Cadle Co. v. Wallach Concrete, Inc., 120 N.M. 56, 897 P.2d 1104 (1995).

And interpretation by court. - Since former 55-3-606 NMSA 1978 allowed a surety to waive his defenses and this section allowed parties by agreement to determine the standards by which performance of their good faith obligations could be measured, a court could then interpret the provisions of the guaranty agreement to determine whether the guarantors should be relieved of liability under the general law of suretyship. American Bank of Commerce v. Covolo, 88 N.M. 405, 540 P.2d 1294 (1975).

Law reviews. - For article, "Fixtures and the Uniform Commercial Code in New Mexico," see 4 Nat. Resources J. 109 (1964).

For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), commented on in 8 Nat. Resources J. 183 (1968).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 51; 68A Am. Jur. 2d Secured Transactions § 358 et seq.

Sufficiency of description of collateral in financing statement under U.C.C. §§ 9-110 and 9-402, 100 A.L.R.3d 10.

Sufficiency of secured party's signature on financing statement or security agreement under U.C.C. § 9-402, 100 A.L.R.3d 390.

Sufficiency of description of collateral in security agreement under U.C.C. §§ 9-110 and 9-203, 100 A.L.R.3d 940.

31 C.J.S. Estoppel §§ 55, 57, 98; 82 C.J.S. Statutes § 315.

55-1-103. Supplementary general principles of law applicable.

Unless displaced by the particular provisions of this act [this chapter], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy or other validating or invalidating cause, shall supplement its provisions.

History: 1953 Comp., § 50A-1-103, enacted by Laws 1961, ch. 96, § 1-103.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 2 and 73, Uniform Sales Act; Section 196, Uniform Negotiable Instruments Act; Section 56, Uniform Warehouse Receipts Act; Section 51, Uniform Bills of Lading Act; Section 18, Uniform Stock Transfer Act and Section 17, Uniform Trust Receipts Act.

Changes. Rephrased, the reference to "estoppel" and "validating" being new.

Purposes of changes. - 1. While this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this act, the principle has been stated in more detail and the phrasing enlarged to make it clear that the "validating", as well as the "invalidating" causes referred to in the prior uniform statutory provisions, are included here. "Validating" as used here in conjunction with "invalidating" is not intended as a narrow word confined to original validation, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

2. The general law of capacity is continued by express mention to make clear that Section 2 of the old Uniform Sales Act (omitted in this act as stating no matter not contained in the general law) is also consolidated in the present section. Hence, where a statute limits the capacity of a non-complying corporation to sue, this is equally applicable to contracts of sale to which such corporation is a party.

3. The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

Preservation of common-law principles. - This section does not preserve common-law principles in area thoroughly covered by U.C.C. simply because they are not expressly excluded. Rutherford v. Darwin, 95 N.M. 340, 622 P.2d 245 (Ct. App. 1980).

Under applicable equitable estoppel principles, the party estopped must know or have knowledge imputed to it of concealed material facts at the time of concealment; and the party asserting estoppel must not know the truth of the facts but must rely on the other's conduct to its detriment. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Applicability of pre-UCC contract law. - Under the Uniform Commercial Code, to the extent that the contract does not expressly regulate any matter relating to the exercise

of such powers as options to purchase, the continuing pre-code contract law will supply the answer. Cranetex, Inc. v. Mountain Dev. Corp., 106 N.M. 5, 738 P.2d 123 (1987).

Action for conversion. - An action for conversion is not foreclosed where a plaintiff also sues under 55-8-401 NMSA 1978, relating to the duty of an issuer of a security to register transfer, pledge or release. Broadcort Capital Corp. v. Summa Medical Corp., 972 F.2d 1183 (10th Cir. 1992).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision' " see 4 Nat. Resources J. 398 (1964).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), commented on in 8 Nat. Resources J. 183 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 45, 382; 15A Am. Jur. 2d Commercial Code §§ 15, 68, 75; 17A Am. Jur. 2d Contracts §§ 23, 24.

Liability of parent for dental services to minor child, 7 A.L.R. 1070.

Civil liability of father for necessaries furnished to child taken from home by mother, 32 A.L.R. 1466.

Damages of infant on rescission of exchange of goods, 52 A.L.R.2d 1114.

82 C.J.S. Statutes §§ 363, 364.

55-1-104. Construction against implicit repeal.

This act [this chapter] being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

History: 1953 Comp., § 50A-1-104, enacted by Laws 1961, ch. 96, § 1-104.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - To express the policy that no act which bears evidence of carefully considered permanent regulative intention should lightly be regarded as impliedly repealed by subsequent legislation. This act, carefully integrated and intended as a uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal. See Pacific Wool Growers v. Draper & Co., 158 Or. 1, 73 P.2d 1391 (1937).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 51; 15A Am. Jur. 2d Commercial Code §§ 16, 25.

Applicability of constitutional requirement that repealing or amendatory statute refer to statute repealed or amended, 5 A.L.R.2d 1270.

82 C.J.S. Statutes § 291.

55-1-105. Territorial application of the act; parties' power to choose applicable law.

(1) Except as provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation, the parties may agree that the law either of this state or such other state or nation shall govern their rights and duties. Failing such agreement, the Uniform Commercial Code [this chapter] applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of the Uniform Commercial Code specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

rights of creditors against sold goods. Section 55-2-402 NMSA 1978;

applicability of the article on leases. Sections 55-2A-105 and 55-2A-106 NMSA 1978;

applicability of the article on bank deposits and collections. Section 55-4-102 NMSA 1978;

governing law in the article on fund transfers. Section 55-4A-507 NMSA 1978;

letters of credit. Section 55-5-116 NMSA 1978;

applicability of the article on investment securities. Section 55-8-110 NMSA 1978; and

perfection provisions of the article on secured transactions. Section 55-9-103 NMSA 1978.

History: 1953 Comp., § 50A-1-105, enacted by Laws 1961, ch. 96, § 1-105; 1985, ch. 193, § 1; 1992, ch. 114, § 2; 1996, ch. 47, § 1; 1997, ch. 75, § 1.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) states affirmatively the right of the parties to a multi-state transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the five sections listed in Subsection (2), and is limited to jurisdictions to which the transaction bears a "reasonable relation." In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 47 S. Ct. 626, 71 L. Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a short hand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of course, the act applies to any transaction which takes place in its entirety in a state which has enacted the act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the code.

3. Where a transaction has significant contacts with a state which has enacted the act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the code in an analogous situation. Application of the code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare Global Commerce Corp. v. Clark-Babbitt Industries, Inc., 239 F.2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.

4. The act does not attempt to prescribe choice-of-law rules for states which do not enact it, but this section does not prevent application of the act in a court of such a state. Common law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.

5. Subsection (2) spells out essential limitations on the parties' right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.

6. Section 9-103 should be consulted as to the rules for perfection of security interests and the effects of perfection and nonperfection.

The 1985 amendment deleted "of" following "the law either of this state or" near the middle of Subsection (1), substituted "Perfection provisions of the article" for "policy and scope of the article" and "Section 9-103" for "Sections 9-102 and 9-103" near the end of Subsection (2) and made minor grammatical changes.

The 1992 amendment, effective July 1, 1992, made section reference substitutions throughout the section; and, in Subsection (2), added the provisions relating to applicability of the article on leases and to governing law in the article on fund transfers, and deleted a former provision relating to the article on bulk transfers.

The 1996 amendment, in Subsection (2), substituted "Section 55-8-110" for "Section 55-8-105" and made a minor stylistic change. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

The 1997 amendment, effective July 1, 1997, inserted "letters of credit. Section 55-5-116 NMSA 1978;" in Subsection (2).

Jurisdiction where significant performance occurs governs choice of law. - The law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. United Whsle. Liquor Co. v. Brown-Forman Distillers Corp., 108 N.M. 467, 775 P.2d 233 (1989).

Public policy considerations in applying out-of-state law. - When the choice of law rule leads to the law of another state and that law is different from the law of the forum, the forum may decline to apply the out-of-state law if it offends the public policy of New Mexico. United Whsle. Liquor Co. v. Brown-Forman Distillers Corp., 108 N.M. 467, 775 P.2d 233 (1989).

Determination of validity of contract executed in another state. - The validity of a contract executed in a sister state is determined according to the laws of that state, unless such construction conflicts with some settled policy of the forum state. Kapsa v. Botsford, 95 N.M. 625, 624 P.2d 1022 (Ct. App. 1981).

Probate of will in forum state not significant. - The fact that the will is being probated in the forum state is not significant in determining whether or not to use the forum's law to decide the question of the validity of the contractual claims against the estate. Kapsa v. Botsford, 95 N.M. 625, 624 P.2d 1022 (Ct. App. 1981).

Application of out-of-state liquor law. - Kentucky law and not the New Mexico Alcoholic Beverage Franchise Act applied to distributorship contracts, where the contracts bore a reasonable relation to the state of Kentucky and the choice of law provision therein did not violate some fundamental principle of justice. United Whsle. Liquor Co. v. Brown-Forman Distillers Corp., 108 N.M. 467, 775 P.2d 233 (1989).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 100; 15A Am. Jur. 2d Commercial Code §§ 11, 13, 44; 68A Am. Jur. 2d Secured Transactions § 8 et seq.

17 C.J.S. Contracts § 12.

55-1-106. Remedies to be liberally administered.

(1) The remedies provided by this act [this chapter] shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this act or by other rule of law.

(2) Any right or obligation declared by this act is enforceable by action unless the provision declaring it specifies a different and limited effect.

History: 1953 Comp., § 50A-1-106, enacted by Laws 1961, ch. 96, § 1-106.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - none; Subsection (2) - Section 72, Uniform Sales Act.

Changes. Reworded.

Purposes of changes and new matter. Subsection (1) is intended to effect three things:

1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the act elsewhere makes it clear that damages must be minimized. Cf. Sections 1-203, 2-706 (1) and 2-712 (2). The third purpose of Subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

2. Under Subsection (2) any right or obligation described in this act is enforceable by court action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103 and 2-716.

3. "Consequential" or "special" damages and "penal" damages are not defined in terms in the code, but are used in the sense given them by the leading cases on the subject.

Cross references. - Sections 1-103, 1-203, 2-204 (3), 2-701, 2-706 (1), 2-712 (2) and 2-716.

Definitional cross references. - "Action". Section 1-201.

"Aggrieved party". Section 1-201.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Rights". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 24; 68A Am. Jur. 2d Secured Transactions § 527 et seq.

1A C.J.S. Actions §§ 10 to 17.

55-1-107. Waiver or renunciation of claim or right after breach.

Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

History: 1953 Comp., § 50A-1-107, enacted by Laws 1961, ch. 96, § 1-107.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Compare Section 1, Uniform Written Obligations Act and Sections 119 (3), 120 (2) and 122, Uniform Negotiable Instruments Law.

Purposes. - This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where such renunciation is in writing and signed and delivered by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith (Section 1-203). There may, of course, also be an oral renunciation or waiver sustained by consideration but subject to statute of frauds provisions and to the section of Article 2 on sales dealing with the modification of signed writings (Section 2-209). As is made express in the latter section this act fully recognizes the effectiveness of waiver and estoppel.

Cross references. - Sections 1-203, 2-201 and 2-209. And see Section 2-719.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Rights". Section 1-201.

"Signed". Section 1-201.

"Written". Section 1-201.

Law reviews. - Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), commented on in 8 Nat. Resources J. 183 (1968).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 382, 927, 934, 948 to 950; 28 Am. Jur. 2d Estoppel and Waiver § 162; 68A Am. Jur. 2d Secured Transactions §§ 434 et seq., 590 et seq., 638 et seq.

17A C.J.S. Contracts § 491.

55-1-108. Severability.

If any provision or clause of this act [this chapter] or application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are declared to be severable.

History: 1953 Comp., § 50A-1-108, enacted by Laws 1961, ch. 96, § 1-108.

ANNOTATIONS

OFFICIAL COMMENT

This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

Definitional cross references. - "Person". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 51; 15A Am. Jur. 2d Commercial Code § 30.

82 C.J.S. Statutes § 92.

55-1-109. Section captions.

Section captions are parts of this act [this chapter].

History: 1953 Comp., § 50A-1-109, enacted by Laws 1961, ch. 96, § 1-109.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - To make explicit in all jurisdictions that section captions are a part of the text of this act and not mere surplusage.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 31.

82 C.J.S. Statutes § 350.

PART 2 GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

55-1-201. General definitions.

Subject to additional definitions contained in the subsequent articles of the Uniform Commercial Code [this chapter] which are applicable to specific articles or parts thereof and unless the context otherwise requires, in that act:

(1) "action" in the sense of a judicial proceeding includes recoupment, counterclaim, setoff, suit in equity and any other proceedings in which rights are determined;

(2) "aggrieved party" means a party entitled to resort to a remedy;

(3) "agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances, including course of dealing or usage of trade or course of performance as provided in Sections 55-1-205, 55-2-208 and 55-2A-207 NMSA 1978. Whether an agreement has legal consequences is determined by the provisions of the Uniform Commercial Code, if applicable; otherwise by the law of contracts (Section 55-1-103 NMSA 1978). (Compare "contract".);

(4) "bank" means any person engaged in the business of banking;

(5) "bearer" means the person in possession of an instrument, document of title or certificated security payable to bearer or indorsed in blank;

(6) "bill of lading" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods and includes an airbill. "Airbill" means a document serving for air transportation as a bill of lading does for marine or rail transportation and includes an air consignment note or air waybill;

(7) "branch" includes a separately incorporated foreign branch of a bank;

(8) "burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence;

(9) "buyer in ordinary course of business" means a person who, in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt;

(10) "conspicuous": A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. But in a telegram any stated term is "conspicuous". Whether a term or clause is "conspicuous" or not is for decision by the court;

(11) "contract" means the total legal obligation which results from the parties' agreement as affected by this act and any other applicable rules of law. (Compare "agreement".);

(12) "creditor" includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate;

(13) "defendant" includes a person in the position of defendant in a cross-action or counterclaim;

(14) "delivery" with respect to instruments, documents of title, chattel paper or certificated securities means voluntary transfer of possession;

(15) "document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass;

(16) "fault" means wrongful act, omission or breach;

(17) "fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this act to the extent that under a particular agreement or document unlike units are treated as equivalents;

(18) "genuine" means free of forgery or counterfeiting;

(19) "good faith" means honesty in fact in the conduct or transaction concerned;

(20) "holder", with respect to a negotiable instrument, means the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. "Holder", with respect to a document of title, means the person in possession if the goods are deliverable to bearer or to the order of the person in possession;

(21) to "honor" is to pay or to accept and pay, or where a credit so engages, to purchase or discount a draft complying with the terms of the credit;

(22) "insolvency proceedings" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved;

(23) a person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law;

(24) "money" means a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations;

(25) a person has "notice" of a fact when:

(a) he has actual knowledge of it;

(b) he has received a notice or notification of it; or

(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by the Uniform Commercial Code;

(26) a person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when:

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications;

(27) notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information;

(28) "organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest or any other legal or commercial entity;

(29) "party", as distinct from "third party", means a person who has engaged in a transaction or made an agreement within the Uniform Commercial Code;

(30) "person" includes an individual or an organization (see Section 55-1-102 NMSA 1978);

(31) "presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence;

(32) "purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift or any other voluntary transaction creating an interest in property;

(33) "purchaser" means a person who takes by purchase;

(34) "remedy" means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal;

(35) "representative" includes an agent, an officer of a corporation or association and a trustee, executor or administrator of an estate or any other person empowered to act for another;

(36) "rights" includes remedies;

(37) "security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 55-2-401 NMSA 1978) is limited in effect to a reservation of a "security interest". The term also includes any interest of a buyer of accounts or chattel paper which is subject to Chapter 55, Article 9 NMSA 1978. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 55-2-401 NMSA 1978 is not a "security interest", but a buyer may also acquire a "security interest" by complying with Chapter 55, Article 9 NMSA 1978. Unless a consignment is intended as security, reservation of title thereunder is not a "security interest", but a consignment in any event is subject to the provisions on consignment sales (Section 55-2-326 NMSA 1978).

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and:

(a) the original term of the lease is equal to or greater than the remaining economic life of the goods;

(b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement; or

(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that:

(a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;

(b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording or registration fees or service or maintenance costs with respect to the goods;

(c) the lessee has an option to renew the lease or to become the owner of the goods;

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

For purposes of this Subsection (37):

(x) additional consideration is not nominal if: (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;

(y) "reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(z) "present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially

reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into;

(38) "send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none, to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending;

(39) "signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing;

(40) "surety" includes guarantor;

(41) "telegram" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission or the like;

(42) "term" means that portion of an agreement which relates to a particular matter;

(43) "unauthorized" signature means one made without actual, implied or apparent authority and includes a forgery;

(44) "value". Except as otherwise provided with respect to negotiable instruments and bank collections (Sections 55-3-303, 55-4-210 and 55-4-211 NMSA 1978) a person gives "value" for rights if he acquires them:

(a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;

(b) as security for or in total or partial satisfaction of a pre-existing claim;

(c) by accepting delivery pursuant to a pre-existing contract for purchase; or

(d) generally, in return for any consideration sufficient to support a simple contract;

(45) "warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire; and

(46) "written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form.

History: 1953 Comp., § 50A-1-201, enacted by Laws 1961, ch. 96, § 1-201; 1967, ch. 186, § 4; 1985, ch. 193, § 2; 1987, ch. 248, § 1; 1992, ch. 114, § 3; 1993, ch. 214, § 1.

ANNOTATIONS

Prior Uniform Statutory Provision, Changes and New Matter:

1. "Action". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act. The definition has been rephrased and enlarged.

2. "Aggrieved party". New.

3. "Agreement". New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.

4. "Bank". See Section 191, Uniform Negotiable Instruments Law.

5. "Bearer". From Section 191, Uniform Negotiable Instruments Law. The prior definition has been broadened.

6. "Bill of Lading". See similar definitions in Section 1, Uniform Bills of Lading Act. The definition has been enlarged to include freight forwarders' bills and bills issued by contract carriers as well as those issued by common carriers. The definition of airbill is new.

7. "Branch". New.

8. "Burden of establishing a fact". New.

9. "Buyer in ordinary course of business". From Section 1, Uniform Trusts Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in Section 2-403 [55-2-403 NMSA 1978] and in the Article on Secured Transactions (Article 9).

10. "Conspicuous". New. This is intended to indicate some of the methods of making a term attention-calling. But the test is whether attention can reasonably be expected to be called to it.

11. "Contract". New. But see Sections 3 and 71, Uniform Sales Act.

12. "Creditor". New.

13. "Defendant". From Section 76, Uniform Sales Act. Rephrased.

14. "Delivery". Section 76, Uniform Sales Act, Section 191, Uniform Negotiable Instruments Law, Section 58, Uniform Warehouse Receipts Act and Section 53, Uniform Bills of Lading Act.

15. "Document of title". From Section 76, Uniform Sales Act, but rephrased to eliminate certain ambiguities. Thus, by making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in Hixson v. Ward, 254 Ill. App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title". The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this Section regardless of the name given to the instrument.

The goods must be "described", but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

16. "Fault". From Section 76, Uniform Sales Act.

17. "Fungible". See Sections 5, 6 and 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act. Fungibility of goods "by agreement" has been added for clarity and accuracy. As to securities, see Section 8-107 and Comment.

18. "Genuine". New.

19. "Good faith". See Section 76(2), Uniform Sales Act; Section 58(2), Uniform Warehouse Receipts Act; Section 53(2), Uniform Bills of Lading Act; Section 22(2), Uniform Stock Transfer Act. "Good faith", whenever it is used in the Code, means at least what is here state. In certain Articles, by specific provision, additional requirements are made applicable. See, e.g., Secs. 2-103(1) (b) [55-2-103 NMSA 1978], 7-404 [55-7-404 NMSA 1978]. To illustrate, in the Article on Sales, Section 2-103 [55-2-103 NMSA 1978], good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

20. "Holder". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

21. "Honor". New.

22. "Insolvency proceedings". New.

23. "Insolvent". Section 76(3), Uniform Sales Act. The three tests of insolvency - "ceased to pay his debts in the ordinary course of business," "cannot pay his debts as they become due," and "insolvent within the meaning of the federal bankruptcy law" - are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money". Section 6(5), Uniform Negotiable Instruments Law. The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Notice". New. Compare N.I.L. Sec. 56. Under the definition a person has notice when he has received a notification of the fact in question. But by the last sentence the act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as Graham v. White-Phillips Co., 296 U.S. 27, 56 S. Ct. 21, 80 L. Ed. 20 (1935), are not overruled.

26. "Notifies". New. This is the word used when the essential fact is the proper dispatch of the notice not its receipt. Compare "Send". When the essential fact is the other party's receipt of the notice, that is stated. The second sentence states when a notification is received.

27. New. This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a

transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

28. "Organization". This is the definition of every type of entity or association, excluding an individual, acting as such. Definitions of "person" were included in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. The definition of "organization" given here includes a number of entities or associations not specifically mentioned in prior definition of "person", namely, government, governmental subdivision or agency, business trust, trust and estate.

29. "Party". New. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to his principal, particular account is taken of that situation.

30. "Person". See Comment to definition of "Organization". The reference to Section 1-102 is to subsection (5) of that section.

31. "Presumption". New.

32. "Purchase". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

33. "Purchaser". Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

34. "Remedy". New. The purpose is to make it clear that both remedy and rights (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under this Act, remedial rights being those to which an aggrieved party can resort on his own motion.

35. "Representative". New.

36. "Rights". New. See Comment to "Remedy".

37. "Security Interest". See Section 1, Uniform Trust Receipts Act. The present definition is elaborated, in view especially of the complete coverage of the subject in Article 9. Notice that in view of the Article the term includes the interest of certain outright buyers of certain kinds of property. Section 1-201(37) [55-1-201 NMSA 1978] is being amended at the same time that the Article on Leases (Article 2A) is being promulgated as an amendment to this Act.

One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that has created considerable confusion in the courts: what is a lease? The confusion exists, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act. Section 1-201(37) [55-1-201 NMSA 1978]. The confusion is compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy...." 1 G. Gilmore, *Security Interest in Personal Property* § 3.6, at 76 (1965).

Under pre-Act chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing - Leveraged Leasing* 681, 700 n. 25, 729 n. 80 (2d ed. 1980). The Articles on Leases (Article 2A) has not changed the law in that respect, except for leases of fixtures. Section 2A-309 [55-2A-309 NMSA 1978]. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) [55-1-201 NMSA 1978] of the 1978 Official Text of the Act provides that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.,* leases intended as security; however, the definition is vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j) [55-2A-103 NMSA 1978]. The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this section.

The first paragraph of this definition is a revised version of the first five sentences of the 1978 Official Text of Section 1-201(37) [55-1-201 NMSA 1978]. The changes are modest in that they make a style change in the fourth sentence and delete the reference to lease in the fifth sentence. The balance of this definition is new, although it preserves elements of the last two sentences of the prior definition. The focus of the changes was to draw a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to this amendment, Section 1-201(37) [55-1-201 NMSA 1978] provided that whether a lease was intended as security (*i.e.,* a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an

agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest has led to unfortunate results. In discovering intent, courts have relied upon factors that were thought to be more consistent with sales or loans then [than] leases. Most of these criteria, however, are as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, amended Section 1-201(37) [55-1-201 NMSA 1978] deletes all reference to the parties' intent.

The second paragraph of the new definition is taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to this Act will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9*, 47 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. The second paragraph further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, *e.g., In re Royer's Bakery, Inc.*, 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr.E.D.Pa. 1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (a), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (b), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters.*, 1 Bankr. 647, 651-52 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (c), is whether the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014-15 (Bankr.E.D.Tenn.1984). The fourth of these tests, subparagraph (d), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371-73 (Bankr.W.D.Wis.1983).

The focus on economics is reinforced by the next paragraph, which is new. It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (a) has no statutory derivative; it states that a full payout lease does not *per se* create a security interest. *Rushton v. Shea*, 419 F. Supp. 1349, 1365 (D.Del.1976). Subparagraph (b) provides the same regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v. Ochs*, 42 Or.App. 319, 600 P.2d 899 (Ct.App.1979) *with In re Tillery*, 571 F.2d 1361 (5th Cir.1978). Subparagraph (c) restates and expands the provisions of former Section 1-201(37) [55-1-201 NMSA 1978] to make clear that the option can be to buy or renew. Subparagraphs (d) and (e) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. *Compare Arnold Mach.*

Co. v. Balls, 624 P.2d 678 (Utah 1981) *with Aoki v. Shepard Mach. Co.*, 665 F.2d 941 (9th Cir.1982).

The relationship of the second paragraph of this subsection to the third paragraph of this subsection deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir.1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

The fourth paragraph provides definitions and rules of construction.

38. "Send". New. Compare "notifies".

39. "Signed". New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

40. "Surety". New.

41. "Telegram". New.

42. "Term". New.

43. Under the former version of § 1-201(43), it was not clear whether a reference to an "unauthorized signature" in Articles 3 and 4 applied to indorsements. The words "or indorsement" are deleted so that references to "unauthorized signature" in § 3-406 and elsewhere will unambiguously refer to any signature.

44. "Value". See Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value". All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a preexisting claim. Subsections (a), (b) and (d) in substance continue the definitions of "value" in the earlier acts. Subsection (c) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a preexisting contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4-208 [55-4-208 NMSA 1978], 4-209 [55-4-209 NMSA 1978], 3-303 [55-3-303 NMSA 1978]. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

45. "Warehouse receipt". See Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

46. "Written" or "writing". This is a broadening of the definition contained in Section 191 of the Uniform Negotiable Instruments Law.

I. General Consideration.
II. Contract.
III. Security Interest.
IV. Signed.
V. Written or Writing.
VI. Buyer in Ordinary Course of Business.
VII. Conspicuous.
VIII. Good Faith.
IX. Holder.

I. GENERAL CONSIDERATION.

The 1985 amendment added the second sentence in Subsection (9), deleted "means goods or securities" following "with respect to goods or securities" near the beginning of Subsection (17), substituted "buyer of accounts or chattel paper which is subject to

Article 9" for "buyer of accounts, chattel paper or contract rights which is subject to Article 9" in the third sentence of Subsection (37), and made minor grammatical changes.

The 1987 amendment, effective June 19, 1987, substituted "the Uniform Commercial Code" for "this act" and NMSA citations for UCC citations at several places throughout the section, inserted "certificated" in Subsections (5), (14) and (20), and made minor stylistic changes throughout the section.

The 1992 amendment, effective July 1, 1992, inserted "means goods or securities" in the first sentence of Subsection (17); rewrote Subsection (20); substituted all of the present language of Subsection (24) following "government" for "as a part of its currency"; rewrote Subsection (37); and deleted "or indorsement" following "signature" in Subsection (43).

The 1993 amendment, effective July 1, 1993, substituted "Sections 55-1-205, 55-2-208 and 55-2A-207 NMSA 1978" for "Sections 55-1-205, and 55-2-208 NMSA 1978" in Subsection (3); made a stylistic change in Subsection (25); and in Subsection (44), substituted "(Sections 55-3-303, 55-4-210 and 55-4-211 NMSA 1978)" for "(Sections 55-3-303, 55-4-208 and 55-4-209 NMSA 1978)" and made stylistic changes within the subsection.

Compiler's note. - The "Official Comment" set out above was copyrighted in 1990 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and is reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

For article, "New Mexico's Uniform Commercial Code: Who is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Graham v. Stoneham, 73 N.M. 382, 388 P.2d 389 (1963), commented on in 4 Nat. Resources J. 175 (1964).

For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision' " see 4 Nat. Resources J. 398 (1964).

For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For comment on Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966), see 8 Nat. Resources J. 169 (1968).

For comment on Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For article, "The Community Property Act of 1973: A Commentary and Quasi-Legislative History," see 5 N.M. L. Rev. 1 (1974).

For survey, "The Uniform Owner-Resident Relations Act," see 6 N.M. L. Rev. 293 (1976).

For annual survey of commercial law in New Mexico, see 18 N.M.L. Rev. 313 (1988).

For note, "Commercial Law - And Then Personal Property Became Real Property: In re Anthony," see 23 N.M.L. Rev. 263 (1993).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 48, 49; 15A Am. Jur. 2d Commercial Code §§ 4, 27, 104, 115; 67 Am. Jur. 2d Sales §§ 10 to 69; 68A Am. Jur. 2d Secured Transactions §§ 31, 163 et seq.

Who is "buyer in ordinary course of business" under Uniform Commercial Code, 87 A.L.R.3d 11.

What constitutes "money" within meaning of Uniform Commercial Code, 40 A.L.R.4th 346.

82 C.J.S. Statutes § 315.

II. CONTRACT.

Intent where written contract uncertain. - Where a written contract is uncertain or ambiguous, the intent of the parties may be ascertained by their language and conduct,

the objects sought to be accomplished, and surrounding circumstances at the time of execution of the contract. Leonard v. Barnes, 75 N.M. 331, 404 P.2d 292 (1965).

Purchase order qualified as contract for sale of goods. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

III. SECURITY INTEREST.

When lease deemed security interest. - Where agreement provides that upon full payment of rentals lessee will become owner of property with no other or further consideration, this provision introduces an element under which an equity interest in the property is being created in lessee through payment of rentals. In accordance with the undisputed facts and language of the agreements the parties are deemed as a matter of law to have intended lease as one creating a security interest within the meaning of the code. Rust Tractor Co. v. Bureau of Revenue, 82 N.M. 82, 475 P.2d 779 (Ct. App.), cert. denied, 82 N.M. 81, 475 P.2d 778 (1970).

As intention of parties controls instrument. - Under general law, the character of the instrument is not to be determined by its form, but from the intention of the parties as shown by the contents of the instrument. Transamerica Leasing Corp. v. Bureau of Revenue, 80 N.M. 48, 450 P.2d 934 (Ct. App. 1969).

Payment of "money" to satisfy real estate note. - A borrower was not authorized by the promissory note and deed of trust in a real estate loan transaction to tender the real estate securing the note instead of currency to extinguish the obligation where the lender only agreed to look solely to the property for satisfaction of the principal debt in the event of default rather than take a personal judgment against the borrower. To require the maker of a promissory note, in the absence of a specific agreement otherwise, to pay the note in "money" is consistent with the demands of modern commercial practice. Brown v. Financial Sav., 113 N.M. 500, 828 P.2d 412 (1992).

Mortgage serving as security interest. - Although a mortgage, without more, is not sufficient to automatically attach to the proceeds of a separate real estate contract, when a contract vendor offered his interest in the property as security for a loan the mortgage served as a security interest and was perfected upon filing with the county clerk's office where the property was located. Finch v. Beneficial N.M., Inc., 120 N.M. 658, 905 P.2d 198 (1995).

IV. SIGNED.

The requisites of an effective signature are liberal in scope. 1961-62 Op. Att'y Gen. No. 62-3.

Effect of lack of signature on purchase order. - Where purchase order was completely filled in with all relevant information regarding the backhoe to be purchased, including the full purchase price, approximate delivery date and purchaser's signature,

the lack of the salesman's signature on the appropriate line did not negate present intention to authenticate the purchase order. Watson v. Tom Growney Equip., Inc., 104 N.M. 371, 721 P.2d 1302 (1986).

V. WRITTEN OR WRITING.

Making of instruments generally. - Instruments offered for filing are not required to be either made or written in ink or with an indelible pencil, but such may be either made or executed by lead pencil, or by any other methods of writing or execution. 1961-62 Op. Att'y Gen. No. 62-132.

VI. BUYER IN ORDINARY COURSE OF BUSINESS.

The significance of being a buyer in the ordinary course of business is the acquisition of goods free of any outstanding claims from those who may be the true owners. Therefore, a buyer in the ordinary course of business is a privileged status that is conferred upon a purchaser, even against the true owners, if he meets the requirements of Paragraphs (9) and (19) of this section. Hunick v. Orona, 99 N.M. 306, 657 P.2d 633 (1983).

VII. CONSPICUOUS.

When language on reverse of form is conspicuous. - Language which refers the reader to conditions or provisions on the reverse side of a form suffices to make the language referred to conspicuous. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Limited warranty conspicuous. - The defendant's disclaimer of the implied warranties of merchantability and fitness for a particular purpose was conspicuous as a matter of law, since the record indicated that the warranty was printed on both sides of a full-size page on a different grain of paper, was highlighted and contrasted by different colors, and was set out in capital letters. LWT, Inc. v. Childers, 19 F.3d 539 (10th Cir. 1994).

VIII. GOOD FAITH.

Elements of "good faith". - Nothing in the definition of "good faith" suggests that in addition to being honest, the creditor must exercise due care or reasonable commercial standards or lack of negligence to be in good faith. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978) (specially concurring opinion).

"Good faith" usually question of fact. - "Good faith" is not generally a question of law, but is usually a question of fact. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978); Citizens Bank v. Runyan, 109 N.M. 672, 789 P.2d 620 (1990).

IX. HOLDER.

Payee in possession of instrument. - A negotiable instrument payee is always a holder if the payee has the instrument in his possession, since the payee is the person to whom the instrument was issued. Edwards v. Mesch, 107 N.M. 704, 763 P.2d 1169 (1988).

Where issued cashier's check, bank not holder in due course upon subsequent presentment. - In issuing a cashier's check, a bank acts as both drawer and drawee, since a cashier's check constitutes a draft drawn by the bank upon itself, and upon the subsequent presentment of the check, the bank is not a holder in due course. Casarez v. Garcia, 99 N.M. 508, 660 P.2d 598 (Ct. App. 1983).

55-1-202. Prima facie evidence by third-party documents.

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice or any other document authorized or required by the contract to be issued by a third party shall be prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

History: 1953 Comp., § 50A-1-202, enacted by Laws 1961, ch. 96, § 1-202.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section is designed to supply judicial recognition for documents which have traditionally been relied upon as trustworthy by commercial men.

2. This section is concerned only with documents which have been given a preferred status by the parties themselves who have required their procurement in the agreement and for this reason the applicability of the section is limited to actions arising out of the contract which authorized or required the document. The documents listed are intended to be illustrative and not all inclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

Definitional cross references. - "Bill of lading". Section 1-201.

"Contract". Section 1-201.

"Genuine". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 33.

32A C.J.S. Evidence §§ 819, 820, 967.

55-1-203. Obligation of good faith.

Every contract or duty within this act [this chapter] imposes an obligation of good faith in its performance or enforcement.

History: 1953 Comp., § 50A-1-203, enacted by Laws 1961, ch. 96, § 1-203.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - This section sets forth a basic principle running throughout this act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the act such as the option to accelerate at will (Section 1-208), the right to cure a defective delivery of goods (Section 2-508), the duty of a merchant buyer who has rejected goods to effect salvage operations (Section 2-603), substituted performance (Section 2-614) and failure of presupposed conditions (Section 2-615). The concept, however, is broader than any of these illustrations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this act. It is further implemented by Section 1-205 on course of dealing and usage of trade.

It is to be noted that under the sales article definition of good faith (Section 2-103), contracts made by a merchant have incorporated in them the explicit standard not only of honesty in fact (Section 1-201), but also of observance by the merchant of reasonable commercial standards of fair dealing in the trade.

Cross references. - Sections 1-201; 1-205; 1-208; 2-103; 2-508; 2-603; 2-614 and 2-615.

Definitional cross references. - "Contract". Section 1-201.

"Good faith". Sections 1-201 and 2-103.

Duty imposed on creditor under Subsection (1)(b) encompasses the good faith obligation to exercise reasonable means to protect the rights of guarantors, including

timely perfecting of the security interest. American Bank of Commerce v. Covolo, 88 N.M. 405, 540 P.2d 1294 (1975).

But negligence not deemed bad faith. - Although its omissions were negligent, creditor bank was not shown to have acted in bad faith where it believed, though mistakenly, that the security interest in the liquor license had been properly perfected when it was filed with the alcoholic beverage control department. American Bank of Commerce v. Covolo, 88 N.M. 405, 540 P.2d 1294 (1975).

When motivation behind cancelling contract immaterial. - The motivation of a party in cancelling a contract which by its terms is terminable at will by either party is immaterial. Smith v. Price's Creameries, 98 N.M. 541, 650 P.2d 825 (1982).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 26; 17A Am. Jur. 2d Contracts § 380; 68A Am. Jur. 2d Secured Transactions § 184 et seq.

Sufficiency of designation of debtor or secured party in security agreement of financing statement under UCC § 9-402, 99 A.L.R.3d 478.

Effectiveness of original financing statement under UCC Article 9 after change in debtor's name, identity, or business structure, 99 A.L.R.3d 1194.

17A C.J.S. Contracts § 494.

55-1-204. Time; reasonable time; "seasonably."

(1) Whenever this act [this chapter] requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.

(2) What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.

(3) An action is taken "seasonably" when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time.

History: 1953 Comp., § 50A-1-204, enacted by Laws 1961, ch. 96, § 1-204.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. Under the section, the agreement which fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

Definitional cross reference. - "Agreement". Section 1-201.

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Lessee held to have acted reasonably. - Where lessee wrote assigner of leases before the expiration of either lease, the manner in which lessee notified assignee of its election to purchase certain cranes and the presentment of full payment in fewer than 30 days from expiration of the leases, were acts done in a reasonable fashion, and certainly within a reasonable time, as required by the Uniform Commercial Code. Cranetex, Inc. v. Mountain Dev. Corp., 106 N.M. 5, 738 P.2d 123 (1987).

Law reviews. - For survey, "Civil Procedure in New Mexico in 1975," see 6 N.M. L. Rev. 367 (1976).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 888.

86 C.J.S. Time § 8.

55-1-205. Course of dealing and usage of trade.

(1) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(2) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement, except that no security interest in farm products shall be considered waived by the secured party by any course of dealing between the parties or by any trade usage.

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but, when such construction is unreasonable, express terms control both course of dealing and usage of trade, and course of dealing controls usage of trade. A security interest in farm products shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage.

(5) An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance.

(6) Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter.

History: 1953 Comp., § 50A-1-205, enacted by Laws 1961, ch. 96, § 1-205; 1968, ch. 12, § 1.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. No such general provision but see Sections 9(1), 15(5), 18(2) and 71, Uniform Sales Act.

Purposes. This section makes it clear that:

1. This act rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure

and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. Course of dealing under Subsection (1) is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (Section 2-208.)

3. "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

4. This act deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade" this act expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law". A distinction is to be drawn between mandatory rules of law such as the statute of frauds provisions of Article 2 on sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

5. A usage of trade under Subsection (2) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under the requirement of Subsection (2) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

6. The policy of this act controlling explicit unconscionable contracts and clauses (Sections 1-203 and 2-302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable". However, the emphasis is shifted. The very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

7. Subsection (3), giving the prescribed effect to usages of which the parties "are or should be aware", reinforces the provision of Subsection (2) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of Subsection (2) that such usages may be either general to trade or particular to a special branch of trade.

8. Although the terms in which this act defines "agreement" include the elements of course dealing and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-102(4).

9. In cases of a well established line of usage varying from the general rules of this act where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

10. Subsection (6) is intended to insure that this act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

Cross references. - Point 1: Sections 1-203, 2-104 and 2-202.

Point 2: Section 2-208.

Point 4: Section 2-201 and Part 3 of Article 2.

Point 6: Sections 1-203 and 2-302.

Point 8: Sections 1-102 and 1-201.

Point 9: Section 2-204(3).

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Party". Section 1-201.

"Term". Section 1-201.

I. General Consideration.
II. Course of Dealing.
III. Usage of Trade.
IV. Modification of Agreement.

I. GENERAL CONSIDERATION.

Cross-references. - As to applicability of supplementary general principles, see 55-1-103 NMSA 1978.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For article, "Survey of New Mexico Law, 1979-80: Commercial Law," see 11 N.M.L. Rev. 69 (1981).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 39, 63; 15A Am. Jur. 2d Commercial Code §§ 3, 28, 52; 68A Am. Jur. 2d Secured Transactions §§ 31, 584 et seq.

17A C.J.S. Contracts § 325; 25 C.J.S. Customs and Usages §§ 1, 14.

II. COURSE OF DEALING.

Establishes existence and terms of contract. - The course of conduct of the parties may not only establish the existence of a contract, but the terms as well. Terrel v. Duke City Lumber Co., 86 N.M. 405, 524 P.2d 1021 (Ct. App. 1974), rev'd on other grounds, 86 N.M. 299, 540 P.2d 229 (1975).

Where handbook controls contract. - Where undisputed evidence shows course of conduct that made handbook part of plaintiff's contract, handbook was treated as controlling the relationship between the university administration and its faculty, and failure of the university administration to follow procedures outlined therein constituted a breach of contract by the university. Hillis v. Meister, 82 N.M. 474, 483 P.2d 1314 (Ct. App. 1971).

Where the jury found that there was one continuing contract, not separate loans, then the furnishing of working capital may constitute a course of conduct. Terrel v. Duke City Lumber Co., 86 N.M. 405, 524 P.2d 1021 (Ct. App. 1974), rev'd on other grounds, 88 N.M. 299, 540 P.2d 229 (1975).

Terms of written contract may carry over into substantially identical oral contract. - Where, after a written contract is terminated, an oral contract is entered into, and where there is a course of dealing for a number of years under the oral contract, which is identical in all respects other than to whom payment would be made, the provisions of which are fully known to and understood by the buyer, who has the obligation to give timely notice or waive any and all claims, the terms of the written contract carry over into the oral arrangement. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Express terms control where irreconcilable with course of dealing. - Where the express terms of a contract cannot be reconciled with an established course of dealing, the express terms control. Celebrity, Inc. v. Kemper, 96 N.M. 508, 632 P.2d 743 (1981).

Summary judgment improper. - The trial court erred in granting summary judgment to a bank, on a default clause in a note, where a question of fact existed as to whether the bank, by its conduct, had misled the customer as to its intention to declare a default and accelerate payments. J.R. Hale Contracting Co. v. United New Mexico Bank, 110 N.M. 712, 799 P.2d 581 (1990).

III. USAGE OF TRADE.

Use to determine meaning of contract. - It is proper for a trial court, having found an ambiguity to exist, to consider evidence relating to custom and usage of trade, in determining the meaning to be given a contract. Major v. Bishop, 462 F.2d 1277 (10th Cir. 1972).

IV. MODIFICATION OF AGREEMENT.

Consent by implication. - Consent can be established by implication arising from a course of conduct as well as by express words, and implied consent to a sale of collateral can operate as a waiver of a lien or security interest in farm products, even where security agreement prohibited such sale without express written consent of secured party. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967) (decided prior to 1968 amendment which added the exception clause at the end of Subsection (3) and added the second sentence to Subsection (4)).

Law reviews. - Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), commented on in 8 Nat. Resources J. 183 (1968).

55-1-206. Statute of frauds for kinds of personal property not otherwise covered.

(1) Except in the cases described in Subsection (2) of this section, a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars ($5,000) in amount or value or remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (Section 55-2-201 NMSA 1978) nor of securities (Section 55-8-313 NMSA 1978) nor to security agreements (Section 55-9-203 NMSA 1978).

History: 1953 Comp., § 50A-1-206, enacted by Laws 1961, ch. 96, § 1-206; 1996, ch. 47, § 2.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

Changes. Completely rewritten by this and other sections.

Purposes. To fill the gap left by the statute of frauds provisions for goods (Section 2-201), securities (Section 2-319) and security interests (Section 9-203). The Uniform Sales Act covered the sale of "choses in action"; the principal gap relates to sale of the "general intangibles" defined in Article 9 (Section 9-106) and to transactions excluded from Article 9 by Section 9-104. Typical are the sale of bilateral contracts, royalty rights or the like. The informality normal to such transactions is recognized by lifting the limit for oral transactions to $5,000. In such transactions there is often no standard of practice by which to judge, and values can rise or drop without warning; troubling abuses are avoided when the dollar limit is exceeded by requiring that the subject-matter be reasonably identified in a signed writing which indicates that a contract for sale has been made at a defined or stated price.

Definitional cross references. - "Action". Section 1-201.

"Agreement". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Sale". Section 2-106.

"Signed". Section 1-201.

"Writing". Section 1-201.

The 1996 amendment, substituted "Section 55-8-313" for "Section 8-319" in the middle of Subsection (2) and made minor stylistic changes throughout the section. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Statute of frauds has no application where there has been a full and complete performance of the contract by one of the contracting parties, and the party so performing may sue on the contract in a court of law, particularly where the agreement has been completely performed as to the part thereof which comes within the provisions of the statute, and the part remaining to be performed is merely the payment of money. Boggs v. Anderson, 72 N.M. 136, 381 P.2d 419 (1963).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 37, 114; 72 Am. Jur. 2d Statute of Frauds § 130.

37 C.J.S. Frauds, Statute of § 138.

55-1-207. Performance or acceptance under reservation of rights.

(a) A party who, with explicit reservation of rights, performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest" or the like are sufficient.

(b) Subsection (a) does not apply to an accord and satisfaction.

History: 1953 Comp., § 50A-1-207, enacted by Laws 1961, ch. 96, § 1-207; 1992, ch. 114, § 4.

ANNOTATIONS

OFFICIAL COMMENT

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Judicial authority was divided on the issue of whether former Section 1-207 (present subsection (1) [55-1-207(a) NMSA 1978]) applied to an accord and satisfaction. Typically the cases involved attempts to reach an accord and satisfaction by use of a check tendered in full satisfaction of a claim. Subsection (2) of revised Section 1-207 [55-1-207 NMSA 1978] resolves this conflict by stating that Section 1-207 [55-1-207 NMSA 1978] does not apply to an accord and satisfaction. Section 3-311 [55-3-311 NMSA 1978] of revised Article 3 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 [55-3-311 NMSA 1978] does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 [55-3-311 NMSA 1978] applies, Section 1-207 [55-1-207 NMSA 1978] has no application to an accord and satisfaction.

The 1992 amendment, effective July 1, 1992, designated the formerly undesignated provisions as Subsection (a), and added Subsection (b).

Compiler's note. - The "Official Comment" set out above was copyrighted in 1990 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and is reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 34; 17A Am. Jur. 2d Contracts § 656.

Application of U.C.C. § 1-207 to avoid discharge of disputed claim upon qualified acceptance of check tendered as payment in full, 37 A.L.R.4th 358.

17A C.J.S. Contracts §§ 491, 506, 514; 31 C.J.S. Estoppel § 133.

55-1-208. Option to accelerate at will.

A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

History: 1953 Comp., § 50A-1-208, enacted by Laws 1961, ch. 96, § 1-208.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The increased use of acceleration clauses either in the case of sales on credit or in time paper or in security transactions has led to some confusion in the cases as to the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party. This section is intended to make clear that despite language which can be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the lause means that the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.

Definitional cross references. - "Burden of establishing". Section 1-201.

"Good faith". Section 1-201.

"Party". Section 1-201.

"Term". Section 1-201.

This section has dual elements of whether (1) a reasonable man would have accelerated the debt under the circumstances, and (2) whether the creditor acted in good faith. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978) (specially concurring opinion).

Need for good faith. - The holder of a note may accelerate payment only if he, in good faith, believes that the prospect of payment is impaired. The burden, however, of establishing lack of good faith is on the party against whom the power has been exercised. Merchant v. Worley, 79 N.M. 771, 449 P.2d 787 (Ct. App. 1969).

Elements of "good faith". - Nothing in the definition of "good faith" suggests that in addition to being honest, the creditor must exercise due care or reasonable commercial standards or lack of negligence to be in good faith. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978) (specially concurring opinion).

The UCC does not impose an objective standard of commercial reasonableness on the decision of a bank to accelerate when the bank was honest in its belief that its prospect for repayment was impaired. The requirement of honesty in fact is subjective and is concerned with the actual state of mind of the creditor; even under a subjective test of good faith, though, the trier of fact may evaluate the credibility of a creditor's claim and in doing so may take into account the reasonableness of that claim. Thus, the conduct and credibility of the creditor may be tested by objective standards subject to proof and conducive to the application of reasonable expectations in commercial affairs. J.R. Hale Contracting Co. v. United New Mexico Bank, 110 N.M. 712, 799 P.2d 581 (1990).

Use of expert opinion to assist trier of fact in determining "good faith". - By using a "good faith belief" doctrine, the main problem to solve is how a trier of fact can obtain knowledge of the minds of others, as this knowledge can only be obtained from perceptible manifestations in speech, conduct and behavior of a person, or reasonable inferences to be drawn therefrom, and it is foreseeable that an expert opinion may be necessary to assist the trier of the fact. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978) (specially concurring opinion).

Default clauses conditioned upon occurrence within debtor's control distinguishable. - Whether the acceleration of the balance due on a note is predicated on "good faith" depends on this section, which deals with what are referred to as "at will" or "when he deems himself insecure" creditor option clauses. However, those clauses are distinguishable from default-type clauses where the right to accelerate is conditioned upon the occurrence of a condition which is within the control of the debtor. Brummund v. First Nat'l Bank, 99 N.M. 221, 656 P.2d 884 (1983).

Application of burden of proof. - The burden of proof set out in this section applies to a directed verdict and not to a motion on summary judgment. The burden of proof applies to the quantum of evidence and sufficiency of proof as to the lack of good faith after all the evidence is before the court. McKay v. Farmers & Stockmens Bank, 92 N.M. 181, 585 P.2d 325 (Ct. App.), cert. denied, 92 N.M. 79, 582 P.2d 1292 (1978).

Law reviews. - For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 186; 15A Am. Jur. 2d Commercial Code § 35; 68A Am. Jur. 2d Secured Transactions §§ 121, 590 et seq.

Provision for post-mortem payment or performance as affecting instrument's character and validity as a contract, 1 A.L.R.2d 1178.

What is essential to exercise of option to accelerate maturity of bill or note, 5 A.L.R.2d 968.

What constitutes "good faith" under UCC § 1-208 dealing with "insecure" or "at will" acceleration clauses, 85 A.L.R.4th 284.

17 C.J.S. Contracts § 358.

55-1-209. Subordinated obligations.

An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate his right to payment of an obligation by agreement with either the person obligated or another creditor of the person obligated. Such a subordination does not create a security interest as against either the common debtor or a subordinated creditor. This section shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it.

History: 1978 Comp., § 55-1-209, enacted by Laws 1992, ch. 114, § 5.

ANNOTATIONS

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

ARTICLE 2
SALES

Part 1

Short Title, General Construction and Subject Matter.

Part 2

Form, Formation and Readjustment of Contract.

Part 3

General Obligation and Construction of Contract.

Part 4

Title, Creditors and Good Faith Purchasers.

Part 5

Performance.

Part 6

Breach, Repudiation and Excuse.

Part 7

Remedies.

PART 1
SHORT TITLE, GENERAL CONSTRUCTION AND SUBJECT MATTER

55-2-101. Short title.

This article shall be known and may be cited as Uniform Commercial Code - Sales.

History: 1953 Comp., § 50A-2-101, enacted by Laws 1961, ch. 96, § 2-101.

ANNOTATIONS

OFFICIAL COMMENT

This article is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present article is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present article is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

Law reviews. - For article, "Lender Recourse in Indian Country: A Navajo Case Study," see 21 N.M.L. Rev. 275 (1991).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 64 Am. Jur. 2d Public Works and Contracts § 18; 67 Am. Jur. 2d Sales § 1 et seq.

Applicability of U.C.C. Article 2 to mixed contracts for sale of goods and services, 5 A.L.R.4th 501.

82 C.J.S. Statutes § 221.

55-2-102. Scope; certain security and other transactions excluded from this article.

Unless the context otherwise requires, this article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or [a] present sale is intended to operate only as a security transaction nor does this article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

History: 1953 Comp., § 50A-2-102, enacted by Laws 1961, ch. 96, § 2-102.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 75, Uniform Sales Act.

Changes. Section 75 has been rephrased.

Purposes of changes and new matter. To make it clear that:

The article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Security transaction" is used in the same sense as in the article on secured transactions (Article 9).

Cross reference. - Article 9.

Definitional cross references. - "Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Present sale". Section 2-106.

"Sale". Section 2-106.

Scope of article. - Court can find nothing in the pertinent code provisions or comments to indicate that it is not to apply to all sales of goods. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

Sale of crude oil by the producers is a sale of goods, and is thus governed by Article 2 of the code. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

A business may be sold in which all the assets aside from goodwill would be goods, and nonapplication of the code to the sale of goods in such a case is contrary to the intention of the drafters. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

Article inapplicable to mixed contract. - This article was held inapplicable to a contract itemizing several dozen services to be performed by an interior designer in a health care facility despite the additional contemplation of purchasing and reselling of furnishings as goods between the parties, since the primary purpose of the contract, though mixed, was for the provisions of services. Kirkpatrick v. Introspect Healthcare Corp., 114 N.M. 706, 845 P.2d 800 (1992).

Inapplicable to sale of business. - A sale involving the transfer of a business as a going concern is not a transaction in goods. Stewart v. Lucero, 121 N.M. 722, 918 P.2d 1 (1996).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions §§ 13, 105, 184 et seq.

Validity and mutuality of agreement to buy where there is no express agreement to sell, 60 A.L.R. 215.

Violation of statute as to form of, or terms to be included in, conditional sale contract, as invalidating entire transaction or merely its effect to reserve title in vendor, 144 A.L.R. 1103.

Use of conditional sale contract to secure debt in addition to the purchase price, 148 A.L.R. 346.

Conflict of laws as to conditional sale of chattels, 148 A.L.R. 375, 13 A.L.R.2d 1312.

What amounts to conditional sale, 175 A.L.R. 1366.

Title to unknown valuables secreted in articles sold, 4 A.L.R.2d 318.

Form and substance of notice which buyer of goods must give in order to recover damages for seller's breach of warranty, 53 A.L.R.2d 270.

Validity, construction, and effect of contract between grower of vegetable or fruit crops, and purchasing processor, packer, or canner, 87 A.L.R.2d 732.

What constitutes a transaction, a contract for sale, or a sale within the scope of UCC Article 2, 4 A.L.R.4th 85.

Applicability of UCC Article 2 to mixed contracts for sale of goods and services, 5 A.L.R.4th 501.

77A C.J.S. Sales § 1 et seq.

55-2-103. Definitions and index of definitions.

(1) In this article, unless the context otherwise requires:

(a) "buyer" means a person who buys or contracts to buy goods;

(b) "good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade;

(c) "receipt" of goods means taking physical possession of them; and

(d) "seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"Acceptance" ....Section 55-2-606 NMSA 1978;

"Banker's credit" ....Section 55-2-325 NMSA 1978;

"Between merchants" ....Section 55-2-104 NMSA 1978;

"Cancellation" ....Section 55-2-106(4) NMSA 1978;

"Commercial unit" ....Section 55-2-105 NMSA 1978;

"Confirmed credit" ....Section 55-2-325 NMSA 1978;

"Conforming to contract" ....Section 55-2-
106 NMSA 1978;

"Contract for sale" ....Section 55-2-
106 NMSA 1978;

"Cover" ....Section 55-2-
712 NMSA 1978;

"Entrusting" ....Section 55-2-
403 NMSA 1978;

"Financing agency" ....Section 55-2-
104 NMSA 1978;

"Future goods" ....Section 55-2-
105 NMSA 1978;

"Goods" ....Section 55-2-
105 NMSA 1978;

"Identification" ....Section 55-2-
501 NMSA 1978;

"Installment contract" ....Section 55-2-
612 NMSA 1978;

"Letter of Credit" ....Section 55-2-
325 NMSA 1978;

"Lot" ....Section 55-2-
105 NMSA 1978;

"Merchant" ....Section 55-2-
104 NMSA 1978;

"Overseas" ....Section 55-2-323 NMSA 1978;

"Person in position of seller" ....Section 55-2-707 NMSA 1978;

"Present sale" ....Section 55-2-106 NMSA 1978;

"Sale" ....Section 55-2-106 NMSA 1978;

"Sale on approval" ....Section 55-2-326 NMSA 1978;

"Sale or return" ....Section 55-2-326 NMSA 1978;

"Termination" ....Section 55-2-106 NMSA 1978;

(3) The following definitions in other articles apply to this article:

"Check" ....Section 55-3-104 NMSA 1978;

"Consignee" ....Section 55-7-102 NMSA 1978;

"Consignor" ....Section 55-7-102 NMSA 1978;

"Consumer goods" ....Section 55-9-109 NMSA 1978;

"Dishonor" ....Section 55-3-502 NMSA 1978;

"Draft" ....Section 55-3-104 NMSA 1978.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1953 Comp., § 50A-2-103, enacted by Laws 1961, ch. 96, § 2-103; 1993, ch. 214, § 2.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1): Section 76, Uniform Sales Act.

Changes. - The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of changes and new matter. - 1. The phrase "any legal successor in interest of such person" has been eliminated since Section 2-210 of this article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross references. - Point 1: See Section 2-210 and Comment thereon.

Point 2: Section 1-201.

Definitional cross reference. - "Person". Section 1-201.

The 1993 amendment, effective July 1, 1993, made a stylistic change in Subsection (1), substituted NMSA 1978 citations for Uniform Commercial Code citations throughout

Subsections (2) and (3), and substituted "consumer goods" for "consumer of goods" in Subsection (3).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 39.

77A C.J.S. Sales § 1 et seq.; 82 C.J.S. Statutes § 315.

55-2-104. Definitions: "merchant"; "between merchants"; "financing agency."

(1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (Section 2-707 [55-2-707 NMSA 1978]).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

History: 1953 Comp., § 50A-2-104, enacted by Laws 1961, ch. 96, § 2-104.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None. But see Sections 15(2), (5), 16(c), 45(2) and 71, Uniform Sales Act, and Sections 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this article.

Purposes. - 1. This article assumes that transactions between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of expressly stating rules applicable "between merchants" and "as against a merchant", wherever they are needed instead of making

them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants".

2. The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this article and they are of three kinds. Sections 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant" under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . . ." since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be "merchants". But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in Section 2-314 on the warranty of merchantability, such warranty is implied only "if the seller is a merchant with respect to goods of that kind". Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in Section 2-402(2) for retention of possession by a merchant-seller falls in the same class; as does Section 2-403(2) on entrusting of possession to a merchant "who deals in goods of that kind."

A third group of sections includes 2-103(1) (b), which provides that in the case of a merchant "good faith" includes observance of reasonable commercial standards of fair dealing in the trade; 2-327(1) (c), 2-603 and 2-605, dealing with responsibilities of merchant buyers to follow seller's instructions, etc.; 2-509 on risk of loss, and 2-609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the "practices" or the "goods" aspect of the definition of merchant.

3. The "or to whom such knowledge or skill may be attributed by his employment of an agent or broker . . ." clause of the definition of merchant means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

Cross references. - Point 1: See Sections 1-102 and 1-203.

Point 2: See Sections 2-314, 2-315 and 2-320 to 2-325, of this article, and article 9.

Definitional cross references. - "Bank". Section 1-201.

"Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Document of title". Section 1-201.

"Draft". Section 3-104.

"Goods". Section 2-105.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Seller". Section 2-103.

Rancher deemed merchant. - Rancher, who is a trader, buying and selling and acting as agent for sales of cow and calf units, as well as steers, heifers, feeders and other "goods," is a merchant under this section. Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972).

But not on first sale. - Rancher, who had theretofore sold all cattle he raised or fed to packers, was not a merchant in first sale to a nonpacker. Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Farmers as "merchants" within provisions of U.C.C. Article 2 dealing with sales, 95 A.L.R.3d 484.

77A C.J.S. Sales § 1 et seq.; 82 C.J.S. Statutes § 315.

55-2-105. Definitions: transferability; "goods"; "future" goods; "lot"; "commercial unit."

(1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (Section 2-107 [55-2-107 NMSA 1978]).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross or carload) or any other unit treated in use or in the relevant market as a single whole.

History: 1953 Comp., § 50A-2-105, enacted by Laws 1961, ch. 96, § 2-105.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsections (1), (2), (3) and (4) - Sections 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6) - none.

Changes. Rewritten.

Purposes of changes and new matter. - 1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that:

The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this article. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this article.

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals or structures to be removed from the land Section 2-107(1) (Goods to be severed from Realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This article in including within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale.

"Investment securities" are expressly excluded from the coverage of this article. It is not intended by this exclusion, however, to prevent the application of a particular section of this article by analogy to securities (as was done with the Original Sales Act in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the article of this act dealing specifically with such securities (Article 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of Section 2-501 and all that this section says is what kinds of goods may be the subject of a sale.

Cross references. - Point 1: Sections 2-107, 2-201, 2-501 and Article 8.

Point 5: Section 2-501.

See also Section 1-201.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Fungible". Section 1-201.

"Money". Section 1-201.

"Present sale". Section 2-106.

"Sale". Section 2-106.

"Seller". Section 2-103.

A sale of ski lifts is a sale of goods as defined by this section. Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972).

Sale of crude oil by producers is a sale of goods, and is governed by Article 2 of the code. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

But not immovables. - Radio license, goodwill, real estate, studios and transmission equipment are not movables and hence not "goods" within the meaning of this section. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

The term "goods" includes livestock, since they are frequently intended for commercial sale. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Boat is considered "goods" within this chapter. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

For annual survey of commercial law in New Mexico, see 18 N.M.L. Rev. 313 (1988).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Mutuality and enforceability of contracts to furnish another with his needs, wants, desires, requirements, etc., of certain commodities, 14 A.L.R. 1300, 26 A.L.R. 2d 1139.

Substantial performance of contract for manufacture or sale of article, 19 A.L.R. 815.

Validity and construction of contract for sale of season's output, 23 A.L.R. 574.

Seller's estoppel to deny existence of property sold, 40 A.L.R. 382.

Contract of sale which calls for a definite quantity but leaves a quality, grade or assortment optional with one of the parties as subject to objection of indefiniteness, 105 A.L.R. 1283.

Construction and effect of contract for sale of commodity or goods where quantity is described as "about" or "more or less" than an amount specified, 58 A.L.R.2d 377.

What constitutes "goods" within the scope of UCC Article 2, 4 A.L.R.4th 912.

Applicability of UCC Article 2 to mixed contracts for sale of goods and services, 5 A.L.R.4th 501.

Conveyance of land as including mature but unharvested crops, 51 A.L.R.4th 1263.

77A C.J.S. Sales § 1 et seq.; 82 C.J.S. Statutes § 315.

55-2-106. Definitions: "contract"; "agreement"; "contract for sale"; "sale"; "present sale"; "conforming" to contract; "termination"; "cancellation."

(1) In this article unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (Section 2-401 [55-2-401 NMSA 1978]). A "present sale" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

History: 1953 Comp., § 50A-2-106, enacted by Laws 1961, ch. 96, § 2-106.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - Section 1 (1) and (2), Uniform Sales Act; Subsection (2) - none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4) - none.

Changes. Completely rewritten.

Purposes of changes and new matter. - 1. Subsection (1): "Contract for sale" is used as a general concept throughout this article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or delivery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this article between termination and cancellation.

Cross references. - Point 2: Sections 1-203, 1-205, 2-208 and 2-508.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

A sale implies seller's ownership of the thing sold as well as the passing of title therein to the buyer. Valdez v. Garcia, 79 N.M. 500, 445 P.2d 103 (Ct. App.), cert. denied, 79 N.M. 449, 444 P.2d 776 (1968).

Agreement, that discount on merchandise applicable for certain time, not contract for sale. - An agreement requiring that a certain number of computers must be purchased by a certain time in order for a discount to apply was not a contract for sale, where no title was passed for a price and there was no requirement to purchase even one computer. Data Gen. Corp. v. Communications Diversified, Inc., 105 N.M. 59, 728 P.2d 469 (1986).

Continued liability on purchase agreement. - Where the purchase agreement was not an executory document, failure to make any of the subsequent payments after the deposit does not render it executory and appellant is still liable for the appropriate tax. Garfield Mines Ltd. v. O'Cheskey, 85 N.M. 547, 514 P.2d 304 (Ct. App. 1973).

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Distributorship agreements. - The purpose of distributorship agreements is to provide a contract for the sale of a product from a manufacturer at wholesale prices that is to be marketed in a specific area by the distributor. As such, a distributorship agreement should be subject to the provisions of the UCC. United Whsle. Liquor Co. v. Brown-Forman Distillers Corp., 108 N.M. 467, 775 P.2d 233 (1989).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 39, 73, 90, 113, 114; 68A Am. Jur. 2d Secured Transactions § 13.

Validity and construction of contract for sale of season's output, 1 A.L.R. 1392, 9 A.L.R. 276, 23 A.L.R. 574.

Contract for sale of goods as entire or divisible, 2 A.L.R. 643.

Divisibility of contract for the sale of an outfit, plant or machinery, 4 A.L.R. 1442.

Passing of title to personal property under a contract of sale, as affected by fact that contract covers both real and personal property, 117 A.L.R. 395.

What constitutes a transaction, a contract for sale, or a sale within the scope of UCC Article 2, 4 A.L.R.4th 85.

Applicability of UCC Article 2 to mixed contracts for sale of goods and services, 5 A.L.R.4th 501.

77A C.J.S. Sales § 1 et seq.

55-2-107. Goods to be severed from realty; recording.

(1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in Subsection (1) or of timber to be cut is a contract for the sale of goods within this article whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

History: 1953 Comp., § 50A-2-107, enacted by Laws 1961, ch. 96, § 2-107; 1985, ch. 193, § 3.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Section 76, Uniform Sales Act on prior policy and Section 7, Uniform Conditional Sales Act.

Purposes. - 1. Subsection (1). Notice that this subsection applies only if the minerals or structures "are to be severed by the seller". If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the statute of frauds and of the recording of land rights apply to them. Therefore, the statute of frauds section of this article does not apply to such contracts though they must conform to the statute of frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this article regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in Subsection (3) for recording such contracts is within the purview of this article since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the article on secured transactions (Article 9) and it is to be noted that the definition of goods in that article differs from the definition of goods in this article.

However, both articles treat as goods growing crops and also timber to be cut under a contract of severance.

Cross references. - Point 1: Section 2-201.

Point 2: Section 2-105.

Point 3: Articles 9 and 9-105.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Present sale". Section 2-106.

"Rights". Section 1-201.

"Seller". Section 2-103.

The 1985 amendment deleted "timber," preceding "minerals" and inserted "(including oil and gas)" near the beginning of Subsection (1), inserted "or of timber to be cut" following "Subsection (1)" near the middle of Subsection (2), and made minor grammatical changes.

Immovables not "goods". - Radio license, goodwill, real estate, studios and transmission equipment are not movables and hence not "goods" within the meaning of this section. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 57 et seq.; 72 Am. Jur. 2d Statute of Frauds § 143.

What constitutes "goods" within the scope of UCC Article 2, 4 A.L.R.4th 912.

77A C.J.S. Sales § 1 et seq.

PART 2
FORM, FORMATION AND READJUSTMENT OF CONTRACT

55-2-201. Formal requirements; statute of frauds.

(1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in conformation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of Subsection (1) against such party unless written notice of objection to its contents is given within ten days after it is received.

(3) A contract which does not satisfy the requirements of Subsection (1) but which is valid in other respects is enforceable:

(a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods for which payment has been made and accepted or which have been received and accepted (Section 2-606 [55-2-606 NMSA 1978]).

History: 1953 Comp., § 50A-2-201, enacted by Laws 1961, ch. 96, § 2-201.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

Changes. Completely rephrased; restricted to sale of goods. See also Sections 1-206, 8-319 and 9-203.

Purposes of changes. The changed phraseology of this section is intended to make it clear that:

1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It may be written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted.

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment, therefore, the agreed price of any goods actually delivered can be

recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under Subsection (2) and is sufficient against both parties under Subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the statute of frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the statute of frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Cross references. - See Sections 1-201, 2-202, 2-207, 2-209 and 2-304.

Definitional cross references. - "Action". Section 1-201.

"Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Notice". Section 1-201.

"Party". Section 1-201.

"Reasonable time". Section 1-204.

"Sale". Section 2-106.

"Seller". Section 2-103.

Statute of frauds generally. - A promise to discharge a debt, made to a debtor for adequate consideration by one not liable for the existing debt, is not a promise to answer for the debt of another within the meaning of the statute of frauds. Banes Agency v. Chino, 60 N.M. 297, 291 P.2d 328 (1955) (decided under former law).

Terms of written contract may carry over into substantially identical oral contract. - Where, after a written contract is terminated, an oral contract is entered into, and where there is a course of dealing for a number of years under the oral contract, which is identical in all respects other than to whom payment would be made, the provisions of which are fully known to and understood by the buyer, who has the obligation to give timely notice or waive any and all claims, the terms of the written contract carry over into the oral arrangement. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

There was no enforceable contract between rancher and feedlot operator for the outright purchase of cattle, in the absence of a written agreement as mandated by this section, where the terms of the agreement provided for the transportation of cattle to feed yard, and feed yard's oversee, care and attempt to sell them. Production Credit Ass'n v. Alamo Ranch Co., 989 F.2d 413 (10th Cir. 1993).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For annual survey of commercial law in New Mexico, see 18 N.M.L. Rev. 313 (1988).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 29, 115; 67 Am. Jur. 2d Sales §§ 30, 102 to 139, 180 to 207; 72 Am. Jur. 2d Statute of Frauds §§ 129 to 131, 138, 140, 143, 146, 147, 285, 295, 301, 340, 342, 343, 366; 73 Am. Jur. 2d Statute of Frauds §§ 513, 574, 589.

Contract for sale of goods as entire or divisible, 2 A.L.R. 643.

When goods remaining in custody of seller or some third person deemed received by buyer within exception to statute, 4 A.L.R. 902.

Divisibility of contract for the sale of an outfit, plant or machinery, 4 A.L.R. 1442.

Trade custom or usage to explain or supply essential terms in writing required by statute of frauds (or Sales Act) in sale of goods, 29 A.L.R. 1218.

Mutuality and enforceability of an agreement upon the sale of goods, to give the purchaser an option or the exclusive sale of similar goods without a corresponding obligation on his part, 45 A.L.R. 1197.

Oral contract to enter into written contract as within statute of frauds, 58 A.L.R. 1015.

Contracts relating to corporate stock as within provisions of statute of frauds dealing with sales of goods, etc., 59 A.L.R. 597.

Doctrine of part performance as sustaining action at law based on contract within statute of frauds, 59 A.L.R. 1305.

Necessity and sufficiency of statement in writing of consideration or price for sale of goods or choses in action in order to satisfy statute of frauds, 59 A.L.R. 1422.

Sufficiency of identification of vendor or purchaser in memorandum, 70 A.L.R. 196.

Failure to comply with statute of frauds as to part of a contract within the statute as affecting the enforceability of another part not covered by the statute, 71 A.L.R. 479.

Reformation of memorandum relied upon to take an oral contract out of the statute of frauds, 73 A.L.R. 99.

Extrinsic writing referred to in written agreement as part thereof for purposes of statute of frauds, 73 A.L.R. 1383.

Effect of statute of frauds on right to modify by parol agreement required to be in writing, 80 A.L.R. 539, 118 A.L.R. 1511.

Necessity that each of several papers constituting contract be signed by party to be charged, 85 A.L.R. 1184.

Admission of contract by defendant as affecting sufficiency of acts relied on to constitute part performance under statute of frauds, 90 A.L.R. 231.

Dealings between seller and buyer after latter's knowledge of former's fraud as waiver of claim for damages on account of fraud, 106 A.L.R. 172.

Construction and application of Uniform Sales Act, other than Section 4 relating to statute of frauds, as regards distinction between contract of sale and contract for work or labor, 111 A.L.R. 341.

Acceptance satisfying statute where purchaser in possession at time of sale, 111 A.L.R. 1312.

Writing between one of the parties to a contract and his agent or a third person as satisfying statute of frauds, 112 A.L.R. 490.

Place of signature on memorandum to satisfy statute of frauds, 112 A.L.R. 937.

Acceptance which will take oral sale or contract for sale out of statute of frauds as affected by cancellation of order or repudiation of contract before goods were shipped or delivered to buyer, 113 A.L.R. 810.

Relation between doctrines of estoppel and part performance as basis of enforcement of contract not conforming to the statute of frauds, 117 A.L.R. 939.

Statute of frauds as applied to agreements of repurchase or repayment on sale of corporate stock or other personal property, 121 A.L.R. 312.

Public record as satisfying requirement of statute of frauds as to written contract or memorandum, 127 A.L.R. 236.

Terms "bags," "bales," "cars" or other terms indefinite as to quantity or weight as satisfying statute of frauds, 129 A.L.R. 1230.

Money in possession of seller before contract was made as part payment, 131 A.L.R. 1252, 170 A.L.R. 245.

Check or note as memorandum satisfying statute of frauds, 153 A.L.R. 1112.

Contract to fill in land as one for sale of goods within statute of frauds, 161 A.L.R. 1158.

Printed, stamped or typewritten name as satisfying requirement of statute of frauds as regards signature, 171 A.L.R. 334.

Performance as taking contract not to be performed within a year out of the statute of frauds, 6 A.L.R.2d 1053.

Check as payment within contemplation of statute of frauds, 8 A.L.R.2d 251.

Sale of contractual rights; defect in written record as ground for avoiding sale, 10 A.L.R.2d 728.

Undelivered lease or contract (other than for sale of land), or undelivered memorandum thereof, as satisfying statute of frauds, 12 A.L.R.2d 508.

Agency to purchase personal property for another as within statute of frauds, 20 A.L.R.2d 1140.

Construction and effect of exception making the statute of frauds provision inapplicable where goods are manufactured by seller for buyer, 25 A.L.R.2d 672.

Construction and effect of contract for sale of commodity to fill buyer's requirements, 26 A.L.R.2d 1099.

Statute of frauds as applicable to seller's oral warranty as to quality or condition of chattel, 40 A.L.R.2d 760.

Recovery, on theory of quasi contract, unjust enrichment or restitution, of money paid in reliance upon unenforceable promise to accept a bill of exchange or draft, 81 A.L.R.2d 587.

Buyer's note as payment within contemplation of statute of frauds, 81 A.L.R.2d 1355.

Contract which violates statute of frauds as evidence of value in action not based on the contract, 21 A.L.R.3d 9.

Statute of frauds and conflict of laws, 47 A.L.R.3d 137.

Construction and application of U.C.C. § 2-201(3)(b) rendering contract of sale enforceable notwithstanding statute of frauds, to extent it is admitted in pleading, testimony, or otherwise in court, 88 A.L.R.3d 416.

Liability for interference with invalid or unenforceable contract, 96 A.L.R.3d 1294.

Construction and application of UCC § 2-201(3)(c) rendering contract of sale enforceable notwithstanding statute of frauds with respect to goods for which payment has been made and accepted or which have been received and accepted, 97 A.L.R.3d 908.

Promissory estoppel as basis for avoidance of U.C.C. statute of frauds (U.C.C. § 2-201), 29 A.L.R.4th 1006.

Sales: "specially manufactured goods" statute of frauds exception in UCC § 2-201(3)(a), 45 A.L.R.4th 1126.

Sales: construction of statute of frauds exception under UCC § 2-201(2) for confirmatory writing between merchants, 82 A.L.R.4th 709.

37 C.J.S. Frauds, Statute of § 138.

55-2-202. Final written expression; parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade (Section 1-205 [55-1-205 NMSA 1978]) or by course of performance (Section 2-208 [55-2-208 NMSA 1978]); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

History: 1953 Comp., § 50A-2-202, enacted by Laws 1961, ch. 96, § 2-202.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in Paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the

agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under Paragraph (b), consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross references. - Point 3: Sections 1-205, 2-207, 2-302 and 2-316.

Definitional cross references. - "Agreed" and "agreement". Section 1-201.

"Course of dealing". Section 1-205.

"Parties". Section 1-201.

"Term". Section 1-201.

"Usage of trade". Section 1-205.

"Written" and "writing". Section 1-201.

Parol evidence rule applicable to bills and notes. - The parol evidence rule applicable to written contracts generally is also applicable to bills and notes. Farmington Nat'l Bank v. Basin Plastics, Inc., 94 N.M. 668, 615 P.2d 985 (1980).

Parol evidence may be admitted to explain, qualify, add to or subtract from agreement. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Parol evidence inadmissible to change basic meaning of contract. - Parol evidence is not admissible when it would change the basic meaning of the contract and produce an agreement wholly different from, and wholly inconsistent with, the written agreement and would tend to distort the expressly stated written understanding of the parties. State ex rel. Nichols v. Safeco Ins. Co. of Am., 100 N.M. 440, 671 P.2d 1151 (Ct. App. 1983); Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Usage of trade inadmissible where contract clear. - Where the written contract terms leave no room for a contrary construction consistent with the claimed usage of trade,

the trial court correctly denies an offer of proof as to the usage of trade. State ex rel. Nichols v. Safeco Ins. Co. of Am., 100 N.M. 440, 671 P.2d 1151 (Ct. App. 1983).

Contract provision may preclude action for pre-contract negligent misrepresentation. - Commercial purchaser of a computer system may not maintain an action in tort against the seller for pre-contract negligent misrepresentations regarding the system's capacity to perform specific functions, where the subsequently executed written sales contract contains an effective integration clause, and an effective provision disclaiming all prior representations and all warranties, express or implied, not contained in the contract, where there is no indication or claim that the transaction was not undertaken at arm's length or freely entered into by two commercial entities. Rio Grande Jewelers Supply, Inc. v. Data Gen. Corp., 101 N.M. 798, 689 P.2d 1269 (1984).

Terms of written contract may carry over into substantially identical oral contract. - Where, after a written contract is terminated, an oral contract is entered into, and where there is a course of dealing for a number of years under the oral contract, which is identical in all respects other than to whom payment would be made, the provisions of which are fully known to and understood by the buyer, who has the obligation to give timely notice or waive any and all claims, the terms of the written contract carry over into the oral arrangement. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Alternate financing agreement waived need for written contract modification. - Where a boat buyer's agreement with a bank concerning alternate financing was conduct waiving the need for a written contract modification, the financing terms agreed upon between the buyer and the bank became a part of the contract, and the contract was supplemented in a commercially reasonable manner. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 73; 68A Am. Jur. 2d Secured Transactions §§ 105 et seq., 164; 72 Am. Jur. 2d Statute of Frauds §§ 138, 297, 343.

Affirmations or representations made after the sale is closed as basis of warranty under UCC § 2-313(1)(a), 47 A.L.R.4th 200.

32A C.J.S. Evidence §§ 1168 et seq., 1183.

55-2-203. Seals inoperative.

The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing [of] a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

History: 1953 Comp., § 50A-2-203, enacted by Laws 1961, ch. 96, § 2-203.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 3, Uniform Sales Act.

Changes. Portion pertaining to "seals" rewritten.

Purposes of changes. - 1. This section makes it clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see Section 2-205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly, the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

Cross reference. - Point 1: Section 2-205.

Definitional cross references. - "Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Writing". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 17A Am. Jur. 2d Contracts §§ 58, 116, 182; 67 Am. Jur. 2d Seals § 1 et seq; 68A Am. Jur. 2d Secured Transactions § 169.

77A C.J.S. Sales § 1 et seq.; 79 C.J.S. Seals §§ 2, 3.

55-2-204. Formation in general.

(1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

History: 1953 Comp., § 50A-2-204, enacted by Laws 1961, ch. 96, § 2-204.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 1 and 3, Uniform Sales Act.

Changes. Completely rewritten by this and other sections of this article.

Purposes of changes. - Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this article.

Under Subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to "open terms" underlying later sections of the article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

Cross references. - Subsection (1): Sections 1-103, 2-201 and 2-302.

Subsection (2): Sections 2-205 to 2-209.

Subsection (3): See Part 3.

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 38 Am. Jur. 2d Guaranty § 38.

Validity and construction of contract for sale of season's output, 1 A.L.R. 1392, 9 A.L.R. 276, 23 A.L.R. 574.

Contract for sale of goods as entire or divisible, 2 A.L.R. 643.

Divisibility of contract for sale of an outfit, plant or machinery, 4 A.L.R. 1442.

Contract for sale of commodity to extent of buyer's requirements, 7 A.L.R. 498, 26 A.L.R. 2d 1099.

Sale agreement fixing price at retail less specified percent as indefinite, 57 A.L.R. 747.

Contract for sale of commodity or goods wherein quantity is described as "about" or "more or less" than the amount specified, 58 A.L.R.2d 377.

77A C.J.S. Sales § 9 et seq.

55-2-205. Firm offers.

An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

History: 1953 Comp., § 50A-2-205, enacted by Laws 1961, ch. 96, § 2-205.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 1 and 3, Uniform Sales Act.

Changes. Completely rewritten by this and other sections of this article.

Purposes of changes. - 1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this article since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; Section 2-302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

Cross references. - Point 1: Section 1-102.

Point 2: Section 1-102.

Point 3: Section 2-201.

Point 5: Section 2-302.

Definitional cross references. - "Goods". Section 2-105.

"Merchant". Section 2-104.

"Signed". Section 1-201.

"Writing". Section 1-201.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 29 et seq.

55-2-206. Offer and acceptance in formation of contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances:

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but such a shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

History: 1953 Comp., § 50A-2-206, enacted by Laws 1961, ch. 96, § 2-206.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 1 and 3, Uniform Sales Act.

Changes. Completely rewritten in this and other sections of this article.

Purposes of changes. To make it clear that:

1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance, be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense as in Section 2-504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under Subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection (1)(b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a non-conforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is non-conforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.

Definitional cross references. - "Buyer". Section 2-103.

"Conforming". Section 1-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 38 Am. Jur. 2d Guaranty § 5.

Acceptance of offer with condition which law would imply, 1 A.L.R. 1508.

Acknowledging receipt of order for goods as an acceptance completing the contract, 10 A.L.R. 683.

Acting on order for goods as an acceptance thereof, 29 A.L.R. 1352.

Reward for disproving commercial claim, 96 A.L.R.3d 907.

77A C.J.S. Sales § 29 et seq.

55-2-207. Additional terms in acceptance or confirmation.

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this act [this chapter].

History: 1953 Comp., § 50A-2-207, enacted by Laws 1961, ch. 96, § 2-207.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 1 and 3, Uniform Sales Act.

Changes. Completely rewritten by this and other sections of this article.

Purposes of changes. - 1. This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is offer and acceptance, in which a wire or letter expressed and intended as an acceptance or the closing of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed" or the like. A frequent example of the second situation is the exchange of printed purchase order and acceptance (sometimes called "acknowledgment") forms. Because the forms are oriented to the thinking of the respective drafting parties, the terms contained in them often do not correspond. Often the seller's form contains terms different from or additional to those set forth in the buyer's form. Nevertheless, the parties proceed with the transaction. [Comment 1 was amended in 1966.]

2. Under this article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained in the confirmation or in the acceptance falls within Subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional or different terms. [Comment 2 was amended in 1966.]

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of Subsection (2). If they are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90% or 100% deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due and a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this article on merchant's excuse by failure of presupposed conditions or a clause fixing in advance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for and a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see Sections 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in Subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this act, including Subsection (2). The written confirmation is also subject to Section 2-201. Under that section a failure to respond permits enforcement of a prior oral agreement; under this section a failure to respond permits additional terms to become part of the agreement. [Comment 6 was amended in 1966.]

7. In many cases, as where goods are shipped, accepted and paid for before any dispute arises, there is no question whether a contract has been made. In such cases, where the writings of the parties do not establish a contract, it is not necessary to determine which act or document constituted the offer and which the acceptance. See Section 2-204. The only question is what terms are included in the contract, and Subsection (3) furnishes the governing rule. [Comment 7 was added in 1966.]

Cross references. - See generally Section 2-302.

Point 5: Sections 2-513, 2-602, 2-607, 2-609, 2-612, 2-614, 2-615, 2-616, 2-718 and 2-719.

Point 6: Sections 1-102 and 2-104.

Definitional cross references. - "Between merchants". Section 2-104.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Reasonable time". Section 1-204.

"Seasonably". Section 1-204.

"Send". Section 1-201.

"Term". Section 1-201.

"Written". Section 1-201.

Exchange of forms containing conflicting clauses. - An exchange of forms containing identical dickered terms, such as the identity, price, and quantity of goods, and conflicting undickered boiler plate provisions, such as warranty terms in a provision making the bargain subject to the terms and conditions of the offerees document, however worded, will not propel the transaction into the "expressly conditional" language of Subsection (1) and confer the status of counter offer on the responsive document. The question guiding the inquiry should be whether the offerer could reasonably believe that in the context of the commercial setting in which the parties were acting, a contract had been formed. Gardner Zemke Co. v. Dunham Bush, Inc., 115 N.M. 260, 850 P.2d 319 (1993).

Where clauses on confirming forms sent by both parties conflict, each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection, which is found in Subsection (2), is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmation is agreed, and terms applied by this act, including Subsection (2). Gardner Zemke Co. v. Dunham Bush, Inc., 115 N.M. 260, 850 P.2d 319 (1993).

Contract can be modified by conduct of parties once its existence is established. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Alternative financing agreement waived need for written contract modification. - Where a boat buyer's agreement with a bank concerning alternate financing was conduct waiving the need for a written contract modification, the financing terms agreed upon between the buyer and the bank became a part of the contract, and the contract was supplemented in a commercially reasonable manner. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Attorney fee provision in contract. - The New Mexico courts have not yet decided the issue of whether an attorney fee provision constitutes a material alteration to a contract, but such provision may involve an unreasonable surprise and therefore constitute a material alteration. American Ins. Co. v. El Paso Pipe & Supply Co., 978 F.2d 1185 (10th Cir. 1992).

Because the district court failed to indicate any factual basis for its ultimate conclusion that the attorney fee provision in the purchase order was not a material alteration, the case was remanded for further proceedings to permit the trial court to apply the appropriate criteria and make the missing findings of fact. American Ins. Co. v. El Paso Pipe & Supply Co., 978 F.2d 1185 (10th Cir. 1992).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - What constitutes acceptance "expressly made conditional" converting it to rejection and counteroffer under UCC § 2-207(1), 22 A.L.R.4th 939.

77A C.J.S. Sales § 38 et seq.

55-2-208. Course of performance or practical construction.

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205 [55-1-205 NMSA 1978]).

(3) Subject to the provisions of the next section [55-2-209 NMSA 1978] on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

History: 1953 Comp., § 50A-2-208, enacted by Laws 1961, ch. 96, § 2-208.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. No such general provision but concept of this section recognized by terms such as "course of dealing," "the circumstances of the case," "the conduct of the parties," etc., in Uniform Sales Act.

Purposes. - 1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this article.

2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance elsewhere in this article carries no contrary implication when there is a failure to refer to it in other sections.

3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see Section 2-209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.

4. A single occasion of conduct does not fall within the language of this section but other sections such as the ones on silence after acceptance and failure to specify particular defects can affect the parties' rights on a single occasion (see Sections 2-605 and 2-607).

Cross references. - Point 1: Section 1-201.

Point 2: Section 2-202.

Point 3: Sections 2-209, 2-601 and 2-607.

Point 4: Sections 2-605 and 2-607.

Summary judgment improper. - The trial court erred in granting summary judgment to a bank, on a default clause in a note, where a question of fact existed as to whether the bank, by its conduct, had misled the customer as to its intention to declare a default and accelerate payments. J.R. Hale Contracting Co. v. United New Mexico Bank, 110 N.M. 712, 799 P.2d 581 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 28; 38 Am. Jur. 2d Guaranty § 5; 68A Am. Jur. 2d Secured Transactions § 31.

77A C.J.S. Sales § 85 et seq.

55-2-209. Modification, rescission and waiver.

(1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this article (Section 2-201 [55-2-201 NMSA 1978]) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of Subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

History: 1953 Comp., § 50A-2-209, enacted by Laws 1961, ch. 96, § 2-209.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - Compare Section 1, Uniform Written Obligations Act; Subsections (2) to (5) - none.

Purposes of changes and new matter. - 1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (Section 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under Sections 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in Green v. Doniger, 300 N.Y. 238, 90 N.E. 2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The statute of frauds provisions of this article are expressly applied to modifications by Subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own statute of frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of Subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in Subsection (5).

Cross references. - Point 1: Section 1-203.

Point 2: Sections 1-201, 1-203, 2-615 and 2-616.

Point 3: Sections 2-106, 2-201 and 2-102.

Point 4: Sections 2-202 and 2-208.

Definitional cross references. - "Agreement". Section 1-201.

"Between merchants". Section 2-104.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Signed". Section 1-201.

"Term". Section 1-201.

"Writing". Section 1-201.

Alternative financing agreement waived need for written contract modification. - Where a boat buyer's agreement with a bank concerning alternate financing was conduct waiving the need for a written contract modification, the financing terms agreed upon between the buyer and the bank became a part of the contract, and the contract was supplemented in a commercially reasonable manner. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Assignability of right to rescind or of right to return of money or other property as incident of rescission, 162 A.L.R. 743.

Affirmations or representations made after the sale is closed as basis of warranty under UCC § 2-313(1)(a), 47 A.L.R.4th 200.

37 C.J.S. Frauds, Statute of § 232; 77A C.J.S. Sales § 109 et seq.

55-2-210. Delegation of performance; assignment of rights.

(1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Unless otherwise agreed all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) Unless the circumstances indicate the contrary, a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the

assignor demand assurances from the assignee (Section 2-609 [55-2-609 NMSA 1978]).

History: 1953 Comp., § 50A-2-210, enacted by Laws 1961, ch. 96, § 2-210.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by Subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under Subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the article on secured transactions (Article 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as defined in the article on secured transactions (Article 9) is not covered by this subsection.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved. This article and this section are intended to clarify this problem, particularly in cases dealing with output requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in Subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is barred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This article takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the assignment. This question is dealt with in the article on secured transactions (Article 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this article touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article 9.

Cross references. - Point 3: Articles 5 and 9.

Point 4: Sections 2-306 and 2-609.

Point 5: Article 9, Sections 9-317 and 9-318.

Point 7: Article 9.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Party". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

"Term". Section 1-201.

Law reviews. - For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 104.

77A C.J.S. Sales § 151 et seq.

PART 3
GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

55-2-301. General obligations of parties.

The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

History: 1953 Comp., § 50A-2-301, enacted by Laws 1961, ch. 96, § 2-301.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 11 and 41, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. - This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this article such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that act on the effect of conditions. In order to determine what is "in accordance with the contract" under this article usage of trade, course of dealing and performance and the general background of circumstances must be given due consideration in conjunction with the lay meaning of the words used to define the scope of the conditions and duties.

Cross references. - Section 1-106. See also Sections 1-205, 2-208, 2-209, 2-508 and 2-612.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Party". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 405; 67 Am. Jur. 2d Sales §§ 102 to 239.

What amounts to delivery f.o.b., 16 A.L.R. 597.

Substantial performance of contract for manufacture or sale of article, 19 A.L.R. 815.

What constitutes delivery of goods sold under "c.i.f." contract, 20 A.L.R. 1236.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

Implied or apparent authority of agent to purchase or order goods or merchandise, 55 A.L.R.2d 6.

77A C.J.S. Sales § 157 et seq.

55-2-302. Unconscionable contract or clause.

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

History: 1953 Comp., § 50A-2-302, enacted by Laws 1961, ch. 96, § 2-302.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the

commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; and Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in Subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional cross reference. - "Contract". Section 1-201.

This section is part of the code applicable to sales, and by its terms does not apply to security transactions. Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968).

Comparative liability is not part of the Uniform Commercial Code under this section. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Common-law doctrine of unconscionability. - This section sets out what should be the rule under the common-law doctrine of unconscionability as applied to all contracts, including real property leases. Therefore, a court in which a portion of a contract, including a lease, is challenged as unconscionable should receive evidence, if relevant, as to its commercial setting, purpose and effect in ruling on unconscionability. State ex rel. State Hwy. & Transp. Dep't v. Garley, 111 N.M. 383, 806 P.2d 32 (1991).

Determination of unconscionability in a contract clause is a matter of law. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Requiring loss claims to be made within two days not unconscionable. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Terms of written contract may carry over into substantially identical oral contract. - Where, after a written contract is terminated, an oral contract is entered into, and where there is a course of dealing for a number of years under the oral contract, which is identical in all respects other than to whom payment would be made, the provisions of which are fully known to and understood by the buyer, who has the obligation to give timely notice or waive any and all claims, the terms of the written contract carry over into the oral arrangement. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Court may not modify otherwise legal language of contract. - It is not the province of the courts to alter or amend a contract freely made by the parties for themselves. The courts cannot change or modify the language of a contract, otherwise legal, for the benefit of one party and to the detriment of another. Smith v. Price's Creameries, 98 N.M. 541, 650 P.2d 825 (1982).

Condemnation clause in lease agreement. - Lessor of condemned commercial premises was entitled to summary judgment in a dispute over a condemnation clause in

the lease, where the lessee failed to carry his burden to support a contention that the commercial setting purpose and effect of the clause were such as to make it unconscionable. State ex rel. State Hwy. & Transp. Dep't v. Garley, 111 N.M. 383, 806 P.2d 32 (1991).

Law reviews. - For survey, "The Uniform Owner-Resident Relations Act," see 6 N.M. L. Rev. 293 (1976).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 28; 68A Am. Jur. 2d Secured Transactions § 8.

Sufficiency of description of collateral in security agreement under UCC §§ 9-110 and 9-203, 100 A.L.R.3d 940.

Unconscionability, under UCC § 2-302 or § 2-719(3), of disclaimer of warranties or limitation or exclusion of damages in contract subject to UCC Article 2 (Sales), 38 A.L.R.4th 25.

"Unconscionability," under UCC § 2-302, of bank's letter of credit or other financing arrangements, 15 A.L.R.5th 365.

Validity, construction, and effect of statute or lease provision expressly governing rights and compensation of lessee upon condemnation of leased property, 22 A.L.R.5th 327.

77A C.J.S. Sales § 87; 81 C.J.S. Specific Performance § 40.

55-2-303. Allocation or division of risks.

Where this article allocates a risk or a burden as between the parties "unless otherwise agreed," the agreement may not only shift the allocation but may also divide the risk or burden.

History: 1953 Comp., § 50A-2-303, enacted by Laws 1961, ch. 96, § 2-303.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this article as they desire, always subject, of course, to the provisions on unconscionability.

Compare Section 1-102(4).

2. The risk or burden may be divided by the express terms of the agreement or by the attending circumstances, since under the definition of "agreement" in this act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

Cross references. - Point 1: Sections 1-102 and 2-302.

Point 2: Section 1-201.

Definitional cross references. - "Party". Section 1-201.

"Agreement". Section 1-201.

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 151 et seq.

55-2-304. Price payable in money, goods, realty or otherwise.

(1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

History: 1953 Comp., § 50A-2-304, enacted by Laws 1961, ch. 96, § 2-304.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsections (2) and (3) of Section 9, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. - 1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accuracy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects

any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under Subsection (1) the provisions of this article are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole article applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons of the article must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this article apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regulation of various particular contracts which fall outside the scope of this article is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this article. In contrast, this article declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this article control.

Cross references. - Point 1: Section 1-102.

Point 3: Sections 1-102, 1-103, 1-104 and 2-107.

Definitional cross references. - "Goods". Section 2-105.

"Money". Section 1-201.

"Party". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 73, 113.

Right of purchaser to opportunity to pay in cash where tender has been made in other medium, 23 A.L.R. 630, 46 A.L.R. 914.

Necessity of independent consideration to support a modification of the price in a contract of sale, 34 A.L.R. 511.

Validity and enforceability of contract which expressly leaves open terms of payment for future negotiation, 49 A.L.R. 1464.

33 C.J.S. Exchange of Property § 1; 77A C.J.S. Sales § 94 et seq.

55-2-305. Open price term.

(1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if:

(a) nothing is said as to price; or

(b) the price is left to be agreed by the parties and they fail to agree; or

(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party, the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

History: 1953 Comp., § 50A-2-305, enacted by Laws 1961, ch. 96, § 2-305.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 9 and 10, Uniform Sales Act.

Changes. Completely rewritten.

Purposes of changes. - 1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended by the parties to be a binding agreement. This article rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within Subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness". Instead this article recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this article recognizes remedies such as cover (Section 2-712), resale (Section 2-706) and specific performance (Section 2-716) which go beyond any mere arithmetic as between contract price and market price, there

is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of Subsection (1) ("The parties *if they so intend* ") and in Subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price" or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For example, the case where a known and trusted expert is to "value" a particular painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under Subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this act. (Section 1-203).

Cross references. - Point 1: Sections 2-204(3), 2-706, 2-712 and 2-716.

Point 3: Section 2-103.

Point 5: Sections 2-311 and 2-610.

Point 6: Section 1-203.

Definitional cross references. - "Agreement". Section 1-201.

"Burden of establishing". Section 1-201.

"Buyer". Section 2-103.

"Cancellation". Section 2-106.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Fault". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Receipt of goods". Section 2-103.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - "Escalator" price adjustment clause, 63 A.L.R.2d 1337.

Construction and application of U.C.C. § 2-305 dealing with open price term contracts, 91 A.L.R.3d 1237.

77A C.J.S. Sales § 94 et seq.

55-2-306. Output, requirements and exclusive dealings.

(1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

History: 1953 Comp., § 50A-2-306, enacted by Laws 1961, ch. 96, § 2-306.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem the general approach of this act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made, but normal expansion undertaken in good faith would be within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in Southwest Natural Gas Co. v. Oklahoma Portland Cement Co., 102 F.2d 630 (C.C.A. 10, 1939). This article takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this article, and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use reasonable diligence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of Subsection (1). It also raises questions of insecurity and right to adequate assurance under this article.

Cross references. - Point 4: Section 2-210.

Point 5: Sections 1-203 and 2-609.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Good faith". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Term". Section 1-201.

"Seller". Section 2-103.

Good faith controls requirement contract. - Contract that required contractor to furnish subcontractor all concrete aggregate and sand material "necessary to the preparation of said concrete pavement" amounts to a requirement contract; and whether contractor in good faith delivered a quantity of the material which was disproportionate to the normal requirements for the purpose for which it was delivered is a question of fact necessary to the determination of subcontractor's liability for breach of contract. Gruschus v. C.R. Davis Contracting Co., 75 N.M. 649, 409 P.2d 500 (1965).

And excessive delivery deemed lack of good faith. - Delivery of at least 10% in excess of all material actually used, wasted and dumped warrants inference that delivery was unreasonably disproportionate to the requirements for which it was delivered and too excessive to have been delivered in good faith. Gruschus v. C.R. Davis Contracting Co., 77 N.M. 614, 426 P.2d 589 (1967).

Lawful agreement imposes corresponding duty. - A lawful agreement by either seller or buyer imposes a corresponding duty on the other party under this section. McCasland v. Prather, 92 N.M. 192, 585 P.2d 336 (Ct. App. 1978).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Construction and effect of contract for sale of commodity to fill buyer's requirements, 7 A.L.R. 498, 26 A.L.R.2d 1099.

Requirements contracts under § 2-306(1) of the Uniform Commercial Code, 96 A.L.R.3d 1275.

Output contracts under § 2-306(1) of Uniform Commercial Code, 30 A.L.R.4th 396.

77A C.J.S. Sales § 176 et seq.

55-2-307. Delivery in single lot or several lots.

Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

History: 1953 Comp., § 50A-2-307, enacted by Laws 1961, ch. 96, § 2-307.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 45(1), Uniform Sales Act.

Changes. Rewritten and expanded.

Purposes of changes. - 1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original act, Section 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire

amount of brick at once, or it may be necessary to assemble the goods as in the case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of Section 2-609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of Section 2-503 on manner of tender of delivery. This is reinforced by the express provisions of Section 2-608 that if a lot has been accepted on the reasonable assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of Kelly Construction Co. v. Hackensack Brick Co., 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in Lynn M. Ranger, Inc. v. Gildersleeve, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

Cross references. - Point 1: Section 1-201.

Point 2: Sections 2-508 and 2-601.

Point 3: Sections 2-503, 2-608 and 2-609.

Definitional cross references. - "Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Lot". Section 2-105.

"Party". Section 1-201.

"Rights". Section 1-201.

Whether there has been sufficient delivery depends on the intent of the seller to deliver as manifested by the acts and circumstances surrounding the transaction. Garrison Gen. Tire Serv., Inc. v. Montgomery, 75 N.M. 321, 404 P.2d 143 (1965).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right upon buyer's default in payment of installment due, to recover amount not due, in absence of acceleration clause, 57 A.L.R. 825.

Buyer's acceptance of part of goods as affecting right to damages for failure to complete delivery, 169 A.L.R. 595.

Buyer's acceptance of delayed or defective installment of goods as waiver of similar default as to later installments, 32 A.L.R.2d 1117.

77A C.J.S. Sales § 172 et seq.

55-2-308. Absence of specified place for delivery.

Unless otherwise agreed:

(a) the place for delivery of goods is the seller's place of business or if he has none his residence; but

(b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and

(c) documents of title may be delivered through customary banking channels.

History: 1953 Comp., § 50A-2-308, enacted by Laws 1961, ch. 96, § 2-308.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Paragraphs (a) and (b) - Section 43(1), Uniform Sales Act; Paragraph (c) - none.

Changes. Slight modification in language.

Purposes of changes and new matter. - 1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement", the seller's duties as to delivery of the goods are governed not by this section but by Section 2-504.

2. Under Paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a

bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are on hand, leaving the buyer himself to see to the physical receipt of the goods, tender at the buyer's address is not required under Paragraph (c). But that paragraph merely eliminates the possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by documents or has undertaken its collection on behalf of the seller, Part 5 of Article 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the article on letters of credit spells out the duties and relations between the bank, the seller and the buyer.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement".

Cross references. - Point 1: Sections 2-504 and 2-505.

Point 2: Section 2-503.

Point 3: Section 2-512, Articles 4, Part 5, and 5.

Definitional cross references. - "Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 168 et seq.

55-2-309. Absence of specific time provisions; notice of termination.

(1) The time for shipment or delivery or any other action under a contract if not provided in this article or agreed upon shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

History: 1953 Comp., § 50A-2-309, enacted by Laws 1961, ch. 96, § 2-309.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - see Sections 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article; Subsection (2) - none; Subsection (3) - none.

Changes. Completely different in scope.

Purposes of changes and new matter. - 1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in Sections 1-203, 1-204 and 2-103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is "agreed" by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in Section 2-513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this article impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this article as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which

may amount without more to breach or to create breach by the other side. See Sections 2-207 and 2-609.

5. The obligation of good faith under this act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver.

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this article pending further negotiations. Only when a party insists on undue delay or on rejection of the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

Cross references. - Point 1: Sections 1-203, 1-204 and 2-103.

Point 2: Sections 2-320, 2-321, 2-504 and 2-511 to 2-514.

Point 5: Section 1-203.

Point 6: Section 2-609.

Point 7: Section 2-204.

Point 9: Sections 2-106, 2-318, 2-610 and 2-703.

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Notification". Section 1-201.

"Party". Section 1-201.

"Reasonable time". Section 1-204.

"Termination". Section 2-106.

Contract with indefinite time provisions terminable at will. - Subsections (2) and (3), when read together, set out that a contract with indefinite time provisions is terminable at will upon reasonable notification. McCasland v. Prather, 92 N.M. 192, 585 P.2d 336 (Ct. App. 1978).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 168 et seq.

55-2-310. Open time for payment or running of credit; authority to ship under reservation.

Unless otherwise agreed:

(a) payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and

(b) if the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (Section 2-513 [55-2-513 NMSA 1978]); and

(c) if delivery is authorized and made by way of documents of title otherwise than by Subsection (b) then payment is due at the time and place at which the buyer is to receive the documents regardless of where the goods are to be received; and

(d) where the seller is required or authorized to ship the goods on credit, the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

History: 1953 Comp., § 50A-2-310, enacted by Laws 1961, ch. 96, § 2-310.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 42 and 47(2), Uniform Sales Act.

Changes. Completely rewritten in this and other sections.

Purposes of Changes. This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus:

1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery except in documentary shipment cases (Paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article 4. In the absence of a credit term, the seller is permitted to ship under reservation and if he does, payment is then due where and when the buyer is to receive the documents.

3. Unless otherwise agreed, the place for the receipt of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under Paragraph (b), and Sections 2-512 and 2-513 the buyer is under no duty to pay prior to inspection.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit adequate inspection before receipt, the seller must be guided by the provisions of this article on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time of shipment. The provision concerning any delay in sending forth the invoice is included because such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

Cross references. - Generally: Part 5.

Point 1: Section 2-509.

Point 2: Sections 2-505, 2-511, 2-512, 2-513 and Article 4.

Point 3: Sections 2-308(b), 2-512 and 2-513.

Point 4: Section 2-513(3)(b).

Definitional cross references. - "Buyer". Section 2-103.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Receipt of goods". Section 2-103.

"Seller". Section 2-103.

"Send". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 185, 194, 409.

Validity and enforceability of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

77A C.J.S. Sales § 208 et seq.

55-2-311. Options and cooperation respecting performance.

(1) An agreement for sale which is otherwise sufficiently definite (Subsection (3) of Section 2-204 [55-2-204 NMSA 1978]) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such

specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed, specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in Subsections (1) (c) and (3) of Section 2-319 [55-2-319 NMSA 1978] specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies:

(a) is excused for any resulting delay in his own performance; and

(b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

History: 1953 Comp., § 50A-2-311, enacted by Laws 1961, ch. 96, § 2-311.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under Subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably

forthcoming; the subsection relieves the other party from the necessity for performance or excuses his delay in performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies". The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in Subsection (3) is one which does not operate in the situation which falls within the scope of Section 2-614 on substituted performance. Where the failure to cooperate results from circumstances set forth in that section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the noncooperating party.

Cross references. - Point 1: Sections 1-201, 2-204 and 1-203.

Point 3: Sections 1-203 and 2-609.

Point 4: Section 2-614.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Applicability of pre-UCC contract law. - Where leases do not define which party was to determine the particulars of the option to purchase, the courts will look to pre-code contract law to resolve matters relating to the exercise of the option. Cranetex, Inc. v. Mountain Dev. Corp., 106 N.M. 5, 738 P.2d 123 (1987).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Construction and effect of contract for sale of commodity or goods wherein quantity is described as "about" or "more or less" than amount specified, 58 A.L.R.2d 377.

77A C.J.S. Sales § 151 et seq.

55-2-312. Warranty of title and against infringement; buyer's obligation against infringement.

(1) Subject to Subsection (2) there is in a contract for sale a warranty by the seller that:

(a) the title conveyed shall be good, and its transfer rightful; and

(b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under Subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

History: 1953 Comp., § 50A-2-312, enacted by Laws 1961, ch. 96, § 2-312.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 13, Uniform Sales Act.

Changes. Completely rewritten, the provisions concerning infringement being new.

Purposes of changes. - 1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in Subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this article requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith Section 2-725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this article "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

6. The warranty of Subsection (1) is not designated as an "implied" warranty, and hence is not subject to Section 2-316 (3). Disclaimer of the warranty of title is governed instead by Subsection (2), which requires either specific language or the described circumstances.

Cross references. - Point 1: Section 2-403.

Point 2: Sections 2-607 and 2-725.

Point 3: Section 1-203.

Point 4: Sections 2-609 and 2-725.

Point 6: Section 2-316.

Definitional cross references. - "Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Person". Section 1-201.

"Right". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 38 Am. Jur. 2d Guaranty § 13; 63 Am. Jur. 2d Products Liability §§ 451, 526, 527.

Assignment of lease, 19 A.L.R. 608.

Breach of warranty as to title as within statutory provision requiring notice of breach of warranty on sale of goods, 114 A.L.R. 707.

Validity of provision negativing implied warranties, 117 A.L.R. 1350.

Warranty of title by seller in conditional sale contract, 132 A.L.R. 338.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

77A C.J.S. Sales § 236 et seq.

55-2-313. Express warranties by affirmation, promise, description, sample.

(1) Express warranties by the seller are created as follows:

(a) any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise;

(b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description;

(c) any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

History: 1953 Comp., § 50A-2-313, enacted by Laws 1961, ch. 96, § 2-313.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 12, 14 and 16, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To consolidate and systematize basic principles with the result that:

1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied".

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case

law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under Section 2-316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon, good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1) (b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any affirmation of fact is intended to

become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as describing values of the goods contracted for unless it is accompanied by an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (Section 2-209).

8. Concerning affirmations of value or a seller's opinion or commendation under Subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain? As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of Subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

Cross references. - Point 1: Section 2-316.

Point 2: Sections 1-102(3) and 2-318.

Point 3: Section 2-316(2) (b).

Point 4: Section 2-316.

Point 5: Sections 1-205(4) and 2-314.

Point 6: Section 2-316.

Point 7: Section 2-209.

Point 8: Section 1-103.

Definitional cross references. - "Buyer". Section 2-103.

"Conforming". Section 2-106.

"Goods". Section 2-105.

"Seller". Section 2-103.

I. General Consideration.
II. Seller's Opinion.
III. Affirmation of Facts.

I. GENERAL CONSIDERATION.

Any express warranty made with respect to surgeon would inure to patient's benefit on the basis that the surgeon is acting as the patient's agent in the use of a medical product. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

Insufficiency of evidence. - Where there is no evidence that either the terms of the rental agreement or the reference to "good tires" were part of the basis of the bargain by renters, the evidence was insufficient for the question of express warranty to be submitted to the jury. Stang v. Hertz Corp., 83 N.M. 217, 490 P.2d 475 (Ct. App. 1971), rev'd on other grounds, 83 N.M. 730, 497 P.2d 732 (1972).

Law reviews. - For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability §§ 1, 191 to 210, 450 to 527, 947 to 950.

Right of retailer to rely upon express or implied warranty by wholesaler or manufacturer where there is an express warranty to the consumer, 59 A.L.R. 1239.

Construction and effect of express or implied warranty on sale of an article intended for use as an explosive, 62 A.L.R. 1510.

Scope and effect of provision of Uniform Sales Act as to effect of express warranty or condition to negative implied warranty or condition, 64 A.L.R. 951.

Express warranty as excluding implied warranty of fitness, 164 A.L.R. 1321.

Warranties and conditions upon sale of seed, nursery stock, etc., 168 A.L.R. 581.

What amounts to "sale by sample" as regards implied warranties, 12 A.L.R.2d 524.

Time to inspect goods for compliance with warranty of fitness or merchantability, 52 A.L.R.2d 900.

Warranty of amount by contract for sale of commodity or goods wherein quantity is described as "about" or "more or less" than an amount specified, 58 A.L.R.2d 377.

Question whether oral statements amount to express warranty, as one of fact for jury or of law for court, 67 A.L.R.2d 619.

Construction and effect of affirmative provision in contract of sale by which purchaser agrees to take article in the condition in which it is, 24 A.L.R.3d 465.

Liability for representations and express warranties in connection with sale of used motor vehicle, 36 A.L.R.3d 125.

Sales: Liability for warranty or representation that article, other than motor vehicle, is new, 36 A.L.R.3d 237.

Products liability: stoves, 93 A.L.R.3d 99.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

What constitutes "affirmation of fact" giving rise to express warranty under U.C.C. § 2-313(1)(a), 94 A.L.R.3d 729.

Products liability: flammable clothing, 1 A.L.R.4th 251.

Products liability: fertilizers, insecticides, pesticides, fungicides, weed killers, and the like, or articles used in application thereof, 12 A.L.R.4th 462.

Products liability: stud guns, staple guns, or parts thereof, 33 A.L.R.4th 1189.

Computer sales and leases: breach of warranty, misrepresentation, or failure of consideration as defense or ground for affirmative relief, 37 A.L.R.4th 110.

Products liability: inconsistency of verdicts on separate theories of negligence, breach of warranty, or strict liability, 41 A.L.R.4th 9.

Affirmations or representations made after the sale is closed as basis of warranty under UCC § 2-313(1)(a), 47 A.L.R.4th 200.

Liability of successor corporation for punitive damages for injury caused by predecessor's product, 55 A.L.R.4th 166.

Computer sales and leases: time when cause of action for failure of performance accrues, 90 A.L.R.4th 298.

Products liability: roofs and roofing materials, 3 A.L.R.5th 851.

Validity, construction, and application of computer software licensing agreements, 38 A.L.R.5th 1.

77A C.J.S. Sales § 242 et seq.

II. SELLER'S OPINION.

When seller's opinion not express warranty. - When a seller asserts a fact of which the buyer is ignorant, and the buyer relies on the assertion, the seller makes an express warranty, but when the seller merely states his opinion or his judgment upon a matter of which the seller has no special knowledge, or upon which the buyer may be expected to have an opinion and exercise his judgment, then the seller's statement does not constitute an express warranty. Lovington Cattle Feeders, Inc. v. Abbott Labs., 97 N.M. 564, 642 P.2d 167 (1982).

When opinion amounts to warranty. - Even if a representative's statement amounts to an opinion, the opinion amounts to a warranty if the statement becomes a part of the basis of the bargain. Lovington Cattle Feeders, Inc. v. Abbott Labs., 97 N.M. 564, 642 P.2d 167 (1982).

All circumstances considered in determining whether warranty exists. - All of the circumstances of a sale are to be considered when determining whether there was an express warranty or a mere expression of opinion. Lovington Cattle Feeders, Inc. v. Abbott Labs., 97 N.M. 564, 642 P.2d 167 (1982).

III. AFFIRMATION OF FACTS.

When affirmations of facts express warranty. - Affirmations of facts do not amount to express warranties unless they are part of the basis of the bargain. Jones v. Minnesota Mining & Mfg. Co., 100 N.M. 268, 669 P.2d 744 (Ct. App. 1983).

Affirmation of fact consists of all of the language in the manufacturer's publication; the plaintiff cannot limit the express warranty issue to words taken out of context. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

No independent "reliance" requirement as to affirmation of fact. - If there is an affirmation of fact which is a part of the basis of the bargain, there is no independent "reliance" requirement as to that affirmation of fact. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

But user must be aware of manufacturer's warning, or no express warranty. - Where a user is not aware of a manufacturer's warning and the warning does not enter into his decision to use the manufacturer's product, the affirmation is not part of any bargain and there is no express warranty. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

55-2-314. Implied warranty: merchantability; usage of trade.

(1) Unless excluded or modified (Section 2-316 [55-2-316 NMSA 1978]), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as:

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (Section 2-316 [55-2-316 NMSA 1978]) other implied warranties may arise from course of dealing or usage of trade.

History: 1953 Comp., § 50A-2-314, enacted by Laws 1961, ch. 96, § 2-314.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 15(2), Uniform Sales Act.

Changes. Completely rewritten.

Purposes of changes. This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of Section 2-316).

Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in Section 15(2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee".

5. The second sentence of Subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be consumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in Subsections (1) and (2) (c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as . . . ," and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of Subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but

the goods are not "fair average" if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in Paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary, and merchantable goods must therefore be "honestly" resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a reminder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction require a certain type of container, package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra consideration arises in this connection since, under this article, an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its Subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under Section 2-316. A typical instance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action

an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

Cross references. - Point 1: Section 2-316.

Point 3: Sections 1-203 and 2-104.

Point 5: Section 2-315.

Point 11: Section 2-316.

Point 12: Sections 1-201, 1-205 and 2-316.

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Seller". Section 2-103.

Sale of goods required. - There must be a sale of goods to bring the warranty provisions of this section into operation. Where a gas company did not sell the faulty furnace, there is no basis under this section for a cause of action against the gas company in an action to recover for carbon monoxide poisoning sustained as a result of the faulty furnace. Ortiz v. Gas Co., 97 N.M. 81, 636 P.2d 900 (Ct. App. 1981).

Refusal to provide warranted service is breach of contract. - A seller's refusal to provide warranted service perfects a cause of action for breach of contract, subject to the statutory time limit for filing an action. Lieb v. Milne, 95 N.M. 716, 625 P.2d 1233 (Ct. App. 1980).

Product liability claim and implied warranty claim may be identical. - In a personal injury case, a products liability claim and a claim concerning an implied warranty of merchantability may be identical. Both claims require a defect. Where the identical defect is relied on to support both theories of liability, both theories may be submitted to the jury. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

Privity of contract not required. - A defendant may be held liable for breach of implied warranty of merchantability under the UCC without regard to privity of contract. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

Expiration of warranty period not bar to action. - The expiration of the term of a written warranty period is not a jurisdictional bar to an action for breach of implied warranties. Lieb v. Milne, 95 N.M. 716, 625 P.2d 1233 (Ct. App. 1980).

Sale of beverages for on-premises consumption. - Since the warranty of merchantable goods provisions in this section specifically apply to the sale of beverages to be consumed on the premises, 55-2-725 NMSA 1978 governs claims arising from such sales; the limitation period for on-premise beverage sales is four years. Fernandez v. Char-Li-Jon, Inc., 119 N.M. 25, 888 P.2d 471 (Ct. App. 1994).

Passing without objection in the trade. - Summary judgment on claims of breach of implied warranty of merchantability was precluded since there were issues of fact as to whether the steel manufactured for a tube used in a light-gas gun, and the boring and finishing of the tube, would have passed "without objection in the trade under the contract description." Spectron Dev. Lab. v. American Hollow Boring Co., N.M. , 936 P.2d 852 (Ct. App. 1997).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

For annual survey of commercial law in New Mexico, see 18 N.M.L. Rev. 313 (1988).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 13; 38 Am. Jur. 2d Guaranty § 13; 63 Am. Jur. 2d Products Liability §§ 470 to 472.

Chain, cable, or wire, implied warranty of strength or fitness, 59 A.L.R. 1235.

Construction and effect of express or implied warranty on sale of an article intended for use as explosive, 62 A.L.R. 1510.

Liability of seller of article not inherently dangerous for personal injuries due to the defective or dangerous condition of the article, 74 A.L.R. 343, 168 A.L.R. 1054.

Implied warranty by other than packer of fitness of food sold in sealed cans, 90 A.L.R. 1269, 142 A.L.R. 1434.

Implied warranty of quality, condition or fitness on sale of "job lot," "leftovers" and the like, 103 A.L.R. 1347.

Liability of manufacturer or packer of defective article for injury to person or property of ultimate consumer who purchased from middleman, 111 A.L.R. 1239, 140 A.L.R. 191, 142 A.L.R. 1490.

Cosmetics, implied warranty by retailer, 131 A.L.R. 123.

Construction and application of provision in conditional sale contract regarding implied warranties, 139 A.L.R. 1276.

Implied warranty of reasonable fitness of food for human consumption, as breached by substance natural to the original product and not removed in processing, 143 A.L.R. 1421.

Implied warranty of quality, condition or fitness on sale of secondhand article, 151 A.L.R. 446.

Express warranty as excluding implied warranty of fitness, 164 A.L.R. 1321.

Implied warranty of fitness by one serving food, 7 A.L.R.2d 1027.

Seller's or manufacturer's liability for injuries as affected by buyer's or user's allergy or unusual susceptibility to injury from the article, 26 A.L.R.2d 963.

Implied warranty of fitness on sale of article by trade name, trademark or other particular description, 49 A.L.R.2d 852.

Time to inspect or test for compliance with warranty of fitness or merchantability, 52 A.L.R.2d 900.

Existence and scope of implied warranty of fitness on sale of livestock, 53 A.L.R.2d 892.

Implied warranty of fitness by manufacturer or seller of medical or health supplies, appliances or equipment, 79 A.L.R.2d 401.

Construction and effect of affirmative provision in contract of sale by which purchaser agrees to take article in the condition in which it is, 24 A.L.R.3d 465.

Liability for representations and express warranties in connection with sale of used motor vehicle, 36 A.L.R.3d 125.

Sales: Liability for warranty or representation that article, other than motor vehicle, is new, 36 A.L.R.3d 237.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

Who is "merchant" under U.C.C. § 2-314(1) dealing with implied warranties of merchantability, 91 A.L.R.3d 876.

Products liability: stoves, 93 A.L.R.3d 99.

Modern cases determining whether product is defectively designed, 96 A.L.R.3d 22.

Defective vehicular gasoline tanks, 96 A.L.R.3d 265.

Liability of packer, food store, or restaurant for causing trichinosis, 96 A.L.R.3d 451.

Architect's liability for personal injury or death allegedly caused by improper or defective plans or design, 97 A.L.R.3d 455.

Personal injury or death allegedly caused by defect in aircraft or its parts, supplies, or equipment, 97 A.L.R.3d 627.

Personal injury or death allegedly caused by defect in motorcycle or its parts, supplies, or equipment, 98 A.L.R.3d 317.

Personal injury or death allegedly caused by defect in braking system in motor vehicle, 99 A.L.R.3d 179.

When is person "engaged in the business" for purposes of doctrine of strict tort liability, 99 A.L.R.3d 671.

Manufacturer's or seller's obligation to supply or recommend available safety accessories in connection with industrial machinery or equipment, 99 A.L.R.3d 693.

Personal injury or death allegedly caused by defect in steering system in motor vehicle, 100 A.L.R.3d 158.

Personal injury or death allegedly caused by defect in drive train system in motor vehicle, 100 A.L.R.3d 471.

Personal injury or death allegedly caused by defect in suspension system in motor vehicle, 100 A.L.R.3d 912.

Application of rule of strict liability in tort to person or entity rendering medical services, 100 A.L.R.3d 1205.

Liability for injury on, or in connection with, escalator, 1 A.L.R.4th 144.

Products liability: flammable clothing, 1 A.L.R.4th 251.

Liability of manufacturer or seller for injury or death caused by defect in boat or its parts, supplies, or equipment, 1 A.L.R.4th 411.

Products liability: defective heating equipment, 1 A.L.R.4th 748.

Products liability in connection with prosthesis or other product designed to be surgically implanted in patient's body, 1 A.L.R.4th 921.

Products liability: fertilizers, insecticides, pesticides, fungicides, weed killers, and the like, or articles used in application thereof, 12 A.L.R.4th 462.

Allowance of punitive damages in products liability case, 13 A.L.R.4th 52.

Products liability: Cranes and other lifting apparatuses, 13 A.L.R.4th 476.

Pre-emption of strict liability in tort by provisions of UCC Article 2, 15 A.L.R.4th 791.

Products liability: firearms, ammunition, and chemical weapons, 15 A.L.R.4th 909.

Products liability: cement and concrete, 15 A.L.R.4th 1186.

Products liability: tire rims and wheels, 16 A.L.R.4th 137.

Liability of builder or real estate developer who sells new dwelling for failure to provide potable water, 16 A.L.R.4th 1246.

Products liability: blasting materials and supplies, 18 A.L.R.4th 206.

Products liability: firefighting equipment, 19 A.L.R.4th 326.

What statute of limitations applies to actions for personal injuries based on breach of implied warranty under UCC provisions governing sales (UCC § 2-725(1)), 20 A.L.R.4th 915.

Liability of blood supplier or donor for injury or death resulting from blood transfusion, 24 A.L.R.4th 508.

Recovery, under strict liability in tort, for injury or damage caused by defects in building or land, 25 A.L.R.4th 351.

Strict products liability: liability for failure to warn as dependent on defendant's knowledge of danger, 33 A.L.R.4th 368.

Products liability: stud guns, staple guns, or parts thereof, 33 A.L.R.4th 1189.

Computer sales and leases: breach of warranty, misrepresentation, or failure of consideration as defense or ground for affirmative relief, 37 A.L.R.4th 110.

Products liability: inconsistency of verdicts on separate theories of negligence, breach of warranty, or strict liability, 41 A.L.R.4th 9.

Liability of successor corporation for punitive damages for injury caused by predecessor's product, 55 A.L.R.4th 166.

Products liability: electricity, 60 A.L.R.4th 732.

Liability for injury incurred in operation of power golf cart, 66 A.L.R.4th 622.

Products liability: general recreational equipment, 77 A.L.R.4th 1121.

Burden of proving feasibility of alternative safe design in products liability action based on defective design, 78 A.L.R.4th 154.

Consequential loss of profits from injury to property as element of damages in products liability, 89 A.L.R.4th 11.

Liability for injury or death allegedly caused by foreign substance in beverage, 90 A.L.R.4th 12.

Products liability: roofs and roofing materials, 3 A.L.R.5th 851.

Products liability: prefabricated buildings, 4 A.L.R.5th 667.

Validity, construction, and application of computer software licensing agreements, 38 A.L.R.5th 1.

Presumption or inference, in products liability action based on failure to warn, that user of product would have heeded an adequate warning had one been given, 38 A.L.R.5th 683.

Products liability: theatrical equipment and props, 42 A.L.R.5th 699.

Consumer product warranty suits in federal court under Magnuson-Moss Warranty - Federal Trade Commission Improvement Act (15 USCS §§ 2301 et seq.), 59 A.L.R. Fed. 461.

77A C.J.S. Sales § 252 et seq.

55-2-315. Implied warranty: fitness for particular purpose.

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section [55-2-316 NMSA 1978] an implied warranty that the goods shall be fit for such purpose.

History: 1953 Comp., § 50A-2-315, enacted by Laws 1961, ch. 96, § 2-315.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 15(1), (4), (5), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. - 1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this article on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this article on the allocation or division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with

certain laws or regulations. How the risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to nonmerchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this article. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is to call attention to the possibility of eliminating the warranty in any given case. However, it must be noted that under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

Cross references. - Point 2: Sections 2-314 and 2-317.

Point 3: Section 2-303.

Point 6: Section 2-316.

Definitional cross references. - "Buyer". Section 2-103.

"Goods". Section 2-105.

"Seller". Section 2-103.

Cross-references. - As to warranty against serum hepatitis not implied in blood transfusions, see 24-10-5 NMSA 1978.

When no warranty generally. - There is no implied warranty where rancher at all times exercised his own skill and judgment in the selection of the cattle he wanted from the herd and he did not rely on other ranchers. Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972).

Where no express representations are made, and buyer does not tell seller what his plans are for the cattle he purchases and there is no discussion of the kind of ranching activity involved, an implied warranty of fitness for a particular purpose does not exist. Fear Ranches, Inc. v. Berry, 470 F.2d 905 (10th Cir. 1972).

No defect required. - Products liability requires a defect; the implied warranty of fitness for a particular purpose does not require a defect. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

Hospital's reliance on purchased prosthesis extends to surgeon. - Where a hospital purchases a prosthesis from a manufacturer and supplies that prosthesis to a surgeon for use, the warranty of fitness for a particular purpose does not require that the manufacturer have actual knowledge that the prosthesis would be implanted in a particular patient nor that the surgeon rely on the manufacturer's skill or judgment. Evidence that the hospital purchased the prosthesis from the manufacturer for use as an implant is evidence of the hospital's reliance; the hospital's reliance extends to the surgeon, who is in the distributive chain. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

Knowledge of end use of steel. - The manufacturer of steel for a tube used in a light-gas gun could not be held liable for breach of implied warranty because there was no evidence that the manufacturer knew the purpose for which the steel was to be used. Spectron Dev. Lab. v. American Hollow Boring Co., N.M. , 936 P.2d 852 (Ct. App. 1997).

No reliance on manufacturer's expertise. - The manufacturer that bored and finished a tube used in a light-gas gun could not be held liable for breach of implied warranty because the owner of the gun, the expert in the country regarding production of such guns, did not rely on the manufacturer's expertise in selecting the specifications for the tube. Spectron Dev. Lab. v. American Hollow Boring Co., N.M. , 936 P.2d 852 (Ct. App. 1997).

Refusal to provide warranted service. - A seller's refusal to provide warranted service perfects a cause of action for breach of contract, subject to the statutory time limit for filing an action. Lieb v. Milne, 95 N.M. 716, 625 P.2d 1233 (Ct. App. 1980).

Expiration of warranty period not bar to action. - The expiration of the term of a written warranty period is not a jurisdictional bar to an action for breach of implied warranties. Lieb v. Milne, 95 N.M. 716, 625 P.2d 1233 (Ct. App. 1980).

Law reviews. - For comment, "The Miller Act in New Mexico - Materialman's Right to Recover on Prime's Surety Bond in Public Works Contracts - Notice as Condition Precedent to Action," see 9 Nat. Resources J. 295 (1969).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 38 Am. Jur. 2d Guaranty § 13; 63 Am. Jur. 2d Products Liability §§ 470 to 508.

Implied warranty by other than packer of fitness of food sold in sealed cans, 9 A.L.R. 1269, 90 A.L.R. 1269, 142 A.L.R. 1434.

Chain, cable or wire, implied warranty of strength or fitness, 59 A.L.R. 1235.

Construction and effect of express or implied warranty on sale of an article intended for use as explosive, 62 A.L.R. 1510.

Implied warranty of quality, condition or fitness on sale of "job lot," "leftovers," and the like, 103 A.L.R. 1347.

Cosmetics, implied warranty by retailer, 131 A.L.R. 123.

Implied warranty of reasonable fitness of food for human consumption as breached by substance natural to the original product and not removed in processing, 143 A.L.R. 1421.

Secondhand article, sale of, implied warranty of quality, condition or fitness, 151 A.L.R. 446.

Express warranty as excluding implied warranty of fitness, 164 A.L.R. 1321.

What amounts to "sale by sample" as regards implied warranties, 12 A.L.R.2d 524.

Seller's or manufacturer's liability for injuries as affected by buyer's or user's allergy or unusual susceptibility to injury from the article, 26 A.L.R.2d 963.

Existence and scope of implied warranty of fitness on sale of livestock, 53 A.L.R.2d 892.

Implied warranty of fitness by manufacturer or seller of medical or health supplies, appliances or equipment, 79 A.L.R.2d 401.

Liability for representations and express warranties in connection with sale of used motor vehicle, 36 A.L.R.3d 125.

Sales: Liability for warranty or representation that article, other than motor vehicle, is new, 36 A.L.R.3d 237.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

Products liability: stoves, 93 A.L.R.3d 99.

Products liability: flammable clothing, 1 A.L.R.4th 251.

Products liability: fertilizers, insecticides, pesticides, fungicides, weed killers, and the like, or articles used in application thereof, 12 A.L.R.4th 462.

Liability of blood supplier or donor for injury or death resulting from blood transfusion, 24 A.L.R.4th 508.

Recovery, under strict liability in tort, for injury or damage caused by defects in building or land, 25 A.L.R.4th 351.

Products liability: stud guns, staple guns, or parts thereof, 33 A.L.R.4th 1189.

Computer sales and leases: breach of warranty, misrepresentation, or failure of consideration as defense or ground for affirmative relief, 37 A.L.R.4th 110.

Products liability: inconsistency of verdicts on separate theories of negligence, breach of warranty, or strict liability, 41 A.L.R.4th 9.

Applicability of warranty of fitness under UCC § 2-315 to supplies or equipment used in performance of a service contract, 47 A.L.R.4th 238.

Liability of successor corporation for punitive damages for injury caused by predecessor's product, 55 A.L.R.4th 166.

Liability for injury incurred in operation of power golf cart, 66 A.L.R.4th 622.

Validity, construction, and application of computer software licensing agreements, 38 A.L.R.5th 1.

Products liability: theatrical equipment and props, 42 A.L.R.5th 699.

77A C.J.S. Sales § 258 et seq.

55-2-316. Exclusion or modification of warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as

consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (Section 2-202 [55-2-202 NMSA 1978]) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to Subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding Subsection (2):

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this article on liquidation or limitation of damages and on contractual modification of remedy (Sections 2-718 [55-2-718 NMSA 1978] and 2-719 [55-2-719 NMSA 1978]).

History: 1953 Comp., § 50A-2-316, enacted by Laws 1961, ch. 96, § 2-316.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None. See Sections 15 and 71, Uniform Sales Act.

Purposes. - 1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this article against false allegations of oral warranties by its provisions on parol and extrinsic evidence and against unauthorized representations by the customary "lack of authority" clauses. This article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under Subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under Subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this article on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had "reason to know" under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in Paragraphs (a), (b) and (c) of Subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warrant is being excluded.

7. Paragraph (a) of Subsection (3) deals with general terms such as "as is," "as they stand," "with all faults," and the like. Such terms in ordinary commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms covered by Paragraph (a) are in fact merely a particularization of Paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under Paragraph (b) of Subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than

proximately from a breach of warranty. See Sections 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in Paragraph (b), it is not sufficient that the goods are available for inspection. There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by Subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under Paragraph (c) of that section in case of such an inconsistency the implied warranty of merchantability is displaced by the express warranty that the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

Cross references. - Point 2: Sections 2-202, 2-718 and 2-719.

Point 7: Sections 1-205 and 2-208.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Course of dealing". Section 1-205.

"Goods". Section 2-105.

"Remedy". Section 1-201.

"Seller". Section 2-103.

"Usage of trade". Section 1-205.

Contract provision may preclude action for pre-contract negligent misrepresentation. - Commercial purchaser of a computer system may not maintain an action in tort against the seller for pre-contract negligent misrepresentations regarding the system's capacity to perform specific functions, where the subsequently executed written sales contract contains an effective integration clause, and an effective provision disclaiming all prior representations and all warranties, express or implied, not contained in the contract, where there is no indication or claim that the transaction was not undertaken at arm's length or freely entered into by two commercial entities. Rio Grande Jewelers Supply, Inc. v. Data Gen. Corp., 101 N.M. 798, 689 P.2d 1269 (1984).

Law reviews. - For note, "Contracts - Exculpatory Provisions - A Bank's Liability for Ordinary Negligence: Lynch v. Santa Fe National Bank," see 12 N.M.L. Rev. 821 (1982).

For annual survey of New Mexico commercial law, see 16 N.M.L. Rev. 1 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability §§ 509 to 520.

Validity of provision negativing implied warranties, 117 A.L.R. 1350.

Express warranty as excluding implied warranty of fitness, 164 A.L.R. 1321.

Warranty of amount by contract for sale of commodity or goods wherein quantity is described as "about" or "more or less" than an amount specified, 58 A.L.R.2d 377.

Express warranty as affecting implied warranty by seller of injury-causing animal feed or medicine, crop spray, fertilizer, insecticide, rodenticide or similar product, 81 A.L.R.2d 138, 12 A.L.R.4th 462, 29 A.L.R.4th 1045.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

77A C.J.S. Sales § 263 et seq.

55-2-317. Cumulation and conflict of warranties express or implied.

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) exact or technical specifications displace an inconsistent sample or model or general language of description;

(b) a sample from an existing bulk displaces inconsistent general language of description;

(c) express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

History: 1953 Comp., § 50A-2-317, enacted by Laws 1961, ch. 96, § 2-317.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. On cumulation of warranties see Sections 14, 15 and 16, Uniform Sales Act.

Changes. Completely rewritten into one section.

Purposes of changes. - 1. The present section rests on the basic policy of this article that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This article thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the circumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the

seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in Subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

Cross reference. - Point 1: Section 2-315.

Definitional cross reference. - "Party". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability § 519; 68A Am. Jur. 2d Secured Transactions § 106.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

77A C.J.S. Sales § 236 et seq.

55-2-318. Third-party beneficiaries of warranties express or implied.

A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

History: 1953 Comp., § 50A-2-318, enacted by Laws 1961, ch. 96, § 2-318.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by Section 2-316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in Section 2-718 or 2-719. To the extent that the contract of sale contains provisions under which warranties are

excluded or modified, or remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him [As amended in 1966].

3. The first alternative expressly includes as beneficiaries within its provisions the family, household and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain. The second alternative is designed for states where the case law has already developed further and for those that desire to expand the class of beneficiaries. The third alternative goes further, following the trend of modern decisions as indicated by Restatement of Torts 2d § 402A (Tentative Draft No. 10, 1965) in extending the rule beyond injuries to the person [As amended in 1966].

Cross references. - Point 1: Sections 2-316, 2-718 and 2-719.

Point 2: Section 2-314.

Definitional cross references. - "Buyer". Section 2-103.

"Goods". Section 2-105.

"Seller". Section 2-103.

Compiler's note. - New Mexico adopted Alternative A of 2-318 of the 1972 Official Text of the U.C.C.

Privity of contract not required. - A defendant may be held liable for breach of implied warranty of merchantability under the UCC without regard to privity of contract. Perfetti v. McGhan Medical, 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

This section only addresses horizontal privity, leaving vertical privity to judicial decision. Armijo v. Ed Black's Chevrolet Center, Inc., 105 N.M. 422, 733 P.2d 870 (Ct. App. 1987).

Employees of a purchaser are excluded from the manufacturer's warranty protections offered by provisions comparable to this section. Armijo v. Ed Black's Chevrolet Center, Inc., 105 N.M. 422, 733 P.2d 870 (Ct. App. 1987).

Law reviews. - For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

For annual survey of New Mexico law of products liability, 19 N.M.L. Rev. 743 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability § 450 et seq.; 67 Am. Jur. 2d Sales §§ 706 to 722.

Manufacturer's responsibility for defective component supplied by another and incorporated in product, 3 A.L.R.3d 1016.

Privity of contract as essential in action against remote manufacturer or distributor for defects in goods not causing injury to person or to other property, 16 A.L.R.3d 683.

In personam jurisdiction over nonresidential manufacturer or seller under "long-arm" statutes, 19 A.L.R.3d 13.

Discovery, in products liability case, of defendant's knowledge as to injury to or complaints by others than plaintiff, related to product, 20 A.L.R.3d 1430.

Right of manufacturer or seller to contribution or indemnity from user of product causing injury or damage to third person, and vice versa, 28 A.L.R.3d 943.

Extension of strict liability in tort to permit recovery by a third person who was neither a purchaser nor user of product, 33 A.L.R.3d 415.

Necessity and sufficiency of identification of defendant as manufacturer or seller of product alleged to have caused injury, 51 A.L.R.3d 1344.

Necessity and propriety of instructing on alternative theories of negligence or breach of warranty, where instruction on strict liability in tort is given in products liability case, 52 A.L.R.3d 101.

Application of strict liability in tort doctrine to lessor of personal property, 52 A.L.R.3d 121.

Product as unreasonably dangerous or unsafe under doctrine of strict liability in tort, 54 A.L.R.3d 352.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

Third-party beneficiaries of warranties under UCC § 2-318, 100 A.L.R.3d 743.

Pre-emption of strict liability in tort by provisions of UCC Article 2, 15 A.L.R.4th 791.

Products liability: general recreational equipment, 77 A.L.R.4th 1121.

Admiralty products liability: recovery against remote manufacturer or distributor for economic or commercial loss caused by defect in product, 81 A.L.R. Fed. 181.

77A C.J.S. Sales § 240 et seq.

55-2-319. F.O.B. and F.A.S. terms.

(1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which:

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this article (Section 2-504 [55-2-504 NMSA 1978]) and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this article (Section 2-503 [55-2-503 NMSA 1978]);

(c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this article on the form of bill of lading (Section 2-323 [55-2-323 NMSA 1978]).

(2) Unless otherwise agreed the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must:

(a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within Subsection (1) (a) or (c) or Subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this article (Section 2-311 [55-2-

311 NMSA 1978]). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

History: 1953 Comp., § 50A-2-319, enacted by Laws 1961, ch. 96, § 2-319.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in Subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which had led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt with in this act by Section 2-311(2) (seller's option re-arrangements relating to shipment) and Sections 2-614 and 615 (substituted performance and seller's excuse).

2. Subsection (1) (c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in Subsection (1) (c) and Subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of Subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring into play, instead, the second sentence of Section 2-704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and case-law; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., Section 2-320).

Cross references. - Sections 2-311(3), 2-323, 2-503 and 2-504.

Definitional cross references. - "Agreed". Section 1-201.

"Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Goods". Section 2-105.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - F.O.B. provision in sale contract as affecting time or place of passing title, 101 A.L.R. 292.

77A C.J.S. Sales §§ 94 et seq., 168 et seq.

55-2-320. C.I.F. and C.&F. terms.

(1) The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C.&F. or C.F. means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to:

(a) put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract; and

(e) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term C.&F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(4) Under the term C.I.F. or C.&F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

History: 1953 Comp., § 50A-2-320, enacted by Laws 1961, ch. 96, § 2-320.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination".

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit, to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance - for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not required to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner.

Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of paying or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation in the appropriate space on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, sufficiently shown to cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other considerations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this article.

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods again at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship "freight collect" and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the buyer's risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier "ship and/or cargo lost or not lost," or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance "for the account of whom it may concern" is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be "sufficiently shown to cover the same goods covered by the bill of lading". It must cover separately the quantity of goods called for by the buyer's contract and not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term "certificate of insurance", however, does not of itself include certificates or "cover notes" issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers' certificates and "cover notes" but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller's failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e.g., one insuring the goods "lost or not lost." The provisions of this article on cure of improper tender and on waiver of buyer's objections by silence are

applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document which evidences points of description, quality and the like which do not readily appear in other documents. This article rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time".

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the nonconformity of the goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point to a seaport and thence transported by vessel to the named destination under a "through" or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller's control.

14. Although Subsection (2) stating the legal effects of the C.I.F. term is an "unless otherwise agreed" provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are

so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed form designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under Subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F. term by purchasing and tendering landed goods.

16. Under the C.&F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C.&F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer's agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an "open" or "floating" policy covering all shipments made by him or to him, in either of which events the C.&F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

Cross references. - Point 4: Section 2-323.

Point 6: Section 2-509(1)(a).

Point 9: Sections 2-508 and 2-605(1)(a).

Point 12: Sections 2-321(3), 2-512 and 2-513(3) and Article 5.

Definitional cross references. - "Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Rights". Section 1-201.

"Seller". Section 2-103.

"Term". Section 2-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 551 to 565.

What constitutes delivery of goods sold under C.I.F. contract, 10 A.L.R. 701, 20 A.L.R. 1236, 47 A.L.R. 193.

77A C.J.S. Sales § 167 et seq.

55-2-321. C.I.F. or C.&F.: "net landed weights"; "payment on arrival"; warranty of condition on arrival.

Under a contract containing a term C.I.F. or C.&F.:

(1) where the price is based on or is to be adjusted according to "net landed weights," "delivered weights," "out turn" quantity or quality or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness;

(2) an agreement described in Subsection (1) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss;

(3) unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost, delivery of the documents and payment are due when the goods should have arrived.

History: 1953 Comp., § 50A-2-321, enacted by Laws 1961, ch. 96, § 2-321.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C.&F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the

payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

Cross reference. - Section 2-324.

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Goods". Section 2-105.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 551 to 565.

What constitutes delivery of goods sold under "C.I.F." contract, 10 A.L.R. 701, 20 A.L.R. 1236.

Buyer's right to inspect at destination where goods are delivered to carrier, 27 A.L.R. 524.

Applicability of provision in contract of sale for return of article, where article delivered does not answer to description, 30 A.L.R. 321.

Notice of rejection, duty of purchaser of goods "on trial" or "on approval,", 78 A.L.R. 533.

Time within which buyer must make inspection, trial or test to determine whether goods are of requisite quality, 52 A.L.R.2d 900.

Elements and measure of damages for breach of warranty in sale of horse, 91 A.L.R.3d 419.

77A C.J.S. Sales § 167 et seq.

55-2-322. Delivery "ex-ship."

(1) Unless otherwise agreed a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and

requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed:

(a) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and

(b) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded.

History: 1953 Comp., § 50A-2-322, enacted by Laws 1961, ch. 96, § 2-322.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The delivery term, "ex-ship", as between seller and buyer, is the reverse of the f. a. s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex-ship", even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropriate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex-ship" with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

Cross reference. - Point 1: Section 2-319(2).

Definitional cross references. - "Buyer". Section 2-103.

"Goods". Section 2-105.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 559 to 562.

Delay in delivery placing goods at risk of party at fault under § 22(b) of Uniform Sales Act, 38 A.L.R.2d 658.

77A C.J.S. Sales § 168 et seq.

55-2-323. Form of bill of lading required in overseas shipment; "overseas."

(1) Where the contract contemplates overseas shipment and contains a term C.I.F. or C.&F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C.&F., received for shipment.

(2) Where in a case within Subsection (1) a bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set:

(a) due tender of a single part is acceptable within the provisions of this article on cure of improper delivery (Subsection (1) of Section 2-508 [55-2-508 NMSA 1978]); and

(b) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air or a contract contemplating such shipment is "overseas" insofar as by usage of trade or agreement it is subject to the commercial, financing or shipping practices characteristic of international deep water commerce.

History: 1953 Comp., § 50A-2-323, enacted by Laws 1961, ch. 96, § 2-323.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See Section 2-319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single

bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming.

This subsection codifies that practice as between buyer and seller. Article 5 (Section 5-113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article 5.

Cross references. - Sections 2-508(2) and 5-113.

Definitional cross references. - "Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Financing agency". Section 2-104.

"Person". Section 1-201.

"Seller". Section 2-103.

"Send". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 265; 15A Am. Jur. 2d Commercial Code § 39; 67 Am. Jur. 2d Sales § 561.

77A C.J.S. Sales § 168 et seq.; 80 C.J.S. Shipping § 111.

55-2-324. "No arrival, no sale" term.

Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed:

(a) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the nonarrival; and

(b) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (Section 2-613 [55-2-613 NMSA 1978]).

History: 1953 Comp., § 50A-2-324, enacted by Laws 1961, ch. 96, § 2-324.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller but gives him an exemption from liability for non-delivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances imposed upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming one, for the exemption under a "no arrival, no sale" term applies only to the hazards of transportation and the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the "no arrival, no sale" clause to exemption from payment of damages for non-delivery if the goods do not arrive or if the goods which actually arrive are non-conforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this article on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the contract refers there can be no application of an exemption for their non-arrival.

3. The seller's duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase "to arrive" is often employed in the same sense as "no arrival, no sale" and may then be given the same effect. But a "to arrive" term, added to a C.I.F. or C.&F. contract, does not have the full meaning given by this section to "no arrival, no sale". Such a "to arrive" term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the "to arrive" term may be regarded as a time of

payment term, or, in the case of the reselling seller discussed in Point 1 above, as negating responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of Sections 2-316 and 2-317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this article on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

Cross references. - Point 1: Section 1-203.

Point 2: Section 2-501(a) and (c).

Point 5: Section 2-613.

Definitional cross references. - "Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Fault". Section 1-201.

"Goods". Section 2-105.

"Sale". Section 2-106.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 563 to 565.

77A C.J.S. Sales § 168 et seq.

55-2-325. "Letter of credit" term; "confirmed credit."

(1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market.

History: 1953 Comp., § 50A-2-325, enacted by Laws 1961, ch. 96, § 2-325.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit":

1. Subsection (2) follows the general policy of this article and Article 3 (Section 3-802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (3) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary, unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under Section 5-116(2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require the obligation of two banks both local to the seller.

Cross references. - Sections 2-403, 2-511(3) and 3-802 and Article 5.

Definitional cross references. - "Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Draft". Section 3-104.

"Financing agency". Section 2-104.

"Notifies". Section 1-201.

"Overseas". Section 2-323.

"Purchaser". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 270, 674.

Construction of provision for letter of credit in contract for sale, 38 A.L.R. 608.

77A C.J.S. Sales § 208 et seq.

55-2-326. Sale on approval and sale or return; consignment sales and rights of creditors.

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is:

(a) a "sale on approval" if the goods are delivered primarily for use; and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) Except as provided in Subsection (3) of this section, goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum." However, this subsection is not applicable if the person making delivery:

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign;

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others;

(c) complies with the filing provisions of the article on secured transactions (Article 9); or

(d) is delivering a work of art pursuant to the Artists' Consignment Act [56-11-1 to 56-11-3 NMSA 1978].

(4) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this article (Section 2-201 [55-2-201 NMSA 1978]) and as contradicting the sale aspect of the contract within the provisions of this article on parol or extrinsic evidence (Section 2-202 [55-2-202 NMSA 1978]).

History: 1953 Comp., § 50A-2-326, enacted by Laws 1961, ch. 96, § 2-326; 1979, ch. 196, § 4.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 19(3), Uniform Sales Act.

Changes. Completely rewritten in this and the succeeding section.

Purposes of changes. To make it clear that:

1. A "sale on approval" or "sale or return" is distinct from other types of transactions with which they have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt with involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

The right to return the goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this and the following section. The present section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted.

This section nevertheless presupposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described.

Where the buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" where an industrial machine is involved, this article takes no position.

2. Pursuant to the general policies of this act which require good faith not only between the parties to the sales contract, but as against interested third parties, Subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest. However, there is no intent in this section to narrow the protection afforded to third parties in any jurisdiction which has a selling factors act. The purpose of the exception is merely to limit the effect of the present subsection itself, in the absence of any such factors act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.

3. Subsection (4) resolves a conflict in the preexisting case law by recognition that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are involved it must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the statute of frauds section and as contradicting the sale insofar as questions of parol or extrinsic evidence are concerned.

Cross references. - Point 2: Article 9.

Point 3: Sections 2-201 and 2-202.

Definitional cross references. - "Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract for sale". Section 2-106.

"Creditor". Section 1-201.

"Goods". Section 2-105.

"Sale". Section 2-106.

"Seller". Section 2-103.

The 1979 amendment inserted "of this section" following "Subsection (3)" near the beginning of Subsection (2), added Paragraph (d) in Subsection (3) and made other minor changes.

"Sale or return" generally. - Despite insurer's contention that policy exclusion for cars sold was in effect, insurer was liable on policy when one of insured's vehicles, used in a sales promotion with another dealer, was involved in an accident, because transaction between dealers here was not within the code's "sale or return" provision. Security Ins. Co. v. Alliance Mut. Ins. Cos., 408 F.2d 878 (10th Cir. 1969).

Allegations that seller shipped cattle to buyer subject to buyer's right to return some or all of the cattle and subject to further negotiations on the price did not raise material issues of fact as to whether a contract existed. The fact that the transaction was a "sale or return" did not negate the existence of the contract. O'Brien v. Chandler, 107 N.M. 797, 765 P.2d 1165 (1988).

Law reviews. - For article, "Out of sight but not out of mind: New Mexico's tax on out-of-state services," see 20 N.M.L. Rev. 501 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 7; 67 Am. Jur. 2d Sales §§ 465 to 502; 68A Am. Jur. 2d Secured Transactions §§ 13, 107.

Validity and effect of provision in a contract of sale making acceptance of goods conditional on third person's approval, 46 A.L.R. 864.

Contracts of sale or return as distinguished from contracts for sale on approval, 52 A.L.R. 589.

Goods consigned to shipper's order, 60 A.L.R. 677.

Duty of purchaser of goods "on trial" or "on approval" regarding notice of rejection, 78 A.L.R. 533.

Validity and enforceability of agreement of seller to repurchase on buyer's demand as affected by failure to fix time for demand, 88 A.L.R. 842.

Application of statute of frauds to agreements of repurchase or repayment, 121 A.L.R. 312.

Presumption and burden of proof as to consignee's title to or interest in respect of goods comprising shipment, in consignee's action against carrier for loss, damage, delay, nondelivery or conversion, 135 A.L.R. 456.

Conclusiveness of determination of third party whose approval is provided for by contract for sale of goods, 7 A.L.R.3d 555.

35 C.J.S. Factors §§ 1, 56, 60, 63; 77A C.J.S. Sales § 214 et seq.

55-2-327. Special incidents of sale on approval and sale or return.

(1) Under a sale on approval unless otherwise agreed:

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

(b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and

(c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed:

(a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) the return is at the buyer's risk and expense.

History: 1953 Comp., § 50A-2-327, enacted by Laws 1961, ch. 96, § 2-327.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 19(3), Uniform Sales Act.

Changes. Completely rewritten in preceding and this section.

Purposes of changes. To make it clear that:

1. In the case of a sale on approval:

If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this article allowing partial acceptance of a defective delivery has no application here. A case where a buyer takes home two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed".

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in Section 1-204. Nevertheless, the provisions of both this article and of the contract on this point must be read with commercial reason and with full attention to good faith.

Cross references. - Point 1: Sections 2-501, 2-601 and 2-603.

Point 2: Sections 2-607 and 2-608.

Point 4: Sections 1-201 and 1-204.

Definitional cross references. - "Agreed". Section 1-201.

"Buyer". Section 2-103.

"Commercial unit". Section 2-105.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Notifies". Section 1-201.

"Notification". Section 1-201.

"Sale on approval". Section 2-326.

"Sale or return". Section 2-326.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 465 to 502.

Notice of rejection, duty of purchaser of goods "on trial" or "on approval,", 78 A.L.R. 533.

Duty of consignee as to valuation of goods on reshipment to consignor, 16 A.L.R.2d 866.

Time within which buyer must make inspection, trial, or test to determine whether goods are of requisite quality, 52 A.L.R.2d 900.

Reasonableness of personal judgment of buyer as test where goods are sold subject to being satisfactory to the buyer, 86 A.L.R.2d 200.

Time for return of goods sold on "sale or return" absent specific time provision in contract, 93 A.L.R.2d 342.

77A C.J.S. Sales § 214 et seq.

55-2-328. Sale by auction.

(1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the

last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

History: 1953 Comp., § 50A-2-328, enacted by Laws 1961, ch. 96, § 2-328.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 21, Uniform Sales Act.

Changes. Completely rewritten.

Purposes of changes. To make it clear that:

1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This article accepts the view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present. This is subject to any peculiar facts which might bring the case within the "firm offer" principle of this article, but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

Cross reference. - Point 2: Section 2-205.

Definitional cross references. - "Buyer". Section 2-103.

"Good faith". Section 1-201.

"Goods". Section 2-105.

"Lot". Section 2-105.

"Notice". Section 1-201.

"Sale". Section 2-106.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Implied authority of auctioneer to receive payment for commodities which he is authorized to sell, 8 A.L.R. 227, 105 A.L.R. 718.

Modes of making and accepting bids at auctions, 11 A.L.R. 543.

Advertisements of property offered at auction as affecting rights of purchaser, 28 A.L.R. 991, 158 A.L.R. 1413.

Regulations affecting auctions or auctioneers, 31 A.L.R. 299, 39 A.L.R 773, 111 A.L.R. 473.

By-bidding or puffing, effect on auction sale, 46 A.L.R. 122.

Title to goods, as between purchaser from, and one who entrusted them to auctioneer, 36 A.L.R.2d 1362.

Withdrawal of property from auction sale, 37 A.L.R.2d 1049.

Liability of auctioneer, 80 A.L.R.2d 1237.

Liability of defaulting purchaser to auctioneer, 30 A.L.R.3d 1395.

Auction sales under UCC § 2-328, 44 A.L.R.4th 110.

7 C.J.S. Auctions and Auctioneers §§ 8 to 20.

PART 4
TITLE, CREDITORS AND GOOD FAITH PURCHASERS

55-2-401. Passing of title; reservation for security; limited application of this section.

Each provision of this article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this article and matters concerning title become material the following rules apply:

(1) title to goods cannot pass under a contract for sale prior to their identification to the contract (Section 2-501 [55-2-501 NMSA 1978]), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this act [chapter]. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the article on secured transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties;

(2) unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading:

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there;

(3) unless otherwise explicitly agreed where delivery is to be made without moving the goods:

(a) if the seller is to deliver a document of title, title passes at the time when and the place where he delivers such documents; or

(b) if the goods are at the time of contracting already identified and no documents are to be delivered, title passes at the time and place of contracting;

(4) a rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale."

History: 1953 Comp., § 50A-2-401, enacted by Laws 1961, ch. 96, § 2-401.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See generally, Sections 17, 18, 19 and 20, Uniform Sales Act.

Purposes. To make it clear that:

1. This article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the article is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this article that known purpose and reason should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this article in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in Section 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this article such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to goods on the seller's insolvency and on the buyer's right to specific performance or replevin.

4. The factual situations in Subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated Subsection (3) turns on the seller's final commitment, i.e. the delivery of documents or the making of the contract.

Cross references. - Point 2: Sections 2-102, 2-501 and 2-502.

Point 3: Sections 1-201, 2-402, 2-403, 2-502 and 2-716.

Definitional cross references. - "Agreement". Section 1-201.

"Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Good faith". Section 2-103.

"Goods". Section 2-105.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Receipt" of goods. Section 2-103.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Sale". Section 2-106.

"Security interest". Section 1-201.

"Seller". Section 2-103.

"Send". Section 1-201.

Question of ownership of automobile in suit on insurance policy is for jury, where alleged owner was part-time salesman for an automobile dealer under an arrangement whereby salesman was to sell the car or keep it himself, paying off the balance. Knotts v. Safeco Ins. Co. of Am., 78 N.M. 395, 432 P.2d 106 (1967).

And title revests on refusal of conditional tender. - Bankrupt, when it refused to accept the tender of crude oil from seller conditioned upon payment by bankrupt of seller's common carrier lien, caused thereby title to the oil to revest in the oil producing sellers. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 7; 67 Am. Jur. 2d Sales §§ 387 to 464; 68A Am. Jur. 2d Secured Transactions §§ 13, 225 et seq.

Receipt of partial payment or commercial paper for purchase price for goods as terminating vendor's right of stoppage in transitu, 7 A.L.R. 1412.

Dishonor of draft or check for purchase price on a cash sale as affecting seller's rights in respect of property or its proceeds, 31 A.L.R. 578, 54 A.L.R. 526.

Failure to ship by carrier designated by buyer as affecting passing of title, 31 A.L.R. 955.

Rule that title passes on delivery to carrier as applicable to shipment in "pool" car for several purchasers, 36 A.L.R. 410.

Delivery to carrier of quantity of goods greater than that called for by contract as passing title, 38 A.L.R. 1544.

Effect of provision making acceptance of goods conditional on approval by third person, as affecting passing of title, 46 A.L.R. 869.

Passing of title to goods by acceptance of draft for purchase price, with warehouse receipt attached, or by transfer of draft with receipt, 55 A.L.R. 1116.

Time and place of passage of title to goods shipped under bill of lading, with draft attached, consigning them to shipper's order, 60 A.L.R. 677.

Validity as to creditors of the buyer or consignee of reservation of title to goods delivered under implied or express authority to resell, 63 A.L.R. 355.

Accession to property which is the subject of a conditional sale or chattel mortgage, 68 A.L.R. 1242.

Necessity and sufficiency of appropriation to pass title on sale of corporate stock or securities, 78 A.L.R. 1019.

Applicability of protective provisions of Uniform Conditional Sales Act or similar statutes where there has been a novation of the contract, 83 A.L.R. 998.

F.O.B. provision in sale contract as affecting time or place of passing of title, 101 A.L.R. 292.

Right of seller of fixtures retaining title thereto or lien thereon, as against purchasers or encumbrancers of the realty, 111 A.L.R. 362, 141 A.L.R. 1283.

Passing title to personal property under contract covering real and personal property, 117 A.L.R. 395.

Valuables secreted in articles sold, 4 A.L.R.2d 318.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

77A C.J.S. Sales § 214 et seq.

55-2-402. Rights of seller's creditors against sold goods.

(1) Except as provided in Subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this article (Sections 2-502 [55-2-502 NMSA 1978] and 2-716 [55-2-716 NMSA 1978]).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this article shall be deemed to impair the rights of creditors of the seller:

(a) under the provisions of the article on secured transactions (Article 9); or

(b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this article constitute the transaction a fraudulent transfer or voidable preference.

History: 1953 Comp., § 50A-2-402, enacted by Laws 1961, ch. 96, § 2-402.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (2) - Section 26, Uniform Sales Act; Subsections (1) and (3) - none.

Changes. Rephrased.

Purposes of changes and new matter. To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hindrance by making it clear that:

1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this article, but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this article.

2. The retention of possession of the goods by a merchant seller for a commercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of Subsection (3) have no application to identification or delivery made in the current course of trade, as measured against general commercial understanding of what a "current" transaction is.

Definitional cross references. - "Contract for sale". Section 2-106.

"Creditor". Section 1-201.

"Good faith". Section 2-103.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Money". Section 1-201.

"Reasonable time". Section 1-204.

"Rights". Section 1-201.

"Sale". Section 2-106.

"Seller". Section 2-103.

Law reviews. - For article, "Attachment in New Mexico - Part I," see 1 Nat. Resources J. 303 (1961).

For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 69; 78 Am. Jur. 2d Warehouses §§ 74, 81, 108, 224.

37 C.J.S. Fraudulent Conveyances § 212; 77A C.J.S. Sales § 219 et seq.

55-2-403. Power to transfer; good faith purchase of goods; "entrusting".

(1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase the purchaser has such power even though:

(a) the transferor was deceived as to the identity of the purchaser, or

(b) the delivery was in exchange for a check which is later dishonored, or

(c) it was agreed that the transaction was to be a "cash sale", or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the articles on Secured Transactions (Article 9) and Documents of Title (Article 7).

History: 1953 Comp., § 50A-2-403, enacted by Laws 1961, ch. 96, § 2-403; 1992, ch. 114, § 6.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 20(4), 23, 24 and 25, Uniform Sales Act; Section 9, especially 9(2), Uniform Trust Receipts Act; Section 9, Uniform Conditional Sales Act.

Changes. Consolidated and rewritten.

Purposes of changes. To gather together a series of prior uniform statutory provisions and the case law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under Subsection (1). In this respect the provisions of the section are applicable to a person taking by any form of "purchase" as defined by this act. Moreover the policy of this act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based on statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier factors acts. In addition Subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by Subsections (2)-(4) into a single principle protecting persons who buy in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in Subsection (3) to fit with the abolition of the old law of "cash sale" by Subsection (1) (c). It is also freed from any technicalities depending on the extended law of larceny; such extension of the concept of theft to include trick, particular types of fraud, and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of Section 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, Subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (Section 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of overtechnical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. Section 1-201(9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in Subsection (1), the rights of purchasers other than buyers in ordinary course are left to the articles on secured transactions, documents of title, and bulk sales.

Cross references. - Point 1: Sections 1-103 and 1-201.

Point 2: Sections 1-201, 2-402, 7-205 and 9-307(1).

Points 3 and 4: Sections 1-102, 1-201, 2-104, 2-707 and Articles 6, 7 and 9.

Definitional cross references. - "Buyer in ordinary course of business". Section 1-201.

"Good faith". Sections 1-201 and 2-103.

"Goods". Section 2-105.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Signed". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

The 1992 amendment, effective July 1, 1992, deleted a reference to the article on bulk transfers in Subsection (4).

Status of "bona fide purchaser" does not automatically pass. - After property has passed into the hands of a bona fide purchaser, every subsequent purchaser does not automatically stand in the shoes of such a bona fide purchaser, irrespective of the subpurchaser's notice of any other claimed interests in the property. Hunick v. Orona, 99 N.M. 306, 657 P.2d 633 (1983).

The significance of being a buyer in the ordinary course of business is the acquisition of goods free of any outstanding claims from those who may be the true owners. Therefore, a buyer in the ordinary course of business is a privileged status that is conferred upon a purchaser, even against the true owners, if he meets the requirements of Subsections (9) and (19) of 55-1-201 NMSA 1978. Hunick v. Orona, 99 N.M. 306, 657 P.2d 633 (1983).

Statute is not intended as cure for false misrepresentation or breach of warranty of title and does not preclude buyers of automobiles from repudiating transaction on the ground of used car dealer's material misrepresentation and breach of warranty. State v. DeBaca, 82 N.M. 727, 487 P.2d 155 (Ct. App. 1971).

Power to transfer upheld. - Upon delivery of cattle pursuant to seller's agreement with buyer, buyer had the power to transfer good title to a good faith purchaser for value, notwithstanding seller's contention that the cattle had been shipped to buyer under a title-retention contract. O'Brien v. Chandler, 107 N.M. 797, 765 P.2d 1165 (1988).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 67 to 69; 68A Am. Jur. 2d Secured Transactions § 117 et seq.; 788.

Right of purchaser of stolen bonds, 1 A.L.R. 717, 85 A.L.R. 357, 102 A.L.R. 28.

Delivery of key as satisfying condition of immediate delivery and actual or continued change of possession to uphold sale of personal property against subsequent purchaser or third persons generally, 56 A.L.R. 518.

Right of purchaser from agent or dealer in possession of article for purpose of demonstration or solicitation, without actual authority to sell, 57 A.L.R. 393.

Right of purchaser from party to conditional sale as affected by actual or apparent authority in party to sell property, 88 A.L.R. 109.

Estoppel of owner of tangible personal property who permits another to have possession of evidences of title, endorsed in blank, or otherwise showing ownership in possessor, to deny latter's authority to sell, mortgage, pledge or otherwise deal with, the property, 151 A.L.R. 690.

Relative rights as between purchase of chattel from one who had previously bought it with stolen money, and victim of the theft, 62 A.L.R.2d 537.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

Sales: what is "entrusting" goods to merchant dealer under UCC § 2-403, 59 A.L.R.4th 567.

31 C.J.S. Estoppel §§ 118, 119; 77A C.J.S. Sales § 230 et seq.

PART 5
PERFORMANCE

55-2-501. Insurable interest in goods; manner of identification of goods.

(1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs:

(a) when the contract is made if it is for the sale of goods already existing and identified;

(b) if the contract is for the sale of future goods other than those described in Paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers;

(c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve months after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may, until default or insolvency or notification to the buyer that the identification is final, substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

History: 1953 Comp., § 50A-2-501, enacted by Laws 1961, ch. 96, § 2-501.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 17 and 19, Uniform Sales Act.

Purposes. - 1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of Paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect

given to identification by this article, the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of Paragraphs (a), (b) and (c) are displaced - as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under Subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this article.

6. Identification of crops under Paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly excludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the the concept of "growing". Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

Cross references. - Point 1: Section 2-502.

Point 4: Sections 2-509, 2-510 and 2-703.

Point 5: Sections 2-105, 2-308, 2-503 and 2-509.

Point 6: Sections 2-105(1), 2-107(1) and 2-402.

Definitional cross references. - "Agreement". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Future goods". Section 2-105.

"Goods". Section 2-105.

"Notification". Section 1-201.

"Party". Section 1-201.

"Sale". Section 2-106.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Question of ownership of automobile in suit on insurance policy is for jury, where alleged owner was a part-time salesman for an automobile dealer under an arrangement whereby salesman was to sell the car or keep it himself, paying off the balance. Knotts v. Safeco Ins. Co. of Am., 78 N.M. 395, 432 P.2d 106 (1967).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 503 to 689; 68A Am. Jur. 2d Secured Transactions § 42.

Vendee or vendor under executory contract as having exclusive ownership or interest, within the meaning of condition in insurance policy requiring interest of insured to be that of "unconditional and sole ownership," or the like, 60 A.L.R. 11.

Insurable interest of buyer of automobile, 58 A.L.R.2d 1351.

Right of vendor and purchaser inter se in respect of proceeds of insurance, 64 A.L.R.2d 1402.

What constitutes theft within automobile theft insurance policy, 67 A.L.R.4th 82.

44 C.J.S. Insurance § 218 et seq.

55-2-502. Buyer's right to goods on seller's insolvency.

(1) Subject to Subsection (2) and even though the goods have not been shipped, a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section [55-2-501 NMSA 1978] may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer, he acquires the right to recover the goods only if they conform to the contract for sale.

History: 1953 Comp., § 50A-2-502, enacted by Laws 1961, ch. 96, § 2-502.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Compare Sections 17, 18 and 19, Uniform Sales Act.

Purposes. - 1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2-501. The buyer is given a right to the goods on the seller's insolvency occurring within 10 days after he receives the first installment on their price.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the article on secured transactions (Article 9).

3. Subsection (2) is included to preclude the possibility of unjust enrichment which exists if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

Cross references. - Point 1: Sections 1-201 and 2-702.

Point 2: Article 9.

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Insolvent". Section 1-201.

"Right". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 42.

77A C.J.S. Sales § 214 et seq.

55-2-503. Manner of seller's tender of delivery.

(1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this article, and in particular:

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section [55-2-504 NMSA 1978] respecting shipment, tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination, tender requires that he comply with Subsection (1) and also in any appropriate case tender documents as described in Subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved:

(a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) tender to the buyer of a nonnegotiable document of title or of a written direction to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents:

(a) he must tender all such documents in correct form, except as provided in this article with respect to bills of lading in a set (Subsection (2) of Section 2-323 [55-2-323 NMSA 1978]); and

(b) tender through customary banking channels is sufficient and dishonor of a draft accompanying the documents constitutes nonacceptance or rejection.

History: 1953 Comp., § 50A-2-503, enacted by Laws 1961, ch. 96, § 2-503.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 11, 19, 20, 43(3) and (4), 46 and 51, Uniform Sales Act.

Changes. The general policy of the above sections is continued and supplemented but Subsection (3) changes the rule of prior Section 19(5) as to what constitutes a "destination" contract and Subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

Purposes of changes. - 1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this article in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and must be followed by actual performance if the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this article and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect when measured against the contract obligation. Used in either sense, however, "tender"

connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner.

2. The seller's general duty to tender and deliver is laid down in Section 2-301 and more particularly in Section 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by Section 1-205. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this article on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under Subsection (1) by tendering documents which give the buyer complete control of the goods under the provisions of Article 7 on due negotiation.

3. Under Paragraph (a) of Subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under Subsection (1), Paragraph (b). This obligation of the buyer is no part of the seller's tender.

5. For the purposes of Subsections (2) and (3) there is omitted from this article the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of Subsection (4) continues the rule of the prior uniform legislation as to acknowledgment by the bailee. Paragraph (b) of Subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under Subsection (5) documents are never "required" except where there is an express contract term or it is plainly implicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": all documents must be in correct form.

When a prescribed document cannot be procured, a question of fact arises under the provision of this article on substituted performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

Cross references. - Point 2: Sections 1-205, 2-301, 2-310, 2-507 and 2-513 and Article 7.

Point 5: Sections 2-308, 2-310 and 2-509.

Point 7: Section 2-614(1).

Specific matters involving tender are covered in many additional sections of this article. See Sections 1-205, 2-301, 2-306 to 2-319, 2-321(3), 2-504, 2-507(2), 2-511(1), 2-513, 2-612 and 2-614.

Definitional cross references. - "Agreement". Section 1-201.

"Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Dishonor". Section 3-508.

"Document of title". Section 1-201.

"Draft". Section 3-104.

"Goods". Section 2-105.

"Notification". Section 1-201.

"Reasonable time". Section 1-204.

"Receipt" of goods. Section 2-103.

"Rights". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

"Written". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of seller as condition of delivery to insist on payment or resort to means not provided by contract to assure payment, 44 A.L.R. 443.

Insolvency of buyer as justifying seller on credit in refusing to deliver except for cash, 117 A.L.R. 1125.

Duty of seller to tender delivery where buyer has not exercised his option under contract to require shipment before time specified, 119 A.L.R. 1495.

May delivery which will support gift be predicated upon deposit in mail, filing of telegram or delivery to carrier, 126 A.L.R. 924.

Presumption and burden of proof as to consignee's title to or interest in respect of goods comprising shipment, in consignee's action against carrier for loss, damage, delay, nondelivery or conversion, 135 A.L.R. 456.

What amounts to acknowledgment by third person that he holds goods on buyer's behalf within statutory provision respecting delivery when goods are in possession of third person, 4 A.L.R.2d 213.

Delay in delivery placing goods at the risk of the party at fault under § 22(b) of Uniform Sales Act, 38 A.L.R.2d 658.

77A C.J.S. Sales § 157 et seq.

55-2-504. Shipment by seller.

Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must:

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and

(b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) promptly notify the buyer of the shipment.

Failure to notify the buyer under Paragraph (c) or to make a proper contract under Paragraph (a) is a ground for rejection only if material delay or loss ensues.

History: 1953 Comp., § 50A-2-504, enacted by Laws 1961, ch. 96, § 2-504.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 46, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that:

1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located. The general principles embodied in this section cover the special cases of F. O. B. point of shipment contracts and C. I. F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier under Paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this article on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this article on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this article on options and cooperation respecting performance gives the seller the choice of any reasonable carrier, routing

and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances, such as refrigeration, watering of live stock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for Paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under Paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of Paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and deliver promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in Paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of Paragraph (b) unless the contract requires some other form of document.

5. This article, unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt forwarding of the documents as under Paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of Paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters

not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

Cross references. - Point 1: Sections 2-319, 2-320 and 2-503(2).

Point 2: Sections 1-203, 2-323(2), 2-601 and 2-614(1).

Point 3: Section 2-311(2).

Point 5: Section 1-203.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Goods". Section 2-105.

"Notifies". Section 1-201.

"Seller". Section 2-103.

"Send". Section 1-201.

"Usage of trade". Section 1-205.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Construction and effect of provision as to declaration by seller of carrier vessel, 27 A.L.R. 165.

Failure to ship by carrier designated by buyer as affecting passing of title, 31 A.L.R. 955.

Right to fill orders from diverted ship, under contract which calls for shipment to certain point, 36 A.L.R. 518.

Delivery to carrier of quantity of goods greater than that called for by contract as passing title to goods, 38 A.L.R. 1544.

Misrouting as affecting duty of the buyer to accept goods, 46 A.L.R. 1120.

Right of shipper or consignee to divert shipment, 61 A.L.R. 1309.

Seller's remedy against consignee's carrier for consignee's wrongful refusal to accept goods and pay freight because of damage by carrier, 96 A.L.R. 774.

Railroad carrier's liability where goods were allegedly damaged by failure to properly refrigerate, 4 A.L.R.3d 994.

77A C.J.S. Sales § 161 et seq.

55-2-505. Seller's shipment under reservation.

(1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named;

(b) a nonnegotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (Subsection (2) of Section 2-507 [55-2-507 NMSA 1978]) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section [55-2-504 NMSA 1978] but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document.

History: 1953 Comp., § 50A-2-505, enacted by Laws 1961, ch. 96, § 2-505.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 20(2), (3) and (4), Uniform Sales Act.

Changes. Completely rephrased, the "powers" of the parties in cases of reservation being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of changes. To continue in general the policy of the prior uniform statutory provision with certain modifications of emphasis and language, so that:

1. The security interest reserved to the seller under Subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this

article, the provision as to the passing of interest expressly applies "despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in Subsection (1) are not to be altered by any apparent "contrary intent" of the parties as to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This article does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under Subsection (1) Paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This article does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the article on documents of title (Article 7).

3. A non-negotiable bill of lading taken to a party other than the buyer under Subsection (1) Paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by non-negotiable bill of lading taken to a buyer, the seller, under Subsection (1) retains no security interest or possession as against the buyer and by the shipment he *de facto* loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under Section 2-403.

5. Under Subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as results from identification of the goods. The security title reserved by the seller under Subsection (1) does not protect his holding of the document or the goods for the purpose of exacting more than is due him under the contract.

Cross references. - Point 1: Section 1-201.

Point 2: Article 7.

Point 3: Sections 2-501(2) and 2-504.

Point 4: Sections 2-403, 2-507(2) and 2-705.

Point 5: Sections 2-310, 2-319(4), 2-320(4), 2-501 and 2-502 and Article 7.

Definitional cross references. - "Bill of lading". Section 1-201.

"Buyer". Section 2-103.

"Consignee". Section 7-102.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Financing agency". Section 2-104.

"Goods". Section 2-105.

"Holder". Section 1-201.

"Person". Section 1-201.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Receipt of partial payment or commercial paper for purchase price for goods as terminating vendor's right of stoppage in transitu, 7 A.L.R. 1412.

Rule that title passes on delivery to carrier as applicable to shipment in "pool" car for several purchasers, 36 A.L.R. 410.

Passing of title to goods by acceptance of draft for purchase price, with warehouse receipt attached, or by transfer of draft with receipt, 55 A.L.R. 1116, 60 A.L.R. 677.

Seller's consignment to own order, 60 A.L.R. 677.

77A C.J.S. Sales § 161 et seq.; 80 C.J.S. Shipping § 113.

55-2-506. Rights of financing agency.

(1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular on its face.

History: 1953 Comp., § 50A-2-506, enacted by Laws 1961, ch. 96, § 2-506.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. "Financing agency" is broadly defined in this article to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction. The term as used in Subsection (1) is not in any sense intended as a limitation and covers any other appropriate situation which may arise outside the scope of the definition.

2. "Paying" as used in Subsection (1) is typified by the letter of credit, or "authority to pay" situation in which a banker, by arrangement with the buyer or other consignee, pays on his behalf a draft for the price of the goods. It is immaterial whether the draft is formally drawn on the party paying or his principal, whether it is a sight draft paid in cash or a time draft "paid" in the first instance by acceptance, or whether the payment is viewed as absolute or conditional. All of these cases constitute "payment" under this subsection. Similarly, "purchasing for value" is used to indicate the whole area of financing by the seller's banker, and the principle of Subsection (1) is applicable without any niceties of distinction between "purchase," "discount," "advance against collection" or the like. But it is important to notice that the only right to have the draft honored that is acquired is that *against the buyer;* if any right against any one else is claimed it will have to be under some separate obligation of that other person. A letter of credit does not necessarily protect *purchasers* of drafts. See Article 5. And for the relations of the parties to documentary drafts see Part 5 of Article 4.

3. Subsection (1) is made applicable to payments or advances against a draft which "relates to" a shipment of goods and this has been chosen as a term of maximum breadth. In particular the term is intended to cover the case of a draft against an invoice or against a delivery order. Further, it is unnecessary that there be an explicit assignment of the invoice attached to the draft to bring the transaction within the reason of this subsection.

4. After shipment, "the rights of the shipper in the goods" are merely security rights and are subject to the buyer's right to force delivery upon tender of the price. The rights acquired by the financing agency are similarly limited and, moreover, if the agency fails to procure any outstanding negotiable document of title, it may find its exercise of these rights hampered or even defeated by the seller's disposition of the document to a third party. This section does not attempt to create any new rights in the financing agency against the carrier which would force the latter to honor a stop order from the agency, a stranger to the shipment, or any new rights against a holder to whom a document of title has been duly negotiated under Article 7.

Cross references. - Point 1: Section 2-104(2) and Article 4.

Point 2: Part 5 of Article 4, and Article 5.

Point 4: Sections 2-501 and 2-502(1) and Article 7.

Definitional cross references. - "Buyer". Section 2-103.

"Document of title". Section 1-201.

"Draft". Section 3-104.

"Financing agency". Section 2-104.

"Good faith". Section 2-103.

"Goods". Section 2-105.

"Honor". Section 1-201.

"Purchase". Section 1-201.

"Rights". Section 1-201.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 161 et seq.

55-2-507. Effect of seller's tender; delivery on condition.

(1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

History: 1953 Comp., § 50A-2-507, enacted by Laws 1961, ch. 96, § 2-507.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 11, 41, 42 and 69, Uniform Sales Act.

Purposes. - 1. Subsection (1) continues the policies of the prior uniform statutory provisions with respect to tender and delivery by the seller. Under this article the same rules in these matters are applied to present sales and to contracts for sale. But the provisions of this subsection must be read within the framework of the other sections of this article which bear upon the question of delivery and payment.

2. The "unless otherwise agreed" provision of Subsection (1) is directed primarily to cases in which payment in advance has been promised or a letter of credit term has been included. Payment "according to the contract" contemplates immediate payment, payment at the end of an agreed credit term, payment by a time acceptance or the like. Under this act, "contract" means the total obligation in law which results from the parties' agreement including the effect of this article. In this context, therefore, there must be considered the effect in law of such provisions as those on means and manner of payment and on failure of agreed means and manner of payment.

3. Subsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. The provision of this article for a ten day limit within which the seller may reclaim goods delivered on credit to an insolvent buyer is also applicable here.

Cross references. - Point 1: Sections 2-310, 2-503, 2-511, 2-601 and 2-711 to 2-713.

Point 2: Sections 1-201, 2-511 and 2-614.

Point 3: Sections 2-401, 2-403, and 2-702(1) (b).

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Rights". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Effect of stipulation for return of advance payment, if order is not accepted, 1 A.L.R. 1513.

Entirety or divisibility of contract as affecting time of payment, 2 A.L.R. 677.

Right of purchaser to opportunity to pay in cash where tender has been made in other medium, 11 A.L.R. 811, 23 A.L.R. 630, 46 A.L.R. 914.

Rights and remedies of purchaser under seller's agreement to assist him in reselling the goods, 29 A.L.R. 666.

Right of seller as condition of delivery to insist on payment or resort to means not provided by contract to assure payment, 44 A.L.R. 443.

Time of delivery as of the essence of the contract so as to release buyer in case of premature delivery, 47 A.L.R. 193.

Contract requiring seller to look to property alone for payment, 50 A.L.R. 714.

Reserving to seller right to demand cash or security, if buyer's credit or financial responsibility becomes impaired, 64 A.L.R. 1117.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

In absence of written provision in sales contract, place where cash consideration for goods purchased is payable, 49 A.L.R.2d 1350.

77A C.J.S. Sales § 161 et seq.

55-2-508. Cure by seller of improper tender or delivery; replacement.

(1) Where any tender or delivery by the seller is rejected because nonconforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance, the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

History: 1953 Comp., § 50A-2-508, enacted by Laws 1961, ch. 96, § 2-508.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) permits a seller who has made a non-conforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the non-conforming goods and refunded the purchase price. He may still make a good tender within the contract period. The closer, however, it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery, a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by a reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid

compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare Section 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

Cross references. - Point 2: Section 2-302.

Point 3: Section 2-511.

Point 4: Sections 1-205 and 2-721.

Definitional cross references. - "Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Money". Section 1-201.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Applicability of provision in contract of sale for return of article, where article delivered does not answer to description, 30 A.L.R. 321.

Remedy of seller in case of mistake as to amount of commodity called for by contract, 31 A.L.R. 384.

Seller's cure of improper tender or delivery under U.C.C. § 2-508, 36 A.L.R.4th 544.

77A C.J.S. Sales § 176 et seq.

55-2-509. Risk of loss in the absence of breach.

(1) Where the contract requires or authorizes the seller to ship the goods by carrier:

(a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (Section 2-505 [55-2-505 NMSA 1978]); but

(b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer:

(a) on his receipt of a negotiable document of title covering the goods; or

(b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) after his receipt of a nonnegotiable document of title or other written direction to deliver, as provided in Subsection (4) (b) of Section 2-503 [55-2-503 NMSA 1978].

(3) In any case not within Subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this article on sale on approval (Section 2-327 [55-2-327 NMSA 1978]) and on effect of breach on risk of loss (Section 2-510 [55-2-510 NMSA 1978]).

History: 1953 Comp., § 50A-2-509, enacted by Laws 1961, ch. 96, § 2-509.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 22, Uniform Sales Act.

Changes. Rewritten, Subsection (3) of this section modifying prior law.

Purposes of changes. To make it clear that:

1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases

where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of Subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under Paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass. To transfer the risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement, the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk.

5. The provisions of this section are made subject by Subsection (4) to the "contrary agreement" of the parties. This language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

Cross references. - Point 1: Section 2-510(1).

Point 2: Sections 2-503 and 2-504.

Point 3: Sections 2-104, 2-503 and 2-510.

Point 4: Section 2-503(4).

Point 5: Section 1-201.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Party". Section 1-201.

"Receipt" of goods. Section 2-103.

"Sale on approval". Section 2-326.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Goods remaining in custody of seller or third person, when deemed to have been received by buyer, 4 A.L.R. 902.

Liability for loss of or damage to property delivered on trial or with privilege of return, 31 A.L.R. 1365.

Who bears loss incidentally to destruction of goods sold conditionally, 38 A.L.R. 1319.

Delay in delivery placing goods at the risk of the party at fault, 38 A.L.R.2d 658.

Upon whom loss from theft or the like falls, where seller turns over goods at buyer's premises, 50 A.L.R.2d 330.

77A C.J.S. Sales § 223 et seq.

55-2-510. Effect of breach on risk of loss.

(1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection, the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance, he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

History: 1953 Comp., § 50A-2-510, enacted by Laws 1961, ch. 96, § 2-510.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To make clear that:

1. Under Subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by Subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure, waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by

his insurance falls upon the contract breaker under Subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

Cross reference. - Section 2-509.

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Delay in delivery placing goods at the risk of the party at fault under § 22(b) of Uniform Sales Act, 38 A.L.R.2d 658.

77A C.J.S. Sales § 223 et seq.

55-2-511. Tender of payment by buyer; payment by check.

(1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time necessary to procure it.

(3) Subject to provisions of the Uniform Commercial Code on the effect of an instrument on an obligation (Section 55-3-310 NMSA 1978), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

History: 1953 Comp., § 50A-2-511, enacted by Laws 1961, ch. 96, § 2-511; 1992, ch. 114, § 7.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 42, Uniform Sales Act.

Changes. Rewritten by this section and Section 2-507.

Purposes of changes. - 1. The requirement of payment against delivery in Subsection (1) is applicable to noncommercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the article dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery" integrates this section with the language and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This article determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment may be demanded before inspection by the buyer.

3. The essence of the principle involved in Subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This article recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article 3 (Section 3-802). Similarly the reason of this

subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under Subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of article on commercial paper. (Section 3-802). But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (Section 3-411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check postdated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As between the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

Cross references. - Point 1: Sections 2-307, 2-310, 2-320, 2-325, 2-503, 2-513 and 2-609.

Point 2: Sections 2-307, 2-310, 2-319, 2-322, 2-503, 2-504 and 2-513.

Point 3: Section 2-614.

Point 5: Article 3, esp. Sections 3-802 and 3-411.

Point 6: Sections 2-507, 2-702, and Article 3.

Definitional cross references. - "Buyer". Section 2-103.

"Check". Section 3-104.

"Dishonor". Section 3-508.

"Party". Section 1-201.

"Reasonable time". Section 1-204.

"Seller". Section 2-103.

The 1992 amendment, effective July 1, 1992, substituted "the Uniform Commercial Code" for "this act" and "55-3-310 NMSA 1978" for "3-802" in Subsection (3).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Entirety or divisibility of contract as affecting time of payment, 2 A.L.R. 677.

Authority of agent to receive payment for commodities which he is authorized to sell, or for which he is to find market, 8 A.L.R. 203, 105 A.L.R. 718.

Right of purchaser to opportunity to pay in cash where tender has been made in other medium, 11 A.L.R. 811, 23 A.L.R. 630, 46 A.L.R. 914.

Dishonor of draft or check for purchase price on a cash sale as affecting sellers' rights in respect of property or its proceeds, 31 A.L.R. 578, 54 A.L.R. 526.

Option to pay purchase price in cash or on terms, 36 A.L.R. 857.

Acceptance of draft for purchase price with warehouse receipt attached or by transfer of draft with receipt as passing title to goods, 55 A.L.R. 116, 76 A.L.R. 885, 109 A.L.R. 1381.

Right of purchaser in making tender to deduct from agreed purchase price amount of obligations which it is the vendor's duty to satisfy, 173 A.L.R. 1309.

In absence of written provision in sales contract, place where cash consideration for goods purchased is payable, 49 A.L.R.2d 1350.

Conclusiveness of determination of third party whose approval is provided for by contract for sale of goods, 7 A.L.R.3d 555.

77A C.J.S. Sales § 208 et seq.; 86 C.J.S. Tender § 21.

55-2-512. Payment by buyer before inspection.

(1) Where the contract requires payment before inspection non-conformity of the goods does not excuse the buyer from so making payment unless:

(a) the non-conformity appears without inspection; or

(b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of the Uniform Commercial Code (Section 55-5-109 NMSA 1978).

(2) Payment pursuant to Subsection (1) of this section does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies.

History: 1953 Comp., § 50A-2-512, enacted by Laws 1961, ch. 96, § 2-512; 1997, ch. 75, § 2.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None, but see Sections 47 and 49, Uniform Sales Act.

Purposes. - 1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. "Inspection" under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on common sense and normal commercial practice. The apparent non-conformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. Section 5-114.

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by the seller. The remedies preserved to the buyer are all of his remedies, which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present section must therefore be considered in conjunction with the provision on rights to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

Cross references. - Point 4: Article 5.

Point 5: Section 1-207.

Point 6: Section 2-513(3).

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Financing agency". Section 2-104.

"Goods". Section 2-105.

"Remedy". Section 1-201.

"Rights". Section 1-201.

The 1997 amendment, effective July 1, 1997, in Paragraph (1)(b), substituted "the Uniform Commercial Code (Section 55-5-109 NMSA 1978)" for "this Act (Section 5-114)" and made minor stylistic changes in Subsection (2).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Effect of opportunity to inspect on question of implied warranty, 52 A.L.R. 1536.

Time within which buyer must make inspection, trial or test to determine whether goods are of requisite quality, 52 A.L.R.2d 900.

77A C.J.S. Sales § 208 et seq.

55-2-513. Buyer's right to inspection of goods.

(1) Unless otherwise agreed and subject to Subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this article on C.I.F. contracts (Subsection (3) of Section 2-321 [55-2-321 NMSA 1978]), the buyer is not entitled to inspect the goods before payment of the price when the contract provides:

(a) for delivery "C.O.D." or on other like terms; or

(b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition, failure of which avoids the contract.

History: 1953 Comp., § 50A-2-513, enacted by Laws 1961, ch. 96, § 2-513.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 47(2) and (3), Uniform Sales Act.

Changes. Rewritten, Subsections (2) and (3) being new.

Purposes of changes and new matter. To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that:

1. The buyer is entitled to inspect goods as provided in Subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations as those outlined in Subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right of the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may, unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to inspect after receipt of the goods unless the case falls within Subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of Subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, Subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly arrive and be tendered while the goods are still in transit. This article recognizes no exception in any peculiar case in which the goods happen to arrive before the documents. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be held until arrival the buyer is entitled to inspect before payment since the goods are then "available for inspection". Proof of usage is not necessary to establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under Subsection (3) (b). This result is reinforced by the buyer's right under Subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under Subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this article.

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this article if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that

subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this article which requires that such a time limitation must be reasonable.

8. Inspection under this article is not to be regarded as a "condition precedent to the passing of title" so that risk until inspection remains on the seller. Under Subsection (4) such an approach cannot be sustained. Issues between the buyer and seller are settled in this article almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

Cross references. - Generally: Sections 2-310 (b), 2-321(3) and 2-606(1)(b).

Point 1: Section 2-607.

Point 2: Sections 2-501 and 2-502.

Point 4: Section 2-715.

Point 5: Section 2-321(3).

Point 6: Sections 2-606 to 2-608.

Point 7: Section 1-204.

Point 8: Comment to Section 2-401.

Point 9: Section 2-316(3)(b).

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Presumed". Section 1-201.

"Reasonable time". Section 1-204.

"Rights". Section 1-201.

"Seller". Section 2-103.

"Send". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Buyer's right to inspect at destination where goods are delivered to carrier, 27 A.L.R. 524.

Effect of provision making acceptance of goods conditional on approval by third person on passing title, 46 A.L.R. 869.

Effect of opportunity to inspect on question of implied warranty, 52 A.L.R. 1543.

Duty of a purchaser of goods "on trial" or "on approval" regarding notice or rejection, 78 A.L.R. 533.

Buyer's acceptance of delayed or defective installment of goods as waiver of similar default as to later installments, 32 A.L.R.2d 1117.

Time within which buyer must make inspection, trial, or test to determine whether goods are of requisite quality, 52 A.L.R.2d 900.

Reasonableness of personal judgment of buyer as test where goods are sold subject to being satisfactory to the buyer, 86 A.L.R.2d 200.

Time, place and manner of buyer's inspection of goods under U.C.C. § 2-513, 36 A.L.R.4th 726.

77A C.J.S. Sales § 185 et seq.

55-2-514. When documents deliverable on acceptance; when on payment.

Unless otherwise agreed, documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

History: 1953 Comp., § 50A-2-514, enacted by Laws 1961, ch. 96, § 2-514.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 41, Uniform Bills of Lading Act.

Changes. Rewritten.

Purposes of changes. To make the provision one of general application so that:

1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in Sections 4-503 and 5-112.

2. An "arrival" draft is a sight draft within the purpose of this section.

Cross references. - Point 1: See Sections 2-502, 2-505(2), 2-507(2), 2-512, 2-513, 2-607 concerning protection of rights of buyer and seller, and 4-503 and 5-112 on delivery of documents.

Definitional cross references. - "Delivery". Section 1-201.

"Draft". Section 3-104.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 311.

Damages for bank's breach of duty in surrendering attached bill of lading before payment of draft held for collection, 19 A.L.R. 555, 67 A.L.R. 1511.

77A C.J.S. Sales § 189 et seq.

55-2-515. Preserving evidence of goods in dispute.

In furtherance of the adjustment of any claim or dispute:

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample

the goods including such of them as may be in the possession or control of the other; and

(b) the parties may agree to a third-party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent itigation [litigation] or adjustment.

History: 1953 Comp., § 50A-2-515, enacted by Laws 1961, ch. 96, § 2-515.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under Paragraph (a), to afford either party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor does Paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, non-conformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, therefore, until the buyer has made payment, inspected and rejected the goods, there is no occasion or use for the rights under Paragraph (a).

3. Under Paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity", at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition", at

the other end of the scale, includes nothing but the degree of damage or deterioration which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing in this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this act, for it is a third party document.

Cross references. - Point 2: Sections 2-513(3), 2-706 and 2-711(2) and Article 5.

Point 3: Sections 1-202 and 1-207.

Definitional cross references. - "Conform". Section 2-106.

"Goods". Section 2-105.

"Notification". Section 1-201.

"Party". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Effect of provision making acceptance of goods conditional on approval by third person on passing title, 46 A.L.R. 869.

17A C.J.S. Contracts § 496; 77A C.J.S. Sales § 206 et seq.

PART 6
BREACH, REPUDIATION AND EXCUSE

55-2-601. Buyer's rights on improper delivery.

Subject to the provisions of this article on breach in installment contracts (Section 2-612 [55-2-612 NMSA 1978]) and unless otherwise agreed under the sections on contractual limitations of remedy (Sections 2-718 [55-2-718 NMSA 1978] and 2-719 [55-2-719 NMSA 1978]), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may:

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

History: 1953 Comp., § 50A-2-601, enacted by Laws 1961, ch. 96, § 2-601.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. No one general equivalent provision but numerous provisions, dealing with situations of non-conformity where buyer may accept or reject, including Sections 11, 44 and 69(1), Uniform Sales Act.

Changes. Partial acceptance in good faith is recognized and the buyer's remedies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

Purposes of changes. To make it clear that:

1. A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in Paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

Cross references. - Sections 2-602(2) (a), 2-612, 2-718 and 2-719.

Definitional cross references. - "Buyer". Section 2-103.

"Commercial unit". Section 2-105.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Installment contract". Section 2-612.

"Rights". Section 1-201.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d Sales §§ 407, 431, 504, 518, 530, 679; 67A Am. Jur. 2d Sales §§ 853 et seq., 1037, 1212, 1213.

Remedy of seller in case of mistake as to amount of commodity called for by contract, 31 A.L.R. 384.

Delivery to carrier of quantity of goods greater than that called for by contract as passing title to goods, 38 A.L.R. 1544.

Acceptance of some "commercial units" of goods purchased under UCC § 2-601(C), 41 A.L.R.4th 396.

77A C.J.S. Sales § 194 et seq.

55-2-602. Manner and effect of rightful rejection.

(1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (Sections 2-603 [55-2-603 NMSA 1978] and 2-604 [55-2-604 NMSA 1978]):

(a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this article (Subsection (3) of Section 2-711 [55-2-711 NMSA 1978]), he is under a duty after rejection to hold them

with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this article on seller's remedies in general (Section 2-703 [55-2-703 NMSA 1978]).

History: 1953 Comp., § 50A-2-602, enacted by Laws 1961, ch. 96, § 2-602.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 50, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To make it clear that:

1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance. Under Subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this article dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in Section 1-201.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's [seller's] disposition, this section continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to be appropriately limited or modified when a negotiation is in process.

Cross references. - Point 1: Sections 1-201, 1-204(1) and (3), 2-512(2), 2-513(1) and 2-606(1) (b).

Point 2: Section 2-603(1).

Point 3: Section 2-703.

Definitional cross references. - "Buyer". Section 2-103.

"Commercial unit". Section 2-105.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Seasonably". Section 1-204.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Burden is on buyers to make timely and unequivocal rejection if they do not intend to accept goods as delivered. Woods v. Van Wallis Trailer Sales Co., 77 N.M. 121, 419 P.2d 964 (1966).

Actions of buyer inconsistent with rejection. - Buyer's claims that it had rejected or revoked acceptance of juniper plants by telephone statement that plants were not "up to snuff" was refuted by the fact that four months after receiving them it had removed them from their five gallon containers and had planted them in fulfillment of its contract with a third party. Oda Nursery, Inc. v. Garcia Tree & Lawn, Inc., 103 N.M. 438, 708 P.2d 1039 (1985).

Buyer's acts amounting to ownership prohibited after rejection. - A buyer, after having given seller notice of a rejection of goods within a reasonable time, may not then exercise acts over the property amounting to dominion or ownership, and a buyer who

does not have a security interest in such property is under a duty after rejection to hold the goods with reasonable care for a time sufficient to permit the seller to remove them. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Except to extent of security interest therein. - Where the buyer rightfully rejects goods in his possession, it necessarily follows that he has a security interest in the goods pursuant to 55-2-711(3) NMSA 1978, in the entire amount spent for the goods, and he should not be required to return them for an amount less than the entire amount. Consequently, Subsection (2)(b) of this section, which obligates a buyer without a security interest in rejected goods in his possession to hold them with reasonable care, cannot apply. Because the security interest entitles the buyer to hold the goods and resell them, such action cannot constitute a violation of Subsection (2)(a) of this section, which makes any exercise of ownership by the buyer after rejection wrongful. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Continued use of property will not negate the claim of revocation of acceptance in every case, particularly where the sellers fail to contact the buyers to arrange for removal of the property, or to show how any delay may have prejudiced them or to show that the delay could have been avoided. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Three-month delay in rejection not seasonable notice. - Where buyer fails to reject the entire shipment of goods until three months after seller's salesman refused to make requested adjustments for those goods rejected by buyer, the buyer has failed to give seller seasonable and particular notice of rejection as to the entire shipment and is precluded from rejecting any goods other than those originally set aside and presented to salesman. Celebrity, Inc. v. Kemper, 96 N.M. 508, 632 P.2d 743 (1981).

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Comparative liability is not part of the UCC under this section. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Law reviews. - For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Applicability of provision in contract of sale for return of article, where article delivered does not answer to description, 30 A.L.R. 321.

Duty of purchaser of goods "on trial" or "on approval" regarding notice of rejection, 78 A.L.R. 533.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

77A C.J.S. Sales § 194 et seq.

55-2-603. Merchant buyer's duties as to rightfully rejected goods.

(1) Subject to any security interest in the buyer (Subsection (3) of Section 2-711 [55-2-711 NMSA 1978]), when the seller has no agent or place of business at the market of rejection, a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under Subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten percent on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

History: 1953 Comp., § 50A-2-603, enacted by Laws 1961, ch. 96, § 2-603.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under Subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at

the market of rejection". A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of Sections 4-503 and 5-112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control", but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practicably effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in Subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in Subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, Subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

Cross references. - Point 2: Sections 4-503 and 5-112.

Point 5: Section 1-106. Compare generally Section 2-706.

Definitional cross references. - "Buyer". Section 2-103.

"Good faith". Section 1-201.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Farmers as "merchants" within provisions of U.C.C. Article 2, dealing with sales, 95 A.L.R.3d 484.

77A C.J.S. Sales § 198.

55-2-604. Buyer's options as to salvage of rightfully rejected goods.

Subject to the provisions of the immediately preceding section [55-2-603 NMSA 1978] on perishables, if the seller gives no instructions within a reasonable time after notification of rejection, the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

History: 1953 Comp., § 50A-2-604, enacted by Laws 1961, ch. 96, § 2-604.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The basic purpose of this section is twofold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1) non-conformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and non-merchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

Cross references. - Sections 2-602(1), 2-603(1) and 2-706.

Definitional cross references. - "Buyer". Section 2-103.

"Notification". Section 1-201.

"Reasonable time". Section 1-204.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 198.

55-2-605. Waiver of buyer's objections by failure to particularize.

(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach:

(a) where the seller could have cured it if stated seasonably; or

(b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent on the face of the documents.

History: 1953 Comp., § 50A-2-605, enacted by Laws 1961, ch. 96, § 2-605.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable. Subsection (1) (a), following the general policy of this article which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, Subsection (1) (b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under Paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent on their face. Where payment is required

against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an acceptance of the goods or impair any options or remedies of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only what is apparent on the face of the documents.

Cross references. - Point 2: Section 2-508.

Point 4: Sections 2-512(2), 2-606(1) (b) and 2-607(2).

Definitional cross references. - "Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

"Writing" and "written". Section 1-201.

Complaint that goods not "up to snuff" insufficient to permit cure. - Buyer's complaint that plants did not look "up to snuff," without detailing the particular problems, was insufficient to constitute rejection so as to permit cure by seller as contemplated by this section. Oda Nursery, Inc. v. Garcia Tree & Lawn, Inc., 103 N.M. 438, 708 P.2d 1039 (1985).

Three-month delay in rejection not seasonable notice. - Where buyer fails to reject the entire shipment of goods until three months after seller's salesman refused to make requested adjustments for those goods rejected by buyer, the buyer has failed to give seller seasonable and particular notice of rejection as to the entire shipment and is precluded from rejecting any goods other than those originally set aside and presented to salesman. Celebrity, Inc. v. Kemper, 96 N.M. 508, 632 P.2d 743 (1981).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 194 et seq.

55-2-606. What constitutes acceptance of goods.

(1) Acceptance of goods occurs when the buyer:

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity; or

(b) fails to make an effective rejection (Subsection (1) of Section 2-602 [55-2-602 NMSA 1978]), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

History: 1953 Comp., § 50A-2-606, enacted by Laws 1961, ch. 96, § 2-606.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 48, Uniform Sales Act.

Changes. Rewritten, the qualification in Paragraph (c) and Subsection (2) being new; otherwise the general policy of the prior legislation is continued.

Purposes of changes and new matter. To make it clear that:

1. Under this article "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he is obligated to do so, and whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this article acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material under this article to the detailed rights and duties of the parties. (See Section 2-401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller's and buyer's remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under Paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under Paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of Paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of Paragraph (c) modifies some of the prior case law and makes it clear that "acceptance" in law based on the wrongful act of the acceptor is acceptance only as against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller's ownership under Paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under Paragraph (a). However, the sections on buyer's rights on improper delivery and on the effect of rightful rejection, make it clear that after he once rejects a tender, Paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to Section 2-601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

Cross references. - Point 2: Sections 2-401, 2-509, 2-510, 2-607, 2-608 and Part 7.

Point 4: Sections 2-601 through 2-604.

Point 5: Section 2-601.

Definitional cross references. - "Buyer". Section 2-103.

"Commercial unit". Section 2-105.

"Goods". Section 2-105.

"Seller". Section 2-103.

Rights upon revocation of acceptance. - Buyer who justifiably revokes his acceptance has the same right to rescission as though he had rejected the goods in the first place. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

Items not properly rejected are accepted. - Where buyer fails to properly reject all but certain specific items, those items not rejected are accepted. Celebrity, Inc. v. Kemper, 96 N.M. 508, 632 P.2d 743 (1981).

Reasonable time to reject determined by circumstances. - Absent a specific provision in a sales contract, a buyer has a reasonable time within which to determine whether or not the goods are defective, and the time depends upon all the circumstances surrounding the transaction. The actions of the parties may affect what is deemed to constitute a "reasonable time." O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Three-month delay in rejection not seasonable notice. - Where buyer fails to reject the entire shipment of goods until three months after seller's salesman refused to make requested adjustments for those goods rejected by buyer, the buyer has failed to give seller seasonable and particular notice of rejection as to the entire shipment and is precluded from rejecting any goods other than those originally set aside and presented to salesman. Celebrity, Inc. v. Kemper, 96 N.M. 508, 632 P.2d 743 (1981).

Acceptance by actions inconsistent with seller's ownership is question of fact. - Whether a buyer accepts goods by subsequent acts inconsistent with the seller's ownership is a question of fact to be determined from the evidence in each particular case. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Material alteration of goods by buyer will void a prior revocation of acceptance. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

For article, "Out of sight but not out of mind: New Mexico's tax on out-of-state services," see 20 N.M.L. Rev. 501 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 72 Am. Jur. 2d Statute of Frauds §§ 130, 155, 157.

Contractual provision making acceptance conditional on approval by, or satisfaction of, third person, 46 A.L.R. 864.

Acceptance as affected by cancellation of contract before goods were shipped, 113 A.L.R. 810.

Buyer's acceptance of delayed or defective installment of goods as waiver of similar default as to later installments, 32 A.L.R.2d 1117.

Reasonableness of personal judgment of buyer as test where goods are sold subject to being satisfactory to the buyer, 86 A.L.R.2d 200.

77A C.J.S. Sales § 189 et seq.

55-2-607. Effect of acceptance; notice of breach; burden of establishing breach after acceptance; notice of claim or litigation to person answerable over.

(1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a nonconformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this article for nonconformity.

(3) Where a tender has been accepted:

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and

(b) if the claim is one for infringement or the like (Subsection (3) of Section 2-312 [55-2-312 NMSA 1978]) and the buyer is sued as a result of such a breach, he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over:

(a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then, unless the seller after seasonable receipt of the notice does come in and defend, he is so bound;

(b) if the claim is one for infringement or the like (Subsection (3) of Section 2-312 [55-2-312 NMSA 1978]), the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then, unless the buyer after seasonable receipt of the demand does turn over control, the buyer is so barred.

(6) The provisions of Subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (Subsection (3) of Section 2-312 [55-2-312 NMSA 1978]).

History: 1953 Comp., § 50A-2-607, enacted by Laws 1961, ch. 96, § 2-607.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - Section 41, Uniform Sales Act; Subsections (2) and (3) - Sections 49 and 69, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that:

1. Under Subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in quantum valebat cases, to be determined in terms of "the contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this article have been brought to bear.

2. Under Subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a non-conformity known to the buyer at the time of acceptance, except where the buyer has accepted on the reasonable assumption that the non-conformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under Subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier non-conforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section

covering statements of defects upon rejection (Section 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort to a remedy. The notification which saves the buyer's rights under this article need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this article various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was non-conforming and the buyer has given the seller notice of breach under Subsection (3). For Subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by way of cross-claim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3) (b) and (5) (b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5) (a) codifies for all warranties the practice of voucher to defend. Compare Section 3-803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under Section 2-312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

Cross references. - Point 1: Section 1-201.

Point 2: Section 2-608.

Point 4: Sections 1-204 and 2-605.

Point 5: Section 2-318.

Point 6: Section 2-717.

Point 7: Sections 2-312 and 3-803.

Point 8: Section 1-207.

Definitional cross references. - "Burden of establishing". Section 1-201.

"Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

"Remedy". Section 1-201.

"Seasonably". Section 1-204.

Comparative liability is not part of the UCC under this section. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

The purpose of the requirement of notice to the seller of a breach of warranty is to enable the seller to minimize damages in some manner, if possible to correct the defect, and also to give the seller some immunity against stale claims. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

No notice of intent to claim damages. - When a tender has been accepted, the buyer must, within a reasonable time after he discovers or should have discovered any breach, notify the seller or be barred from any remedy. There is no requirement that the buyer also notify the seller of an intent to claim damages for the breach. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

Notification of breach may be oral or written. - Notification of a breach of warranty may be either oral or in writing and is sufficient if it is informative to the seller of the general nature of the difficulty encountered with the warranted goods. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Buyer must give notice within "reasonable time". - After a buyer has determined that there has been a breach of warranty relating to the property sold, the buyer must give notice to the seller within a "reasonable time" after he discovers or should have discovered the breach, to avoid liability for the sale. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Sufficiency and timeliness of notice are questions of fact. - The sufficiency of notice and what is considered a reasonable time within which to give notice of a breach of

warranty are ordinarily questions of fact, based upon the circumstances of each case. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Acceptance of partial shipment. - Notice is not a condition precedent to the remedy of "cover" for failure to make a complete delivery. Not until the buyer accepts a complete tender must he, within a reasonable time after he discovers or should have discovered any breach, notify the seller of a breach or be barred from any remedy. A buyer's mere acceptance of partial goods does not waive or otherwise affect his right to damages for the seller's failure to deliver the remainder under the contract of sale. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability § 525.

Effect of stipulation for return of advance payment, if order is not accepted, 1 A.L.R. 1513.

Judgment against seller of chattels for breach of warranty as conclusive upon prior warrantor, 8 A.L.R. 667.

Right of purchaser to opportunity to pay in cash where tender has been made in other medium, 11 A.L.R. 811, 23 A.L.R. 630, 46 A.L.R. 914.

Liability of seller of article not inherently dangerous for personal injuries to the buyer due to the defective or dangerous condition of the article, 13 A.L.R. 1176, 74 A.L.R. 343, 168 A.L.R. 1054.

Right of dealer against his vendor in case of breach of warranty as to article purchased for resale and resold, 22 A.L.R. 133, 64 A.L.R. 883.

Right of seller to ship goods after notice of repudiation by buyer, 27 A.L.R. 1230.

Loss of profits as element of damages for fraud of seller as to quality of goods purchased for resale, 28 A.L.R. 354.

Rights and remedies of purchaser under seller's agreement to assist him in reselling the goods, 29 A.L.R. 666.

Applicability of provision in contract of sale for return of article, where article delivered does not answer to description, 30 A.L.R. 321.

Automobile or truck, right of action for breach of warranty, 34 A.L.R. 549, 43 A.L.R. 648.

Effect of action as an election of remedy or choice of substantive rights in case of fraud in sale of property, 35 A.L.R. 1153, 123 A.L.R. 378.

Liability of seller of serum or vaccine matter for use on livestock for defects in quality thereof, 39 A.L.R. 399.

Right of seller as condition of delivery to insist on payment or resort to means not provided by contract to assure payment, 44 A.L.R. 443.

Misrouting as affecting duty of the buyer to accept goods, 46 A.L.R. 1120.

What constitutes delivery of goods sold under C.I.F. contracts, 47 A.L.R. 193.

Contract requiring seller to look to property alone for payment, 50 A.L.R. 714.

Factor's failure to account for proceeds of sale as affecting rights of seller and purchaser inter se, 50 A.L.R. 1301.

Reserving to seller right to demand cash or security, if buyer's credit or financial responsibility becomes impaired, 64 A.L.R. 1117.

Acceptance after agreed time of delivery as waiver of damages on account of seller's delay, 80 A.L.R. 322.

Effect of express provision of contract limiting obligation in case of breach of warranty to replacement of defective article or part under Uniform Sales Act, 106 A.L.R. 1466.

Breach of warranty as to title, as within statutory provision requiring notice of breach of warranty on sale of goods, 114 A.L.R. 707.

Insolvency of buyer as justifying seller on credit in refusing to deliver except for cash, 117 A.L.R. 1105.

Sufficiency of buyer's attempt to rescind, 118 A.L.R. 530.

Duty of seller to tender delivery where buyer has not exercised his option under contract to require shipment before time specified, 119 A.L.R. 1495.

Purchaser's remedy for personal injury due to defective or dangerous condition of purchased article not inherently dangerous, 168 A.L.R. 1054.

Buyer's acceptance of part of goods as affecting right to damages for failure to complete delivery, 169 A.L.R. 595.

What amounts to acknowledgment by third person that he holds goods on buyer's behalf within statutory provision respecting delivery when goods are in possession of third person, 4 A.L.R.2d 213.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

Seller's waiver of sales contract provision limiting time within which buyer may object to or return goods or article for defects or failure to comply with warranty or representations, 24 A.L.R.2d 717.

Buyer's acceptance of delayed or defective installment of goods as waiver of similar default as to later installments, 32 A.L.R.2d 1117.

Purchaser's use or attempted use of articles known to be defective as affecting damages recoverable for breach of warranty, 33 A.L.R.2d 511.

Time within which buyer of goods must give notice in order to recover damages for seller's breach of express warranty, 41 A.L.R.2d 812.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 41 A.L.R.2d 1173.

In absence of written provision and sales contract, place where cash consideration for goods purchased is payable, 49 A.L.R.2d 1350.

Form and substance of notice which buyer of goods must give in order to recover damages for seller's breach of warranty, 53 A.L.R.2d 270.

Sufficiency and timeliness of buyer's notice under U.C.C. § 2-607 of seller's breach of warranty, 93 A.L.R.3d 363.

Third-party beneficiaries of warranties under U.C.C. § 2-318, 100 A.L.R.3d 743.

Extent of liability of seller of livestock infected with communicable disease, 14 A.L.R.4th 1096.

Necessity that buyer of goods give notice of breach of warranty to manufacturer under UCC § 2-607, requiring notice to seller of breach, 24 A.L.R.4th 277.

Products liability: seller's right to indemnity from manufacturer, 79 A.L.R.4th 278.

77A C.J.S. Sales § 189 et seq.

55-2-608. Revocation of acceptance in whole or in part.

(1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it:

(a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

History: 1953 Comp., § 50A-2-608, enacted by Laws 1961, ch. 96, § 2-608.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 69(1) (d), (3), (4) and (5), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To make it clear that:

1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the nonconformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under Paragraph (b) of Subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in Paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this article is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reasonable time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of non-conformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under Subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this article, the requirements of the content of notification are less stringent in the case of a non-merchant buyer.

6. Under Subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

Cross references. - Point 3: Section 2-721.

Point 4: Sections 1-204, 2-602 and 2-607.

Point 5: Sections 2-605 and 2-607.

Point 7: Section 2-601.

Definitional cross references. - "Buyer". Section 2-103.

"Commercial unit". Section 2-105.

"Conform". Section 2-106.

"Goods". Section 2-105.

"Lot". Section 2-105.

"Notifies". Section 1-201.

"Reasonable time". Section 1-204.

"Rights". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Rights upon revocation of acceptance. - Buyer who justifiably revokes his acceptance has the same right to rescission as though he had rejected the goods in the first place. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

But reasonable efforts required. - After buyers accepted delivery of gelding they believed to be a stallion, they were still able to revoke acceptance by making every reasonable effort to locate and inform seller of horse's misrepresentation, upon their discovery of the mistake of sex. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

And damages generally. - Since Subsection (3) of this section states that a buyer who revokes has same rights with regard to goods involved as if he had rejected them, plaintiff, who purchased used automobile but then revoked acceptance of the vehicle when defendant vendor failed to deliver clear title as warranted, was not precluded from recovering "nondelivery" damages under 55-2-711 NMSA 1978, even where physical delivery took place. Gawlick v. American Bldrs. Supply, Inc., 86 N.M. 77, 519 P.2d 313 (Ct. App. 1974).

Buyer may not revoke acceptance and recover for breach. - Even though buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach, recovery from one claim precludes recovery from the other. GMAC v. Anaya, 103 N.M. 72, 703 P.2d 169 (1985).

Continued possession not waiver of right to revoke acceptance. - Continued possession and reasonable use of property after the buyer has notified the seller of a revocation of acceptance does not, as a matter of law, constitute a waiver of the right to revoke acceptance. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Continued use of property will not negate the claim of revocation of acceptance in every case, particularly where the sellers fail to contact the buyers to arrange for removal of the property, or to show how any delay may have prejudiced them or to show that the delay could have been avoided. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Strict adherence to use of specific revoking words not required of buyers: they must, however, give sufficient indication of revocation that there can be no surprise on the part of the seller. Ybarra v. Modern Trailer Sales, Inc., 94 N.M. 249, 609 P.2d 331 (1980).

Actions of buyer inconsistent with revocation. - Buyer's claims that it had rejected or revoked acceptance of juniper plants by telephone statement that plants were not "up to snuff" was refuted by the fact that four months after receiving them it had removed them from their five gallon containers and had planted them in fulfillment of its contract with a third party. Oda Nursery, Inc. v. Garcia Tree & Lawn, Inc., 103 N.M. 438, 708 P.2d 1039 (1985).

"Reasonable time" within which to reject is question of fact. - The question of what is a "reasonable time" within which to rescind a sale is a question of fact which differs under the facts of each case. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Reasonable to require loss claims to be made within two days. - In general, a contract provision requiring claims of loss to be made within two days of delivery is reasonable, lawful and not unconscionable. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Four years not unreasonable time to revoke acceptance, following constant complaints. - In a suit to revoke acceptance of a contract for the sale of a mobile home, four years was not an unreasonable time for the buyer's revocation, where the buyers complained about the defects as soon as they were discovered, continually asked the seller to remedy the defects and relied upon seller's assurances that repairs would be made. Ybarra v. Modern Trailer Sales, Inc., 94 N.M. 249, 609 P.2d 331 (1980).

Proof of substantial impairment not required for rejection. - Where the buyer is simply rejecting goods, he is not required to prove substantial impairment. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Buyer to hold goods with reasonable care. - A buyer, after having given seller notice of a rejection of goods within a reasonable time, is under a duty after rejection to hold

the goods with reasonable care for a time sufficient to permit the seller to remove them. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

When buyer may retain possession. - Where a buyer notifies a seller of a revocation of acceptance of goods, and receives no instructions from the seller concerning the return or disposition of the property, the buyer is entitled to retain possession of such property. O'Shea v. Hatch, 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

Comparative liability is not part of the UCC under this section. Bowlin's, Inc. v. Ramsey Oil Co., 99 N.M. 660, 662 P.2d 661 (Ct. App. 1983).

Law reviews. - For comment, "The Miller Act in New Mexico - Materialman's Right to Recover on Prime's Surety Bond in Public Works Contracts - Notice as Condition Precedent to Action," see 9 Nat. Resources J. 295 (1969).

For annual survey of New Mexico law relating to commercial law, see 12 N.M.L. Rev. 173 (1982).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability §§ 521 to 525.

Resale by buyer where seller has refused to receive property rejected for breach of warranty, 24 A.L.R. 1445.

Acceptance of installment of goods as affecting buyer's right to rescind because of defects in that installment, 29 A.L.R. 1517.

Abandonment of possession as prerequisite to vendee's suit to obtain a rescission or to recover back money paid, 142 A.L.R. 582.

Buyer's return of subject of sale and acceptance of return or credit for the purchase price as affecting right to recover special damages for breach of warranty, 157 A.L.R. 1077.

Measure and elements of recovery of buyer rescinding sale of domestic animal for seller's breach of warranty, 35 A.L.R.2d 1273.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 41 A.L.R.2d 1173.

What constitutes "substantial impairment" entitling buyer to revoke his acceptance of goods under UCC § 2-608(1), 38 A.L.R.5th 191.

77A C.J.S. Sales § 199 et seq.

55-2-609. Right to adequate assurance of performance.

(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party, the other may in writing demand adequate assurance of due performance and until he receives such assurance may, if commercially reasonable, suspend any performance for which he has not already received the agreed return.

(2) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand, failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

History: 1953 Comp., § 50A-2-609, enacted by Laws 1961, ch. 96, § 2-609.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 53, 54(1) (b), 55 and 63(2), Uniform Sales Act.

Purposes. - 1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of

performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, Section 63(2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that "reasonable" grounds and "adequate" assurance as used in Subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in Jay Dreher Corporation v. Delco Appliance Corporation, 93 F.2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend

his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance or other commercially reasonable cure.

A fact situation such as arose in Corn Products Refining Co. v. Fasola, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity".

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith

and observe commercial standards. This article thus approves the statement of the court in James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc., 32 F.2d 74 (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the Corn Products Refining Co. case, which held that in the seller's sole judgment, if for *any* reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the buyer's failure to take the 2% discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to re-establish the security of expectation, results in a breach only "by repudiation" under Subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this article. Acceleration clauses are treated similarly in the articles on commercial paper and secured transactions.

Cross references. - Point 3: Section 1-203.

Point 5: Section 2-611.

Point 6: Sections 1-203, 1-208 and Articles 3 and 9.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Between merchants". Section 2-104.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Party". Section 1-201.

"Reasonable time". Section 1-204.

"Rights". Section 1-201.

"Writing". Section 1-201.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Nature, construction and effect of "lay away" or "will call" plan or system, 10 A.L.R.3d 456.

Sales: what constitutes "reasonable grounds for insecurity" justifying demand for adequate assurance of performance under UCC § 2-609, 37 A.L.R.5th 459.

77A C.J.S. Sales § 157 et seq.

55-2-610. Anticipatory repudiation.

When either party repudiates the contract with respect to a performance not yet due, the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(a) for a commercially reasonable time await performance by the repudiating party; or

(b) resort to any remedy for breach (Section 2-703 [55-2-703 NMSA 1978] or Section 2-711 [55-2-711 NMSA 1978]), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) in either case suspend his own performance or proceed in accordance with the provisions of this article on the seller's right to identify goods to the contract

notwithstanding breach or to salvage unfinished goods (Section 2-704 [55-2-704 NMSA 1978]).

History: 1953 Comp., § 50A-2-610, enacted by Laws 1961, ch. 96, § 2-610.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 63(2) and 65, Uniform Sales Act.

Purposes. To make it clear that:

1. With the problem of insecurity taken care of by the preceding section and with provision being made in this article as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts - namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see Section 1-203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time

with his options under this section, unless he has taken some positive action which in good faith requires notification to the other party before the remedy is pursued.

Cross references. - Point 1: Sections 2-609 and 2-612.

Point 2: Section 2-609.

Point 3: Section 2-612.

Point 4: Section 1-203.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Contract". Section 1-201.

"Party". Section 1-201.

"Remedy". Section 1-201.

Effect of value lost from "used" condition of goods on mitigation of damages. - The duty of the seller of a boat to mitigate damages arose after the seller was notified of the repudiation of the buyer, and where a loss in value of the boat due to its "used" condition occurred before the buyer's repudiation letter, the boat's "used" value was a proper damage for the court to consider, and was not subject to the duty to mitigate. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit, and Credit Cards § 75 et seq.

Breach of one contract as ground for rescission of another, 27 A.L.R. 1157.

Election to rescind for fraud as barring action for damages, 35 A.L.R. 1155, 123 A.L.R. 378.

Refusal to accept crops to be grown, 44 A.L.R. 215, 108 A.L.R. 1482.

Return or tender of consideration for release or compromise of claim on contract of sale, as condition of action for rescission, 134 A.L.R. 146.

What constitutes anticipatory repudiation of sales contract under UCC § 2-610, 1 A.L.R.4th 527.

77A C.J.S. Sales § 121 et seq.

55-2-611. Retraction of anticipatory repudiation.

(1) Until the repudiating party's next performance is due, he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this article (Section 2-609 [55-2-609 NMSA 1978]).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

History: 1953 Comp., § 50A-2-611, enacted by Laws 1961, ch. 96, § 2-611.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To make it clear that:

1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under Subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to warrant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

Cross reference. - Point 2: Section 2-609.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Cancellation". Section 2-106.

"Contract". Section 1-201.

"Party". Section 1-201.

"Rights". Section 1-201.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 121 et seq.

55-2-612. "Installment contract"; breach.

(1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer must reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonformity does not fall within Subsection (3) and the seller gives adequate assurance of its cure, the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract, there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

History: 1953 Comp., § 50A-2-612, enacted by Laws 1961, ch. 96, § 2-612.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 45(2), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that:

1. The definition of an installment contract is phrased more broadly in this article so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this article applies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This article also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly "entire" and wholly "divisible" contracts has any standing under this article.

3. This article rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect. Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes", a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any noncommercial and legalistic interpretation.

4. One of the requirements for rejection under Subsection (2) is nonconformity substantially impairing the value of the installment in question. However, an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under Subsection (2) an installment delivery must be accepted if the nonconformity is curable and the seller gives adequate assurance of cure. Cure of nonconformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This article requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation. Adequate

assurance for purposes of Subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right of cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such nonconformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this article, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under Subsection (3), a buyer who accepts a nonconforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standards under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross references. - Point 2: Sections 2-307 and 2-607.

Point 3: Section 1-203.

Point 5: Sections 2-208 and 2-609.

Point 6: Section 2-610.

Definitional cross references. - "Action". Section 1-201.

"Aggrieved party". Section 1-201.

"Buyer". Section 2-103.

"Cancellation". Section 2-106.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Lot". Section 2-105.

"Notifies". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of seller to rescind or refuse further deliveries on buyer's failure to pay for installments, 14 A.L.R. 1209, 75 A.L.R. 609.

Right, upon buyer's default in payment of installment due, to recover amount not due, in absence of acceleration clause, 57 A.L.R. 825.

Buyer's acceptance of part of goods as affecting right to damages for failure to complete delivery, 169 A.L.R. 595.

Buyer's acceptance of delayed installment of goods as waiver of similar default as to later installments, 32 A.L.R.2d 1117.

Excess of payment for one period as applicable to subsequent period under contract or mortgage providing for periodic payments, 89 A.L.R.3d 947.

77A C.J.S. Sales § 121 et seq.

55-2-613. Casualty to identified goods.

Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (Section 2-324 [55-2-324 NMSA 1978]) then:

(a) if the loss is total the contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract, the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price

for the deterioration or the deficiency in quantity but without further right against the seller.

History: 1953 Comp., § 50A-2-613, enacted by Laws 1961, ch. 96, § 2-613.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 7 and 8, Uniform Sales Act.

Changes. Rewritten, the basic policy being continued but the test of a "divisible" or "indivisible" sale or contract being abandoned in favor of adjustment in business terms.

Purposes of changes. - 1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved from his obligation but may at his option take the surviving goods at a fair adjustment. "Fault" is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement, including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term "no arrival, no sale" makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

Cross reference. - Point 3: Section 2-324.

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Contract". Section 1-201.

"Fault". Section 1-201.

"Goods". Section 2-105.

"Party". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Construction and effect of UCC § 2-613 governing casualty to goods identified to a contract, without fault of buyer or seller, 51 A.L.R.4th 537.

77A C.J.S. Sales § 147 et seq.

55-2-614. Substituted performance.

(1) Where without fault of either party the agreed berthing, loading or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.

History: 1953 Comp., § 50A-2-614, enacted by Laws 1961, ch. 96, § 2-614.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable. Under this article, in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between Section 2-613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or non-occurrence of a contingency which was a basic assumption of the contract makes the expected performance impossible. The distinction between the present section and those sections lies in whether the failure or impossibility of performance arises in

connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of International Paper Co. v. Rockefeller, 161 App. Div. 180, 146 N.Y.S. 371 (1914) and Meyer v. Sullivan, 40 Cal. App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this article, of course, the seller would also be entitled, had the market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article 5, especially Sections 5-102, 5-103, 5-109, 5-110 and 5-114.

3. Under Subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

Cross reference. - Point 2: Article 5.

Definitional cross references. - "Buyer". Section 2-103.

"Fault". Section 1-201.

"Party". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 147 et seq.

55-2-615. Excuse by failure of presupposed conditions.

Except so far as a seller may have assumed a greater obligation and subject to the preceding section [55-2-614 NMSA 1978] on substituted performance:

(a) delay in delivery or nondelivery in whole or in part by a seller who complies with Paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid;

(b) where the causes mentioned in Paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable;

(c) the seller must notify the buyer seasonably that there will be delay or nondelivery and, when allocation is required under Paragraph (b), of the estimated quota thus made available for the buyer.

History: 1953 Comp., § 50A-2-615, enacted by Laws 1961, ch. 96, § 2-615.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this article, must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to

cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See Ford & Sons, Ltd. v. Henry Leetham & Sons, Ltd., 21 Com. Cas. 55 (1915, K.B.D.).)

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See Davis Co. v. Hoffmann-LaRoche Chemical Works, 178 App.Div. 855, 166 N.Y.S. 179 (1917) and International Paper Co. v. Rockefeller, 161 App.Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See Canadian Industrial Alcohol Co., Ltd. v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and Washington Mfg. Co. v. Midland Lumber Co., 113 Wash. 593, 194 P. 777 (1921).)

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the defaulting supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this article provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the

like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See Madeirense Do Brasil, S. A. v. Stulman-Emrick Lumber Co., 147 F.2d 399 (C.C.A., 2 Cir., 1945).) The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in Paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is given by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement subcontract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this article and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it truly "supervenes" in such a manner as to be beyond the seller's assumption of risk. And any action by the party claiming

excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

Cross references. - Point 1: Sections 2-613 and 2-614.

Point 2: Section 1-102.

Point 5: Sections 1-203 and 2-613.

Point 6: Sections 1-102, 1-203 and 2-609.

Point 7: Section 2-614.

Point 8: Sections 1-201, 2-302 and 2-616.

Point 9: Sections 1-102, 2-306 and 2-613.

Definitional cross references. - "Between merchants". Section 2-104.

"Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Good faith". Section 1-201.

"Merchant". Section 2-104.

"Notifies". Section 1-201.

"Seasonably". Section 1-204.

"Seller". Section 2-103.

Excuse by supervening governmental regulation. - Performance will be excused when made impracticable by having to comply with a supervening governmental regulation. International Minerals & Chem. Corp. v. Llano, Inc., 770 F.2d 879 (10th Cir. 1985), cert. denied, 475 U.S. 1015, 106 S. Ct. 1196, 89 L. Ed. 2d 310 (1986).

Liquor license purchaser not liable following denial of governmental approval. - Purchaser of a liquor license was not liable for breach of contract where governmental approval of the exchange, which was a condition precedent, was denied after the buyer had made a good faith effort to gain the governmental agency's approval. Nor was the buyer required to choose alternate locations for his establishment in order to obtain approval of the liquor license transfer. Dechert v. Allsup's Convenience Stores, Inc., 104 N.M. 748, 726 P.2d 1378 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Inability of seller of commodity manufactured or produced by third person to obtain it from the third person as a defense to action by buyer for breach of contract, 80 A.L.R. 1177.

Nature, construction and effect of "lay away" or "will call" plan or system, 10 A.L.R.3d 456.

Impracticability of performance of sales contract as defense under U.C.C. § 2-615, 93 A.L.R.3d 584.

77A C.J.S. Sales § 121 et seq.

55-2-616. Procedure on notice claiming excuse.

(1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section [55-2-615 NMSA 1978], he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this article relating to breach of installment contracts (Section 2-612 [55-2-612 NMSA 1978]), then also as to the whole:

(a) terminate and thereby discharge any unexecuted portion of the contract; or

(b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller, the buyer fails so to modify the contract within a reasonable time not exceeding thirty days, the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under the preceding section [55-2-615 NMSA 1978].

History: 1953 Comp., § 50A-2-616, enacted by Laws 1961, ch. 96, § 2-616.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under Subsection (2) his silence after receiving the seller's claim of excuse operates as such a termination. Subsection (3) denies effect to any contract clause made in advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

Cross references. - Point 1: Sections 2-209 and 2-615.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Installment contract". Section 2-612.

"Notification". Section 1-201.

"Reasonable time". Section 1-204.

"Seller". Section 2-103.

"Termination". Section 2-106.

"Written". Section 1-201.

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Section 2-609: Right to Adequate Assurance of Performance," see 7 Nat. Resources J. 397 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 77A C.J.S. Sales § 121 et seq.

PART 7 REMEDIES

55-2-701. Remedies for breach of collateral contracts not impaired.

Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this article.

History: 1953 Comp., § 50A-2-701, enacted by Laws 1961, ch. 96, § 2-701.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this article; but contractual arrangements which as a business matter enter vitally into the contract should be considered a part thereof insofar as cross-claims or defenses are concerned.

Definitional cross references. - "Contract for sale". Section 2-106.

"Remedy". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67A Am. Jur. 2d Sales §§ 853 et seq., 986 et seq.

77A C.J.S. Sales § 325 et seq.

55-2-702. Seller's remedies on discovery of buyer's insolvency.

(1) Where the seller discovers the buyer to be insolvent, he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this article (Section 2-705 [55-2-705 NMSA 1978]).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent, he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten-day limitation does not apply. Except as provided in this subsection, the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under Subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser under this article (Section 2-403 [55-2-403 NMSA 1978]). Successful reclamation of goods excludes all other remedies with respect to them.

History: 1953 Comp., § 50A-2-702, enacted by Laws 1961, ch. 96, § 2-702.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Subsection (1) - Sections 53(1) (b), 54(1) (c) and 57, Uniform Sales Act; Subsection (2) - none; Subsection (3) - Section 76(3), Uniform Sales Act.

Changes. Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.

Purposes of changes and new matter. To make it clear that:

1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in Subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.

2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This article makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, Subsection (3) provides that such reclamation bars all his other remedies as to the goods involved. As amended 1966.

Cross references. - Point 1: Sections 2-401 and 2-705.

Compare Section 2-502.

Definitional cross references. - "Buyer". Section 2-103.

"Buyer in ordinary course of business". Section 1-201.

"Contract". Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 2-105.

"Insolvent". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Receipt" of goods. Section 2-103.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Seller". Section 2-103.

"Writing". Section 1-201.

Tender of insufficient funds checks constitutes written misrepresentation of solvency for the purposes of this section. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

And sellers' right to stop delivery. - Upon the notice given by the oil producing sellers to other seller, prior to February 10, 1972 to stop delivery of the crude oil to bankrupt based upon the previous dishonoring by the drawee bank of bankrupt's "insufficient funds" checks to the sellers, the sellers thereby timely exercised their rights of stoppage in transitu under this section. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 37 Am. Jur. 2d Fraud and Deceit § 9; 68A Am. Jur. 2d Secured Transactions §§ 13, 106.

Effect on remedies of seller of contract requiring seller to look to property alone for payment, 17 A.L.R. 714.

Seller's rights in respect of the property, or its proceeds, upon dishonor of draft or check for purchase price, on a cash sale, 31 A.L.R. 578, 54 A.L.R. 526.

Buyer's insolvency, 58 A.L.R. 1301, 117 A.L.R. 1105.

Right to enforce vendor's lien against property purchased by municipality, 76 A.L.R. 695.

Revival of seller's lien on return of chattel to seller after delivery to buyer, and effect of such return on conditions of enforcement of lien, 118 A.L.R. 564.

77A C.J.S. Sales § 325 et seq.

55-2-703. Seller's remedies in general.

Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (Section 2-612 [55-2-612 NMSA 1978]), then also with respect to the whole undelivered balance, the aggrieved seller may:

(a) withhold delivery of such goods;

(b) stop delivery by any bailee as hereafter provided (Section 2-705 [55-2-705 NMSA 1978]);

(c) proceed under the next section [55-2-704 NMSA 1978] respecting goods still unidentified to the contract;

(d) resell and recover damages as hereafter provided (Section 2-706 [55-2-706 NMSA 1978]);

(e) recover damages for nonacceptance (Section 2-708 [55-2-708 NMSA 1978]) or in a proper case the price (Section 2-709 [55-2-709 NMSA 1978]);

(f) cancel.

History: 1953 Comp., § 50A-2-703, enacted by Laws 1961, ch. 96, § 2-703.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. No comparable index section. See Section 53, Uniform Sales Act.

Purposes. - 1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in installment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the non-acceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross references. - Point 2: Section 2-612.

Point 3: Section 2-325.

Point 4: Section 1-106.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Buyer". Section 2-103.

"Cancellation". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Remedy". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of seller to rescind or refuse further deliveries on buyer's failure to pay for installments, 14 A.L.R. 1209, 75 A.L.R. 609.

Seller's rights in respect of property or its proceeds upon dishonor of draft or check for purchase price on a cash sale, 31 A.L.R. 578, 54 A.L.R. 526.

Right of seller as condition of delivery to insist on payment or resort to means not provided by contract to assure payment, 44 A.L.R. 443.

Factor's failure to account for proceeds of sale as affecting rights of seller and purchaser inter se, 50 A.L.R. 1301.

Pecuniary damage as essential to rescission of contract for purchase of real or personal property, 106 A.L.R. 125.

Repossession of chattels by seller upon their return or abandonment by buyer as effecting a mutual rescission or as evidence thereof, 106 A.L.R. 703.

Insolvency of buyer as justifying seller on credit in refusing to deliver except for cash, 117 A.L.R. 1105.

Seller's knowledge of purchaser's intention to put property to illegal use as defense to action for purchase price, 166 A.L.R. 1353.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

Right of action for breach of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

77A C.J.S. Sales § 325 et seq.

55-2-704. Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods.

(1) An aggrieved seller under the preceding section [55-2-703 NMSA 1978] may:

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished, an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

History: 1953 Comp., § 50A-2-704, enacted by Laws 1961, ch. 96, § 2-704.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 63(3) and 64(4), Uniform Sales Act.

Changes. Rewritten, the seller's rights being broadened.

Purposes of changes. - 1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regardless of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this article the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

Cross references. - Sections 2-703 and 2-706.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Rights". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Fraud of buyer in ordering more than his business requires as entitling one contracting to sell to extent of buyer's requirements to maintain action for damages, 7 A.L.R. 505, 26 A.L.R.2d 1099.

Shipping goods after notice of repudiation by buyer, 27 A.L.R. 1230.

Anticipatory repudiation of contract for sale of goods by buyer as affecting time as of which damages are to be computed, 34 A.L.R. 114.

Measure of damages, buyer's repudiation of or failure to accept goods under executory contract, 44 A.L.R. 215, 108 A.L.R. 1482.

Measure of damages, buyer's repudiation of or failure to purchase shares of stock, 44 A.L.R. 358.

Duty to minimize damages by accepting offer modified by party who has breached contract of sale, 46 A.L.R. 1192.

77A C.J.S. Sales § 325 et seq.

55-2-705. Seller's stoppage of delivery in transit or otherwise.

(1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (Section 2-702 [55-2-702 NMSA 1978]) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until:

(a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) such acknowledgment to the buyer by a carrier by reshipment or as warehouseman; or

(d) negotiation to the buyer of any negotiable document of title covering the goods.

(3) (a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods, the bailee is not obliged to obey a notification to stop until surrender of the document.

(d) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

History: 1953 Comp., § 50A-2-705, enacted by Laws 1961, ch. 96, § 2-705.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 57-59, Uniform Sales Act; see also Sections 12, 14 and 42, Uniform Bills of Lading Act and Sections 9, 11 and 49, Uniform Warehouse Receipts Act.

Changes. This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

Purposes. To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case to carriers, and might be a very heavy burden to them if it covered all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger shipments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjustified order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the documents of this article (Section 7-303). Subsection 3(b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the sub-purchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this article that the seller, by making such direct shipment to the sub-purchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under Subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against

the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under Subsection (3) (b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under Subsection (2) (c) when it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the name of the consignee to that of the buyer's local agent but do not alter the destination of a reshipment.

Acknowledgment by the carrier as a "warehouseman" within the meaning of this article requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouseman.

4. Subsection (3) (c) makes the bailee's obedience of a notification to stop conditional upon the surrender of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

Cross references. - Sections 2-702 and 2-703.

Point 1: Sections 2-503 and 2-609, and Article 7.

Point 2: Section 2-103 and Article 7.

Definitional cross references. - "Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Document of title". Section 1-201.

"Goods". Section 2-105.

"Insolvent". Section 1-201.

"Notification". Section 1-201.

"Receipt" of goods. Section 2-103.

"Rights". Section 1-201.

"Seller". Section 2-103.

Acknowledgment to buyer that bailee holds goods for buyer. - Cattle seller failed to exercise his rights under this section in a timely fashion, where he failed to show that he attempted to stop delivery before the buyer was notified by a feedlot that the cattle were being held for him. O'Brien v. Chandler, 107 N.M. 797, 765 P.2d 1165 (1988).

Tender of insufficient funds checks constitutes written misrepresentation of solvency for the purposes of this section. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

And sellers' right to stop delivery. - Upon the notice given by the oil producing sellers to other seller, prior to February 10, 1972 to stop delivery of the crude oil to bankrupt based upon the previous dishonoring by the drawee bank of bankrupt's "insufficient funds" checks to the sellers, the sellers thereby timely exercised their rights of stoppage in transitu under this section. Amoco Pipeline Co. v. Admiral Crude Oil Corp., 490 F.2d 114 (10th Cir. 1974).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 439; 78 Am. Jur. 2d Warehouses § 203.

When right of stoppage in transitu terminates, 7 A.L.R. 1374.

Right of seller to rescind or refuse further deliveries upon the buyer's failure to pay for installments, 14 A.L.R. 1209, 75 A.L.R. 609.

77A C.J.S. Sales § 333 et seq.

55-2-706. Seller's resale including contract for resale.

(1) Under the conditions stated in Section 2-703 [55-2-703 NMSA 1978] on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this article (Section 2-710 [55-2-710 NMSA 1978]), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in Subsection (3) or unless otherwise agreed, resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary

that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale, the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale:

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) if the goods are not to be within the view of those attending the sale, the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) the seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (Section 2-707 [55-2-707 NMSA 1978]) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (Subsection (3) of Section 2-711 [55-2-711 NMSA 1978]).

History: 1953 Comp., § 50A-2-706, enacted by Laws 1961, ch. 96, § 2-706.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 60, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To simplify the prior statutory provision and to make it clear that:

1. The only condition precedent to the seller's right of resale under Subsection (1) is a breach by the buyer within the section on the seller's remedies in general or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this article and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by Subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in Subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708.

Under this article the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in Subsection (1). Evidence of market or current prices at any particular time or place is relevant only on the question of whether the seller acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller has resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods, is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, Subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This article rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of Subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in making the resale to depart from the terms and conditions of the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of Subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of Subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, Subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification of a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4) (b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, Subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i. e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under Subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to attend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of Subsection (4) qualifies the last sentence of Subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind.

The provisions of Paragraph (c) of Subsection (4) are intended to permit intelligent bidding.

The provision of Paragraph (d) of Subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This article departs in Subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under Subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this article divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of Subsection (6).

Cross references. - Point 1: Sections 2-610, 2-702 and 2-703.

Point 2: Section 1-201.

Point 3: Sections 2-708 and 2-710.

Point 4: Section 2-328.

Point 8: Section 2-104.

Point 9: Section 2-710.

Point 11: Sections 2-401, 2-707 and 2-711(3).

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Good faith". Section 2-103.

"Goods". Section 2-105.

"Merchant". Section 2-104.

"Notification". Section 1-201.

"Person in position of seller". Section 2-707.

"Purchase". Section 1-201.

"Rights". Section 1-201.

"Sale". Section 2-106.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Notice necessary for resale. - As to the sale of goods, where no notice of resale is given, the remedy provided by this section may not be utilized. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

And notice generally. - This section permits a seller of goods to utilize the contract price less resale price remedy, but requires reasonable notice to the buyer where the intended resale is to be private, even though most of the subject matter of the contract is not goods. Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967).

Excessive delay in a resale is enough to make the sale commercially unreasonable. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," 8 Nat. Resources J. 176 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 22 Am. Jur. 2d Damages §§ 509, 510.

Seller's right to recover for expenses of caring for personal property prior to its resale, 29 A.L.R. 61.

Loss of anticipated profits as damages, 32 A.L.R. 120.

Right to sell property in enforcement of lien of seller after having sued for purchase price, 38 A.L.R. 1432.

Resale of property as affecting measure of seller's damages, 44 A.L.R. 296, 119 A.L.R. 1141.

77A C.J.S. Sales § 344 et seq.

55-2-707. "Person in the position of a seller."

(1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this article withhold or stop delivery (Section 2-705 [55-2-705 NMSA 1978]) and resell (Section 2-706 [55-2-706 NMSA 1978]) and recover incidental damages (Section 2-710 [55-2-710 NMSA 1978]).

History: 1953 Comp., § 50A-2-707, enacted by Laws 1961, ch. 96, § 2-707.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 52(2), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To make it clear that:

In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for the seller has been included in the term "a person in the position of a seller."

Cross reference. - Article 5, Section 2-506.

Definitional cross references. - "Consignee". Section 7-102.

"Consignor". Section 7-102.

"Goods". Section 2-105.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 75 et seq.; 68A Am. Jur. 2d Secured Transactions § 13.

Factor's liability based on delay in marketing and selling principal's goods, 3 A.L.R.3d 815.

77A C.J.S. Sales § 325 et seq.

55-2-708. Seller's damages for nonacceptance or repudiation.

(1) Subject to Subsection (2) and to the provisions of this article with respect to proof of market price (Section 2-723 [55-2-723 NMSA 1978]), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this article (Section 2-710 [55-2-710 NMSA 1978]) but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in Subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this article (Section 2-710 [55-2-710 NMSA 1978]), less due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

History: 1953 Comp., § 50A-2-708, enacted by Laws 1961, ch. 96, § 2-708; 1967, ch. 186, § 5.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 64, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To make it clear that:

1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for non-acceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of

market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.

3. In all cases the seller may recover incidental damages.

Cross references. - Point 1: Sections 2-319 through 2-324, 2-503, 2-723 and 2-724.

Point 2: Section 2-709.

Point 3: Section 2-710.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Seller". Section 2-103.

Compiler's note. - Laws 1967, ch. 186, § 6, is compiled as 55-3-105 NMSA 1978.

Utilization of section in jury instructions. - Where damages are not sufficiently before the jury, an instruction incorporating the mandates of this section is not improper, and a court of appeals will not condemn a trial court's utilization of a local statute in instructing on damages without substantial authority to the contrary. Jaeco Pump Co. v. Inject-O-Meter Mfg. Co., 467 F.2d 317 (10th Cir. 1972).

Court can make findings on damages caused by buyer's repudiation of the contract when there is sufficient evidence. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Fraud of buyer in ordering more than his business requires as entitling one selling to extent of buyer's requirements to maintain action for damages, 7 A.L.R. 498, 26 A.L.R.2d 1099.

Shipping goods after notice of repudiation by buyer, 27 A.L.R. 1230.

Damages as affected by anticipatory breach of contract by buyer, 34 A.L.R. 114.

Measure of damages, buyer's repudiation of or failure to accept goods under executory contract, 44 A.L.R. 215, 108 A.L.R. 1482.

Resale of property as affecting measure of seller's damages under executory contract, 44 A.L.R. 296, 119 A.L.R. 1141.

Measure of damages, buyer's repudiation of or failure to purchase shares of stock, 44 A.L.R. 358.

Duty to minimize damages by accepting offer modified by party who has breached contract of sale, 46 A.L.R. 1192.

Stipulation as to damages in case of breach of contract for purchase of goods to be manufactured by other party, as penalty or liquidated damages, 79 A.L.R. 188.

Measure of damages for buyer's repudiation of or failure to accept goods under executory contract, 108 A.L.R. 1482.

Presumption and burden of proof as to market price or value of goods in action by seller against buyer who refuses to accept goods, 130 A.L.R. 1336.

Interest as element of damages recoverable in action for breach of contract for the sale of a commodity, 4 A.L.R.2d 1388.

Unjustified refusal of buyer to accept goods as affecting recovery of down payment, 11 A.L.R.2d 701.

Measure of damages for buyer's breach of contract to purchase article from dealer or manufacturer's agent, 24 A.L.R.2d 1008.

Validity and enforceability of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

77A C.J.S. Sales § 363 et seq.

55-2-709. Action for the price.

(1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section [55-2-710 NMSA 1978], the price:

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price, he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (Section 2-610 [55-2-610 NMSA 1978]), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceding section [55-2-708 NMSA 1978].

History: 1953 Comp., § 50A-2-709, enacted by Laws 1961, ch. 96, § 2-709.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 63, Uniform Sales Act.

Changes. Rewritten, important commercially needed changes being incorporated.

Purposes of changes. To make it clear that:

1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under Subsection (1) (b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the

advance, a security interest in the goods, the buyer on making the advance has such an interest as soon as the seller has rights in the agreed collateral. See Section 9-204.

5. "Goods accepted" by the buyer under Subsection (1) (a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under Subsection (1) (b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for non-acceptance. In such a situation, Subsection (3) permits recovery of those damages in the same action.

Cross references. - Point 4: Section 1-106.

Point 5: Sections 2-501, 2-509, 2-510 and 2-704.

Point 7: Section 2-708.

Definitional cross references. - "Action". Section 1-201.

"Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Seller". Section 2-103.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of action to recover purchase price under sale of corporate stock where title has not passed as affected by provisions of sales act, 9 A.L.R. 275.

Contract requiring seller to look to property loan for payment as affecting action for purchase price, 17 A.L.R. 714.

Repudiation of contract by buyer as affecting seller's right to ship goods and bring action to recover purchase price, 27 A.L.R. 1231.

Dishonor of draft or check for purchase price on cash sale as affecting seller's rights in respect to property or its proceeds, 31 A.L.R. 578, 54 A.L.R. 526.

Right to recover installments not due upon buyer's default in payment of installment due, in absence of acceleration clause, 57 A.L.R. 825.

Right of seller to rescind or refuse further deliveries on buyer's failure to pay for installments, where contract expressly provides remedy, 75 A.L.R. 619.

Effect of sales act on right of action to recover purchase price of corporate stock where title has not passed, 99 A.L.R. 275.

Rights of buyer in action by seller for purchase price as affected by invalidity of, or subsequent changes or developments with respect to taxes included in purchase price, 115 A.L.R. 667, 132 A.L.R. 706.

Presumptions and burden of proof as to market price or value of goods in action by seller against buyer who refuses to accept goods, 130 A.L.R. 1336.

Seller's knowledge of purchaser's intention to put property to an illegal use as defense to action for purchase price, 166 A.L.R. 1353.

Right of purchaser in making tender to deduct from agreed purchase price amount of obligations which it is the vendor's duty to satisfy, 173 A.L.R. 1309.

Measure of damages for buyer's breach of contract to purchase article from dealer or manufacturer's agent, 24 A.L.R.2d 1008.

Right of action for breach of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

Liability for purchases on credit or courtesy card, or on credit coin or plate, 15 A.L.R.3d 1086.

77A C.J.S. Sales § 348 et seq.

55-2-710. Seller's incidental damages.

Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation,

care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

History: 1953 Comp., § 50A-2-710, enacted by Laws 1961, ch. 96, § 2-710.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Sections 64 and 70, Uniform Sales Act.

Purposes. To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the principal normal and necessary additional elements of damage flowing from the breach but intends to allow all commercially reasonable expenditures made by the seller.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Buyer". Section 2-103.

"Goods". Section 2-105.

"Seller". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 75 et seq.

Right of seller upon failure of sales contract to recover from purchaser expenses of caring for personal property prior to its resale, 29 A.L.R. 61.

77A C.J.S. Sales § 363 et seq.

55-2-711. Buyer's remedies in general; buyer's security interest in rejected goods.

(1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance, then with respect to any goods involved and with respect to the whole if the breach goes to the whole contract (Section 2-612 [55-2-612 NMSA 1978]), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid:

(a) "cover" and have damages under the next section [55-2-712 NMSA 1978] as to all the goods affected whether or not they have been identified to the contract; or

(b) recover damages for nondelivery as provided in this article (Section 2-713 [55-2-713 NMSA 1978]).

(2) Where the seller fails to deliver or repudiates, the buyer may also:

(a) if the goods have been identified recover them as provided in this article (Section 2-502 [55-2-502 NMSA 1978]); or

(b) in a proper case obtain specific performance or replevy the goods as provided in this article (Section 2-716 [55-2-716 NMSA 1978]).

(3) On rightful rejection or justifiable revocation of acceptance, a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (Section 2-706 [55-2-706 NMSA 1978]).

History: 1953 Comp., § 50A-2-711, enacted by Laws 1961, ch. 96, § 2-711.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. No comparable index section; Subsection (3) - Section 69(5), Uniform Sales Act.

Changes. The prior uniform statutory provision is generally continued and expanded in Subsection (3).

Purposes of changes and new matter. - 1. To index in this section the buyer's remedies, Subsection (1) covering those remedies permitting the recovery of money damages, and Subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in Subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with that of a seller under this article except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the

inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in Subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover, or to have damages for non-delivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross references. - Point 1: Sections 2-508, 2-601(c), 2-608, 2-612 and 2-714.

Point 2: Section 2-706.

Point 3: Section 1-106.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Buyer". Section 2-103.

"Cancellation". Section 2-106.

"Contract". Section 1-201.

"Cover". Section 2-712.

"Goods". Section 2-105.

"Notifies". Section 1-201.

"Receipt" of goods. Section 2-103.

"Remedy". Section 1-201.

"Security interest". Section 1-201.

"Seller". Section 2-103.

Buyer may recover purchase price and incidental damages. - A buyer, who rightfully rejects or justifiably revokes acceptance of goods, has the right not only to rescind and recover back the purchase price paid, but, in addition, the right to recover incidental damages resulting from the seller's breach, including expenses reasonably incurred in the care and custody of such goods. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

And punitive damages for fraudulent acts. - This section permits recovery of damages in an action for rescission, and punitive damages may likewise be recovered in such action where the breach is accompanied by fraudulent acts which are wanton, malicious and intentional. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

Plus damages for nondelivery when proper. - Where plaintiff purchased used automobile but then revoked acceptance of the vehicle when defendant vendor failed to deliver clear title as warranted, damages were properly measured under this section to include the purchase price of the automobile, plus damages for nondelivery, which, as set forth in 55-2-713 NMSA 1978, would be the difference between the purchase price and the market value of the vehicle with clear title. Since 55-2-608(3) NMSA 1978 states that a buyer who revokes has same rights with regard to goods involved as if he had rejected them, physical delivery of the vehicle to the plaintiff did not eliminate the recovery of nondelivery damages. Gawlick v. American Bldrs. Supply, Inc., 86 N.M. 77, 519 P.2d 313 (Ct. App. 1974).

Acceptance of partial shipment. - Notice is not a condition precedent to the remedy of "cover" for failure to make a complete delivery. Not until the buyer accepts a complete tender must he, within a reasonable time after he discovers or should have discovered any breach, notify the seller of a breach or be barred from any remedy. A buyer's mere acceptance of partial goods does not waive or otherwise affect his right to damages for the seller's failure to deliver the remainder under the contract of sale. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

Lost profits need not be proved with mathematical certainty, but where the only basis for awarding lost profits is the difference between the suggested retail price and the cost to the distributor, the business is entirely new and the distributor produces neither proof of potential buyers nor evidence of its cost of doing business, an award of lost profits is too speculative to be upheld. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Resale under Subsection (3) security interest not wrongful exercise of ownership. - Where the buyer rightfully rejects goods in his possession, it necessarily follows that he has a security interest in the goods pursuant to Subsection (3) of this section, in the entire amount spent for the goods, and he should not be required to return them for an amount less than the entire amount. Because the security interest entitles the buyer to hold the goods and resell them, such action cannot constitute a violation of 55-2-602(2)(a) NMSA 1978, which makes any exercise of ownership by the buyer after rejection wrongful. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Excessive delay in a resale is enough to make the sale commercially unreasonable. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67A Am. Jur. 2d Sales §§ 853 et seq., 1164 et seq.

Resale by buyer where seller has refused to receive property rejected for breach of warranty, 24 A.L.R. 1445.

Effect of action as an election of remedy or choice of substantive rights in case of fraud in sale of property, 35 A.L.R. 1153, 123 A.L.R. 378.

Assignability of right to rescind or of right to return of money or other property as incident of rescission, 110 A.L.R. 849, 162 A.L.R. 743.

Seller's waiver of sales contract provision limiting time within which buyer may object to or return goods, 24 A.L.R.2d 717.

Purchaser's use or attempted use of articles known to be defective as affecting damages recoverable for breach of warranty, 35 A.L.R.2d 1273.

Time within which buyer of goods must give notice in order to recover damages for seller's breach of express warranty, 41 A.L.R.2d 812.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 41 A.L.R.2d 1173.

Validity and enforceability of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

77A C.J.S. Sales § 374 et seq.

55-2-712. "Cover"; buyer's procurement of substitute goods.

(1) After a breach within the preceding section [55-2-711 NMSA 1978] the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages

as hereinafter defined (Section 2-715 [55-2-715 NMSA 1978]), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

History: 1953 Comp., § 50A-2-712, enacted by Laws 1961, ch. 96, § 2-712.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under Subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this article as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or non-merchant consumer is required only to act in normal good faith while

the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

Cross references. - Point 1: Section 2-706.

Point 2: Section 1-204.

Point 3: Sections 2-713, 2-715 and 2-716.

Point 4: Section 1-203.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Good faith". Section 2-103.

"Goods". Section 2-105.

"Purchase". Section 1-201.

"Remedy". Section 1-201.

"Seller". Section 2-103.

Plaintiff's subsequent purchase of the smaller backhoe from seller was not a "cover" transaction under this section. Watson v. Tom Growney Equip., Inc., 104 N.M. 371, 721 P.2d 1302 (1986).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 22 Am. Jur. 2d Damages §§ 509, 510.

What constitutes "cover" upon breach by seller under UCC § 2-712(1), 79 A.L.R.4th 844.

77A C.J.S. Sales § 391 et seq.

55-2-713. Buyer's damages for nondelivery or repudiation.

(1) Subject to the provisions of this article with respect to proof of market price (Section 2-723 [55-2-723 NMSA 1978]), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and

consequential damages provided in this article (Section 2-715 [55-2-715 NMSA 1978]), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

History: 1953 Comp., § 50A-2-713, enacted by Laws 1961, ch. 96, § 2-713.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 67(3d), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. To clarify the former rule so that:

1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this article. Such scarcity conditions, moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

Cross references. - Point 3: Sections 1-106, 2-716 and 2-723.

Point 5: Section 2-712.

Definitional cross references. - "Buyer". Section 2-103.

"Contract". Section 1-201.

"Seller". Section 2-103.

Buyer may recover purchase price and incidental damages. - A buyer, who rightfully rejects or justifiably revokes acceptance of goods, has the right not only to rescind and recover back the purchase price paid, but, in addition, the right to recover incidental damages resulting from the seller's breach, including expenses reasonably incurred in the care and custody of such goods. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 22 Am. Jur. 2d Damages §§ 509, 510.

Loss of anticipated profits as damages for breach of seller's contract as to machine for buyer's use, 32 A.L.R. 120.

Measure of recovery by buyer where seller breaches agreement to repurchase at selling price, 50 A.L.R. 325.

Loss of, or damage to, crops as element of damages for breach of contract of sale of agricultural machinery or fertilizer, 69 A.L.R. 748.

Inability of a seller of a commodity manufactured or produced by a third person to obtain the same from the latter as a defense to an action by the buyer for breach of contract, 80 A.L.R. 1177.

Buyer's acceptance of part of goods as affecting right to damages for failure to complete delivery, 169 A.L.R. 595.

Interest as element of damages recoverable in action for breach of contract for the sale of a commodity, 4 A.L.R.2d 1388.

Right to recover, in action for breach of contract, expenditures incurred in preparation for performance, 17 A.L.R.2d 1300.

Necessity that buyer, relying on market price as measure of damages for seller's breach of sales contract, show that goods in question were available for market at the price shown, 20 A.L.R.2d 819.

Mental anguish as element of damages in action for breach of contract to furnish goods, 88 A.L.R.2d 1367.

Allegation of buyer's ability and willingness to perform, in action for damages for failure to deliver goods purchased, 94 A.L.R.2d 1215.

77A C.J.S. Sales § 395 et seq.

55-2-714. Buyer's damages for breach in regard to accepted goods.

(1) Where the buyer has accepted goods and given notification (Subsection (3) of Section 2-607 [55-2-607 NMSA 1978]), he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section [55-2-715 NMSA 1978] may also be recovered.

History: 1953 Comp., § 50A-2-714, enacted by Laws 1961, ch. 96, § 2-714.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 69(6) and (7), Uniform Sales Act.

Changes. Rewritten.

Purposes of changes. - 1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted, but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be

available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "non-conformity" referred to in Subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such non-conformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for non-delivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide, as where the buyer signifies his acceptance upon the tender. If, however, the non-conformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in Subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

Cross references. - Point 1: Compare Section 2-711; Sections 2-607 and 2-717.

Point 2: Section 2-106.

Point 3: Sections 2-608 and 2-713.

Point 4: Section 2-715.

Definitional cross references. - "Buyer". Section 2-103.

"Conform". Section 2-106.

"Goods". Section 1-201.

"Notification". Section 1-201.

"Seller". Section 2-103.

Not applicable when acceptance revoked. - Subsection (2) of this section sets forth a measure of damages for breach of warranty based on an acceptance, and does not apply where the unchallenged finding is that plaintiff's acceptance of used automobile has been revoked. The applicable provision in such situation is 55-2-711 NMSA 1978. Gawlick v. American Bldrs. Supply, Inc., 86 N.M. 77, 519 P.2d 313 (Ct. App. 1974).

In order to recover for breach of warranty, a buyer must prove four essential elements: (1) the existence of a defect; (2) that the defect was caused by the seller; (3) that the buyer notified the seller and sought repairs; and (4) that the seller failed or refused to repair or replace defective parts. Deaton, Inc. v. Aeroglide Corp., 99 N.M. 253, 657 P.2d 109 (1982).

Costs of reprocessing accepted materials. - Contractor, supplied with materials which did not meet project specifications, was entitled to damages for costs incurred in reprocessing these materials. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

Measure of damages. - The district court properly awarded plaintiff $1,900, the cost of the x-ray machine, in direct damages. This amount was the difference between the value of the x-ray machine as warranted and the value of the machine actually delivered. Manouchehri v. Heim, N.M. , 941 P.2d 978 (Ct. App. 1997).

Law reviews. - For annual survey of New Mexico law relating to commercial law, see 13 N.M.L. Rev. 293 (1983).

For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability § 451; 63A Am. Jur. 2d Products Liability § 967 et seq.

Judgment against seller of chattels for breach of warranty as conclusive upon prior warrantor, 8 A.L.R. 667.

Liability of seller of article not inherently dangerous for personal injuries to the buyer due to the defective or dangerous condition of the article, 13 A.L.R. 1176, 74 A.L.R. 343, 168 A.L.R. 1054.

Right of dealer against his vendor in case of breach of warranty as to article purchased for resale and resold, 22 A.L.R. 133, 64 A.L.R. 883.

Resale by buyer where seller has refused to receive property rejected for breach of warranty, 24 A.L.R. 1445.

Right of seller to ship goods after notice of repudiation by buyer, 27 A.L.R. 1230.

Applicability of provision in contract of sale for return of article, where article delivered does not answer to description, 30 A.L.R. 321.

Automobile or truck, right of action for breach of warranty, 34 A.L.R. 549, 43 A.L.R. 648.

Effect of action as an election of remedy or choice of substantive rights in case of fraud in sale of property, 35 A.L.R. 1153, 123 A.L.R. 378.

Liability of seller of serum or vaccine matter for use on livestock for defects in quality thereof, 39 A.L.R. 399.

Time within which buyer of goods must give notice in order to recover damages for seller's breach of express warranty, 41 A.L.R. 812.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 77 A.L.R. 1165, 41 A.L.R.2d 1173.

Effect of express provision of contract limiting obligation in case of breach of warranty to replacement of defective article or part under Uniform Sales Act, 106 A.L.R. 1466.

Breach of warranty as to title, as within statutory provision requiring notice of breach of warranty on sale of goods, 114 A.L.R. 707.

Damages for breach of warranty, 130 A.L.R. 753.

Buyer's return of subject of sale and acceptance of return of or credit for the purchase price as affecting right to recover special damages for breach of warranty, 157 A.L.R. 1077.

Necessity that buyer, relying on market price, as measure of damages for seller's breach of sale contract, show that goods in question were available for market at price shown, 20 A.L.R.2d 819.

Purchaser's use or attempted use of articles known to be defective as affecting damages recoverable for breach of warranty, 33 A.L.R.2d 511.

Measure and elements of recovery of buyer rescinding sale of domestic animal for seller's breach of warranty, 35 A.L.R.2d 1273.

Time within which buyer of goods must give notice in order to recover damages for seller's breach of express warranty, 41 A.L.R.2d 812.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 41 A.L.R.2d 1173.

Who may enforce guarantee, 41 A.L.R.2d 1213.

Form and substance of notice which buyer of goods must give in order to recover damages for seller's breach of warranty, 53 A.L.R.2d 270.

Prospective buyer's release of prospective seller from liability for injuries resulting from trial use or inspection of product for sale, 93 A.L.R.3d 1296.

Measures of damages in action for breach of warranty of title to personal property under U.C.C. § 2-714, 94 A.L.R.3d 583.

Extent of liability of seller of livestock infected with communicable disease, 14 A.L.R.4th 1096.

77A C.J.S. Sales § 395 et seq.

55-2-715. Buyer's incidental and consequential damages.

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include:

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

History: 1953 Comp., § 50A-2-715, enacted by Laws 1961, ch. 96, § 2-715.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. Subsection (2) (b) - Sections 69(7) and 70, Uniform Sales Act.

Changes. Rewritten.

Purposes of changes and new matter. - 1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2) (b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of Subsection (2) (a).

Cross references. - Point 1: Section 2-608.

Point 3: Sections 1-203, 2-615 and 2-719.

Point 4: Section 1-106.

Definitional cross references. - "Cover". Section 2-712.

"Goods". Section 1-201.

"Person". Section 1-201.

"Receipt" of goods. Section 2-103.

"Seller". Section 2-103.

Mitigating damages. - Plaintiff did not need to present evidence that he could avoid consequential damages by renting or buying a substitute machine. The evidence indicated that plaintiff took reasonable steps to prevent consequential damages and those reasonable steps eventually resulted in lost profits giving rise to the consequential damage award. Manouchehri v. Heim, N.M. , 941 P.2d 978 (Ct. App. 1997).

Buyer may recover purchase price and incidental damages. - A buyer, who rightfully rejects or justifiably revokes acceptance of goods, has the right not only to rescind and recover back the purchase price paid, but, in addition, the right to recover incidental damages resulting from the seller's breach, including expenses reasonably incurred in the care and custody of such goods. Grandi v. LeSage, 74 N.M. 799, 399 P.2d 285 (1965).

Failure to timely furnish materials. - The highway department assessed a contractor $21,000 in liquidated damages for its delay in completing a project. The liquidated damage provision had been incorporated in a purchase order agreement between the contractor and a supplier, and the damages had resulted from the supplier's failure to timely furnish materials. This was a proper case, in a later suit against the supplier, for an award of consequential damages. State ex rel. Concrete Sales & Equip. Rental Co. v. Kent Nowlin Constr., Inc., 106 N.M. 539, 746 P.2d 645 (1987).

Law reviews. - For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 22 Am. Jur. 2d Damages §§ 456 to 459; 63A Am. Jur. 2d Products Liability § 967 et seq.

Right of dealer against his vendor in case of breach of warranty as to article, 22 A.L.R. 133, 64 A.L.R. 883.

Loss of profits as element of damages for fraud of seller as to quality of goods purchased for resale, 28 A.L.R. 354.

Loss of anticipated profits as damages, 32 A.L.R. 120.

Loss of or damage to crop as element of damages for breach of contract of sale or warranty of agricultural machinery or fertilizer, 69 A.L.R. 748.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 77 A.L.R. 1165, 41 A.L.R.2d 1173.

Liability of seller for special damages based on resale by buyer, as affected by his knowledge or ignorance of the resale, 88 A.L.R. 1439.

Damages for breach of warranty, 130 A.L.R. 753.

Buyer's return of subject of sale and acceptance of return of or credit for the purchase price as affecting right to recover special damages for breach of warranty, 157 A.L.R. 1077.

Interest as element of damages recoverable in action for breach of contract for the sale of a commodity, 4 A.L.R.2d 1388.

Right to recover, in action for breach of contract, expenditures incurred in preparation for performance, 17 A.L.R.2d 1300.

Recovery for loss of good will occasioned by use of unfit materials, 28 A.L.R.2d 591.

Privity of contract as essential to recovery in action based on theory other than negligence, against manufacturer or seller of product alleged to have caused injury, 75 A.L.R.2d 39.

Prospective buyer's release of prospective seller from liability for injuries resulting from trial use or inspection of product for sale, 93 A.L.R.3d 1296.

Measure of damages in action for breach of warranty of title to personal property under UCC sec. 2-714, 94 A.L.R.3d 583.

Buyer's incidental and consequential damages from seller's breach under UCC § 2-715, 96 A.L.R.3d 299.

Extent of liability of seller of livestock infected with communicable disease, 14 A.L.R.4th 1096.

Bystander recovery for emotional distress at witnessing another's injury under strict products liability or breach of warranty, 31 A.L.R.4th 162.

Damages for breach of contract as affected by income tax considerations, 50 A.L.R.4th 452.

77A C.J.S. Sales § 400 et seq.

55-2-716. Buyer's right to specific performance or replevin.

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered.

History: 1953 Comp., § 50A-2-716, enacted by Laws 1961, ch. 96, § 2-716.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 68, Uniform Sales Act.

Changes. Rephrased.

Purposes of changes. To make it clear that:

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

3. The legal remedy of replevin is given the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods on the seller's insolvency (Section 2-502).

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article 7, especially Section 7-602.

Cross references. - Point 3: Section 2-502.

Point 4: Section 2-709.

Point 5: Article 7.

Definitional cross references. - "Buyer". Section 2-103.

"Goods". Section 1-201.

"Rights". Section 1-201.

Specific performance proper even though goods not unique. - Where the evidence shows that no seller was willing to make a long-term contract with the buyer on any basis other than the market price at the time of delivery and there was no way to predict the price the buyer might have to pay, specific performance is a proper remedy, even though the goods involved are not "unique" in the traditional sense of that term. United Nuclear Corp. v. General Atomic Co., 96 N.M. 155, 629 P.2d 231 (1980), appeal dismissed, 451 U.S. 901, 101 S. Ct. 1966, 68 L. Ed. 2d 289 (1981).

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 42; 71 Am. Jur. 2d Specific Performance § 153.

Specific performance, or injunction against breach, of contract for sale of tangible personal property, 152 A.L.R. 4

Specific performance of contract which expressly leaves open for future agreement or negotiation the terms of payment for property, 68 A.L.R.2d 1221.

Specific performance of sale of goods under UCC § 2-716, 26 A.L.R.4th 294.

77 C.J.S. Replevin § 1 et seq.; 77A C.J.S. Sales § 389 et seq.; 81 C.J.S. Specific Performance § 65.

55-2-717. Deduction of damages from the price.

The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

History: 1953 Comp., § 50A-2-717, enacted by Laws 1961, ch. 96, § 2-717.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. See Section 69(1) (a), Uniform Sales Act.

Purposes. - 1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this article, no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

Cross reference. - Point 2: Section 2-609.

Definitional cross references. - "Buyer". Section 2-103.

"Notifies". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of purchaser in making tender to deduct from purchase price amount of obligations which it is the vendor's duty to satisfy, 173 A.L.R. 1309.

77A C.J.S. Sales § 395 et seq.

55-2-718. Liquidation or limitation of damages; deposits.

(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds:

(a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with Subsection (1); or

(b) in the absence of such terms, twenty percent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

(3) The buyer's right to restitution under Subsection (2) is subject to offset to the extent that the seller establishes:

(a) a right to recover damages under the provisions of this article other than Subsection (1); and

(b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods, their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of Subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this article on resale by an aggrieved seller (Section 2-706 [55-2-706 NMSA 1978]).

History: 1953 Comp., § 50A-2-718, enacted by Laws 1961, ch. 96, § 2-718.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Under Subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under Subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

Cross references. - Point 1: Section 2-302.

Point 2: Section 2-706.

Definitional cross references. - "Aggrieved party". Section 1-201.

"Agreement". Section 1-201.

"Buyer". Section 2-103.

"Goods". Section 2-105.

"Notice". Section 1-201.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Seller". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability § 450 et seq.

Return of deposit or advance payment if the order is not accepted, 1 A.L.R. 1513.

Money in possession of seller before contract was made as part payment, 131 A.L.R. 1252, 170 A.L.R. 245.

Seller's right to retain down payment on buyer's unjustified refusal to accept goods, 11 A.L.R.2d 701.

Contractual liquidated damages provisions under UCC Article 2, 98 A.L.R.3d 586.

25 C.J.S. Damages § 113.

55-2-719. Contractual modification or limitation of remedy.

(1) Subject to the provisions of Subsections (2) and (3) of this section and of the preceding section [55-2-718 NMSA 1978] on liquidation and limitation of damages:

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this act [this chapter].

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

History: 1953 Comp., § 50A-2-719, enacted by Laws 1961, ch. 96, § 2-719.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this article in an unconscionable manner is subject to deletion and in that event the remedies made available by this article are applicable as if the stricken clause had never existed. Similarly, under Subsection (2), where an apparently fair and reasonable clause because of

circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this article.

2. Subsection (1) (b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2-316.

Cross references. - Point 1: Section 2-302.

Point 3: Section 2-316.

Definitional cross references. - "Agreement". Section 1-201.

"Buyer". Section 2-103.

"Conforming". Section 2-106.

"Contract". Section 1-201.

"Goods". Section 2-105.

"Remedy". Section 1-201.

"Seller". Section 2-103.

Law reviews. - For article, "New Mexico's 'Lemon Law': Consumer Protection or Consumer Frustration?", see 16 N.M.L. Rev. 251 (1986).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63 Am. Jur. 2d Products Liability §§ 301, 450 et seq.; 63A Am. Jur. 2d Products Liability § 976; 68A Am. Jur. 2d Secured Transactions § 106.

Validity, construction and application under Uniform Sales Act of express provision of contract limiting obligation in case of breach of warranty to replacing defective article or part, 106 A.L.R. 1466.

Prospective buyer's release of prospective seller from liability for injuries resulting from trial use or inspection of product for sale, 93 A.L.R.3d 1296.

Construction and effect of new motor vehicle warranty limiting manufacturer's liability to repair or replacement of defective parts, 2 A.L.R.4th 576.

Unconscionability, under UCC § 2-302 or § 2-719(3), of disclaimer of warranties or limitation or exclusion of damages in contract subject to UCC Article 2 (Sales), 38 A.L.R.4th 25.

77A C.J.S. Sales § 374 et seq.

55-2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach.

Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

History: 1953 Comp., § 50A-2-720, enacted by Laws 1961, ch. 96, § 2-720.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purpose. - This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention to forego them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights", or the like, it cannot be considered to be a renunciation under this section.

Cross reference. - Section 1-107.

Definitional cross references. - "Cancellation". Section 2-106.

"Contract". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Measure and elements of recovery of buyer rescinding sale of domestic animal for seller's breach of warranty, 35 A.L.R.2d 1273.

77A C.J.S. Sales § 121 et seq.

55-2-721. Remedies for fraud.

Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach. Neither rescission or a claim for rescission of the

contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

History: 1953 Comp., § 50A-2-721, enacted by Laws 1961, ch. 96, § 2-721.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. This section thus makes it clear that neither rescission of the contract for fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.

Definitional cross references. - "Contract for sale". Section 2-106.

"Goods". Section 1-201.

"Remedy". Section 1-201.

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 37 Am. Jur. 2d Fraud and Deceit § 9.

Use of article by buyer as waiver of right to rescind for fraud, breach of warranty or failure of goods to comply with contract, 77 A.L.R. 1165, 41 A.L.R.2d 1173.

Finance company's liability in connection with consumer fraud practices of party selling goods or services, 18 A.L.R.4th 824.

Computer sales and leases: breach of warranty, misrepresentation, or failure of consideration as defense or ground for affirmative relief, 37 A.L.R.4th 110.

77A C.J.S. Sales § 325 et seq.

55-2-722. Who can sue third parties for injury to goods.

Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract:

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted, a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) either party may with the consent of the other sue for the benefit of whom it may concern.

History: 1953 Comp., § 50A-2-722, enacted by Laws 1961, ch. 96, § 2-722.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance both parties may have the right of action if the seller retains possession or otherwise retains an interest.

Definitional cross references. - "Action". Section 1-201.

"Buyer". Section 2-103.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Rights". Section 1-201.

"Security interest". Section 1-201.

Law reviews. - For article, "Special Property Under the Uniform Commercial Code: A New Concept in Sales," see 4 Nat. Resources J. 98 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 121.

Recovery of value of use of property wrongfully attached, 45 A.L.R.2d 1221.

77A C.J.S. Sales § 222.

55-2-723. Proof of market price; time and place.

(1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (Section 2-708 [55-2-708 NMSA 1978] or Section 2-713 [55-2-713 NMSA 1978]) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this article is not readily available, the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

History: 1953 Comp., § 50A-2-723, enacted by Laws 1961, ch. 96, § 2-723.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this article. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this article against surprise, however, a party intending to offer evidence of such a substitute price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

Definitional cross references. - "Action". Section 1-201.

"Aggrieved party". Section 1-201.

"Goods". Section 2-105.

"Notifies". Section 1-201.

"Party". Section 1-201.

"Reasonable time". Section 1-204.

"Usage of trade". Section 1-205.

To resolve conflicts over missing or unclear terms, the U.C.C. allows substitution of a price or financing term by "using commercial judgment or usage of trade." The only term that cannot be supplied by the court is the quantity term. Elephant Butte Resort Marina, Inc. v. Woolridge, 102 N.M. 286, 694 P.2d 1351 (1985).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Presumption and burden of proof as to market price or value of goods in action by seller against buyer who refuses to accept goods, 130 A.L.R. 1336.

Necessity that buyer, relying on market price as measure of damages for seller's breach of contract of sale, show that goods in question were available for market at price shown, 20 A.L.R.2d 819.

77A C.J.S. Sales § 406 et seq.

55-2-724. Admissibility of market quotations.

Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

History: 1953 Comp., § 50A-2-724, enacted by Laws 1961, ch. 96, § 2-724.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

Definitional cross reference. - "Goods". Section 2-105.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 32A C.J.S. Evidence § 1003, 1004, 1006; 77A C.J.S. Sales § 406 et seq.

55-2-725. Statute of limitations in contracts for sale.

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance, the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by Subsection (1) is so terminated as to leave available a remedy by another action for the same breach, such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this act [this chapter] becomes effective.

History: 1953 Comp., § 50A-2-725, enacted by Laws 1961, ch. 96, § 2-725.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This article takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun within the four year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this article does not purport to alter or modify in any respect the law on tolling of the statute of limitations as it now prevails in the various jurisdictions.

Definitional cross references. - "Action". Section 1-201.

"Aggrieved party". Section 1-201.

"Agreement". Section 1-201.

"Contract for sale". Section 2-106.

"Goods". Section 2-105.

"Party". Section 1-201.

"Remedy". Section 1-201.

"Term". Section 1-201.

"Termination". Section 2-106.

The United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights. United States v. Bunker Livestock Comm'n, Inc., 437 F. Supp. 1079 (D.N.M. 1977).

Action to recover on deficiency after default. - This section governs an action to recover a deficiency after a default on a motor vehicle installment contract; thus, the statute of limitations is four years. First Nat'l Bank v. Chase, 118 N.M. 783, 887 P.2d 1250 (1994).

Sale of beverages for on-premises consumption. - Since the warranty of merchantable goods provisions of 55-2-314 NMSA 1978 specifically apply to the sale of beverages to be consumed on the premises, this section governs claims arising from such sales; the limitation period for on-premise beverage sales is four years. Fernandez v. Char-Li-Jon, Inc., 119 N.M. 25, 888 P.2d 471 (Ct. App. 1994).

Law reviews. - For comment, "Commercial Law - Uniform Commercial Code - Sale of Goods," see 8 Nat. Resources J. 176 (1968).

For annual survey of commercial law in New Mexico, see 18 N.M.L. Rev. 313 (1988).

For annual survey of New Mexico law of products liability, 19 N.M.L. Rev. 743 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 63A Am. Jur. 2d Products Liability § 909 et seq.

What constitutes warranty explicitly extending to "future performance" for purposes of U.C.C. § 2-725(2), 93 A.L.R.3d 690.

What statute of limitations governs action arising out of transaction consummated by use of credit card, 2 A.L.R.4th 677.

Application, to security aspects of sales contract, of UCC § 2-725 limiting time for bringing actions for breach of sales contract, 16 A.L.R.4th 1335.

What statute of limitations applies to actions for personal injuries based on breach of implied warranty under UCC provisions governing sales (UCC § 2-725(1)), 20 A.L.R.4th 915.

Computer sales and leases: time when cause of action for failure of performance accrues, 90 A.L.R.4th 298.

54 C.J.S. Limitation of Actions § 61; 77A C.J.S. Sales §§ 327, 377.

ARTICLE 2A
LEASES

Part 1

General Provisions.

Part 2

Formation and Construction of Lease Contract.

Part 3

Effect of Lease Contract.

Part 4

Performance of Lease Contract: Repudiated, Substituted and Excused.

Part 5

Default.

ANNOTATIONS

Compiler's notes. - Following each section in Article 2A appear "Official Comments", which were copyrighted in 1987 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and are reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1
GENERAL PROVISIONS

55-2A-101. Short title.

This article shall be known and may be cited as the Uniform Commercial Code - Leases.

History: 1978 Comp., § 55-2A-101, enacted by Laws 1992, ch. 114, § 8.

ANNOTATIONS

Rationale for Codification:

There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases. Yet the distinction between a lease and a security interest disguised as a lease is not clear. Second, will the lessor be deemed to have made warranties to the lessee? If the transaction is a sale the express and implied warranties of Article 2 of the Uniform Commercial Code apply. However, the warranty law with respect to leases is uncertain. Third, what remedies are available to the lessor upon the lessee's default? If the transaction is a security interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured Transactions (Article 9). There is no clear answer with respect to leases.

There are reasons to codify the law with respect to leases of goods in addition to those suggested by a review of the reported cases. The answer to this important question should not be limited to the issues raised in these cases. Is it not also proper to determine the remedies available to the lessee upon the lessor's default? It is, but that issue is not reached through a review of the reported cases. This is only one of the many issues presented in structuring, negotiating and documenting a lease of goods.

Statutory Analogue: - After it was decided to proceed with the codification project, the drafting committee of the National Conference of Commissioners on Uniform State Laws looked for a statutory analogue, gradually narrowing the focus to the Article on Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transaction frequently are without counsel; the agreement of the parties often is oral or evidenced by scant writings; obligations between the parties are bilateral; applicable law is influenced by the need to preserve freedom of contract. A review of the literature with respect to personal property security law reveals that Article 9 is predicated upon very different assumptions: Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced to a writing, extensive in scope; the obligations between the parties are essentially unilateral; and applicable law seriously limits freedom of contract.

The lease is closer in spirit and form to the sale of goods than to the creation of a security interest. While parties to a lease are sometimes represented by counsel and their agreement is often reduced to a writing, the obligations of the parties are bilateral and the common law of leasing is dominated by the need to preserve freedom of contract. Thus the drafting committee concluded that Article 2 was the appropriate statutory analogue.

Issues: - The drafting committee then identified and resolved several issues critical to codification:

Scope: - The scope of the Article was limited to leases (Section 2A-102) [55-2A-102 NMSA 1978]. There was no need to include leases intended as security, i.e., security interests disguised as leases, as they are adequately treated in Article 9. Further, even if leases intended as security were included, the need to preserve the distinction would remain, as policy suggests treatment significantly different from that accorded leases.

Definition of Lease: - Lease was defined to exclude leases intended as security (Section 2A-103(1)(j)) [55-2A-103 NMSA 1978]. Given the litigation to date a revised definition of security interest was suggested for inclusion in the Act. (Section 1-201(37)). This revision sharpens the distinction between leases and security interests disguised as leases.

Filing: - The lessor was not required to file a financing statement against the lessee or take any other action to protect the lessor's interest in the goods (Section 2A-301) [55-2A-301 NMSA 1978]. The refined definition of security interest will more clearly signal the need to file to potential lessors of goods. Those lessors who are concerned will file a protective financing statement (Section 9-408) [55-9-408 NMSA 1978].

Warranties: - All of the express and implied warranties of the Article on Sales (Article 2) were included (Sections 2A-210 through 2A-216) [55-2A-210 to 55-2A-216 NMSA 1978], revised to reflect differences in lease transactions. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Further, many courts have reached the same decision.

Certificate of Title Laws: - Many leasing transactions involve goods subject to certificate of title statutes. To avoid conflict with those statutes, this Article is subject to them (Section 2A-104(1)(a) [55-2A-104 NMSA 1978]).

Consumer Leases: - Many leasing transactions involve parties subject to consumer protection statutes or decisions. To avoid conflict with those laws this Article is subject to them to the extent provided in (Section 2A-104(1)(c) and (2) [55-2A-104 NMSA 1978]). Further, certain consumer protections have been incorporated in the Article.

Finance Leases: - Certain leasing transactions substitute the supplier of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like. The definition of finance lease (Section 2A-103(1)(g) [55-2A-104 NMSA 1978]) was developed to describe these transactions. Various sections of the Article implement the substitution of the supplier for the lessor, including Sections 2A-209 [55-2A-209 NMSA 1978] and 2A-407 [55-2A-407 NMSA 1978]. No attempt was made to fashion a special rule where the finance lessor is an affiliate of the supplier of goods; this is to be developed by the courts, case by case.

Sale and Leaseback: - Sale and leaseback transactions are becoming increasingly common. A number of state statutes treat transactions where possession is retained by the seller as fraudulent *per se* or *prima facie* fraudulent. That position is not in accord

with modern practice and thus is changed by the Article "if the buyer bought for value and in good faith" (Section 2A-308(3) [55-2A-308 NMSA 1978]).

Remedies: - The Article has not only provided for lessor's remedies upon default by the lessee (Sections 2A-523 through 2A-531 [55-2A-523 to 55-2A-531 NMSA 1978]), but also for lessee's remedies upon default by the lessor (Sections 2A-508 through 2A-522 [55-2A-508 to 55-2A-522 NMSA 1978]). This is a significant departure from Article 9, which provides remedies only for the secured party upon default by the debtor. This difference is compelled by the bilateral nature of the obligations between the parties to a lease.

Damages: - Many leasing transactions are predicated on the parties' ability to stipulate an appropriate measure of damages in the event of default. The rule with respect to sales of goods (Section 2-718) [55-2-718 NMSA 1978] is not sufficiently flexible to accommodate this practice. Consistent with the common law emphasis upon freedom to contract, the Article has created a revised rule that allows greater flexibility with respect to leases of goods (Section 2A-504(1) [55-2A-504 NMSA 1978]).

History: - This Article is a revision of the Uniform Personal Property Leasing Act, which was approved by the National Conference of Commissioners on Uniform State Laws in August, 1985. However, it was believed that the subject matter of the Uniform Personal Property Leasing Act would be better treated as an article of this Act. Thus, although the Conference promulgated the Uniform Personal Property Leasing Act as a Uniform Law, activity was held in abeyance to allow time to restate the Uniform Personal Property Leasing Act as Article 2A.

In August, 1986 the Conference approved and recommended this Article (including conforming amendments to Article 1 and Article 9) for promulgation as an amendment to this Act. In December, 1986 the Council of the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In March, 1987 the Permanent Editorial Board for the Uniform Commercial Code approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In May, 1987 the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In August, 1987 the Conference confirmed its approval of the final text of this Article.

Upon its initial promulgation, Article 2A was rapidly enacted in several states, was introduced in a number of other states, and underwent bar association, law revision commission and legislative study in still further states. In that process debate emerged, principally sparked by the study of Article 2A by the California Bar Association, California's non-uniform amendments to Article 2A, and articles appearing in a symposium on Article 2A published after its promulgation in the Alabama Law Review. The debate chiefly centered on whether Article 2A had struck the proper balance or was

clear enough concerning the ability of a lessor to grant a security interest in its leasehold interest and in the residual, priority between a secured party and the lessee, and the lessor's remedy structure under Article 2A.

This debate over issues on which reasonable minds could and did differ began to affect the enactment effort for Article 2A in a deleterious manner. Consequently, the Standby Committee for Article 2A, composed predominantly of the former members of the drafting committee, reviewed the legislative actions and studies in the various states, and opened a dialogue with the principal proponents of the non-uniform amendments. Negotiations were conducted in conjunction with, and were facilitated by, a study of the uniform Article and the non-uniform Amendments by the New York Law Revision Commission. Ultimately, a consensus was reached, which has been approved by the membership of the Conference, the Permanent Editorial Board, and the Council of the Institute. Rapid and uniform enactment of Article 2A is expected as a result of the completed amendments. The Article 2A experience reaffirms the essential viability of the procedures of the Conference and the Institute for creating and updating uniform state law in the commercial law area.

Relationship of Article 2A to Other Articles: - The Article on Sales provided a useful point of reference for codifying the law of leases. Many of the provisions of that Article were carried over, changed to reflect differences in style, leasing terminology or leasing practices. Thus, the official comments to those sections of Article 2 whose provisions were carried over are incorporated by reference in Article 2A, as well; further, any case law interpreting those provisions should be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases. Any change in the sequence that has been made when carrying over a provision from Article 2 should be viewed as a matter of style, not substance. This is not to suggest that in other instances Article 2A did not also incorporate substantially revised provisions of Article 2, Article 9 or otherwise where the revision was driven by a concern over the substance; but for the lack of a mandate, the drafting committee might well have made the same or a similar change in the statutory analogue. Those sections in Article 2A include Sections 2A-104, 2A-105, 2A-106, 2A-108(2) and (4), 2A-109(2), 2A-208, 2A-214(2) and (3)(a), 2A-216, 2A-303, 2A-306, 2A-503, 2A-504(3)(b), 2A-506(2), and 2A-515 [55-2A-104, 55-2A-105, 55-2A-106, 55-2A-108, 55-2A-109, 55-2A-208, 55-2A-214, 55-2A-216, 55-2A-303, 55-2A-306, 55-2A-503, 55-2A-504, 55-2A-506 and 55-2A-515, respectively.] For lack of relevance or significance not all of the provisions of Article 2 were incorporated in Article 2A.

This codification was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases of goods: freedom of the parties to contract. Note that, like all other Articles of this Act, the principles of construction and interpretation contained in Article 1 are applicable throughout Article 2A (Section 2A-103(4) [55-2A-103 NMSA 1978]). These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care (Section 1-102(3) [55-1-102 NMSA 1978]). Consistent with those principles no negative

inference is to be drawn by the episodic use of the phrase "unless otherwise agreed" in certain provisions of Article 2A. Section 1-102(4) [55-1-102 NMSA 1978]. Indeed, the contrary is true, as the general rule in the Act, including this Article, is that the effect of the Act's provisions may be varied by agreement. Section 1-102(3) [55-1-102 NMSA 1978]. This conclusion follows even where the statutory analogue contains the phrase and the correlative provision in Article 2A does not.

Cross-references. - For the Rental-Purchase Agreement Act, see Chapter 57, Article 26 NMSA 1978.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-102. Scope.

This article applies to any transaction, regardless of form, that creates a lease.

History: 1978 Comp., § 55-2A-102, enacted by Laws 1992, ch. 114, § 9.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-102(1) [55-9-102 NMSA 1978]. Throughout this Article, unless otherwise stated, references to "Section" are to other sections of this Act.

Changes: Substantially revised.

Purposes: - This Article governs transactions as diverse as the lease of a hand tool to an individual for a few hours and the leveraged lease of a complex line of industrial equipment to a multi-national organization for a number of years.

To achieve that end it was necessary to provide that this Article applies to any transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an interest in goods (Section 2A-103(1)(j) [55-2A-103 NMSA 1978]) and goods is defined to include fixtures (Section 2A-103(1)(h) [55-2A-103 NMSA 1978]), application is limited to the extent the transaction relates to goods, including fixtures. Further, since the definition of lease does not include a sale (Section 2-106(1) [55-2-106 NMSA 1978]) or retention or creation of a security interest (Section 1-201(37) [55-1-201 NMSA 1978]), application is further limited; sales and security interests are governed by other Articles of this Act.

Finally, in recognition of the diversity of the transactions to be governed, the sophistication of many of the parties to these transactions, and the common law tradition as it applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, *Secured Transactions Under the*

Uniform Commercial Code, § 29B.02[2] (1986). Thus, despite the extensive regulatory scheme established by this Article, the parties to a lease will be able to create private rules to govern their transaction. Sections 2A-103(4) [55-2A-103 NMSA 1978] and 1-102(3) [55-1-102 NMSA 1978]. However, there are special rules in this Article governing consumer leases, as well as other state and federal statutes, that may further limit freedom of contract with respect to consumer leases.

A court may apply this Article by analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods. *E.g.,* Hawkland, *The Impact of the Uniform Commercial Code on Equipment Leasing*, 1972 Ill. L.F. 446; Murray, *Under the Spreading Analogy of Article 2 of the Uniform Commercial Code*, 39 Fordham L. Rev. 447 (1971). Whether such application would be appropriate for other bailments of personal property, gratuitous or for hire, should be determined by the facts of each case. *See Mieske v. Bartell Drug Co.*, 92 Wash.2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

Further, parties to a transaction creating a lease of personal property other than goods, or a bailment of personal property may provide by agreement that this Article applies. Upholding the parties' choice is consistent with the spirit of this Article.

Cross References: - Sections 1-102(3), 1-201(37), Article 2, esp. Section 2-106(1), and Sections 2A-103(1)(h), 2A-103(1)(j) and 2A-103(4) [55-1-102, 55-1-201, 55-1-106 and 55-2A-103 NMSA 1978, respectively].

Definitional Cross References: - "Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-103. Definitions and index of definitions.

(1) In this article unless the context otherwise requires:

(a) "buyer in ordinary course of business" means a person who, in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind, but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt;

(b) "cancellation" occurs when either party puts an end to the lease contract for default by the other party;

(c) "commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole;

(d) "conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract;

(e) "consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family or household purpose;

(f) "fault" means wrongful act, omission, breach or default;

(g) "finance lease" means a lease with respect to which:

(i) the lessor does not select, manufacture or supply the goods;

(ii) the lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and

(iii) one of the following occurs:

(A) the lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;

(B) the lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;

(C) the lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or

(D) if the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this article to the promises and warranties, including

those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies;

(h) "goods" means all things that are movable at the time of identification to the lease contract or are fixtures (Section 55-2A-309 NMSA 1978), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals;

(i) "installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent;

(j) "lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease; unless the context clearly indicates otherwise, the term includes a sublease;

(k) "lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances, including course of dealing or usage or trade or course of performance as provided in this article; unless the context clearly indicates otherwise, the term includes a sublease agreement;

(l) "lease contract" means the total legal obligation that results from the lease agreement as affected by this article and any other applicable rules of law; unless the context clearly indicates otherwise, the term includes a sublease contract;

(m) "leasehold interest" means the interest of the lessor or the lessee under a lease contract;

(n) "lessee" means a person who acquires the right to possession and use of goods under a lease; unless the context clearly indicates otherwise, the term includes a sublessee;

(o) "lessee in ordinary course of business" means a person who in good faith and without knowledge that the lease to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, leases in ordinary course from a person in the business of selling or leasing goods of that kind, but does not include a pawnbroker; "leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-

existing lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt;

(p) "lessor" means a person who transfers the right to possession and use of goods under a lease; unless the context clearly indicates otherwise, the term includes a sublessor;

(q) "lessor's residual interest" means the lessor's interest in the goods after expiration, termination or cancellation of the lease contract;

(r) "lien" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest;

(s) "lot" means a parcel or a single article that is the subject matter of a separate lease or delivery whether or not it is sufficient to perform the lease contract;

(t) "merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease;

(u) "present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain; the discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into;

(v) "purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift or any other voluntary transaction creating an interest in goods;

(w) "sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease;

(x) "supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease;

(y) "supply contract" means a contract under which a lessor buys or leases goods to be leased; and

(z) "termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this article and the sections in which they appear are:

"Accessions" Section 55-2A-310(1) NMSA 1978.

"Construction mortgage". Section 55-2A-309(1)(d) NMSA 1978.

"Encumbrance" Section 55-2A-309(1)(e) NMSA 1978.

"Fixtures" Section 55-2A-309(1)(a) NMSA 1978.

"Fixture filing". Section 55-2A-309(1)(b) NMSA 1978.

"Purchase money lease". Section 55-2A-309(1)(c) NMSA 1978.

(3) The following definitions in other articles apply to this article:

"Account" Section 55-9-106 NMSA 1978.

"Between merchants". Section 55-2-104(3) NMSA 1978.

"Buyer" Section 55-2-103(1)(a) NMSA 1978.

"Chattel paper". Section 55-9-105(1)(b) NMSA 1978.

"Consumer goods". Section 55-9-109(1) NMSA 1978.

"Document" Section 55-9-105(1)(f) NMSA 1978.

"Entrusting" Section 55-2-403(3) NMSA 1978.

"General intangibles". Section 55-9-106 NMSA 1978.

"Good faith". Section 55-2-103(1)(b) NMSA 1978.

"Instrument" Section 55-9-105(1)(i) NMSA 1978.

"Merchant" Section 55-2-104(1) NMSA 1978.

"Mortgage" Section 55-9-105(1)(j) NMSA 1978.

"Pursuant to commitment". Section 55-9-105(1)(k) NMSA 1978.

"Receipt" Section 55-2-103(1)(c) NMSA 1978.

"Sale" Section 55-2-106(1) NMSA 1978.

"Sale on approval". Section 55-2-326 NMSA 1978.

"Sale or return". Section 55-2-326 NMSA 1978.

"Seller" Section 55-2-103(1)(d) NMSA 1978.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1978 Comp., § 55-2A-103, enacted by Laws 1992, ch. 114, § 10; 1993, ch. 214, § 3.

ANNOTATIONS

OFFICIAL COMMENT

(a) "Buyer in ordinary course of business". Section 1-201(9) [55-1-201 NMSA 1978].

(b) "Cancellation". Section 2-106(4) [55-2-106 NMSA 1978]. The effect of a cancellation is provided in Section 2A-505(1) [55-2A-505 NMSA 1978].

(c) "Commercial unit". Section 2-105(6) [55-2-105 NMSA 1978].

(d) "Conforming". Section 2-106(2) [55-2-106 NMSA 1978].

(e) "Consumer lease". New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A-106, 2A-108(2), 2A-108(4), 2A-109(2), 2A-221, 2A-309, 2A-406, 2A-407, 2A-504(3)(b), and 2A-516(3)(b) [55-2A-106, 55-2A-108, 55-2A-109, 55-2A-221, 55-2A-309, 55-2A-406, 55-2A-407, 55-2A-504 and 55-2A-516 NMSA 1978, respectively].

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A-103(1)(j) [55-2A-103 NMSA 1978]. Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes, present and future, and existing consumer protection decisions are unaffected by this Article. Section 2A-104(1)(c) and (2) [55-2A-104 NMSA 1978]. Of course, Article 2A as state law also is subject to federal consumer protection law.

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered, and whether there should be a limitation by dollar amount and its amount is left up to the individual states.

This definition focuses on the parties as well as the transaction. If a lease is within this definition, the lessor must be regularly engaged in the business of leasing or selling, and the lessee must be an individual not an organization; note that a lease to two or more individuals having a common interest through marriage or the like is not excluded as a lease to an organization under Section 1-201(28) [55-1-201 NMSA 1978]. The

lessee must take the interest primarily for a personal, family or household purpose. If required by the enacting state, total payments under the lease contract, excluding payments for options to renew or buy, cannot exceed the figure designated.

(f) "Fault". Section 1-201(16) [55-1-201 NMSA 1978].

(g) "Finance Lease". New. This Article includes a subset of rules that applies only to finance leases. Sections 2A-209, 2A-211(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2) and 2A-517(1)(a) and (2) [55-2A-209, 55-2A-211, 55-2A-212, 55-2A-213, 55-2A-219, 55-2A-220, 55-2A-221, 55-2A-405, 55-2A-407, 55-2A-516 and 55-2A-517 NMSA 1978, respectively].

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j) [55-2A-103 NMSA 1978]. Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article.

A finance lease is the product of a three-party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. If a manufacturer's warranty carries through, the lessee may also look to that. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62-71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A-308(3) [55-2A-308 NMSA 1978]) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B had bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A-103(1)(j) [55-2A-103 NMSA 1978]. In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied

as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) (A) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee's reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods (where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the phrase "in connection with" is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations and covenants, and upon the supplier or a manufacturer, or both, for warranties with respect to the goods, subsection (iii) requires that one of the following occur: (A) the lessee receive a copy of the supply contract before signing the lease contract; (B) the lessee's approval of the supply contract is a condition to the effectiveness of the lease contract; (C) the lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract; or (D) before signing the lease contract and except in a consumer lease, the lessee receive a writing identifying the supplier (unless the supplier was selected and required by the lessee) and the rights of the lessee under Section 2A-209 [55-2A-209 NMSA 1978], and advising the lessee a statement of promises and warranties is available from the supplier. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract. Moreover, where the lessor does not want the lessee to see the entire supply contract, including price information, the lessee may be provided with a separate statement of the terms of the supply contract relevant to the lessee; promises between the supplier and the lessor that do not affect the lessee need not be included. The statement can be a restatement of those terms or a copy of portions of the supply contract with the relevant terms clearly designated. Any implied warranties need not be designated, but a disclaimer or modification of remedy must be designated. A copy of any manufacturer's warranty is sufficient if that is the warranty provided. However, a copy of any Regulation M disclosure given pursuant to 12 C.F.R. § 213.4(g) concerning warranties in itself is not sufficient since those disclosures need only briefly identify express warranties and need not include any disclaimer of warranty.

If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like),

a lease that qualifies as a finance lease and is assigned by the lessor or the lessee to a third party does not lose its status as a finance lease under this Article. Finally, this Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case.

(h) "Goods". Section 9-105(1)(h) [55-9-105 NMSA 1978]. See Section 2A-103(3) [55-2A-103 NMSA 1978] for reference to the definition of "Account", "Chattel paper", "Document", "General intangibles" and "Instrument". See Section 2A-217 [55-2A-217 NMSA 1978] for determination of the time and manner of identification.

(i) "Installment lease contract". Section 2-612(1) [55-2-612 NMSA 1978].

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A-309 [55-2A-309 NMSA 1978]), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, *Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision*, 12 U.S.F. L.Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, *Personal Property Leasing: A Challenge*, 36 Bus.Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2-106(1) [55-2-106 NMSA 1978]) nor a retention or creation of a security interest (Section 1-201(37) [55-1-201 NMSA 1978]). Due to extensive litigation to distinguish true leases from security interests, an amendment to Section 1-201(37) [55-1-201 NMSA 1978] has been promulgated with this Article to create a sharper distinction.

This section as well as Section 1-201(37) [55-1-201 NMSA 1978] must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to

renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A-103(1)(h) [55-2A-103 NMSA 1978]). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A-103(3) and 2-106(1) [55-2A-103 and 55-2-106 NMSA 1978, respectively]. Under pre-Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. *Da Rocha v. Macomber*, 330 Mass. 611, 614-15, 116 N.E.2d 139, 142 (1953). Under Section 1-201(37) [55-1-201 NMSA 1978], as amended with the promulgation of this Article, the same result would follow. While the lessee is obligated to pay rent for the one-month term of the lease, one of the other four conditions of the second paragraph of Section 1-201(37) [55-1-201 NMSA 1978] must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, subparagraph (a) of Section 1-201(37) [55-1-201 NMSA 1978] is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, subparagraph (b) of Section 1-201(37) [55-1-201 NMSA 1978] is not satisfied. Finally, there are no options; thus, subparagraphs (c) and (d) of Section 1-201(37) [55-1-201 NMSA 1978] are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre-Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. *Hervey v. Rhode Island Locomotive Works*, 93 U.S. 664, 672-73 (1876). Under this subsection, and Section 1-201(37) [55-1-201 NMSA 1978], as amended with the inclusion of this Article in the Act, the same result would follow. The lessee's obligation for the term is not subject to termination by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions have not been properly categorized by the courts in applying the 1978 and earlier Official Texts of Section 1-201(37) [55-1-201 NMSA 1978]. This subsection, together with Section 1-201(37) [55-1-201 NMSA 1978], as amended with the promulgation of this Article, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from the first sentence of Section 1-201(3) [55-1-201 NMSA 1978]. Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2-106(1) [55-2-106 NMSA 1978]). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A-309(2) [55-2A-309 NMSA 1978].

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively].

(*l*) "Lease contract". This definition is derived from the definition of contract in Section 1-201(11) [55-1-201 NMSA 1978]. Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) "Leasehold interest". New.

(n) "Lessee". New.

(o) "Lessee in ordinary course of business". Section 1-201(9).

(p) "Lessor". New.

(q) "Lessor's residual interest". New.

(r) "Lien". New. This term is used in Section 2A-307 [55-2A-307 NMSA 1978] (Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) "Lot". Section 2-105(5) [55-2-105 NMSA 1978].

(t) "Merchant lessee". New. This term is used in Section 2A-511 [55-2A-511 NMSA 1978] (Merchant Lessee's Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. *E.g., Taylor v. Commercial Credit Equip. Corp.*, 170 Ga.App. 322, 316 S.E.2d 788 (Ct. App. 1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people

would differ as to the rate of discount to apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.

(v) "Purchase". Section 1-201(32) [55-1-201 NMSA 1978]. This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1-201(32) [55-1-201 NMSA 1978]). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A-103(1)(r) [55-2A-103 NMSA 1978]. Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1-201(32) [55-1-201 NMSA 1978] to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) "Sublease". New.

(x) "Supplier". New.

(y) "Supply contract". New.

(z) "Termination". Section 2-106(3) [55-2-106 NMSA 1978]. The effect of a termination is provided in Section 2A-505(2) [55-2A-505 NMSA 1978].

The 1993 amendment, effective July 1, 1993, deleted "and" at the end of Subsection (1)(g)(iii)(A).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-104. Leases subject to other law.

(1) A lease, although subject to this article, is also subject to any applicable:

(a) certificate of title statute of this state: Sections 64-4-4, 66-3-1 and 66-12-5.2 NMSA 1978;

(b) certificate of the title statute of another jurisdiction (Section 55-2A-105 NMSA 1978); or

(c) consumer protection statute of this state, or final consumer protection decision of a court of this state existing on the effective date of this article.

(2) In case of conflict between this article, other than Sections 55-2A-105, 55-2A-304(3) and 55-2A-305(3) NMSA 1978, and a statute or decision referred to in Subsection (1), the statute or decision controls.

(3) Failure to comply with an applicable law has only the effect specified therein.

History: 1978 Comp., § 55-2A-104, enacted by Laws 1992, ch. 114, § 11.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 9-203(4) and 9-302(3)(b) and (c) [55-9-203 and 55-9-302 NMSA 1978, respectively].

Changes: Substantially revised.

Purposes: - 1. This Article creates a comprehensive scheme for the regulation of transactions that create leases. Section 2A-102 [55-2A-102 NMSA 1978]. Thus, the Article supersedes all prior legislation dealing with leases, except to the extent set forth in this Section.

2. Subsection (1) states the general rule that a lease, although governed by the scheme of this Article, also may be governed by certain other applicable laws. This may occur in the case of a consumer lease. Section 2A-103(1)(e) [55-2A-103 NMSA 1978]. Those laws may be state statutes existing prior to enactment of Article 2A or passed afterward. In this case, it is desirable for this Article to specify which statute controls. Or the law may be a pre-existing consumer protection decision. This Article preserves such decisions. Or the law may be a statute of the United States. Such a law controls without any statement in this Article under applicable principles of preemption.

An illustration of a statute of the United States that governs consumer leases is the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667(e) (1982) and its implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing personal property, and regulates the advertising of lease terms. An illustration of a state statute that governs consumer leases and which if adopted in the enacting state prevails over this Article is the Unif. Consumer Credit Code, which includes many provisions similar to those of the Consumer Leasing Act, e.g. Unif. Consumer Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as provisions in addition to those of the Consumer Leasing Act, e.g., Unif. Consumer Credit Code §§ 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default). Such statutes may define consumer lease so as to govern transactions within and without the definition of consumer lease under this Article.

3. Under subsection (2), subject to certain limited exclusions, in case of conflict a statute or a decision described in subsection (1) prevails over this Article. For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176 (1974), limiting self-help repossession, prevails over Section 2A-525(3) [55-2A-525 NMSA 1978]. A consumer protection decision rendered after the effective date of this Article may

supplement its provisions. For example, in relation to Article 9 a court might conclude that an acceleration clause may not be enforced against an individual debtor after late payments have been accepted unless a prior notice of default is given. To the extent the decision establishes a general principle applicable to transactions other than secured transactions, it may supplement Section 2A-502 [55-2A-502 NMSA 1978].

4. Consumer protection in lease transactions is primarily left to other law. However, several provisions of this Article do contain special rules that may not be varied by agreement in the case of a consumer lease. E.g., Sections 2A-106, 2A-108, and 2A-109(2) [55-2A-106, 55-2A-108, 55-2A-109 NMSA 1978, respectively]. Were that not so, the ability of the parties to govern their relationship by agreement together with the position of the lessor in a consumer lease too often could result in a one-sided lease agreement.

5. In construing this provision the reference to statute should be deemed to include applicable regulations. A consumer protection decision is "final" on the effective date of this Article if it is not subject to appeal on that date or, if subject to appeal, is not later reversed on appeal. Of course, such a decision can be overruled by a later decision or superseded by a later statute.

Cross References: - Sections 2A-103(1)(e), 2A-106, 2A-108, 2A-109(2) and 2A-525(3) [55-2A-103, 55-2A-106, 55-2A-108, 55-2A-109 and 55-2A-525 NMSA 1978, respectively].

Definitional Cross Reference: - "Lease". Section 2A-103(1)(j).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

"Effective date of this article". - The phrase "effective date of this article", referred to in this section, means July 1, 1992, the effective date of Laws 1992, ch. 114.

55-2A-105. Territorial application of article to goods covered by certificate of title.

Subject to the provisions of Sections 55-2A-304(3) and 55-2A-305(3) NMSA 1978, with respect to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter until a new certificate of title is issued by another jurisdiction.

History: 1978 Comp., § 55-2A-105, enacted by Laws 1992, ch. 114, § 12.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-103(2)(a) and (b) [55-9-103 NMSA 1978].

Changes: Substantially revised. The provisions of the last sentence of Section 9-103(2)(b) [55-9-103 NMSA 1978] have not been incorporated as it is superfluous in this context. The provisions of Section 9-103(2)(d) [55-9-103 NMSA 1978] have not been incorporated because the problems dealt with are adequately addressed by this section and Sections 2A-304(3) and 305(3) [55-2A-304 and 55-2A-305 NMSA 1978, respectively].

Purposes: - The new certificate referred to in (b) must be permanent, not temporary. Generally, the lessor or creditor whose interest is indicated on the most recently issued certificate of title will prevail over interests indicated on certificates issued previously by other jurisdictions. This provision reflects a policy that it is reasonable to require holders of interests in goods covered by a certificate of title to police the goods or risk losing their interests when a new certificate of title is issued by another jurisdiction.

Cross References: - Sections 2A-304(3), 2A-305(3), 9-103(2)(b) and 9-103(2)(d) [55-2A-304, 55-2A-305 and 55-9-103 NMSA 1978, respectively].

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-106. Limitation on power of parties to consumer lease to choose applicable law and judicial forum.

(1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within thirty days thereafter or in which the goods are to be used, the choice is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

History: 1978 Comp., § 55-2A-106, enacted by Laws 1992, ch. 114, § 13.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Unif. Consumer Credit Code § 1.201(8), 7A U.L.A. 36 (1974).

Changes: Substantially revised.

Purposes: - There is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. As a result, this section invalidates these choice of law or forum clauses, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept, or the forum chosen is one that otherwise would have jurisdiction over the lessee.

Subsection (1) limits potentially abusive choice of law clauses in consumer leases. The 30-day rule in subsection (1) was suggested by Section 9-103(1)(c) [55-9-103 NMSA 1978]. This section has no effect on choice of law clauses in leases that are not consumer leases. Such clauses would be governed by other law.

Subsection (2) prevents enforcement of potentially abusive jurisdictional consent clauses in consumer leases. By using the term judicial forum, this section does not limit selection of a nonjudicial forum, such as arbitration. This section has no effect on choice of forum clauses in leases that are not consumer leases; such clauses are, as a matter of current law, "prima facie valid". The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972). Such clauses would be governed by other law, including the Model Choice of Forum Act (1968).

Cross Reference: - Section 9-103(1)(c).

Definitional Cross Reference: - "Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-107. Waiver or renunciation of claim or right after default.

Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

History: 1978 Comp., § 55-2A-107, enacted by Laws 1992, ch. 114, § 14.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-107.

Changes: Revised to reflect leasing practices and terminology. This clause is used throughout the official comments to this Article to indicate the scope of change in the provisions of the Uniform Statutory Source included in the section; these changes range from one extreme, e.g., a significant difference in practice (a warranty as to merchantability is not implied in a finance lease (Section 2A-212) [55-2A-212 NMSA 1978]) to the other extreme, e.g., a modest difference in style or terminology (the transaction governed is a lease not a sale (Section 2A-203) [55-2A-203 NMSA 1978]).

Cross References: - Sections 2A-203 and 2A-212 [55-2A-203 and 55-2A-212 NMSA 1978, respectively].

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Signed". Section 1-201(39) [55-1-201 NMSA 1978].

"Written". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-108. Unconscionability.

(1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under Subsection (1) or (2), the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to

present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:

(a) If the court finds unconscionability under Subsection (1) or (2), the court shall award reasonable attorney's fees to the lessee.

(b) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he knew to be groundless, the court shall award reasonable attorney's fees to the party against whom the claim is made.

(c) In determining attorney's fees, the amount of the recovery on behalf of the claimant under Subsections (1) and (2) is not controlling.

History: 1978 Comp., § 55-2A-108, enacted by Laws 1992, ch. 114, § 15.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-302 and Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974).

Changes: Subsection (1) is taken almost verbatim from the provisions of Section 2-302(1) [55-2-302 NMSA 1978]. Subsection (2) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (3), taken from the provisions of Section 2-302(2) [55-2-302 NMSA 1978], has been expanded to cover unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167 (1974). The provision for the award of attorney's fees to consumers, subsection (4), covers unconscionability under subsection (1) as well as (2). Subsection (4) is modeled on the provisions of Unif. Consumer Credit Code § 5.108(6), 7A U.L.A. 169 (1974).

Purposes: - Subsections (1) and (3) of this section apply the concept of unconscionability reflected in the provisions of Section 2-302 [55-2-302 NMSA 1978] to leases. See Dillman & Assocs. v. Capitol Leasing Co., 110 Ill.App.3d 335, 342, 442 N.E.2d 311, 316 (App.Ct. 1982). Subsection (3) omits the adjective "commercial" found in subsection 2-302(2) [55-2-302 NMSA 1978] because subsection (3) is concerned with all leases and the relevant standard of conduct is determined by the context.

The balance of the section is modeled on the provisions of Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (2) recognizes that a consumer lease or a clause in a consumer lease may not itself be unconscionable but that the agreement would never have been entered into if unconscionable means had not been employed to induce the consumer to agree. To make a statement to induce the

consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable. Subsection (2) also provides a consumer remedy for unconscionable conduct, such as using or threatening to use force or violence, in the collection of a claim arising from a lease contract. These provisions are not exclusive. The remedies of this section are in addition to remedies otherwise available for the same conduct under other law, for example, an action in tort for abusive debt collection or under another statute of this State for such conduct. The reference to appropriate relief in subsection (2) is intended to foster liberal administration of this remedy. Sections 2A-103(4) [55-2A-103 NMSA 1978] and 1-106(1) [55-1-106 NMSA 1978].

Subsection (4) authorizes an award of reasonable attorney's fees if the court finds unconscionability with respect to a consumer lease under subsections (1) or (2). Provision is also made for recovery by the party against whom the claim was made if the court does not find unconscionability and does find that the consumer knew the action to be groundless. Further, subsection (4)(b) is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees.

Cross References: - Sections 1-106(1), 2-302 and 2A-103(4) [55-1-106, 55-2-302 and 55-2A-103 NMSA 1978, respectively].

Definitional Cross Reference: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-109. Option to accelerate at will.

(1) A term providing that one party or his successor in interest may accelerate payment of performance or require collateral or additional collateral "at will" or "when he deems himself insecure" or in words of similar import must be construed to mean that he has power to do so only if he in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under Subsection (1) is on the party who exercised the power; otherwise the burden of establishing lack of good faith is on the party against whom the power has been exercised.

History: 1978 Comp., § 55-2A-109, enacted by Laws 1992, ch. 114, § 16.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-208 [55-1-208 NMSA 1978] and Unif. Consumer Credit Code § 5.109(2), 7A U.L.A. 171 (1974).

Purposes: - Subsection (1) reflects modest changes in style to the provisions of the first sentence of Section 1-208 [55-1-208 NMSA 1978].

Subsection (2), however, reflects a significant change in the provisions of the second sentence of Section 1-208 [55-1-208 NMSA 1978] by creating a new rule with respect to a consumer lease. A lease provision allowing acceleration at the will of the lessor or when the lessor deems itself insecure is of critical importance to the lessee. In a consumer lease it is a provision that is not usually agreed to by the parties but is usually mandated by the lessor. Therefore, where its invocation depends not on specific criteria but on the discretion of the lessor, its use should be regulated to prevent abuse. Subsection (1) imposes a duty of good faith upon its exercises. Subsection (2) shifts the burden of establishing good faith to the lessor in the case of a consumer lease, but not otherwise.

Cross Reference: - Section 1-208 [55-1-208 NMSA 1978].

Definitional Cross Reference: - "Burden of establishing". Section 1-201(8) [55-1-201 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Good faith". Sections 1-201(19) [55-1-201 NMSA 1978] and 2-103(1)(b) [55-2-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 2
FORMATION AND CONSTRUCTION OF LEASE CONTRACT

55-2A-201. Statute of frauds.

(1) A lease contract is not enforceable by way of action or defense unless:

(a) the total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than one thousand dollars ($1,000); or

(b) there is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies Subsection (1)(b), whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under Subsection (1)(b) beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of Subsection (1), but which is valid in other respects, is enforceable:

(a) if the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) with respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in Subsection (4) is:

(a) if there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) if the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) a reasonable lease term.

History: 1978 Comp., § 55-2A-201, enacted by Laws 1992, ch. 114, § 17.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-201, 9-203(1) and 9-110 [55-2-201, 55-9-203 and 55-9-110 NMSA 1978, respectively].

Changes: This section is modeled on Section 2-201 [55-2-201 NMSA 1978], with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the writing "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a) [55-9-203 NMSA 1978]. Subsection (2), relying on the statutory analogue in Section 9-110 [55-9-110 NMSA 1978], sets forth the minimum criterion for satisfying that requirement.

Purposes: - The changes in this section conform the provisions of Section 2-201 [55-2-201 NMSA 1978] to custom and usage in lease transactions. Section 2-201(2) [55-2-201 NMSA 1978], stating a special rule between merchants, was not included in this section as the number of such transactions involving leases, as opposed to sales, was thought to be modest. Subsection (4) creates no exception for transactions where payment has been made and accepted. This represents a departure from the analogue, Section 2-201(3)(c) [55-2-201 NMSA 1978]. The rationale for the departure is grounded in the distinction between sales and leases. Unlike a buyer in a sales transaction, the lessee does not tender payment in full for goods delivered, but only payment of rent for one or more months. It was decided that, as a matter of policy, this act of payment is not a sufficient substitute for the required memorandum. Subsection (5) was needed to establish the criteria for supplying the lease term if it is omitted, as the lease contract may still be enforceable under subsection (4).

Cross References: - Sections 2-201, 9-110 and 9-203(1)(a) [55-2-201, 55-9-110 and 55-9-203 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Buying". Section 2A-103(1)(a) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Signed". Section 1-201(39) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-202. Final written expression; parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) by course of dealing or usage of trade or by course of performance; and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

History: 1978 Comp., § 55-2A-202, enacted by Laws 1992, ch. 114, § 18.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-202 [55-2-202 NMSA 1978].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Course of dealing". Section 1-205 [55-1-205 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Usage of trade". Section 1-205 [55-1-205 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-203. Seals inoperative.

The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer.

History: 1978 Comp., § 55-2A-203, enacted by Laws 1992, ch. 114, § 19.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-203 [55-2-203 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-204. Formation in general.

(1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy.

History: 1978 Comp., § 55-2A-204, enacted by Laws 1992, ch. 114, § 20.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-204 [55-2-204 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-205. Firm offers.

An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed three months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

History: 1978 Comp., § 55-2A-205, enacted by Laws 1992, ch. 114, § 21.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-205 [55-2-205 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Signed". Section 1-201(39) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-206. Offer and acceptance in formation of lease contract.

(1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

History: 1978 Comp., § 55-2A-206, enacted by Laws 1992, ch. 114, § 22.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-206(1)(a) and (2) [55-2-206 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-207. Course of performance or practical construction.

(1) If a lease contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the lease agreement.

(2) The express terms of a lease agreement and any course of performance, as well as any course of dealing and usage of trade, must be construed whenever reasonable as consistent with each other; but if that construction is unreasonable, express terms

control course of performance, course of performance controls both course of dealing and usage of trade, and course of dealing controls usage of trade.

(3) Subject to the provisions of Section 55-2A-208 NMSA 1978 on modification and waiver, course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

History: 1978 Comp., § 55-2A-207, enacted by Laws 1992, ch. 114, § 23.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-208 and 1-205(4) [55-2-208 and 55-1-205 NMSA 1978, respectively].

Changes: Revised to reflect leasing practices and terminology, except that subsection (2) was further revised to make the subsection parallel the provisions of Section 1-205(4) [55-1-205 NMSA 1978] by adding that course of dealing controls usage of trade.

Purposes: - The section should be read in conjunction with Section 2A-208 [55-2A-208 NMSA 1978]. In particular, although a specific term may control over course of performance as a matter of lease construction under subsection (2), subsection (3) allows the same course of dealing to show a waiver or modification, if Section 2A-208 [55-2A-208 NMSA 1978] is satisfied.

Cross References: - Sections 1-205(4), 2-208 and 2A-208 [55-1-205, 55-2-208 and 55-2A-208 NMSA 1978, respectively].

Definitional Cross References: - "Course of dealing". Section 1-205 [55-1-205 NMSA 1978].

"Knowledge". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Usage of trade". Section 1-205 [55-1-205 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-208. Modification, rescission and waiver.

(1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of Subsection (2), it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

History: 1978 Comp., § 55-2A-208, enacted by Laws 1992, ch. 114, § 24.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-209 [55-2-209 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology, except that the provisions of subsection 2-209(3) [55-2-209 NMSA 1978] were omitted.

Purposes: - Section 2-209(3) [55-2-209 NMSA 1978] provides that "the requirements of the statute of frauds section of this Article (Section 2-201) [55-2-201 NMSA 1978] must be satisfied if the contract as modified is within its provisions." This provision was not incorporated as it is unfair to allow an oral modification to make the entire lease contract unenforceable, e.g., if the modification takes it a few dollars over the dollar limit. At the same time, the problem could not be solved by providing that the lease contract would still be enforceable in its pre-modification state (if it then satisfied the statute of frauds) since in some cases that might be worse than no enforcement at all. Resolution of the issue is left to the courts based on the facts of each case.

Cross References: - Sections 2-201 and 2-209 [55-2-201 and 55-2-209 NMSA 1978, respectively].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Between merchants". Section 2-104(3) [55-2-104 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Notification". Section 1-201(26) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Signed". Section 1-201(39) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-209. Lessee under finance lease as beneficiary of supply contract.

(1) The benefit of a supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as part of the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all defenses or claims arising therefrom.

(2) The extension of the benefit of a supplier's promises and of warranties to the lessee (Section 55-2A-209(1) NMSA 1978) does not: (i) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (ii) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective between the supplier and the lessee unless, before the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the modification or rescission is effective between the supplier and the lessee, the lessor is deemed to have assumed, in addition to the obligations of the lessor to the lessee under the lease contract, promises of the supplier to the lessor and warranties that were so modified or rescinded as they existed and were available to the lessee before modification or rescission.

(4) In addition to the extension of the benefit of the supplier's promises and of warranties to the lessee under Subsection (1), the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law.

History: 1978 Comp., § 55-2A-209, enacted by Laws 1992, ch. 114, § 25.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: None.

Changes: This section is modeled on Section 9-318 [55-9-318 NMSA 1978], the Restatement (Second) of Contracts §§ 302-315 (1981), and leasing practices. See Earman Oil Co. v. Burroughs Corp., 625 F.2d 1291, 1296-97 (5th Cir. 1980).

Purposes: - 1. The function performed by the lessor in a finance lease is extremely limited. Section 2A-103(1)(g) [55-2A-103 NMSA 1978]. The lessee looks to the supplier of the goods for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. That expectation is reflected in subsection (1), which is self-executing. As a matter of policy, the operation of this provision may not be excluded, modified or limited; however, an exclusion, modification, or limitation of any term of the supply contract or warranty, including any with respect to rights and remedies, and any defense or claim such as a statute of limitations, effective against the lessor as the acquiring party under the supply contract, is also effective against the lessee as the beneficiary designated under this provision. For example, the supplier is not precluded from excluding or modifying an express or implied warranty under a supply contract. Sections 2-312(2) and 2-316, or Section 2A-214 [55-2-312 and 55-316 or 55-2A-214 NMSA 1978, respectively]. Further, the supplier is not precluded from limiting the rights and remedies of the lessor and from liquidating damages. Sections 2-718 [55-2-718 NMSA 1978] and 2-719 [55-2-719 NMSA 1978] or Sections 2A-503 [55-2A-503 NMSA 1978] and 2A-504 [55-2A-504 NMSA 1978]. If the supply contract excludes or modifies warranties, limits remedies, or liquidates damages with respect to the lessor, such provisions are enforceable against the lessee as beneficiary. Thus, only selective discrimination against the beneficiaries designated under this section is precluded, i.e., exclusion of the supplier's liability to the lessee with respect to warranties made to the lessor. This section does not affect the development of other law with respect to products liability.

2. Enforcement of this benefit is by action. Sections 2A-103(4) and 1-106(2) [55-2A-103 and 55-1-106 NMSA 1978, respectively].

3. The benefit extended by these provisions is not without a price, as this Article also provides in the case of a finance lease that is not a consumer lease that the lessee's promises to the lessor under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. Section 2A-407 [55-2A-407 NMSA 1978].

4. Subsection (2) limits the effect of subsection (1) on the supplier and the lessor by preserving, notwithstanding the transfer of the benefits of the supply contract to the lessee, all of the supplier's and the lessor's rights and obligations with respect to each

other and others; it further absolves the lessee of any duties with respect to the supply contract that might have been inferred from the extension of the benefits thereof.

5. Subsections (2) and (3) also deal with difficult issues related to modification or rescission of the supply contract. Subsection (2) states a rule that determines the impact of the statutory extension of benefit contained in subsection (1) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-216 [55-2A-216 NMSA 1978] and 2-318 [55-2-318 NMSA 1978], is not a modification of the supply contract by the parties. Thus, subsection (3) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (3) provides that a modification or rescission is not effective between the supplier and the lessee if, before the modification or rescission occurs, the supplier received notice that the lessee has entered into the finance lease. On the other hand, if the modification or rescission is effective, then to the extent of the modification or rescission of the benefit or warranty, the lessor by statutory dictate assumes an obligation to provide to the lessee that which the lessee would otherwise lose. For example, assume a reduction in an express warranty from four years to one year. No prejudice to the lessee may occur if the goods perform as agreed. If, however, there is a breach of the express warranty after one year and before four years pass, the lessor is liable. A remedy for any prejudice to the lessee because of the bifurcation of the lessee's recourse resulting from the action of the supplier and the lessor is left to resolution by the courts based on the facts of each case.

6. Subsection (4) makes it clear that the rights granted to the lessee by this section do not displace any rights the lessee otherwise may have against the supplier.

Cross References: - Sections 2A-103(1)(g), 2A-407 and 9-318 [55-2A-103, 55-2A-407 and 55-9-318 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Leasehold interest". Section 2A-103(1)(m) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Supply contract". Section 2A-103(1)(y) [55-2A-103 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-210. Express warranties.

(1) Express warranties by the lessor are created as follows:

(a) any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise;

(b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description; and

(c) any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee", or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty.

History: 1978 Comp., § 55-2A-210, enacted by Laws 1992, ch. 114, § 26.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313 [55-2-313 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Purposes: - All of the express and implied warranties of the Article on Sales (Article 2) are included in this Article, revised to reflect the differences between a sale of goods and a lease of goods. Sections 2A-210 through 2A-216 [55-2A-210 to 55-2A-216 NMSA 1978]. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill.L.F. 446, 459-60. Many state and federal courts have reached the same conclusion.

Value of the goods, as used in subsection (2), includes rental value.

Cross References: - Article 2, esp. Section 2-313 [55-2-313 NMSA 1978], and Sections 2A-210 through 2A-216 [55-2A-210 to 55-2A-216 NMSA 1978].

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-211. Warranties against interference and against infringement; lessee's obligation against infringement.

(1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement or the like that arises out of compliance with the specifications.

History: 1978 Comp., § 55-2A-211, enacted by Laws 1992, ch. 114, § 27.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312 [55-2-312 NMSA 1978].

Changes: This section is modeled on the provisions of Section 2-312 [55-2-312 NMSA 1978], with modifications to reflect the limited interest transferred by a lease contract and the total interest transferred by a sale. Section 2-312(2) [55-2-312 NMSA 1978], which is omitted here, is incorporated in Section 2A-214 [55-2A-214 NMSA 1978]. The

warranty of quiet possession was abolished with respect to sales of goods. Section 2-312 [55-2-312 NMSA 1978] official comment 1. Section 2A-211(1) [55-2A-211 NMSA 1978] reinstates the warranty of quiet possession with respect to leases. Inherent in the nature of the limited interest transferred by the lease - the right to possession and use of the goods - is the need of the lessee for protection greater than that afforded to the buyer. Since the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee. Further, to the extent the market will allow, the lessor can attempt to pass on the anticipated additional cost to the lessee in the guise of higher rent.

Purposes: - General language was chosen for subsection (1) that expresses the essence of the lessee's expectation: with an exception for infringement and the like, no person holding a claim or interest that arose from an act or omission of the lessor will be able to interfere with the lessee's use and enjoyment of the goods for the lease term. Subsection (2), like other similar provisions in later sections, excludes the finance lessor from extending this warranty; with few exceptions (Sections 2A-210 and 2A-211(1) [55-2A-210 and 55-2A-211 NMSA 1978]), the lessee under a finance lease is to look to the supplier for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. Subsections (2) and (3) are derived from Section 2-312(3) [55-2-312 NMSA 1978]. These subsections, as well as the analogue, should be construed so that applicable principles of law and equity supplement their provisions. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively].

Cross References: - Sections 2-312, 2-312(1), 2-312(2), 2-312 official comment 1, 2A-210, 2A-211(1) and 2A-214 [55-2-312, 55-2A-210, 55-2A-211 and 55-2A-214 NMSA 1978, respectively].

Definitional Cross References: - "Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Leasehold interest". Section 2A-103(1)(m) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-212. Implied warranty of merchantability.

(1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as:

(a) pass without objection in the trade under the description in the lease agreement;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that type are used;

(d) run, within the variation permitted by the lease agreement, of even kind, quality and quantity within each unit and among all units involved;

(e) are adequately contained, packaged and labeled as the lease agreement may require; and

(f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade.

History: 1978 Comp., § 55-2A-212, enacted by Laws 1992, ch. 114, § 28.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314 [55-2-314 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. E.g., Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 225, 541 P.2d 1184, 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease transactions).

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Course of dealing". Section 1-205 [55-1-205 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Fungible". Section 1-201(17) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease Agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Usage of trade". Section 1-205 [55-1-205 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-213. Implied warranty of fitness for particular purpose.

Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose.

History: 1978 Comp., § 55-2A-213, enacted by Laws 1992, ch. 114, § 29.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315 [55-2-315 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. E.g., All-States Leasing Co. v. Bass, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975) (implied warranty of fitness for a particular purpose (Article 2) extends to lease transactions).

Definitional Cross References: - "Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Knows". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-214. Exclusion or modification of warranties.

(1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of Section 55-2A-202 NMSA 1978 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to Subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention "merchantability", be by a writing and be conspicuous. Subject to Subsection (3), to exclude or modify any implied warranty of fitness the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous and states, for example, "There is no warranty that the goods will be fit for a particular purpose".

(3) Notwithstanding Subsection (2), but subject to Subsection (4):

(a) unless the circumstances indicated otherwise, all implied warranties are excluded by expressions like "as is", or "with all faults", or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, if in writing and conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (Section 55-2A-211 NMSA 1978) or any part of it, the language must be specific, be by a writing and be conspicuous, unless the circumstances, including course of performance, course of dealing or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person.

History: 1978 Comp., § 55-2A-214, enacted by Laws 1992, ch. 114, § 30.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-316 [55-2-316 NMSA 1978] and 2-312(2) [55-2-312 NMSA 1978].

Changes: Subsection (2) requires that a disclaimer of the warranty of merchantability be conspicuous and in writing as is the case for a disclaimer of the warranty of fitness; this is contrary to the rule stated in Section 2-316(2) [55-2-316 NMSA 1978] with respect to the disclaimer of the warranty of merchantability. This section also provides that to exclude or modify the implied warranty of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous. There are, however, exceptions to the rule. E.g., course of dealing, course of performance, or usage of trade may exclude or modify an implied warranty. Section 2A-214(3)(c) [55-2A-214 NMSA 1978]. The analogue of Section 2-312(2) [55-2-312 NMSA 1978] has been moved to subsection (4) of this section for a more unified treatment of disclaimers; there is no policy with respect to leases of goods that would justify continuing certain distinctions found in the Article on Sales (Article 2) regarding the treatment of the disclaimer of various warranties. Compare Sections 2-312(2) [55-2-312 NMSA 1978] and 2-316(2) [55-2-316 NMSA 1978]. Finally, the example of a disclaimer of the implied warranty of fitness stated in subsection (2) differs from the analogue stated in Section 2-316(2) [55-2-316 NMSA 1978]; this example should promote a better understanding of the effect of the disclaimer.

Purposes: - These changes were made to reflect leasing practices. E.g., FMC Finance Corp. v. Murphree, 632 F.2d 413, 418 (5th Cir.1980) (disclaimer of implied warranty under lease transactions must be conspicuous and in writing). The omission of the provisions of Section 2-316(4) [55-2-316 NMSA 1978] was not substantive. Sections 2A-503 [55-2A-503 NMSA 1978] and 2A-504 [55-2A-504 NMSA 1978].

Cross References: - Article 2, esp. Sections 2-312(2) [55-2-312 NMSA 1978] and 2-316 [55-2-316 NMSA 1978], and Sections 2A-503 [55-2A-503 NMSA 1978] and 2A-504 [55-2A-504 NMSA 1978].

Definitional Cross References: - "Conspicuous". Section 1-201(10) [55-1-201 NMSA 1978].

"Course of dealing". Section 1-205 [55-1-205 NMSA 1978].

"Fault". Section 2A-103(1)(f) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Knows". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Usage of trade". Section 1-205 [55-1-205 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-215. Cumulation and conflict of warranties express or implied.

Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) exact or technical specifications displace an inconsistent sample or model or general language of description;

(b) a sample from an existing bulk displaces inconsistent general language of description; and

(c) express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

History: 1978 Comp., § 55-2A-215, enacted by Laws 1992, ch. 114, § 31.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317 [55-2-317 NMSA 1978].

Definitional Cross Reference: - "Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-216. Third-party beneficiaries of express and implied warranties.

A warranty to or for the benefit of a lessee under this article, whether express or implied, extends to any natural person who is in the family or household of the lessee or who is a guest in the lessee's home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. This section does not displace principles of law and equity that extend a warranty to or for the benefit of a lessee to other persons. The operation of this section may not be excluded, modified or limited, but an exclusion, modification or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against any beneficiary designated under this section.

History: 1978 Comp., § 55-2A-216, enacted by Laws 1992, ch. 114, § 32.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318 [55-2-318 NMSA 1978].

Changes: The provisions of Section 2-318 [55-2-318 NMSA 1978] have been included in this section, modified in two respects: first, to reflect leasing practice, including the special practices of the lessor under a finance lease; second, to reflect and thus codify elements of the official comment to Section 2-318 [55-2-318 NMSA 1978] with respect to the effect of disclaimers and limitations of remedies against third parties.

Purposes: - Alternative A is based on the 1962 version of Section 2-318 and is least favorable to the injured person as the doctrine of privity imposed by other law is abrogated to only a limited extent. Alternatives B and C are based on later additions to Section 2-318 [55-2-318 NMSA 1978] and are more favorable to the injured person. In determining which alternative to select, the state legislature should consider making its choice parallel to the choice it made with respect to Section 2-318 [55-2-318 NMSA 1978], as interpreted by the courts.

The last sentence of each of Alternatives A, B and C does not preclude the lessor from excluding or modifying an express or implied warranty under a lease. Section 2A-214 [55-2A-214 NMSA 1978]. Further, that sentence does not preclude the lessor from limiting the rights and remedies of the lessee and from liquidating damages. Sections 2A-503 [55-2A-503 NMSA 1978] and 2A-504 [55-2A-504 NMSA 1978]. If the lease excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessee, such provisions are enforceable against the beneficiaries designated under this section. However, this last sentence forbids selective discrimination against the beneficiaries designated under this section, i.e., exclusion of the lessor's liability to the beneficiaries with respect to warranties made by the lessor to the lessee.

Other law, including the Article on Sales (Article 2), may apply in determining the extent to which a warranty to or for the benefit of the lessor extends to the lessee and third parties. This is in part a function of whether the lessor has bought or leased the goods.

This Article does not purport to change the development of the relationship of the common law, with respect to products liability, including strict liability in tort (as restated in Restatement (Second) of Torts, § 402A (1965)), to the provisions of this Act. Compare Cline v. Prowler Indus. of Maryland, 418 A.2d 968 (Del.1980) and Hawkins Constr. Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643 (1973) with Dippel v. Sciano, 37 Wis.2d 443, 155 N.W.2d 55 (1967).

Cross References: - Article 2, esp. Section 2-318, and Sections 2A-214, 2A-503 and 2A-504.

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-217. Identification.

Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) when the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) when the goods are shipped, marked or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) when the young are conceived, if the lease contract is for a lease of unborn young of animals.

History: 1978 Comp., § 55-2A-217, enacted by Laws 1992, ch. 114, § 33.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501 [55-2-501 NMSA 1978].

Changes: This section, together with Section 2A-218 [55-2A-218 NMSA 1978], is derived from the provisions of Section 2-501 [55-2-501 NMSA 1978], with changes to reflect lease terminology; however, this section omits as irrelevant to leasing practice the treatment of special property.

Purposes: - With respect to subsection (b) there is a certain amount of ambiguity in the reference to when goods are designated, e.g., when the lessor is both selling and leasing goods to the same lessee/buyer and has marked goods for delivery but has not distinguished between those related to the lease contract and those related to the sales contract. As in Section 2-501(1)(b) [55-2-501 NMSA 1978], this issue has been left to be resolved by the courts, case by case.

Cross References: - Sections 2-501 and 2A-218 [55-2-501 and 55-2A-218 NMSA 1978, respectively].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-218. Insurance and proceeds.

(1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under Subsections (1) and (2), the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance.

History: 1978 Comp., § 55-2A-218, enacted by Laws 1992, ch. 114, § 34.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501 [55-2-501 NMSA 1978].

Changes: This section, together with Section 2A-217 [55-2A-217 NMSA 1978], is derived from the provisions of Section 2-501 [55-2-501 NMSA 1978], with changes and additions to reflect leasing practices and terminology.

Purposes: - Subsection (2) states a rule allowing substitution of goods by the lessor under certain circumstances, until default or insolvency of the lessor, or until notification to the lessee that identification is final. Subsection (3) states a rule regarding the lessor's insurable interest that, by virtue of the difference between a sale and a lease, necessarily is different from the rule stated in Section 2-501(2) [55-2-501 NMSA 1978] regarding the seller's insurable interest. For this purpose the option to buy shall be deemed to have been exercised by the lessee when the resulting sale is closed, not when the lessee gives notice to the lessor. Further, subsection (5) is new and reflects the common practice of shifting the responsibility and cost of insuring the goods between the parties to the lease transaction.

Cross References: - Sections 2-501, 2-501(2) and 2A-217 [55-2-501 and 55-2A-217 NMSA 1978, respectively].

Definitional Cross References: - "Agreement". Section 1-102(3) [55-1-102 NMSA 1978].

"Buying". Section 2A-103(1)(a) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Insolvent". Section 1-201(23) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notification". Section 1-201(26) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-219. Risk of loss.

(1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this article on the effect of default on risk of loss (Section 55-2A-220 NMSA 1978), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) if the lease contract requires or authorizes the goods to be shipped by carrier:

(i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but

(ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery;

(b) if the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods; and

(c) in any case not within Paragraph (a) or (b), the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery.

History: 1978 Comp., § 55-2A-219, enacted by Laws 1992, ch. 114, § 35.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-509(1) through (3) [55-2-509 NMSA 1978].

Changes: Subsection (1) is new. The introduction to subsection (2) is new, but subparagraph (a) incorporates the provisions of Section 2-509(1) [55-2-509 NMSA 1978]; subparagraph (b) incorporates the provisions of Section 2-509(2) [55-2-509 NMSA 1978] only in part, reflecting current practice in lease transactions.

Purposes: - Subsection (1) states rules related to retention or passage of risk of loss consistent with current practice in lease transactions. The provisions of subsection (4) of Section 2-509 [55-2-509 NMSA 1978] are not incorporated as they are not necessary. This section does not deal with responsibility for loss caused by the wrongful act of either the lesser or the lessee.

Cross References: - Sections 2-509(1), 2-509(2) and 2-509(4) [55-2-509 NMSA 1978].

Definitional Cross References: - "Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-220. Effect of default on risk of loss.

(1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) if a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance; and

(b) if the lessee rightfully revokes acceptance, he, to the extent of any deficiency in his effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time.

History: 1978 Comp., § 55-2A-220, enacted by Laws 1992, ch. 114, § 36.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510 [55-2-510 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. The rule in Section (1)(b) does not allow the lessee under a finance lease to treat the risk of loss as having remained with the supplier from the beginning. This is appropriate given the limited circumstances under which the lessee under a finance lease is allowed to revoke acceptance. Section 2A-517 and Section 2A-516 [55-2A-517 and 55-2A-516 NMSA 1978, respectively] official comment.

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-221. Casualty to identified goods.

If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or Section 55-2A-219 NMSA 1978, then:

(a) if the loss is total, the lease contract is avoided; and

(b) if the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor.

History: 1978 Comp., § 55-2A-221, enacted by Laws 1992, ch. 114, § 37.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613 [55-2-613 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Purpose: - Due to the vagaries of determining the amount of due allowance (Section 2-613(b)) [55-2-613 NMSA 1978], no attempt was made in subsection (b) to treat a problem unique to lease contracts and installment sales contracts: determining how to recapture the allowance, e.g., application to the first or last rent payments or allocation, pro rata, to all rent payments.

Cross References: - Section 2-613 [55-2-613 NMSA 1978].

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Fault". Section 2A-103(1)(f) [55-2A-103 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 3
EFFECT OF LEASE CONTRACT

55-2A-301. Enforceability of lease contract.

Except as otherwise provided in this article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods, and against creditors of the parties.

History: 1978 Comp., § 55-2A-301, enacted by Laws 1992, ch. 114, § 38.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201 [55-9-201 NMSA 1978].

Changes: The first sentence of Section 9-201 [55-9-201 NMSA 1978] was incorporated, modified to reflect leasing terminology. The second sentence of Section 9-201 [55-9-201 NMSA 1978] was eliminated as not relevant to leasing practices.

Purposes: - 1. This section establishes a general rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201 [55-2A-201 NMSA 1978]. Enforceability is also a function

of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1). Section 2A-103(4) [55-2A-103 NMSA 1978].

2. The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Section 2A-309 [55-2A-309 NMSA 1978]. Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37) [55-1-201 NMSA 1978]. Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408 [55-9-408 NMSA 1978]. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing-Leveraged Leasing 681, 744-46 (2d ed. 1980).

3. Hypothetical: - (a) In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a hypothetical. Assume that on February 1 A, a manufacturer of combines and other farm equipment, leased a fleet of six combines to B, a corporation engaged in the business of farming, for a 12 month term. Under the lease agreement between A and B, A agreed to defer B's payment of the first two months' rent to April 1. On March 1 B recognized that it would need only four combines and thus subleased two combines to C for an 11 month term.

(b) This hypothetical raises a number of issues that are answered by the sections contained in this part. Since lease is defined to include sublease (Section 2A-103(1)(j) and (w)) [55-2A-103 NMSA 1978], this section provides that the prime lease between A and B and the sublease between B and C are enforceable in accordance with their terms, except as otherwise provided in this Article; that exception, in this case, is one of considerable scope.

(c) The separation of ownership, which is in A, and possession, which is in B with respect to four combines and which is in C with respect to two combines, is not relevant. Section 2A-302 [55-2A-302 NMSA 1978]. A's interest in the six combines cannot be challenged simply because A parted with possession to B, who in turn parted with possession of some of the combines to C. Yet it is important to note that by the terms of Section 2A-302 [55-2A-302 NMSA 1978] this conclusion is subject to change if otherwise provided in this Article.

(d) B's entering the sublease with C raises an issue that is treated by this part. In a dispute over the leased combines A may challenge B's right to sublease. The rule is permissive as to transfers of interests under a lease contract, including subleases. Section 2A-303(2) [55-2A-303 NMSA 1978]. However, the rule has two significant

qualifications. If the prime lease contract between A and B prohibits B from subleasing the combines, or makes such a sublease an event of default, Section 2A-303(2) [55-2A-303 NMSA 1978] applies; thus, while B's interest under the prime lease may not be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5) [55-2A-303 NMSA 1978]. Absent a prohibition or default provision in the prime lease contract A might be able to argue that the sublease to C materially increases A's risk; thus, while B's interest under the prime lease may be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5) [55-2A-303 NMSA 1978]. Section 2A-303(5)(b)(ii) [55-2A-303 NMSA 1978].

(e) Resolution of this issue is also a function of the section dealing with the sublease of goods by a prime lessee (Section 2A-305) [55-2A-305 NMSA 1978]. Subsection (1) of Section 2A-305 [55-2A-305 NMSA 1978], which is subject to the rules of Section 2A-303 [55-2A-303 NMSA 1978] stated above, provides that C takes subject to the interest of A under the prime lease between A and B. However, there are two exceptions. First, if B is a merchant (Sections 2A-103(3) and 2-104(1)) [55-2A-103 and 55-2-104 NMSA 1978, respectively] dealing in goods of that kind and C is a sublessee in the ordinary course of business (Sections 2A-103(1)(o) and 2A-103(1)(n)) [55-2A-103 NMSA 1978], C takes free of the prime lease between A and B. Second, if B has rejected the six combines under the prime lease with A, and B disposes of the goods by sublease to C, C takes free of the prime lease if C can establish good faith. Section 2A-511(4) [55-2A-511 NMSA 1978].

(f) If the facts of this hypothetical are expanded and we assume that the prime lease obligated B to maintain the combines, an additional issue may be presented. Prior to entering the sublease, B, in satisfaction of its maintenance covenant, brought the two combines that it desired to sublease to a local independent dealer of A's. The dealer did the requested work for B. C inspected the combines on the dealer's lot after the work was completed. C signed the sublease with B two days later. C, however, was prevented from taking delivery of the two combines as B refused to pay the dealer's invoice for the repairs. The dealer furnished the repair service to B in the ordinary course of the dealer's business. If under applicable law the dealer has a lien on repaired goods in the dealer's possession, the dealer's lien will take priority over B's and C's interests, and also should take priority over A's interest, depending upon the terms of the lease contract and the applicable law. Section 2A-306 [55-2A-306 NMSA 1978].

(g) Now assume that C is in financial straits and one of C's creditors obtains a judgment against C. If the creditor levies on C's subleasehold interest in the two combines, who will prevail? Unless the levying creditor also holds a lien covered by Section 2A-306 [55-2A-306 NMSA 1978], discussed above, the judgment creditor will take its interest subject to B's rights under the sublease and A's rights under the prime lease. Section 2A-307(1) [55-2A-307 NMSA 1978]. The hypothetical becomes more complicated if we assume that B is in financial straits and B's creditor holds the judgment. Here the judgment creditor takes subject to the sublease unless the lien attached to the two combines before the sublease contract became enforceable. Section 2A-307(2)(a) [55-2A-307 NMSA 1978]. However, B's judgment creditor cannot prime A's interest in the

goods because, with respect to A, the judgment creditor is a creditor of B in its capacity as lessee under the prime lease between A and B. Thus, here the judgment creditor's interest is subject to the lease between A and B. Section 2A-307(1) [55-2A-307 NMSA 1978].

(h) Finally, assume that on April 1 B is unable to pay A the deferred rent then due under the prime lease, but that C is current in its payments under the sublease from B. What effect will B's default under the prime lease between A and B have on C's rights under the sublease between B and C? Section 2A-301 [55-2A-301 NMSA 1978] provides that a lease contract is effective against the creditors of either party. Since a lease contract includes a sublease contract (Section 2A-103(1)(*l*)) [55-2A-103 NMSA 1978], the sublease contract between B and C arguably could be enforceable against A, a prime lessor who has extended unsecured credit to B the prime lessee/sublessor, if the sublease contract meets the requirements of Section 2A-201 [55-2A-201 NMSA 1978]. However, the rule stated in Section 2A-301 [55-2A-301 NMSA 1978] is subject to other provisions in this Article. Under Section 2A-305 [55-2A-305 NMSA 1978], C, as sublessee, would take subject to the prime lease contract in most cases. Thus, B's default under the prime lease will in most cases lead to A's recovery of the goods from C. Section 2A-523 [55-2A-523 NMSA 1978]. A and C could provide otherwise by agreement. Section 2A-311 [55-2A-311 NMSA 1978]. C's recourse will be to assert a claim for damages against B. Sections 2A-211(1) and 2A-508 [55-2A-211 and 55-2A-508 NMSA 1978, respectively].

4. Relationship Between Sections: - (a) As the analysis of the hypothetical demonstrates, Part 3 of the Article focuses on issues that relate to the enforceability of the lease contract (Sections 2A-301, 2A-302 and 2A-303) [55-2A-301, 55-2A-302 and 55-2A-303 NMSA 1978, respectively] and to the priority of various claims to the goods subject to the lease contract (Sections 2A-304, 2A-305, 2A-306, 2A-307, 2A-308, 2A-309, 2A-310, and 2A-311) [55-2A-304 to 55-2A-311 NMSA 1978, respectively].

(b) This section states a general rule of enforceability, which is subject to specific rules to the contrary stated elsewhere in the Article. Section 2A-302 [55-2A-302 NMSA 1978] negates any notion that the separation of title and possession is fraudulent as a rule of law. Finally, Section 2A-303 [55-2A-303 NMSA 1978] states rules with respect to the transfer of the lessor's interest (as well as the residual interest in the goods) or the lessee's interest under the lease contract. Qualifications are imposed as a function of various issues, including whether the transfer is the creation or enforcement of a security interest or one that is material to the other party to the lease contract. In addition, a system of rules is created to deal with the rights and duties among assignor, assignee and the other party to the lease contract.

(c) Sections 2A-304 and 2A-305 [55-2A-304 and 55-2A-305 NMSA 1978, respectively] are twins that deal with good faith transferees of goods subject to the lease contract. Section 2A-304 [55-2A-304 NMSA 1978] creates a set of rules with respect to transfers by the lessor of goods subject to a lease contract; the transferee considered is a subsequent lessee of the goods. The priority dispute covered here is between the

subsequent lessee and the original lessee of the goods (or persons claiming through the original lessee). Section 2A-305 [55-2A-305 NMSA 1978] creates a set of rules with respect to transfers by the lessee of goods subject to a lease contract; the transferees considered are buyers of the goods or sublessees of the goods. The priority dispute covered here is between the transferee and the lessor of the goods (or persons claiming through the lessor).

(d) Section 2A-306 [55-2A-306 NMSA 1978] creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 [55-2A-307 NMSA 1978] creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

(e) Section 2A-308 [55-2A-308 NMSA 1978] creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the buyer-lessor can establish that he or she bought for value and in good faith.

(f) Sections 2A-309 and 2A-310 [55-2A-309 and 55-2A-310 NMSA 1978, respectively] create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

(g) Finally, Section 2A-311 [55-2A-311 NMSA 1978] allows parties to alter the statutory priorities by agreement.

Cross References: - Article 1, especially Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(*l*), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(2), 2A-303(5), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-311, 2A-508, 2A-511(4), 2A-523, Article 9, especially Sections 9-201 and 9-408 [55-1-201, 55-2-104, 55-2A-103, 55-2A-201, 55-2A-301 to 55-2A-311, 55-2A-508, 55-2A-511, 55-2A-523, 55-9-201 and 55-9-408 NMSA 1978, respectively].

Definitional Cross References: - "Creditor". Section 1-201(12) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Purchaser". Section 1-201(33) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-302. Title to and possession of goods.

Except as otherwise provided in this article, each provision of this article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

History: 1978 Comp., § 55-2A-302, enacted by Laws 1992, ch. 114, § 39.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202 [55-9-202 NMSA 1978].

Changes: Section 9-202 [55-9-202 NMSA 1978] was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.

Purposes: - The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So.2d 1151 (Fla.Dist.Ct.App.1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308 [55-2A-301 and 55-2A-308 NMSA 1978, respectively].

Cross References: - Sections 2A-301, 2A-308 and 9-202 [55-2A-301, 55-2A-308 and 55-9-202 NMSA 1978, respectively].

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-303. Alienability of party's interest under lease contract or of lessor's residual interest in goods; delegation of performance; transfer of rights.

(1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to Article 9, Secured Transactions, by reason of Paragraph (b) of Subsection (1) of Section 55-9-102 NMSA 1978.

(2) Except as provided in Subsections (3) and (4), a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation or enforcement of a security interest, or attachment, levy or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in Subsection (5), but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits the creation or enforcement of a security interest in an interest of a party under the lease contract or in the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, is not enforceable unless, and then only to the extent that, there is an actual transfer by the lessee of the lessee's right of possession or use of the goods in violation of the provision or an actual delegation of a material performance of either party to the lease contract in violation of the provision. Neither the granting nor the enforcement of a security interest in (i) the lessor's interest under the lease contract, or (ii) the lessor's residual interest in the goods is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of or materially increases the burden or risk imposed on, the lessee within the purview of Subsection (5) unless, and then only to the extent that, there is an actual delegation of a material performance of the lessor.

(4) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview of Subsection (5).

(5) Subject to Subsections (3) and (4):

(a) if a transfer is made which is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in Section 55-2A-501(2) NMSA 1978;

(b) if Paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement, or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then,

except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer, and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(6) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights, and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(7) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(8) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing and conspicuous.

History: 1978 Comp., § 55-2A-303, enacted by Laws 1992, ch. 114, § 40.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-210 and 9-311 [55-2-210 and 55-9-311 NMSA 1978, respectively].

Changes: The provisions of Sections 2-210 and 9-311 [55-2-210 and 55-9-311 NMSA 1978, respectively] were incorporated in this section, with substantial modifications to reflect leasing terminology and practice and to harmonize the principles of the respective provisions, i.e., limitations on delegation of performance on the one hand and alienability of rights on the other. In addition, unlike Section 2-210 [55-2-210 NMSA 1978] which deals only with voluntary transfers, this section deals with involuntary as well as voluntary transfers. Moreover, the principle of Section 9-318(4) [55-9-318 NMSA 1978] denying effectiveness to contractual terms prohibiting assignments of receivables due and to become due also is implemented.

Purposes: - 1. Subsection (2) states a rule, consistent with Section 9-311 [55-9-311 NMSA 1978], that voluntary and involuntary transfers of an interest of a party under the lease contract or of the lessor's residual interest, including by way of the creation or enforcement of a security interest, are effective, notwithstanding a provision in the lease agreement prohibiting the transfer or making the transfer an event of default. Although the transfers are effective, the provision in the lease agreement is nevertheless

enforceable, but only as provided in subsection (5). Under subsection (5) the prejudiced party is limited to the remedies on "default under the lease contract" in this Article and, except as limited by this Article, as provided in the lease agreement, if the transfer has been made an event of default. Section 2A-501(2) [55-2A-501 NMSA 1978]. Usually, there will be a specific provision to this effect or a general provision making a breach of a covenant an event of default. In those cases where the transfer is prohibited, but not made an event of default, the prejudiced party may recover damages; or, if the damage remedy would be ineffective adequately to protect that party, the court can order cancellation of the lease contract or enjoin the transfer. This rule that such provisions generally are enforceable is subject to subsections (3) and (4), which make such provisions unenforceable in certain instances.

2. The first such instance is described in subsection (3). A provision in a lease agreement which prohibits the creation or enforcement of a security interest, including sales of lease contracts subject to Article 9 (Sections 9-102(1)(b) and 9-104(f)) [55-9-102 and 55-9-104 NMSA 1978, respectively], or makes it an event of default is generally not enforceable, reflecting the policy of Section 9-318(4) [55-9-318 NMSA 1978]. However, that policy gives way to the doctrine stated in Section 2-210(2) [55-2-210 NMSA 1978], which gives one party to a contract the right to protect itself against an actual delegation (but not just a provision under which delegation might later occur) of a material performance by the other party. Accordingly, such a provision in a lease agreement is enforceable when the transfer delegates a material performance. Generally, as expressly provided in subsection (6), a transfer for security is not a delegation of duties. However, inasmuch as the creation of a security interest includes the sale of a lease contract, if there are then unperformed duties on the part of the lessor/seller, there could be a delegation of duties in the sale, and, if such a delegation actually takes place and is of a material performance, a provision in a lease agreement prohibiting it or making it an event of default would be enforceable, giving rise to the rights and remedies stated in subsection (5). The statute does not define "material." The parties may set standards to determine its meaning. The term is intended to exclude delegations of matters such as accounting to a professional accountant and the performance of, as opposed to the responsibility for, maintenance duties to a person in the maintenance service industry.

3. For similar reasons, the lessor is entitled to protect its residual interest in the goods by prohibiting anyone but the lessee from possessing or using them. Accordingly, under subsection (3) if there is an actual transfer by the lessee of its right of possession or use of the goods in violation of a provision in the lease agreement, such a provision likewise is enforceable, giving rise to the rights and remedies stated in subsection (5). A transfer of the lessee's right of possession or use of the goods resulting from the enforcement of a security interest granted by the lessee in its leasehold interest is a "transfer by the lessee" under this subsection.

4. Finally, subsection (3) protects against a claim that the creation or enforcement of a security interest in the lessor's interest under the lease contract or in the residual interest is a transfer that materially impairs the prospect of obtaining return performance

by, materially changes the duty of, or materially increases the burden or risk imposed on the lessee so as to give rise to the rights and remedies stated in subsection (5), unless the transfer involves an actual delegation of a material performance of the lessor.

5. While it is not likely that a transfer by the lessor of its right to payment under the lease contract would impair at a future time the ability of the lessee to obtain the performance due the lessee under the lease contract from the lessor, if under the circumstances reasonable grounds for insecurity as to receiving that performance arise, the lessee may employ the provision of this Article for demanding adequate assurance of due performance and has the remedy provided in that circumstance. Section 2A-401 [55-2A-401 NMSA 1978].

6. Sections 9-206 and 9-318(1) through (3) [55-9-206 and 55-9-318 NMSA 1978, respectively] also are relevant. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318(1) through (3) [55-9-318 NMSA 1978] deal with, among other things, the other party's rights against the assignee where Section 9-206(1) [55-9-206 NMSA 1978] does not apply. Since the definition of contract under Section 1-201(11) [55-1-201 NMSA 1978] includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) [55-9-105 NMSA 1978] includes a lessee of goods. As a result, Section 9-206 [55-9-206 NMSA 1978] applies to lease agreements, and there is no need to restate those sections in this Article. The reference to "defenses or claims arising out of a sale" in Section 9-318(1) [55-9-318 NMSA 1978] should be interpreted broadly to include defenses or claims arising out of a lease inasmuch as that section codifies the common law rule with respect to contracts, including lease contracts.

7. Subsection (4) is based upon Section 2-210(2) and Section 9-318(4) [55-2-210 and 55-9-318 NMSA 1978]. It makes unenforceable a prohibition against transfers of certain rights to payment or a provision making the transfer an event of default. It also provides that such transfers do not materially impair the prospect of obtaining return performance by, materially change the duty of, or materially increase the burden or risk imposed on, the other party to the lease contract so as to give rise to the rights and remedies stated in subsection (5). Accordingly, a transfer of a right to payment cannot be prohibited or made an event of default, or be one that materially impairs performance, changes duties or increases risk, if the right is already due or will become due without further performance being required by the party to receive payment. Thus, a lessor can transfer the right to future payments under the lease contract, including by way of a grant of a security interest, and the transfer will not give rise to the rights and remedies stated in subsection (5) if the lessor has no remaining performance under the lease contract. The mere fact that the lessor is obligated to allow the lessee to remain in possession and to use the goods as long as the lessee is not in default does not mean that there is "remaining performance" on the part of the lessor. Likewise, the fact that the lessor has potential liability under a "non-operating" lease contract for breaches of warranty does not mean that there is "remaining performance." In contrast, the lessor would have "remaining performance" under a lease contract requiring the lessor to regularly maintain and service the goods or to provide "upgrades" of the equipment on a periodic

basis in order to avoid obsolescence. The basic distinction is between a mere potential duty to respond which is not "remaining performance," and an affirmative duty to render stipulated performance. Although the distinction may be difficult to draw in some cases, it is instructive to focus on the difference between "operating" and "non-operating" leases as generally understood in the marketplace. Even if there is "remaining performance" under a lease contract, a transfer for security of a right to payment that is made an event of default or that is in violation of a prohibition against transfer does not give rise to the rights and remedies under subsection (5) if it does not constitute an actual delegation of a material performance under subsection (3).

8. The application of either the rule of subsection (3) or the rule of subsection (4) to the grant by the lessor of a security interest in the lessor's right to future payment under the lease contract may produce the same result. Both subsections generally protect security transfers by the lessor in particular because the creation by the lessor of a security interest or the enforcement of that interest generally will not prejudice the lessee's rights if it does not result in a delegation of the lessor's duties. To the contrary, the receipt of loan proceeds or relief from the enforcement of an antecedent debt normally should enhance the lessor's ability to perform its duties under the lease contract. Nevertheless, there are circumstances where relief might be justified. For example, if ownership of the goods is transferred pursuant to enforcement of a security interest to a party whose ownership would prevent the lessee from continuing to possess the goods, relief might be warranted. See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft in the United States based on the citizenship or corporate qualification of the registrant.

9. Relief on the ground of material prejudice when the lease agreement does not prohibit the transfer or make it an event of default should be afforded only in extreme circumstances, considering the fact that the party asserting material prejudice did not insist upon a provision in the lease agreement that would protect against such a transfer.

10. Subsection (5) implements the rule of subsection (2). Subsection (2) provides that, even though a transfer is effective, a provision in the lease agreement prohibiting it or making it an event of default may be enforceable as provided in subsection (5). See Brummond v. First National Bank of Clovis, 656 P.2d 884, 35 U.C.C. Rep. Serv. (Callaghan) 1311 (N. Mex. 1983), stating the analogous rule for Section 9-311. If the transfer prohibited by the lease agreement is made an event of default, then, under subsection 5(a), unless the default is waived or there is an agreement otherwise, the aggrieved party has the rights and remedies referred to in Section 2A-501(2) [55-2A-501 NMSA 1978], viz. those in this Article and, except as limited in the Article, those provided in the lease agreement. In the unlikely circumstance that the lease agreement prohibits the transfer without making a violation of the prohibition an event of default or, even if there is no prohibition against the transfer, and the transfer is one that materially impairs performance, changes duties, or increases risk (for example, a sublease or assignment to a party using the goods improperly or for an illegal purpose), then subsection 5(b) is applicable. In that circumstance, unless the party aggrieved by the

transfer has otherwise agreed in the lease contract, such as by assenting to a particular transfer or to transfers in general, or agrees in some other manner, the aggrieved party has the right to recover damages from the transferor and a court may, in appropriate circumstances, grant other relief, such as cancellation of the lease contract or an injunction against the transfer.

11. If a transfer gives rise to the rights and remedies provided in subsection (5), the transferee as an alternative may propose, and the other party may accept, adequate cure or compensation for past defaults and adequate assurance of future due performance under the lease contract. Subsection (5) does not preclude any other relief that may be available to a party to the lease contract aggrieved by a transfer subject to an enforceable prohibition, such as an action for interference with contractual relations.

12. Subsection (8) requires that a provision in a consumer lease prohibiting a transfer, or making it an event of default, must be specific, written and conspicuous. See Section 1-201(10) [55-1-201 NMSA 1978]. This assists in protecting a consumer lessee against surprise assertions of default.

13. Subsection (6) is taken almost verbatim from the provisions of Section 2-210(4) [55-2-210 NMSA 1978]. The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests. Security interest is defined to include "any interest of a buyer of . . . chattel paper". Section 1-201(37) [55-1-201 NMSA 1978]. Chattel paper is defined to include a lease. Section 9-105(1)(b) [55-9-105 NMSA 1978]. Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

Cross References: - Sections 1-201(11), 1-201(37), 2-210, 2A-401, 9-102(1)(b), 9-104(f), 9-105(1)(a), 9-206, and 9-318 [55-1-201, 55-2-210, 55-2A-401, 55-9-102, 55-9-104, 55-9-105, 55-9-206 and 55-9-318 NMSA 1978, respectively].

Definitional Cross References: - "Agreed" and "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Conspicuous". Section 1-201(10) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lessor's residual interest". Section 2A-103(1)(q) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-304. Subsequent lease of goods by lessor.

(1) Subject to Section 55-2A-303 NMSA 1978, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in Subsection (2) and Section 55-2A-527(4) NMSA 1978, takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. If goods have been delivered under a transaction of purchase, the lessor has that power even though:

(a) the lessor's transferor was deceived as to the identity of the lessor;

(b) the delivery was in exchange for a check which is later dishonored;

(c) it was agreed that the transaction was to be a "cash sale"; or

(d) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee of that lessor before the interest of the subsequent lessee became enforceable against that lessor obtains to the extent of the leasehold interest

transferred, all of that lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this state or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

History: 1978 Comp., § 55-2A-304, enacted by Laws 1992, ch. 114, § 41.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403 [55-2-403 NMSA 1978].

Changes: While Section 2-403 [55-2-403 NMSA 1978] was used as a model for this section, the provisions of Section 2-403 [55-2-403 NMSA 1978] were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes: - 1. This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303 [55-2A-303 NMSA 1978], which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

2. This section must also be read in conjunction with Section 2-403 [55-2-403 NMSA 1978]. This section and Section 2A-305 [55-2A-305 NMSA 1978] are derived from Section 2-403 [55-2-403 NMSA 1978], which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)) [55-1-201 NMSA 1978], a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403 [55-2-403 NMSA 1978]. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403 [55-2-403 NMSA 1978], first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v) [55-2A-103 NMSA 1978].

3. There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305 [55-2-403, 55-2A-304 and 55-2A-305 NMSA 1978, respectively]. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) [55-2-403 NMSA 1978] as L is not a buyer in the ordinary course of business. Section 1-201(9)

[55-1-201 NMSA 1978]. Further, this transaction is not governed by Section 2A-304(2) [55-2A-304 NMSA 1978] as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) [55-2A-305 NMSA 1978] as B is not M's lessor. Section 2A-307(2) [55-2A-307 NMSA 1978] resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively]. See, e.g., Restatement (Second) of Torts §§ 222A - 243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12) [55-2A-103 and 55-1-201 NMSA 1978, respectively]. Section 2A-307(2) [55-2A-307 NMSA 1978] provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q) [55-2A-103 NMSA 1978].

4. Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively]. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

5. Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

6. The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entrustee and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entrustee's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entrustee. Thus, the lessor entrustee retains the residual interest in the goods. Section 2A-103(1)(q) [55-2A-103 NMSA 1978]. However, entrustment by the existing lessee must have occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is

defined in Section 2-403(3) [55-2-403 NMSA 1978] and that definition applies here. Section 2A-103(3) [55-2A-103 NMSA 1978].

7. Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403 [55-2-403 NMSA 1978], the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2) [55-2A-103 and 55-1-102 NMSA 1978, respectively]. The better rule is that the certificate of title statutes are in harmony with Section 2-403 [55-2-403 NMSA 1978] and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928, (Miss.1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J.Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References: - Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305 [55-1-102, 55-1-103, 55-1-201, 55-2-403, 55-2A-103, 55-2A-303 and 55-2A-305 NMSA 1978, respectively].

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Entrusting". Section 2-403(3) [55-2-403 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Leasehold interest". Section 2A-103(1)(m) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessee in the ordinary course of business". Section 2A-103(1)(o) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Purchase". Section 2A-103(1)(v) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-305. Sale or sublease of goods by lessee.

(1) Subject to the provisions of Section 55-2A-303 NMSA 1978, a buyer or sublessee from the lessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the lessee had or had power to transfer, and except as provided in Subsection (2) and Section 55-2A-511(4) NMSA 1978, takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease the lessee has that power even though:

(a) the lessor was deceived as to the identity of the lessee;

(b) the delivery was in exchange for a check which is later dishonored; or

(c) the delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this state or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

History: 1978 Comp., § 55-2A-305, enacted by Laws 1992, ch. 114, § 42.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403 [55-2-403 NMSA 1978].

Changes: While Section 2-403 [55-2-403 NMSA 1978] was used as a model for this section, the provisions of Section 2-403 [55-2-403 NMSA 1978] were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes: - This section, a companion to Section 2A-304 [55-2A-304 NMSA 1978], states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 [55-2A-304 NMSA 1978] official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1) [55-2-403 NMSA 1978]. Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir.1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D.Mass.1983). Unlike Section 2A-304(2) [55-2A-304 NMSA 1978], this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) [55-2A-304 NMSA 1978] the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) [55-2-403 and 55-2A-305 NMSA 1978, respectively] with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) [55-2A-103 NMSA 1978] makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 [55-2A-304 NMSA 1978] official comment.

Cross References: - Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2) [55-2-403, 55-2-103, 55-2A-304 and 55-2A-305 NMSA 1978, respectively].

Definitional Cross References: - "Buyer". Section 2-103(1)(a) [55-2-103 NMSA 1978].

"Buyer in the ordinary course of business". Section 2A-103(1)(a) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Entrusting". Section 2-403(3) [55-2-403 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Leasehold interest". Section 2A-103(1)(m) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessee in the ordinary course of business". Section 2A-103(1)(o) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant". Section 2-104(1) [55-2-104 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Sublease". Section 2A-103(1)(w) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-306. Priority of certain liens arising by operation of law.

If a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest of the lessor or lessee under the lease contract or this article unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise.

History: 1978 Comp., § 55-2A-306, enacted by Laws 1992, ch. 114, § 43.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310 [55-9-310 NMSA 1978].

Changes: The approach reflected in the provisions of Section 9-310 [55-9-310 NMSA 1978] was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.

Purposes: - This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.

Cross Reference: - Section 9-310 [55-9-310 NMSA 1978].

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lien". Section 2A-103(1)(r) [55-2A-103 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-307. Priority of liens arising by attachment or levy on, security interests in and other claims to goods.

(1) Except as otherwise provided in Section 55-2A-306 NMSA 1978, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in Subsections (3) and (4) and in Sections 55-2A-306 and 55-2A-308 NMSA 1978, a creditor of a lessor takes subject to the lease contract unless:

(a) the creditor holds a lien that attached to the goods before the lease contract became enforceable;

(b) the creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods without knowledge of the security interest; or

(c) the creditor holds a security interest in the goods which was perfected (Section 55-9-303 NMSA 1978) before the lease contract became enforceable.

(3) A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessor even though the security interest is perfected (Section 55-9-303 NMSA 1978) and the lessee knows of its existence.

(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than forty-five days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the forty-five day period.

History: 1978 Comp., § 55-2A-307, enacted by Laws 1992, ch. 114, § 44.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: None for subsection (1). Subsection (2) is derived from Section 9-301 [55-9-301 NMSA 1978], and subsections (3) and (4) are derived from Section 9-307(1) and (3) [55-9-307 NMSA 1978], respectively.

Changes: The provisions of Sections 9-301 [55-9-301 NMSA 1978] and 9-307(1) and (3) [55-9-307 NMSA 1978] were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.

Purposes: - 1. Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) [55-2A-103 NMSA 1978] includes sublessee. Therefore, this subsection not only covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 [55-2A-301 NMSA 1978] official comment 3(g). Further, by using the term creditor (Section 1-201(12)) [55-1-201 NMSA 1978], this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4) [55-2A-103 NMSA 1978].

2. Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 [55-2A-301 NMSA 1978] official comment 3(g). Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

3. To take priority over the lease contract, and the interests derived therefrom, the creditor must come within one of three exceptions stated within the rule. First, subsection (2)(a) provides that where the creditor holds a lien (Section 2A-103(1)(r)) [55-2A-103 NMSA 1978] that attached before the lease contract became enforceable (Section 2A-301) [55-2A-301 NMSA 1978], the creditor does not take subject to the lease. Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)) [55-1-201 NMSA 1978], whether or not perfected, the creditor has priority over a lessee who did not give value (Section 1-201(44)) [55-1-201 NMSA 1978] and receive delivery of the goods without knowledge (Section 1-201(25)) [55-1-201 NMSA 1978] of the security interest. As to other lessees, under subsection (2)(c) a secured creditor holding a perfected security interest before the time the lease contract became enforceable (Section 2A-301) [55-2A-301 NMSA 1978] does not take subject to the lease. With respect to this provision, the lessee in these circumstances is treated like a buyer so that perfection of a purchase money security interest does not relate back (Section 9-301) [55-9-301 NMSA 1978].

4. The rules of this section operate in favor of whichever party to the lease contract may enforce it, even if one party perhaps may not, e.g., under Section 2A-201(1)(b) [55-2A-201 NMSA 1978].

5. The rules stated in subsections (2)(b) and (c), and the rule in subsection (3), are best understood by reviewing a hypothetical. Assume that a merchant engaged in the business of selling and leasing musical instruments obtained possession of a truckload of musical instruments on deferred payment terms from a supplier of musical instruments on January 6. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on January 10. Under subsection (2)(b) the lessee will prevail (assuming the lessee qualifies thereunder) unless subsection (c) provides otherwise. Under the rule stated in subsection (2)(c) a priority dispute between the supplier, as the lessor's secured creditor, and the lessee would be determined by ascertaining on January 10 (the day the lease became enforceable) the validity and perfected status of the security interest in the musical instrument and the enforceability of the lease contract by the lessee. Nothing more appearing, under the rule stated in subsection (2)(c), the supplier's security interest in the musical instrument would not have priority over the lease contract. Moreover, subsection (2) states that its rules are subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(o) [55-2A-103 NMSA 1978]. Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.

6. Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3) [55-9-307 NMSA 1978], respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the

buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

Cross References: - Sections 1-201(12), 1-201(25), 1-201(37), 1-201(44), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-201(1)(b), 2A-301 official comment 3(g), Article 9, especially Sections 9-301, 9-307(1) and 9-307(3) [55-1-201, 55-2A-103, 55-2A-201, 55-2A-301, 55-9-301 and 55-9-307 NMSA 1978, respectively].

Definitional Cross References: - "Creditor". Section 1-201(12) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Knowledge" and "Knows". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Leasehold interest". Section 2A-103(1)(m) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessee in the ordinary course of business". Section 2A-103(1)(o) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lien". Section 2A-103(1)(r) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Pursuant to commitment". Section 2A-103(3) [55-2A-103 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-308. Special rights of creditors.

(1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a preexisting claim for money, security or the like, and (b) is made under circumstances which under any statute or rule of law apart from this article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.

History: 1978 Comp., § 55-2A-308, enacted by Laws 1992, ch. 114, § 45.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b) [55-2-402 NMSA 1978].

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes: - Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract between the buyer as lessor and the seller as lessee. Notwithstanding any statute or rule of law that would treat such retention as fraud, whether per se, prima facie, or otherwise, the retention is not fraudulent if the buyer bought for value (Section 1-201(44)) [55-1-201 NMSA 1978] and in good faith (Sections 1-201(19) and 2-103(1)(b)) [55-1-201 and 55-2-103 NMSA 1978, respectively]. Section 2A-103(3) and (4) [55-2A-103 NMSA 1978]. This provision overrides Section 2-402(2) [55-2-402 NMSA 1978] to the extent it would otherwise apply to a sale-leaseback transaction.

Cross References: - Sections 1-201(19), 1-201(44), 2-402(2) and 2A-103(4) [55-1-201, 55-2-402 and 55-2A-103 NMSA 1978, respectively].

Definitional Cross References: - "Buyer". Section 2-103(1)(a) [55-2-103 NMSA 1978].

"Contract". Section 1-201(11) [55-1-201 NMSA 1978].

"Creditor". Section 1-201(12) [55-1-201 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Money". Section 1-201(24) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Seller". Section 2-103(1)(d) [55-2-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-309. Lessor's and lessee's rights when goods become fixtures.

(1) In this section:

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) a "fixture filing" is the filing, in the office where a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of Paragraph (5) of Section 55-9-402 NMSA 1978;

(c) a lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) a mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this article of ordinary building materials incorporated into an improvement on land.

(3) This article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) the lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) the interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) the fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) the encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) the lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding Paragraph (a) of Subsection (4) but otherwise subject to Subsections (4) and (5), the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures, including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (i) on default, expiration, termination or cancellation of the lease agreement but subject to the lease agreement and this article, or (ii) if necessary to enforce other rights and remedies of the lessor or lessee under this article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but the lessor or lessee must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the article on Secured Transactions (Article 9).

History: 1978 Comp., § 55-2A-309, enacted by Laws 1992, ch. 114, § 46.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313 [55-9-313 NMSA 1978].

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: - 1. While Section 9-313 [55-9-313 NMSA 1978] provided a model for this section, certain provisions were substantially revised.

2. Section 2A-309(1)(c) [55-2A-309 NMSA 1978], which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

3. Section 2A-309(4) [55-2A-309 NMSA 1978], which states one of several priority rules found in this section, deletes reference to office machines and the like (Section 9-313(4)(c)) [55-9-313 NMSA 1978] as well as certain liens (Section 9-313(4)(d)) [55-9-313 NMSA 1978]. However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) [55-9-313 NMSA 1978] to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

4. The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) [55-9-313 NMSA 1978] in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) [55-9-313 NMSA 1978] automatic subordination of the security interest in fixtures. Note that, for the purpose of this section, where the interest of an encumbrancer or owner of the real estate is paramount to the intent of the lessor, the latter term includes the residual interest of the lessor.

5. The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) [55-9-313 NMSA 1978] in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

6. Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37) [55-1-201 NMSA 1978]. The relevant provisions of Article 9 must be interpreted permissively to give effect to this mechanism as it implicitly expands the scope of Article 9 so that its filing provisions apply to transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) [55-2-326 NMSA 1978] for

the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37) [55-1-201 NMSA 1978]. Given the lack of litigation with respect to the mechanism created for consignment sales, this new mechanism should prove effective.

Cross References: - Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, especially Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408 [55-1-201, 55-2A-309, 55-9-313, and 55-9-408 NMSA 1978, respectively].

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lien". Section 2A-103(1)(r) [55-2A-103 NMSA 1978].

"Mortgage". Section 9-105(1)(j) [55-9-105 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-310. Lessor's and lessee's rights when goods become accessions.

(1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in Subsection (4).

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in Subsection (4) but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in Subsection (2) or (3) is subordinate to the interest of:

(a) a buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) a creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under Subsections (2) or (3) and (4) a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default, expiration, termination or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this article, or (b) if necessary to enforce his other rights and remedies under this article remove the goods from the whole, free and clear of all interests in the whole, but he must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

History: 1978 Comp., § 55-2A-310, enacted by Laws 1992, ch. 114, § 47.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314 [55-9-314 NMSA 1978].

Changes: Revised to reflect leasing terminology and to add new material.

Purposes: - Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 [55-9-314 NMSA 1978] to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 [55-9-314 NMSA 1978] to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) [55-9-314 NMSA 1978] as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) [55-9-314 NMSA 1978] with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8) [55-2A-309 NMSA 1978].

Neither this section nor Section 9-314 [55-9-314 NMSA 1978] governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References: - Sections 2A-309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4) [55-2A-309 and 55-9-314 NMSA 1978, respectively].

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Buyer in the ordinary course of business". Section 2A-103(1)(a) [55-2A-103 NMSA 1978].

"Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Creditor". Section 1-201(12) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Holder". Section 1-201(20) [55-1-201 NMSA 1978].

"Knowledge". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessee in the ordinary course of business". Section 2A-103(1)(o) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-311. Priority subject to subordination.

Nothing in this article prevents subordination by agreement by any person entitled to priority.

History: 1978 Comp., § 55-2A-311, enacted by Laws 1992, ch. 114, § 48.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-316 [55-9-316 NMSA 1978].

Purposes: - The several preceding sections deal with questions of priority. This section is inserted to make it entirely clear that a person entitled to priority may effectively agree

to subordinate the claim. Only the person entitled to priority may make such an agreement: the rights of such a person cannot be adversely affected by an agreement to which that person is not a party.

Cross References: - Sections 1-102 and 2A-304 through 2A-310 [55-1-102 and 55-2A-304 to 55-2A-310 NMSA 1978, respectively].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 4 PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED

55-2A-401. Insecurity; adequate assurance of performance.

(1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed thirty days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

History: 1978 Comp., § 55-2A-401, enacted by Laws 1992, ch. 114, § 49.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609 [55-2-609 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)) [55-2-609 NMSA 1978], the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Between merchants". Section 2-104(3) [55-2-104 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-402. Anticipatory repudiation.

If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) for a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) make demand pursuant to Section 55-2A-401 NMSA 1978 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) resort to any right or remedy upon default under the lease contract or this article, even though the aggrieved party has notified the repudiating party that the aggrieved

party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (Section 55-2A-524 NMSA 1978).

History: 1978 Comp., § 55-2A-402, enacted by Laws 1992, ch. 114, § 50.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610 [55-2-610 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-403. Retraction of anticipatory repudiation.

(1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under Section 55-2A-401 NMSA 1978.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

History: 1978 Comp., § 55-2A-403, enacted by Laws 1992, ch. 114, § 51.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611 [55-2-611 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) [55-2-611 NMSA 1978] the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) [55-2A-401 NMSA 1978] as unnecessary, implying no substantive change.

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-404. Substituted performance.

(1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading or unloading facilities fail or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) the lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) if delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive or predatory.

History: 1978 Comp., § 55-2A-404, enacted by Laws 1992, ch. 114, § 52.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614 [55-2-614 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Fault". Section 2A-103(1)(f) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-405. Excused performance.

Subject to Section 55-2A-404 NMSA 1978 on substituted performance, the following rules apply:

(a) delay in delivery or nondelivery in whole or in part by a lessor or a supplier who complies with Subsections (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the lease contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not the regulation or order later proves to be invalid;

(b) if the causes mentioned in Subsection (a) affect only part of the lessor's or the supplier's capacity to perform, he shall allocate production and deliveries among his customers but at his option may include regular customers not then under contract for sale or lease as well as his own requirements for further manufacture; he may so allocate in any manner that is fair and reasonable; and

(c) the lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under Subsection (b), of the estimated quota thus made available for the lessee.

History: 1978 Comp., § 55-2A-405, enacted by Laws 1992, ch. 114, § 53.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615 [55-2-615 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Contract". Section 1-201(11) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Knows". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-406. Procedure on excused performance.

(1) If the lessee receives notification of a material or indefinite delay or an allocation justified under Section 55-2A-405 NMSA 1978, the lessee may by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 55-2A-510 NMSA 1978):

(a) terminate the lease contract (Section 55-2A-505(2) NMSA 1978); or

(b) except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under Section 55-2A-405 NMSA 1978, the lessee fails so to modify the lease agreement within a reasonable time not exceeding thirty days, the lease contract lapses with respect to any deliveries affected.

History: 1978 Comp., § 55-2A-406, enacted by Laws 1992, ch. 114, § 54.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2) [55-2-616 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405) [55-2A-404 and 55-2A-405 NMSA 1978, respectively]. However, subsection 1(b), which allows the lessee the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407 [55-2A-407 NMSA 1978].

Definitional Cross References: - "Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Installment lease contract". Section 2A-103(1)(i) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

"Written". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-407. Irrevocable promises; finance leases.

(1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under Subsection (1):

(a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties; and

(b) is not subject to cancellation, termination, modification, repudiation, excuse or substitution without the consent of the party to whom the promise runs.

(3) This section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

History: 1978 Comp., § 55-2A-407, enacted by Laws 1992, ch. 114, § 55.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: - 1. This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209 [55-2A-209 NMSA 1978]. Thus, upon the lessee's acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203) [55-2A-103 and 55-1-203 NMSA 1978, respectively], and the lessee's revocation of acceptance (Section 2A-517) [55-2A-517 NMSA 1978].

2. The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 2A-211(1)) [55-2A-210 and 55-2A-211 NMSA 1978, respectively]. This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract and, in some cases, the warranty of a manufacturer who is not the supplier, is extended to the lessee under the finance lease. Section 2A-209 [55-2A-209 NMSA 1978]. Despite this balance, this section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code §§ 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C. § 1666i (1982)).

3. The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contracted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)) [55-2A-103 NMSA 1978], this

transaction should qualify as a finance lease. Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

4. The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later the line of equipment malfunctions and B falls behind in its manufacturing schedule.

5. Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213 [55-2A-212 and 55-2A-213 NMSA 1978, respectively]. Absent an express provision in the lease agreement, application of Section 2A-210 or Section 2A-211(1) [55-2A-210 or 55-2A-211 NMSA 1978, respectively], or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103) [55-2A-103 and 55-1-103 NMSA 1978, respectively], B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)) [55-2A-407 NMSA 1978]. B has no right to set-off with respect to any part of the rent still due under the lease. Section 2A-508(6) [55-2A-508 NMSA 1978]. However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1) [55-2A-209 NMSA 1978].

6. This section does not address whether a "hell or high water" clause, i.e., a clause that is to the effect of this section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case and other law which this section does not affect. Sections 2A-104, 2A-103(4), 9-206 and 9-318 [55-2A-104, 55-2A-103, 55-9-206 and 55-9-318 NMSA 1978, respectively]. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

7. Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References: - Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318 [55-1-103, 55-1-203, 55-2A-103, 55-2A-104, 55-2A-209, 55-2A-210, 55-2A-211, 55-2A-212, 55-2A-213, 55-2A-517, 55-9-206 and 55-9-318 NMSA 1978, respectively].

Definitional Cross References: - "Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 5
DEFAULT

55-2A-501. Default; procedure.

(1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this article and, except as limited by this article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration or the like, in accordance with this article.

(4) Except as otherwise provided in Subsection (1) of Section 55-1-106 NMSA 1978 or this article or the lease agreement, the rights and remedies referred to in Subsections (2) and (3) are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this part as to the goods, or under other applicable law as to both the real property and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this part does not apply.

History: 1978 Comp., § 55-2A-501, enacted by Laws 1992, ch. 114, § 56.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501 [55-9-501 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A-508 and 2A-523 [55-2A-508 and 55-2A-523 NMSA 1978, respectively]. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.

2. Subsection (2) is a version of the first sentence of Section 9-501(1) [55-9-501 NMSA 1978], revised to reflect leasing terminology.

3. Subsection (3), an expansive version of the second sentence of Section 9-501(1) [55-9-501 NMSA 1978], lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.

4. Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S. F.L.Rev. 257, 276-80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section 1-106, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.

5. Section 9-501(3) [55-9-501 NMSA 1978], which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References: - Sections 1-106, 2A-508, 2A-523, Article 9, especially Sections 9-501(1) and 9-501(3) [55-1-106, 55-2A-508, 55-2A-523 and 55-9-501 NMSA 1978, respectively].

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-502. Notice after default.

Except as otherwise provided in this article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement.

History: 1978 Comp., § 55-2A-502, enacted by Laws 1992, ch. 114, § 57.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes: - This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a) [55-2A-516 NMSA 1978], the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process

requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2) [55-2A-517 NMSA 1978].

Cross References: - Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5 [55-2A-516 and 55-2A-517 NMSA 1978].

Definitional Cross References: - "Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-503. Modification or impairment of rights and remedies.

(1) Except as otherwise provided in this article, the lease agreement may include rights and remedies for default in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article.

(2) Resort to a remedy provided under this article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this article.

(3) Consequential damages may be liquidated under Section 55-2A-504 NMSA 1978, or may otherwise be limited, altered or excluded unless the limitation, alteration or exclusion is unconscionable. Limitation, alteration or exclusion of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation, alteration or exclusion of damages where the loss is commercial is not prima facie unconscionable.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this article.

History: 1978 Comp., § 55-2A-503, enacted by Laws 1992, ch. 114, § 58.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701 [55-2-719 and 55-2-701 NMSA 1978].

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504 [55-2A-504 NMSA 1978].

Purposes: - 1. A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3) [55-2A-103 and 55-1-102 NMSA 1978, respectively]. Thus, subsection (1), a revised version of the provisions of Section 2-719(1) [55-2-719 NMSA 1978], allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and (2)) [55-2A-105, 55-2A-106, 55-2A-108 NMSA 1978, respectively], this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

2. Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 [55-2-719 NMSA 1978] with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 [55-2-719 NMSA 1978] official comment 1.

3. Subsection (3), a revision of Section 2-719(3) [55-2-719 NMSA 1978], makes clear that consequential damages may also be liquidated. Section 2A-504(1)[55-2A-504 NMSA 1978].

4. Subsection (4) is a revision of the provisions of Section 2-701 [55-2-701 NMSA 1978]. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively]. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References: - Sections 1-102(3), 1-103, Article 2, especially Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), and 2A-504 [55-1-102, 55-1-103, 55-2-701, 55-2-719, 55-2A-103, 55-2A-105, 55-2A-106, 55-2A-108 and 55-2A-504 NMSA 1978, respectively].

Definitional Cross References: - "Agreed". Section 1-201(3) [55-1-201 NMSA 1978].

"Consumer goods". Section 9-109(1) [55-9-109 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-504. Liquidation of damages.

(1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does not comply with Subsection (1), or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (Section 55-2A-525 or 55-2A-526 NMSA 1978), the lessee is entitled to restitution of any amount by which the sum of his payments exceeds:

(a) the amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with Subsection (1); or

(b) in the absence of those terms, twenty percent of the then present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or five hundred dollars ($500).

(4) A lessee's right to restitution under Subsection (3) is subject to offset to the extent the lessor establishes:

(a) a right to recover damages under the provisions of this article other than Subsection (1); and

(b) the amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract.

History: 1978 Comp., § 55-2A-504, enacted by Laws 1992, ch. 114, § 59.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2) [55-2-718 and 55-2-719 NMSA 1978, respectively].

Changes: Substantially rewritten.

Purposes: - Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) [55-2-718 NMSA 1978] may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1) [55-2-718 NMSA 1978], provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) [55-2-718 NMSA 1978] does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1) [55-2-718 NMSA 1978], provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-

201(37) [55-1-201 NMSA 1978]. E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D.Wis.1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, i.e., difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1) [55-2-718 NMSA 1978], providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2) [55-2-719 NMSA 1978], provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718 [55-2-718 NMSA 1978]; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of $500 contained in Section 2-718 [55-2-718 NMSA 1978] is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References: - Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2) [55-1-201, 55-2-718 and 55-2-719 NMSA 1978, respectively].

Definitional Cross References: - "Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Insolvent". Section 1-201(23) [55-1-201 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lessor's residual interest". Section 2A-103(1)(q) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-505. Cancellation and termination and effect of cancellation, termination, rescission or fraud on rights and remedies.

(1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation", "recission [rescission]" or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy.

History: 1978 Comp., § 55-2A-505, enacted by Laws 1992, ch. 114, § 60.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721 [55-2-106, 55-2-720 and 55-2-721 NMSA 1978, respectively].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-506. Statute of limitations.

(1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within four years after the cause of action accrued. By the original lease contract the parties may reduce the period of limitation to not less than one year.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by Subsection (1) is so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this article becomes effective.

History: 1978 Comp., § 55-2A-506, enacted by Laws 1992, ch. 114, § 61.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725 [55-2-725 NMSA 1978].

Changes: Substantially rewritten.

Purposes: - Subsection (1) does not incorporate the limitation found in Section 2-725(1) [55-2-725 NMSA 1978] prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule of Section 2-725(2) [55-2-725 NMSA 1978] is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References: - Sections 2-725(1) and 2-725(2) [55-2-725 NMSA 1978].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Termination". Section 2A-103(1)(z) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-507. Proof of market rent; time and place.

(1) Damages based on market rent (Section 55-2A-519 or 55-2A-528 NMSA 1978) are determined according to the rent for the use of the goods concerned for a lease term

identical to the remaining lease term of the original lease agreement and prevailing at the times specified in Sections 55-2A-519 and 55-2A-528 NMSA 1978.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this article offered by one party is not admissible unless and until he has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility.

History: 1978 Comp., § 55-2A-507, enacted by Laws 1992, ch. 114, § 62.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724 [55-2-723 and 55-2-724 NMSA 1978, respectively].

Changes: Revised to reflect leasing practices and terminology. Sections 2A-519 and 2A-528 [55-2A-519 and 55-2A-528 NMSA 1978, respectively] specify the times as of which market rent is to be determined.

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Usage of trade". Section 1-205 [55-1-205 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-508. Lessee's remedies.

(1) If a lessor fails to deliver the goods in conformity to the lease contract (Section 55-2A-509 NMSA 1978) or repudiates the lease contract (Section 55-2A-402 NMSA 1978), or a lessee rightfully rejects the goods (Section 55-2A-509 NMSA 1978) or justifiably revokes acceptance of the goods (Section 55-2A-517 NMSA 1978), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 55-2A-510 NMSA 1978), the lessor is in default under the lease contract and the lessee may:

(a) cancel the lease contract (Section 55-2A-505(1) NMSA 1978);

(b) recover so much of the rent and security as has been paid and is just under the circumstances;

(c) cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (Sections 55-2A-518 and 55-2A-520 NMSA 1978), or recover damages for nondelivery (Sections 55-2A-519 and 55-2A-520 NMSA 1978); or

(d) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) if the goods have been identified, recover them (Section 55-2A-522 NMSA 1978); or

(b) in a proper case, obtain specific performance or replevy the goods (Section 55-2A-521 NMSA 1978).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease, and in Section 55-2A-519(3) NMSA 1978.

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (Section 55-2A-519(4) NMSA 1978).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to Section 55-2A-527(5) NMSA 1978.

(6) Subject to the provisions of Section 55-2A-407 NMSA 1978, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract.

History: 1978 Comp., § 55-2A-508, enacted by Laws 1992, ch. 114, § 63.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717 [55-2-711 and 55-2-717 NMSA 1978, respectively].

Changes: Substantially rewritten.

Purposes: - 1. This section is an index to Sections 2A-509 through 522 [55-2A-509 to 55-2A-522 NMSA 1978] which set out the lessee's rights and remedies after the lessor's default. The lessor and the lessee can agree to modify the rights and remedies available under this Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessee can exercise the rights and remedies referred to in subsection (1); and they can create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3) [55-2A-103 and 55-1-102 NMSA 1978, respectively].

2. Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1) [55-2-711 NMSA 1978], lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4) [55-2A-501 NMSA 1978]. Subsection (1) also allows the lessee to exercise any contractual remedy. This Article rejects any general doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Use of multiple remedies is barred only if the effect is to put the lessee in a better position than it would have been in had the lessor fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1) [55-2A-103, 55-2A-501 and 55-1-106 NMSA 1978, respectively]. Subsection 1(b), in recognition that no bright line can be created that would operate fairly in all installment lease cases and in recognition of the fact that a lessee may be able to cancel the lease (revoke acceptance of the goods) after the goods have been in

use for some period of time, does not require that all lease payments made by the lessee under the lease be returned upon cancellation. Rather, only such portion as is just of the rent and security payments made may be recovered. If a defect in the goods is discovered immediately upon tender to the lessee and the goods are rejected immediately, then the lessee should recover all payments made. If, however, for example, a 36-month equipment lease is terminated in the 12th month because the lessor has materially breached the contract by failing to perform its maintenance obligations, it may be just to return only a small part or none of the rental payments already made.

3. Subsection (2), a version of the provisions of Section 2-711(2) [55-2-711 NMSA 1978] revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

4. Subsection (3) is new. It covers defaults which do not deprive the lessee of the goods and which are not so serious as to justify rejection or revocation of acceptance under subsection (1). It also covers defaults for which the lessee could have rejected or revoked acceptance of the goods but elects not to do so and retains the goods. In either case, a lessee which retains the goods is entitled to recover damages as stated in Section 2A-519(3) [55-2A-519 NMSA 1978]. That measure of damages is "the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's breach."

5. Subsection (1)(d) and subsection (3) recognize that the lease agreement may provide rights and remedies in addition to or different from those which Article 2A provides. In particular, subsection (3) provides that the lease agreement may give the remedy of cancellation of the lease for defaults by the lessor that would not otherwise be material defaults which would justify cancellation under subsection (1). If there is a right to cancel, there is, of course, a right to reject or revoke acceptance of the goods.

6. Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor justifying revocation of acceptance. If the lessee properly rejects or revokes acceptance of the goods because of a breach of warranty, the rights and remedies are those provided in subsection (1) rather than those in Section 2A-519(4) [55-2A-519 NMSA 1978].

7. Subsection (5), a revised version of the provisions of Section 2-711(3) [55-2-711 NMSA 1978], recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113 [55-9-113 NMSA 1978], which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4) [55-2A-511 NMSA 1978], a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor,

or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512 [55-2A-511 and 55-2A-512 NMSA 1978, respectively]. However, Section 2A-517(5) [55-2A-517 NMSA 1978] provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) [55-2A-511 NMSA 1978] will apply to the lessee's disposition of such goods.

8. Pursuant to Section 2A-527(5) [55-2A-527 NMSA 1978], the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

9. Subsection (6), a slightly revised version of the provisions of Section 2-717 [55-2-717 NMSA 1978], sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 [55-2A-407 NMSA 1978] with respect to irrevocable promises in a finance lease that is not a consumer lease, and further subject to an enforceable "hell or high water" clause in the lease agreement. Section 2A-407 [55-2A-407 NMSA 1978] official comment. No attempt is made to state how the set-off should occur; this is to be determined by the facts of each case.

10. There is no special treatment of the finance lease in this section. Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Sections 2A-210 and 2A-211(1) [55-2A-210 and 55-2A-211 NMSA 1978, respectively]. Since the lessee will look to the supplier for performance, this is appropriate. Section 2A-209.

Cross References: - Sections 1-102(3), 1-103, 1-106(1), Article 2, especially Sections 2-711, 2-717 and Sections 2A-103(4), 2A-209, 2A-210, 2A-211(1), 2A-407, 2A-501(2), 2A-501(4), 2A-509 through 2A-522, 2A-511(3), 2A-517(5), 2A-527(5) and Section 9-113 [55-1-102, 55-1-103, 55-1-106, 55-2-711, 55-2-717, 55-2A-103, 55-2A-209, 55-2A-210, 55-2A-211, 55-2A-407, 55-2A-501, 55-2A-509 to 55-2A-522, 55-2A-511, 55-2A-517, 55-2A-527 and 55-9-113 NMSA 1978, respectively].

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Installment lease contract". Section 2A-103(1)(i) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-509. Lessee's rights on improper delivery; rightful rejection.

(1) Subject to the provisions of Section 2A-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor.

History: 1978 Comp., § 55-2A-509, enacted by Laws 1992, ch. 114, § 64.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-601 and 2-602(1) [55-2-601 and 55-2-602 NMSA 1978, respectively].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Commercial unit". Section 2A-103(1)(c) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Installment lease contract". Section 2A-103(1)(i) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-510. Installment lease contracts; rejection and default.

(1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within Subsection (2) and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries.

History: 1978 Comp., § 55-2A-510, enacted by Laws 1992, ch. 114, § 65.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-612 [55-2-612 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Cancellation". Section 2A-103(1)(b) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Installment lease contract". Section 2A-103(1)(i) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Seasonably"'. Section 1-204(3) [55-1-204 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-511. Merchant lessee's duties as to rightfully rejected goods.

(1) Subject to any security interest of a lessee (Section 55-2A-508(5) NMSA 1978), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions a merchant lessee shall make reasonable efforts to sell, lease or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) If a merchant lessee (Subsection (1)) or any other lessee (Section 55-2A-512 NMSA 1978) disposes of goods, he is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding ten percent of the gross proceeds.

(3) In complying with this section or Section 55-2A-512 NMSA 1978, the lessee is held only to good faith. Good faith conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or Section 55-2A-512 NMSA 1978 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this article.

History: 1978 Comp., § 55-2A-511, enacted by Laws 1992, ch. 114, § 66.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-603 and 2-706(5) [55-2-603 and 55-2-706 NMSA 1978, respectively].

Changes: Revised to reflect leasing practices and terminology. This section, by its terms, applies to merchants as well as others. Thus, in construing the section it is important to note that under this Act the term good faith is defined differently for merchants (Section 2-103(1)(b)) [55-2-103 NMSA 1978] than for others (Section 1-201(19)) [55-1-201 NMSA 1978]. Section 2A-103(3) and (4) [55-2A-103 NMSA 1978].

Definitional Cross References: - "Action". Sections 1-201(1) [55-1-201 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Merchant lessee". Section 2A-103(1)(t) [55-2A-103 NMSA 1978].

"Purchaser". Section 1-201(33) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-512. Lessee's duties as to rightfully rejected goods.

(1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (Section 55-2A-511 NMSA 1978) and subject to any security interest of a lessee (Section 55-2A-508(5) NMSA 1978):

(a) the lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) if the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the lessor's or the supplier's account with reimbursement in the manner provided in Section 55-2A-511 NMSA 1978; but

(c) the lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to Subsection (1) is not acceptance or conversion.

History: 1978 Comp., § 55-2A-512, enacted by Laws 1992, ch. 114, § 67.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-602(2)(b) and (c) and 2-604 [55-2-602 and 55-2-604 NMSA 1978, respectively].

Changes: Substantially rewritten.

Purposes: - The introduction to subsection (1) references goods that threaten to decline in value speedily and not perishables, the reference in Section 2-604 [55-2-604 NMSA 1978], the statutory analogue. This is a change in style, not substance, as the first phrase includes the second. Subparagraphs (a) and (c) are revised versions of the provisions of Section 2-602(2)(b) and (c) [55-2-602 NMSA 1978]. Subparagraphs (a) states the rule with respect to the lessee's treatment of goods in its possession following rejection; subparagraph (b) states the rule regarding such goods if the lessor or supplier then fails to give instructions to the lessee. If the lessee performs in a fashion consistent with subparagraphs (a) and (b), subparagraph (c) exonerates the lessee.

Cross References: - Sections 2-602(2)(b), 2-602(2)(c) and 2-604 [55-2-602 and 55-2-604 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notification". Section 1-201(26) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-513. Cure by lessor of improper tender or delivery; replacement.

(1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he seasonably notifies the lessee.

History: 1978 Comp., § 55-2A-513, enacted by Laws 1992, ch. 114, § 68.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-508 [55-2-508 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Money". Section 1-201(24) [55-1-201 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-514. Waiver of lessee's objections.

(1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) if, stated seasonably, the lessor or the supplier could have cured it (Section 55-2A-513 NMSA 1978); or

(b) between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent on the face of the documents.

History: 1978 Comp., § 55-2A-514, enacted by Laws 1992, ch. 114, § 69.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-605 [55-2-605 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Purposes: - The principles applicable to the commercial practice of payment against documents (subsection 2) are explained in official comment 4 to Section 2-605 [55-2-605 NMSA 1978], the statutory analogue to this section.

Cross Reference: - Section 2-605 [55-2-605 NMSA 1978] official comment 4.

Definitional Cross References: - "Between merchants". Section 2-104(3) [55-2-104 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Writing". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-515. Acceptance of goods.

(1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and:

(a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) the lessee fails to make an effective rejection of the goods (Section 55-2A-509(2) NMSA 1978).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

History: 1978 Comp., § 55-2A-515, enacted by Laws 1992, ch. 114, § 70.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-606 [55-2-606 NMSA 1978].

Changes: The provisions of Section 2-606(1)(a) [55-2-606 NMSA 1978] were substantially rewritten to provide that the lessee's conduct may signify acceptance. Further, the provisions of Section 2-606(1)(c) [55-2-606 NMSA 1978] were not incorporated as irrelevant given the lessee's possession and use of the leased goods.

Cross References: - Sections 2-606(1)(a) and 2-606(1)(c) [55-2-606 NMSA 1978].

Definitional Cross References: - "Commercial unit". Section 2A-103(1)(c) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-516. Effect of acceptance of goods; notice of default; burden of establishing default after acceptance; notice of claim or litigation to person answerable over.

(1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any remedy against the party not notified;

(b) except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (Section 55-2A-211 NMSA 1978) the lessee shall notify the lessor or be barred from any remedy over for liability established by the litigation; and

(c) the burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over the following apply:

(a) The lessee may give the lessor or the supplier, or both, written notice of the litigation. If the notice states that the person notified may come in and defend and that if the person notified does not do so that person will be bound in any action against that person by the lessee by any determination of fact common to the two litigations, then unless the person notified after seasonable receipt of the notice does come in and defend that person is so bound.

(b) The lessor or the supplier may demand in writing that the lessee turn over control of the litigation including settlement if the claim is one for infringement or the like (Section 55-2A-211 NMSA 1978) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then unless the lessee after seasonable receipt of the demand does turn over control the lessee is so barred.

(5) Subsections (3) and (4) apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (Section 55-2A-211 NMSA 1978).

History: 1978 Comp., § 55-2A-516, enacted by Laws 1992, ch. 114, § 71.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-607 [55-2-607 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (2) creates a special rule for finance leases, precluding revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement; this is not inequitable as the lessee has a direct claim against the supplier. Section 2A-209(1) [55-2A-209 NMSA 1978]. Revocation of acceptance of a finance lease is permitted if the lessee's

acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. Section 2A-517(1)(b) [55-2A-517 NMSA 1978]. Absent exclusion or modification, the lessor under a finance lease makes certain warranties to the lessee. Sections 2A-210 and 2A-211(1) [55-2A-210 and 55-2A-211 NMSA 1978, respectively]. Revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-407 [55-2A-407 NMSA 1978] official comment. Where the finance lease creates a security interest, the rule may be to the contrary. General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co., 806 F.2d 1207 (3rd Cir. 1986).

2. Subsection (3)(a) requires the lessee to give notice of default, within a reasonable time after the lessee discovered or should have discovered the default. In a finance lease, notice may be given either to the supplier, the lessor, or both, but remedy is barred against the party not notified. In a finance lease, the lessor is usually not liable for defects in the goods and the essential notice is to the supplier. While notice to the finance lessor will often not give any additional rights to the lessee, it would be good practice to give the notice since the finance lessor has an interest in the goods. Subsection (3)(a) does not use the term finance lease, but the definition of supplier is a person from whom a lessor buys or leases goods to be leased under a finance lease. Section 2A-103(1)(x) [55-2A-103 NMSA 1978]. Therefore, there can be a "supplier" only in a finance lease. Subsection (4) applies similar notice rules as to lessors and suppliers if a lessee is sued for a breach of warranty or other obligation for which a lessor or supplier is answerable over.

3. Subsection (3)(b) requires the lessee to give the lessor notice of litigation for infringement or the like. There is an exception created in the case of a consumer lease. While such an exception was considered for a finance lease, it was not created because it was not necessary - the lessor in a finance lease does not give a warranty against infringement. Section 2A-211(2) [55-2A-211 NMSA 1978]. Even though not required under subsection (3)(b), the lessee who takes under a finance lease should consider giving notice of litigation for infringement or the like to the supplier, because the lessee obtains the benefit of the suppliers' promises subject to the suppliers' defenses or claims. Sections 2A-209(1) and 2-607(3)(b) [55-2A-209 and 55-2-607 NMSA 1978, respectively].

Cross References: - Sections 2-607(3)(b), 2A-103(1)(x), 2A-209(1), 2A-210, 2A-211(1), 2A-211(2), 2A-407 official comment and 2A-517(1)(b) [55-2-607, 55-2A-103, 55-2A-209, 55-2A-210, 55-2A-211, 55-2A-407 and 55-2A-517 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Burden of establishing". Section 1-201(8) [55-1-201 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Consumer lease". Section 2A-103(1)(e) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Discover". Section 1-201(25) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Knowledge". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notice". Section 1-201(25) [55-1-201 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2A-103 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Written". Section 1-201(46) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-517. Revocation of acceptance of goods.

(1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if the lessee has accepted it:

(a) except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.

(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.

(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.

(5) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them.

History: 1978 Comp., § 55-2A-517, enacted by Laws 1992, ch. 114, § 72.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-608 [55-2-608 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology. Note that in the case of a finance lease the lessee retains a limited right to revoke acceptance. Sections 2A-517(1)(b) and 2A-516 [55-2A-517 and 55-2A-516 NMSA 1978, respectively] official comment. New subsections (2) and (3) added.

Purposes: - 1. The section states the situations under which the lessee may return the goods to the lessor and cancel the lease. Subsection (2) recognizes that the lessor may have continuing obligations under the lease and that a default as to those obligations may be sufficiently material to justify revocation of acceptance of the leased items and cancellation of the lease by the lessee. For example, a failure by the lessor to fulfill its obligation to maintain leased equipment or to supply other goods which are necessary for the operation of the leased equipment may justify revocation of acceptance and cancellation of the lease.

2. Subsection (3) specifically provides that the lease agreement may provide that the lessee can revoke acceptance for defaults by the lessor which in the absence of such an agreement might not be considered sufficiently serious to justify revocation. That is, the parties are free to contract on the question of what defaults are so material that the lessee can cancel the lease.

Cross References: - Section 2A-516 [55-2A-516 NMSA 1978] official comment.

Definitional Cross References: - "Commercial unit". Section 2A-103(1)(c) [55-2A-103 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Discover". Section 1-201(25) [55-1-201 NMSA 1978].

"Finance lease". Section 2A-103(1)(g) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Lot". Section 2A-103(1)(s) [55-2A-103 NMSA 1978].

"Notifies". Section 1-201(26) [55-1-201 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Seasonably". Section 1-204(3) [55-1-204 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-518. Cover; substitute goods.

(1) After a default by a lessor under the lease contract of the type described in Section 55-2A-508(1) NMSA 1978, or, if agreed, after other default by the lessor, the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 55-2A-504 NMSA 1978) or otherwise determined pursuant to

agreement of the parties (Subsection (3) of Section 15-1-102 [55-1-102] NMSA 1978 and Section 55-2A-503 NMSA 1978), if a lessee's cover is by a lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, and (ii) any incidental or consequential damages, less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under Subsection (2), or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and Section 55-2A-519 NMSA 1978 governs.

History: 1978 Comp., § 55-2A-518, enacted by Laws 1992, ch. 114, § 73.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-712 [55-2-712 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507 [55-9-507 NMSA 1978].

2. Subsection (2) states a rule for determining the amount of lessee's damages provided that there is no agreement to the contrary. The lessee's damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period which is comparable to the then remaining term of the original lease agreement less the present value of the rent reserved for the remaining term under the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor's default. Consequential damages may include loss suffered by the lessee because of deprivation of the use of the goods during the period between the default and the acquisition of the goods under the new lease agreement. If the

lessee's cover does not satisfy the the criteria of subsection (2), Section 2A-519 [55-2A-519 NMSA 1978] governs.

3. Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus, the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

4. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor's breach it was not possible to obtain the same type of goods in the market place. Because the lessee's remedy under Section 2A-519 [55-2A-519 NMSA 1978] is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2-712(1) [55-2-712 NMSA 1978].

5. Second, the various elements of the new lease agreement should also be examined. Those elements include the presence or absence of options to purchase or release; the lessor's representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to adjust the difference in rental to take account of the difference between the two leases, find that the new lease is substantially similar to the old lease, and award cover damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from the rent due under the new lease before determining the difference in rental between the two leases.

6. Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar commercial realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

Cross References: - Sections 2-712(1), 2A-519 and 9-507 [55-2-712, 55-2A-519 and 55-9-507 NMSA 1978, repectively].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Contract". Section 1-201(11) [55-1-201 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Purchase". Section 2A-103(1)(v) [55-2A-103 NMSA 1978].

Bracketed material. - The bracketed section reference near the beginning of Subsection (2) was inserted by the compiler to correct an apparently erroneous section reference. The bracketed material was not enacted by the legislature and is not part of the law.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-519. Lessee's damages for non-delivery, repudiation, default and breach of warranty in regard to accepted goods.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Subsection (3) of Section 55-2A-504 NMSA 1978) or otherwise determined pursuant to agreement of the parties (Sections 55-1-102 and 55-2A-503 NMSA 1978), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under Section 55-2A-518(2) NMSA 1978, or is by purchase or otherwise, the measure of damages for non-delivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee is the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) Except as otherwise agreed, if the lessee has accepted goods and given notification (Section 55-2A-516(3) NMSA 1978), the measure of damages for non-conforming tender or delivery or other default by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) Except as otherwise agreed, the measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty.

History: 1978 Comp., § 55-2A-519, enacted by Laws 1992, ch. 114, § 74.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-713 and 2-714 [55-2-713 and 55-2-714 NMSA 1978, respectively].

Changes: Substantially revised.

Purposes: - 1. Subsection (1), a revised version of the provisions of Section 2-713(1) [55-2-713 NMSA 1978], states the basic rule governing the measure of lessee's damages for non-delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-518 [55-2A-518 NMSA 1978]. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference in Section 2A-519(1) [55-2A-519 NMSA 1978] is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1) [55-2A-501 NMSA 1978]. This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively].

3. Subsection (2), a revised version of the provisions of Section 2-713(2) [55-2-713 NMSA 1978], states the rule with respect to determining market rent.

4. Subsection (3), a revised version of the provisions of Section 2-714(1) and (3) [55-2-714 NMSA 1978], states the measure of damages where goods have been accepted and acceptance is not revoked. The subsection applies both to defaults which occur at the inception of the lease and to defaults which occur subsequently, such as failure to comply with an obligation to maintain the leased goods. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

5. Subsection (4), a revised version of the provisions of Section 2-714(2) [55-2-714 NMSA 1978], states the measure of damages for breach of warranty. The measure in essence is the present value of the difference between the value of the goods accepted and of the goods if they had been as warranted.

6. Subsections (1), (3) and (4) specifically state that the parties may by contract vary the damages rules stated in those subsections.

Cross References: - Sections 2-713(1), 2-713(2), 2-714 and Section 2A-518 [55-2-713, 55-2-714 and 55-2A-518 NMSA 1978, respectively].

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notification". Section 1-201(26) [55-1-201 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-520. Lessee's incidental and consequential damages.

(1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) any loss resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

History: 1978 Comp., § 55-2A-520, enacted by Laws 1992, ch. 114, § 75.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-715 [55-2-715 NMSA 1978].

Changes: Revised to reflect leasing terminology and practices.

Purposes: - Subsection (1), a revised version of the provisions of Section 2-715(1) [55-2-715 NMSA 1978], lists some examples of incidental damages resulting from a lessor's default; the list is not exhaustive. Subsection (1) makes clear that it applies not only to rightful rejection, but also to justifiable revocation.

Subsection (2), a revised version of the provisions of Section 2-715(2) [55-2-715 NMSA 1978], lists some examples of consequential damages resulting from a lessor's default; the list is not exhaustive.

Cross References: - Section 2-715 [55-2-715 NMSA 1978].

Definitional Cross References: - "Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Knows". Section 1-201(25) [55-1-201 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-521. Lessee's right to specific performance or replevin.

(1) Specific performance may be decreed if the goods are unique or in other proper circumstances.

(2) A decree for specific performance may include any terms and conditions as to payment of the rent, damages or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect cover for those goods or the circumstances reasonably indicate that the effort will be unavailing.

History: 1978 Comp., § 55-2A-521, enacted by Laws 1992, ch. 114, § 76.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-716 [55-2-716 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology, and to expand the reference to the right of replevin in subsection (3) to include other similar rights of the lessee.

Definitional Cross References: - "Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Term". Section 1-201(42) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-522. Lessee's right to goods on lessor's insolvency.

(1) Subject to Subsection (2) and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (Section 55-2A-217 NMSA 1978) on making and keeping good a tender of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within ten days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract.

History: 1978 Comp., § 55-2A-522, enacted by Laws 1992, ch. 114, § 77.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-502 [55-2-502 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Insolvent". Section 1-201(23) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-523. Lessor's remedies.

(1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (Section 55-2A-510 NMSA 1978), the lessee is in default under the lease contract and the lessor may:

(a) cancel the lease contract (Section 55-2A-505(1) NMSA 1978);

(b) proceed respecting goods not identified to the lease contract (Section 55-2A-524 NMSA 1978);

(c) withhold delivery of the goods and take possession of goods previously delivered (Section 55-2A-525 NMSA 1978);

(d) stop delivery of the goods by any bailee (Section 55-2A-526 NMSA 1978);

(e) dispose of the goods and recover damages (Section 55-2A-527 NMSA 1978), or retain the goods and recover damages (Section 55-2A-528 NMSA 1978), or in a proper case recover rent (Section 55-2A-529 NMSA 1978); or

(f) exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under Subsection (1), the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.

(3) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) if the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in Subsection (1) or (2); or

(b) if the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in Subsection (2).

History: 1978 Comp., § 55-2A-523, enacted by Laws 1992, ch. 114, § 78.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-703 [55-2-703 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (1) is an index to Sections 2A-524 through 2A-531 [55-2A-524 to 55-2A-531 NMSA 1978, respectively] and states that the remedies provided in those sections are available for the defaults referred to in subsection (1): wrongful rejection or revocation of acceptance, failure to make a payment when due, or repudiation. In addition, remedies provided in the lease contract are available. Subsection (2) sets out a remedy if the lessor does not pursue to completion a right or actually obtain a remedy available under subsection (1), and subsection (3) sets out statutory remedies for defaults not specifically referred to in subsection (1). Subsection (3) provides that, if any default by the lessee other than those specifically referred to in subsection (1) is material, the lessor can exercise the remedies provided in subsection (1) or (2); otherwise the available remedy is as provided in subsection (3). A lessor who has brought an action seeking or has nonjudicially pursued one or more of the remedies available under subsection (1) may amend so as to claim or may nonjudicially pursue a remedy under subsection (2) unless the right or remedy first chosen has been pursued to an extent actually inconsistent with the new course of action. The intent of the provision is to reject the doctrine of election of remedies and to permit an alteration of course by the lessor unless such alteration would actually have an effect on the lessee that would be unreasonable under the circumstances. Further, the lessor may pursue remedies under both subsections (1) and (2) unless doing so would put the lessor in a better position than it would have been in had the lessee fully performed.

2. The lessor and the lessee can agree to modify the rights and remedies available under the Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessor can exercise the rights and remedies referred to in subsection (1), whether or not the default would otherwise be held to

substantially impair the value of the lease contract to the lessor; they can also create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

3. Subsection (1), a substantially rewritten version of Section 2-703 [55-2-703 NMSA 1978], lists various cumulative remedies of the lessor where the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates. Section 2A-501(2) and (4) [55-2A-501 NMSA 1978]. The subsection also allows the lessor to exercise any contractual remedy.

4. This Article rejects any general doctrine of election of remedy. Whether, in a particular case, one remedy bars another, is a function of whether lessor has been put in as good a position as if the lessee had fully performed the lease contract. Multiple remedies are barred only if the effect is to put the lessor in a better position than it would have been in had the lessee fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1) [55-2A-103, 55-2A-501 and 55-1-106 NMSA 1978, respectively].

5. Hypothetical: To better understand the application of subparagraphs (a) through (e), it is useful to review a hypothetical. Assume that A is a merchant in the business of selling and leasing new bicycles of various types. B is about to engage in the business of subleasing bicycles to summer residents of and visitors to an island resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's island location on June 1; the term of the lease of these bicycles is four months. 20 bicycles are to be delivered by A to B's island location on July 1; the term of the lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A to B's island location on August 1; the term of the lease of these bicycles is two months. B is obligated to pay rent to A on the 15th day of each month during the term for the lease. Rent is $50 per month, per bicycle. B has no option to purchase or release and must return the bicycles to A at the end of the term, in good condition, reasonable wear and tear excepted. Since the retail price of each bicycle is $400 and bicycles used in the retail rental business have a useful economic life of 36 months, this transaction creates a lease. Sections 2A-103(1)(j) and 1-201(37) [55-2A-103 and 55-1-201 NMSA 1978, respectively].

6. A's current inventory of bicycles is not large. Thus, upon signing the lease with B in February, A agreed to purchase 60 new bicycles from A's principal manufacturer, with special instructions to drop ship the bicycles to B's island location in accordance with the delivery schedule set forth in the lease.

7. The first shipment of 20 bicycles was received by B on May 21. B inspected the bicycles, accepted the same as conforming to the lease and signed a receipt of delivery and acceptance. However, due to poor weather that summer, business was terrible and B was unable to pay the rent due on June 15. Pursuant to the lease A sent B notice of default and proceeded to enforce his rights and remedies against B.

8. A's counsel first advised A that under Section 2A-510(2) [55-2A-510 NMSA 1978] and the terms of the lease B's failure to pay was a default with respect to the whole. Thus, to minimize A's continued exposure, A was advised to take possession of the bicycles. If A had possession of the goods A could refuse to deliver. Section 2A-525(1). However, the facts here are different. With respect to the bicycles in B's possession, A has the right to take possession of the bicycles, without breach of the peace. Section 2A-525(2) [55-2A-525 NMSA 1978]. If B refuses to allow A access to the bicycles, A can proceed by action, including replevin or injunctive relief.

9. With respect to the 40 bicycles that have not been delivered, this Article provides various alternatives. First, assume that 20 of the remaining 40 bicycles have been manufactured and delivered by the manufacturer to a carrier for shipment to B. Given the size of the shipment, the carrier was using a small truck for the delivery and the truck had not yet reached the delivery and the truck had not yet reached the island ferry when the manufacturer (at the request of A) instructed the carrier to divert the shipment to A's place of business. A's right to stop delivery is recognized under these circumstances. Section 2A-526(1) [55-2A-526 NMSA 1978]. Second, assume that the 20 remaining bicycles were in the process of manufacture when B defaulted. A retains the right (as between A as lessor and B as lessee) to exercise reasonable commercial judgment whether to complete manufacture or to dispose of the unfinished goods for scrap. Since A is not the manufacturer and A has a binding contract to buy the bicycles, A elected to allow the manufacturer to complete the manufacture of the bicycles, but instructed the manufacturer to deliver the completed bicycles to A's place of business. Section 2A-524(2) [55-2A-524 NMSA 1978].

10. Thus, so far A has elected to exercise the remedies referred to in subparagraphs (b) through (d) in subsection (1). None of these remedies bars any of the others because A's election and enforcement merely resulted in A's possession of the bicycles. Had B performed A would have recovered possession of the bicycles. Thus A is in the process of obtaining the benefit of his bargain. Note that A could exercise any other rights or pursue any other remedies provided in the lease contract (Section 2A-523(1)(f)) [55-2A-523 NMSA 1978], or elect to recover his loss due to the lessee's default under Section 2A-523(2) [55-2A-523 NMSA 1978].

11. A's counsel next would determine what action, if any, should be taken with respect to the goods. As stated in subparagraph (e) and as discussed fully in Section 2A-527(1) [55-2A-527 NMSA 1978] the lessor may, but has no obligation to, dispose of the goods by a substantially similar lease (indeed, the lessor has no obligation whatsoever to dispose of the goods at all) and recover damages based on that action, but lessor will not be able to recover damages which put it in a better position than performance would have done, nor will it be able to recover damages for losses which it could have reasonably avoided. In this case, since A is in the business of leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail trade.

12. A's counsel then will determine which of the various means of ascertaining A's damages against B are available. Subparagraph (e) catalogues each relevant section.

First, under Section 2A-527(2) [55-2A-527 NMSA 1978] the amount of A's claim is computed by comparing the original lease between A and B with any subsequent lease of the bicycles but only if the subsequent lease is substantially similar to the original lease contract. While the section does not define this term, the official comment does establish some parameters. If, however, A elects to lease the bicycles to his retail trade, it is unlikely that the resulting lease will be substantially similar to the original, as leases to retail customers are considerably different from leases to wholesale customers like B. If, however, the leases were substantially similar, the damage claim is for accrued and unpaid rent to the beginning of the new lease, plus the present value as of the same date, of the rent reserved under the original lease for the balance of its term less the present value as of the same date of the rent reserved under the replacement lease for a term comparable to the balance of the term of the original lease, together with incidental damages less expenses saved in consequence of the lessee's default.

13. If the new lease is not substantially similar or if A elects to sell the bicycles or to hold the bicycles, damages are computed under Section 2A-528 or 2A-529 [55-2A-528 or 55-2A-529 NMSA 1978, respectively].

14. If A elects to pursue his claim under Section 2A-528(1) [55-2A-528 NMSA 1978] the damage rule is the same as that stated in Section 2A-527(2) [55-2A-527 NMSA 1978] except that damages are measured from default if the lessee never took possession of the goods or from the time when the lessor did or could have regained possession and that the standard of comparison is not the rent reserved under a substantially similar lease entered into by the lessor but a market rent, as defined in Section 2A-507 [55-2A-507 NMSA 1978]. Further, if the facts of this hypothetical were more elaborate A may be able to establish that the measure of damage under subsection (1) is inadequate to put him in the same position that B's performance would have, in which case A can claim the present value of his lost profits.

15. Yet another alternative for computing A's damage claim against B which will be available in some situations is recovery of the present value, as of entry of judgment, of the rent for the then remaining lease term under Section 2A-529 [55-2A-529 NMSA 1978]. However, this formulation is not available if the goods have been repossessed or tendered back to A. For the 20 bicycles repossessed and the remaining 40 bicycles, A will be able to recover the present value of the rent only if A is unable to dispose of them, or circumstances indicate the effort will be unavailing. If A has prevailed in an action for the rent, at any time up to collection of a judgment by A against B, A might dispose of the bicycles. In such case A's claim for damages against B is governed by Section 2A-527 or 2A-528 [55-2A-527 or 55-2A-528 NMSA 1978, respectively]. Section 2A-529(3) [55-2A-529 NMSA 1978]. The resulting recalculation of claim should reduce the amount recoverable by A gainst B and the lessor is required to cause an appropriate credit to be entered against the earlier judgment. However, the nature of the post-judgment proceedings to resolve the issue, and the sanctions for a failure to comply, if any, will be determined by other law.

16. Finally, if the lease agreement had so provided pursuant to subparagraph (f), A's claim against B would not be determined under any of these statutory formulae, but pursuant to a liquidated damages clause. Section 2A-504(1) [55-2A-504 NMSA 1978].

17. These various methods of computing A's damage claim against B are alternatives subject to Section 2A-501(4) [55-2A-501 NMSA 1978]. However, the pursuit of any one of these alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain possession of the 60 bicycles. These formulae, which vary as a function of an overt or implied mitigation of damage theory, focus on allowing A a recovery of the benefit of his bargain with B. Had B performed, A would have received the rent as well as the return of the 60 bicycles at the end of the term.

18. Finally, A's counsel should also advise A of his right to cancel the lease contract under subparagraph (a). Section 2A-505(1) [55-2A-505 NMSA 1978]. Cancellation will discharge all existing obligations but preserve A's rights and remedies.

19. Subsection (2) recognizes that a lessor who is entitled to exercise the rights or to obtain a remedy granted by subsection (1) may choose not to do so. In such cases, the lessor can recover damages as provided in subsection (2). For example, for non-payment of rent, the lessor may decide not to take possession of the goods and cancel the lease, but rather to merely sue for the unpaid rent as it comes due plus lost interest or other damages "determined in any reasonable manner." Subsection (2) also negates any loss of alternative rights and remedies by reason of having invoked or commenced the exercise or pursuit of any one or more rights or remedies.

20. Subsection (3) allows the lessor access to a remedy scheme provided in this Article as well as that contained in the lease contract if the lessee is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplementary principles of law and equity, e.g., fraud, misrepresentation and duress. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively].

21. There is no special treatment of the finance lease in this section. Absent supplementary principles of law to the contrary, in most cases the supplier will have no rights or remedies against the defaulting lessee. Section 2A-209(2)(ii) [55-2A-209 NMSA 1978]. Given that the supplier will look to the lessor for payment, this is appropriate. However, there is a specific exception to this rule with respect to the right to identify goods to the lease contract. Section 2A-524(2) [55-2A-524 NMSA 1978]. The parties are free to create a different result in a particular case. Sections 2A-103(4) and 1-102(3) [55-2A-103 and 55-1-103 NMSA 1978].

Cross References: - Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2-703, 2A-103(1)(j), 2A-103(4), 2A-209(2)(ii), 2A-501(4), 2A-504(1), 2A-505(1), 2A-507, 2A-510(2), 2A-524 through 2A-531, 2A-524(2), 2A-525(1), 2A-525(2), 2A-526(1), 2A-527(1), 2A-527(2), 2A-528(1) and 2A-529(3) [55-1-102, 55-1-103, 55-1-106, 55-1-201, 55-2-703, 55-2A-103, 55-2A-209, 55-2A-501, 55-2A-504, 55-2A-505, 55-2A-507, 55-2A-510, 55-

2A-524 to 55-2A-531, 55-2A-524, 55-2A-525, 55-2A-526, 55-2A-527, 55-2A-528 and 55-2A-529 NMSA 1978, respectively].

Definitional Cross References: - "Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Installment lease contract". Section 2A-103(1)(i) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-524. Lessor's right to identify goods to lease contract.

(1) After default by the lessee under the lease contract of the type described in Section 55-2A-523(1) NMSA 1978 or 55-2A-523(3)(a) NMSA 1978 or, if agreed, after other default by the lessee, the lessor may:

(a) identify to the lease contract conforming goods not already identified if at the time the lessor learned of the default they were in the lessor's or the supplier's possession or control; and

(b) dispose of goods (Section 55-2A-527(1) NMSA 1978) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner.

History: 1978 Comp., § 55-2A-524, enacted by Laws 1992, ch. 114, § 79.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-704 [55-2-704 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Learn". Section 1-201(25) [55-1-201 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Supplier". Section 2A-103(1)(x) [55-2A-103 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-525. Lessor's right to possession of goods.

(1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) After a default by the lessee under the lease contract of the type described in Section 55-2A-523(1) NMSA 1978 or 55-2A-523(3)(a) NMSA 1978, or, if agreed, after other default by the lessee, the lessor has the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (Section 55-2A-527 NMSA 1978).

(3) The lessor may proceed under Subsection (2) without judicial process if it can be done without breach of the peace or the lessor may proceed by action.

History: 1978 Comp., § 55-2A-525, enacted by Laws 1992, ch. 114, § 80.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-702(1) and 9-503 [55-2-702 and 55-9-503 NMSA 1978, respectively].

Changes: Substantially revised.

Purposes: -

1. Subsection (1), a revised version of the provisions of Section 2-702(1) [55-2-702 NMSA 1978], allows the lessor to refuse to deliver goods if the lessee is insolvent. Note that the provisions of Section 2-702(2), granting the unpaid seller certain rights of reclamation, were not incorporated in this section. Subsection (2) made this unnecessary.

2. Subsection (2), a revised version of the provisions of Section 9-503 [55-9-503 NMSA 1978], allows the lessor, on a Section 2A-523(1) or 2A-523(3)(a) [55-2A-523 NMSA 1978] default by the lessee, the right to take possession of or reclaim the goods. Also, the lessor can contract for the right to take possession of the goods for other defaults by the lessee. Therefore, since the lessee's insolvency is an event of default in a standard lease agreement, subsection (2) is the functional equivalent of Section 2-702(2) [55-2-702 NMSA 1978]. Further, subsection (2) sanctions the classic crate and delivery clause obligating the lessee to assemble the goods and to make them available to the lessor. Finally, the lessor may leave the goods in place, render them unusable (if they are goods employed in trade or business), and dispose of them on the lessee's premises.

3. Subsection (3), a revised version of the provisions of Section 9-503 [55-9-503 NMSA 1978], allows the lessor to proceed under subsection (2) without judicial process, absent breach of the peace, or by action. Sections 2A-501(3), 2A-103(4) and 1-201(1) [55-2A-501, 55-2A-103 and 55-1-201 NMSA 1978, respectively]. In the appropriate case action includes injunctive relief. Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. denied, 402 U.S. 909 (1971). This Section, as well as a number of other Sections in this Part, are included in the Article to codify the lessor's common law right to protect the lessor's reversionary interest in the goods. Section 2A-103(1)(q) [55-2A-103 NMSA 1978]. These Sections are intended to supplement and not displace principles of law and equity with respect to the protection of such interest. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively]. Such principles apply in many instances, e.g., loss or damage to goods if risk of loss passes to the lessee, failure of the lessee to return goods to the lessor in the condition stipulated in the lease, and refusal of the lessee to return goods to the lessor after termination or cancellation of the lease. See also Section 2A-532 [55-2A-532 NMSA 1978].

Cross References: - Sections 1-106(2), 2-702(1), 2-702(2), 2A-103(4), 2A-501(3), 2A-532 and 9-503 [55-1-106, 55-2-702, 55-2A-103, 55-2A-501, 55-2A-532 and 55-9-503 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Discover". Section 1-201(25) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Insolvent". Section 1-201(23) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-526. Lessor's stoppage of delivery in transit or otherwise.

(1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security or otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under Subsection (1), the lessor may stop delivery until:

(a) receipt of the goods by the lessee;

(b) acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) such an acknowledgment to the lessee by a carrier via reshipment or as warehouseman.

(3) To stop delivery, a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(4) After notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(5) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

History: 1978 Comp., § 55-2A-526, enacted by Laws 1992, ch. 114, § 81.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-705 [55-2-705 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Bill of lading". Section 1-201(6) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Discover". Section 1-201(25) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Insolvent". Section 1-201(23) [55-1-201 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Notifies" and "Notification". Section 1-201(26) [55-1-201 NMSA 1978].

"Person". Section 1-201(30) [55-1-201 NMSA 1978].

"Receipt". Section 2-103(1)(c) [55-2-103 NMSA 1978].

"Remedy". Section 1-201(34) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-527. Lessor's rights to dispose of goods.

(1) After a default by a lessee under the lease contract of the type described in Section 55-2A-523(1) or 55-2A-523(3)(a) NMSA 1978 or after the lessor refuses to deliver or takes possession of goods (Section 55-2A-525 or 55-2A-526 NMSA 1978), or, if agreed, after other default by a lessee, the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 55-2A-504 NMSA 1978) or otherwise determined pursuant to agreement of the parties (Subsection (3) of Section 55-1-102 and Section 55-2A-503 NMSA 1978), if the disposition is by lease agreement substantially similar to the original lease agreement and the new lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term which is comparable to the then remaining term of the original lease agreement, and (iii) any incidental damages allowed under Section 55-2A-530 NMSA 1978, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under Subsection (2), or is by sale or otherwise, the lessor may recover from the lessee as if the lessor had elected not to dispose of the goods and Section 55-2A-528 NMSA 1978 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (Section 55-2A-508(5) NMSA 1978).

History: 1978 Comp., § 55-2A-527, enacted by Laws 1992, ch. 114, § 82.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-706(1), (5) and (6) [55-2-706 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (1), a revised version of the first sentence of subsection 2-706(1) [55-2-706 NMSA 1978], allows the lessor the right to dispose of goods after a statutory or other material default by the lessee (even if the goods remain in the lessee's possession - Section 2A-525(2)) [55-2A-525 NMSA 1978], after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507 [55-9-507 NMSA 1978]. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A-527(5) [55-2A-527 NMSA 1978].

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3) [55-2A-504, 55-2A-103 and 55-1-102 NMSA 1978, respectively].

3. The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date of the rent under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A-528 [55-2A-528 NMSA 1978]. Section 2A-523(1)(e) [55-2A-523 NMSA 1978].

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

5. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the options to purchase or release; the lessor's representations, warranties and covenants to the lessee as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commercial judgment pervade the finding. See Section 2A-507(2) [55-2A-507 NMSA 1978]. To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to find that the new lease is substantially similar to the old lease, adjust the difference in the rent between the two leases to take account of the differences, and award damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from rent due under the new lease before the difference in rental between the two leases is determined.

6. The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. It is a question of fact whether it is so difficult to adjust the recovery to take account of the difference between the two leases as to insurance that the second lease is not substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the remaining term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August

1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2nd. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

8. Subsection (3), which is new, provides that if the lessor's disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A-528 [55-2A-528 NMSA 1978] governs.

9. Subsection (4), a revised version of subsection 2-706(5) [55-2-706 NMSA 1978], applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to disposition under this section. Note that by its terms, the rule in subsection 2A-304(1) [55-2A-304 NMSA 1978], which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

10. Subsection (5), a revised version of subsection 2-706(6) [55-2-706 NMSA 1978], provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of good has no equity of redemption to protect.

Cross References: - Sections 1-102(3), 2-706(1), 2-706(5), 2-706(6), 2A-103(4), 2A-304(1), 2A-504, 2A-507(2), 2A-523(1)(e), 2A-525(2), 2A-517(5), 2A-528 and 9-507 [55-1-102, 55-2-706, 55-2A-103, 55-2A-304, 55-2A-504, 55-2A-507, 55-2A-523, 55-2A-525, 55-2A-517, 55-2A-528 and 55-9-507 NMSA 1978, respectively].

Definitional Cross References: - "Buyer" and "Buying". Section 2-103(1)(a) [55-2-103 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Good faith". Sections 1-201(19) and 2-103(1)(b) [55-1-201 and 55-2-103 NMSA 1978, respectively].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

"Value". Section 1-201(44) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-528. Lessor's damages for non-acceptance, failure to pay, repudiation or other default.

(1) Except as otherwise provided with respect to damages liquidated in the lease agreement (Section 55-2A-504 NMSA 1978) or otherwise determined pursuant to agreement of the parties (Sections 1-102(3) and 55-2A-503 NMSA 1978), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under Section 55-2A-527(2) NMSA 1978, or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in Section 55-2A-523(1) or 55-2A-523(3)(a) NMSA 1978, or, if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, and (iii) any incidental damages allowed under Section 55-2A-530 NMSA 1978, less expenses saved in consequence of the lessee's default.

(2) If the measure of damages provided in Subsection (1) is inadequate to put a lessor in as good a position as performance would have, the measure of damages is the present value of the profit, including reasonable overhead, the lessor would have made from full performance by the lessee, together with any incidental damages allowed under Section 55-2A-530 NMSA 1978, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition.

History: 1978 Comp., § 55-2A-528, enacted by Laws 1992, ch. 114, § 83.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-708 [55-2-708 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Subsection (1), a substantially revised version of Section 2-708(1) [55-2-708 NMSA 1978], states the basic rule governing the measure of lessor's damages for a default described in Section 2A-523(1) or (3)(a) [55-2A-523 NMSA 1978], and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A-527(2) [55-2A-527 NMSA 1978]. Section 2A-527(3) [55-2A-527 NMSA 1978]. Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-529 [55-2A-529 NMSA 1978]. There is no sanction for disposition that does not qualify under subsection 2A-527(2) [55-2A-527 NMSA 1978]. Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3) [55-2A-504, 55-2A-103 and 55-1-102 NMSA 1978, respectively].

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A-528(1)(i) and (ii) [55-2A-528 NMSA 1978] is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1) [55-2A-501 NMSA 1978]. This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103 [55-2A-103 and 55-1-103 NMSA 1978, respectively]. If the lessee has taken possession of the goods, the measure of damages is the accrued and unpaid rent as of the earlier of the time the lessor repossesses the goods or the time the lessee tenders the goods to the lessor plus the difference between the present value, as of the same time, of the rent under the lease for the remaining lease term and the present value, as of the same time, of the market rent.

3. Market rent will be computed pursuant to Section 2A-507 [55-2A-507 NMSA 1978].

4. Subsection (2), a somewhat revised version of the provisions of subsection 2-708(2) [55-2-708 NMSA 1978], states a measure of damages which applies if the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor's profit, including overhead, together with incidental damages, with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition a proper value should be attributed to the lessor's residual interest in the goods. Sections 2A-103(1)(q) and 2A-507(4) [55-2A-103 and 55-2A-507 NMSA 1978, respectively].

5. In calculating profit, a court should include any expected appreciation of the goods, e.g. the foal of a leased brood mare. Because this subsection is intended to give the lessor the benefit of the bargain, a court should consider any reasonable benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. Lithonia Lighting, Inc., 317 F. Supp. 406, 413 (N.D.Ga.1970); Locks v. Wade, 36 N.J.Super. 128, 131, 114 A.2d 875, 877 (Super.Ct.App.Div.1955). Further, in calculating profit the concept of present value must be given effect. Taylor v. Commercial credit Equip. Corp., 170 Ga.App. 322, 316 S.E.2d 788 (Ct.App.1984). See generally Section 2A-103(1)(u).

Cross References: - Sections 1-102(3), 2-708, 2A-103(1)(u), 2A-402, 2A-504, 2A-507, 2A-527(2) and 2A-529 [55-1-102, 55-2-708, 55-2A-103, 55-2A-402, 55-2A-504, 55-2A-507, 55-2A-527 and 55-2A-529 NMSA 1978, respectively].

Definitional Cross References: - "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-529. Lessor's action for the rent.

(1) After default by the lessee under the lease contract of the type described in Section 55-2A-523(1) or 55-2A-523(3)(a) NMSA 1978 or, if agreed, after other default by the lessee, if the lessor complies with Subsection (2), the lessor may recover from the lessee as damages:

(a) for goods accepted by the lessee and not repossessed by or tendered to the lessor, and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (Section 55-2A-219 NMSA 1978), (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present

value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 55-2A-530 NMSA 1978, less expenses saved in consequence of the lessee's default; and

(b) for goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under Section 55-2A-530 NMSA 1978, less expenses saved in consequence of the lessee's default.

(2) Except as provided in Subsection (3), the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to Subsection (1). If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages is governed by Section 55-2A-527 or 55-2A-528 NMSA 1978, and the lessor will cause an appropriate credit to be provided against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to Section 55-2A-527 or 55-2A-528 NMSA 1978.

(4) Payment of the judgment for damages obtained pursuant to Subsection (1) entitles the lessee to the use and possession of the goods not then disposed of for the remaining lease term of and in accordance with the lease agreement.

(5) After default by the lessee, a lessor who is held not entitled to rent under this section must nevertheless be awarded damages for non-acceptance under Section 55-2A-527 or 55-2A-528 NMSA 1978.

History: 1978 Comp., § 55-2A-529, enacted by Laws 1992, ch. 114, § 84.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-709 [55-2-709 NMSA 1978].

Changes: Substantially revised.

Purposes: - 1. Absent a lease contract provision to the contrary, an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose

of them at a reasonable price after reasonable effort. There is no general right in a lessor to recover the full rent from the lessee upon holding the goods for the lessee. If the lessee tenders goods back to the lessor, and the lessor refuses to accept the tender, the lessor will be limited to the damages it would have suffered had it taken back the goods. The rule in Article 2 that the seller can recover the price of accepted goods is rejected here. In a lease, the lessor always has a residual interest in the goods which the lessor usually realizes upon at the end of a lease term by either sale or a new lease. Therefore, it is not a substantial imposition on the lessor to require it to take back and dispose of the goods if the lessee chooses to tender them back before the end of the lease term: the lessor will merely do earlier what it would have done any way, sell or relet the goods. Further, the lessee will frequently encounter substantial difficulties if the lessee attempts to sublet the goods for the remainder of the lease term. In contrast to the buyer who owns the entire interest in goods and can easily dispose of them, the lessee is selling only the right to use the goods under the terms of the lease and the sublessee must assume a relationship with the lessor. In that situation, it is usually more efficient to eliminate the original lessee as a middleman by allowing the lessee to return the goods to the lessor who can then redispose of them.

2. In some situations even where possession of the goods is reacquired, a lessor will be able to recover as damages the present value of the full rent due, not under this section, but under 2A-528(2) [55-2A-528 NMSA 1978] which allows a lost profit recovery if necessary to put the lessor in the position it would have been in had the lessee performed. Following is an example of such a case. A is a lessor of construction equipment and maintains a substantial inventory. B leases from A a backhoe for a period of two weeks at a rental of $1,000. After three days, B returns the backhoe and refuses to pay the rent. A has five backhoes in inventory, including the one returned by B. During the next 11 days after the return by B of the backhoe, A rents no more than three backhoes at any one time and, therefore, always has two on hand. If B had kept the backhoe for the full rental period. A would have earned the full rental on that backhoe, plus the rental on the other backhoes it actually did rent during that period. Getting this backhoe back before the end of the lease term did not enable A to make any leases it would not otherwise have made. The only way to put A in the position it would have been in had the lessee fully performed is to give the lessor the full rentals. A realized no savings at all because the backhoe was returned early and might even have incurred additional expense if it was paying for parking space for equipment in inventory. A has no obligation to relet the backhoe for the benefit of B rather than leasing the backhoe or any other in inventory for its own benefit. Further, it is probably not reasonable to expect A to dispose of the backhoe by sale when it is returned in an effort to reduce damages suffered by B. Ordinarily, the loss of a two-week rental would not require A to reduce the size of its backhoe inventory. Whether A would similarly be entitled to full rentals as lost profit in a one-year lease of a backhoe is a question of fact: in any event the lessor, subject to mitigation of damages rules, is entitled to be put in as good a position as it would have been had the lessee fully performed the lease contract.

3. Under subsection (2) a lessor who is able and elects to sue for the rent due under a lease must hold goods not lost or damaged for the lessee. Subsection (3) creates an

exception to the subsection (2) requirement. If the lessor disposes of those goods prior to collection of the judgment (whether as a matter of law or agreement), the lessor's recovery is governed by the measure of damages in Section 2A-527 [55-2A-527 NMSA 1978] if the disposition is by lease that is substantially similar to the original lease, or otherwise by the measure of damages in Section 2A-528 [55-2A-528 NMSA 1978]. Section 2A-523 [55-2A-523 NMSA 1978] official comment.

4. Subsection (4), which is new, further reinforces the requisites of Subsection (2). In the event the judgment for damages obtained by the lessor against the lessee pursuant to subsection (1) is satisfied, the lessee regains the right to use and possession of the remaining goods for the balance of the original lease term; a partial satisfaction of the judgment creates no right in the lessee to use and possession of the goods.

5. The relationship between subsections (2) and (4) is important to understand. Subsection (2) requires the lessor to hold for the lessee identified goods in the lessor's possession. Absent agreement to the contrary, whether in the lease or otherwise, under most circumstances the requirement that the lessor hold the goods for the lessee for the term will mean that the lessor is not allowed to use them. Sections 2A-103(4) and 1-203 [55-2A-103 and 55-1-203 NMSA 1978, respectively]. Further, the lessor's use of the goods could be viewed as a disposition of the goods that would bar the lessor from recovery under this section, remitting the lessor to the two preceding sections for a determination of the lessor's claim for damages against the lessee.

6. Subsection (5), the analogue of subsection 2-709(3) [55-2-709 NMSA 1978], further reinforces the thrust of subsection (3) by stating that a lessor who is held not entitled to rent under this section has not elected a remedy; the lessor must be awarded damages under Sections 2A-527 and 2A-528 [55-2A-527 and 55-2A-528 NMSA 1978, respectively]. This is a function of two significant policies of this Article - that resort to a remedy is optional, unless expressly agreed to be exclusive (Section 2A-503(2)) and that rights and remedies provided in this Article generally are cumulative. (Section 2A-501(2) and (4)) [55-2A-501 NMSA 1978].

Cross References: - Sections 1-203, 2-709, 2-709(3), 2A-103(4), 2A-501(2), 2A-501(4), 2A-503(2), 2A-504, 2A-523(1)(e), 2A-525(2), 2A-527, 2A-528 and 2A-529(2) [55-1-203, 55-2-709, 55-2A-103, 55-2A-501, 55-2A-503, 55-2A-504, 55-2A-523, 55-2A-525, 55-2A-527, 55-2A-528 and 55-2A-529 NMSA 1978, respectively].

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Conforming". Section 2A-103(1)(d) [55-2A-103 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j) [55-2A-103 NMSA 1978].

"Lease agreement". Section 2A-103(1)(k) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-102(1)(n) [55-2A-102 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Present value". Section 2A-103(1)(u) [55-2A-103 NMSA 1978].

"Reasonable time". Section 1-204(1) and (2) [55-1-204 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-530. Lessor's incidental damages.

Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default.

History: 1978 Comp., § 55-2A-530, enacted by Laws 1992, ch. 114, § 85.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-710 [55-2-710 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Aggrieved party". Section 1-201(2) [55-1-201 NMSA 1978].

"Delivery". Section 1-201(14) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-531. Standing to sue third parties for injury to goods.

(1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract (a) the lessor has a right of

action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:

(i) has a security interest in the goods;

(ii) has an insurable interest in the goods; or

(iii) bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his suit or settlement, subject to his own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party with the consent of the other may sue for the benefit of whom it may concern.

History: 1978 Comp., § 55-2A-531, enacted by Laws 1992, ch. 114, § 86.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-722 [55-2-722 NMSA 1978].

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References: - "Action". Section 1-201(1) [55-1-201 NMSA 1978].

"Goods". Section 2A-103(1)(h) [55-2A-103 NMSA 1978].

"Lease contract". Section 2A-103(1)(*l*) [55-2A-103 NMSA 1978].

"Lessee". Section 2A-103(1)(n) [55-2A-103 NMSA 1978].

"Lessor". Section 2A-103(1)(p) [55-2A-103 NMSA 1978].

"Party". Section 1-201(29) [55-1-201 NMSA 1978].

"Rights". Section 1-201(36) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37) [55-1-201 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-2A-532. Lessor's rights to residual interest.

In addition to any other recovery permitted by this article or other law, the lessor may recover from the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee.

History: 1978 Comp., § 55-2A-532, enacted by Laws 1992, ch. 114, § 87.

ANNOTATIONS

OFFICIAL COMMENT

Uniform Statutory Source: None.

This section recognizes the right of the lessor to recover under this Article (as well as under other law) from the lessee for failure to comply with the lease obligations as to the condition of leased goods when returned to the lessor, for failure to return the goods at the end of the lease, or for any other default which causes loss or injury to the lessor's residual interest in the goods.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

ARTICLE 3
NEGOTIABLE INSTRUMENTS

Part 1

General Provisions and Definitions.

Part 2

Negotiation, Transfer and Indorsement.

Part 3

Enforcement of Instruments.

Part 4

Liability of Parties.

Part 5

Dishonor.

Part 6

Discharge and Payment.

Part 7

Advice of International Sight Draft [Repealed].

Part 8

Miscellaneous [Repealed].

ANNOTATIONS

Compiler's notes. - Following each section in Article 3 appear "Official Comments", which were copyrighted in 1990 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and are reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1
GENERAL PROVISIONS AND DEFINITIONS

55-3-101. Short title.

This article may be cited as Uniform Commercial Code - Negotiable Instruments.

History: 1978 Comp., § 55-3-101, enacted by Laws 1992, ch. 114, § 88.

ANNOTATIONS

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-101 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-101, relating to short title, effective July 1, 1992. Laws 1992, ch. 114, § 88, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Law reviews. - For article, "Lender Recourse in Indian Country: A Navajo Case Study," see 21 N.M.L. Rev. 275 (1991).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 42.

55-3-102. Subject matter.

(a) This article applies to negotiable instruments. It does not apply to money, to payment orders governed by Article 4A, or to securities governed by Article 8.

(b) If there is conflict between this article and Article 4 or 9, Articles 4 and 9 govern.

(c) Regulations of the board of governors of the federal reserve system and operating circulars of the federal reserve banks supersede any inconsistent provision of this article to the extent of the inconsistency.

History: 1978 Comp., § 55-3-102, enacted by Laws 1992, ch. 114, § 89.

ANNOTATIONS

OFFICIAL COMMENT

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 [see now 55-3-102 NMSA 1978] was a limitation on scope. In revised Article 3, Section 3-102 [55-3-102 NMSA 1978] states that Article 3 applies to "negotiable instruments," defined in Section 3-104 [55-3-104 NMSA 1978]. Section 3-104(b) [55-3-104 NMSA 1978] also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 uses the shorter term "instrument." This follows the convention used in former Article 3.

2. The reference in former Section 3-103(1) [see now 55-3-102 NMSA 1978] to "documents of title" is omitted as superfluous because these documents contain no promise to pay money. The definition of "payment order" in Section 4A-103 (a)(1)(iii) [55-4A-103 NMSA 1978] excludes drafts which are governed by Article 3. Section 3-102(a) [55-3-102 NMSA 1978] makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

Article 8 states in Section 8-102(1)(c) [55-8-102 NMSA 1978] that "A writing that is a certificated security is governed by this Article and not by Article 3, even though it also meets the requirement of that Article." Section 3-102(a) [55-3-102 NMSA 1978] conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3-104(a) [55-3-104 NMSA 1978] or a certificated security under Section 8-102(a) [55-8-102 NMSA 1978]. Whether a writing is covered by Article 3 or Article 8 has important consequences. Among other things, under Section 8-207 [55-8-207 NMSA 1978], the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3-301 [55-3-301 NMSA 1978]. There are also important consequences to an indorser. An indorser of a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non-bearer form should be relatively clear. A certificated security under Article 8 must be in a registered form (Section 8-102(1)(a)(i)) [55-8-102 NMSA 1978] so that it can be registered on the issuer's records. By contrast, registration plays no part in Article 3. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8-102(1)(a)(iii) [55-8-102 NMSA 1978]. Thus, a promissory note in bearer form could come under either Article 3 if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8-102(1)(a)(ii)) [55-8-102 NMSA 1978]. Thus, a check written in bearer form (i.e., a check made payable to 'cash') would not be a certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 3-102(a) [55-8-102 and 55-3-102 NMSA 1978, respectively].

3. Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3-102(c) [55-3-102 NMSA 1978] states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3-102(c) [55-3-102 NMSA 1978] treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. § 4007 (b).

4. In Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), the Court held that if the United States is party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), the Court stated a three-pronged test to

ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the Kimbell test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In Kimbell the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3-104 [55-3-104 NMSA 1978] will not be governed by Article 3 if it is governed by the Convention.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-102 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-102, relating to definitions and index of definitions, effective July 1, 1992. Laws 1992, ch. 114, § 89, enacts the above provision, effective July 1, 1992. For provisions of former section, see 1991 Cumulative Supplement. For present comparable provisions, see 55-3-103 NMSA 1978.

55-3-103. Definitions.

(a) In this article:

(1) "acceptor" means a drawee who has accepted a draft;

(2) "drawee" means a person ordered in a draft to make payment;

(3) "drawer" means a person who signs or is identified in a draft as a person ordering payment;

(4) "good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing;

(5) "maker" means a person who signs or is identified in a note as a person undertaking to pay;

(6) "order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay;

(7) "ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located,

with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this article or Article 4;

(8) "party" means a party to an instrument;

(9) "promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation;

(10) "prove" with respect to a fact means to meet the burden of establishing the fact (Subsection (8) of Section 55-1-201 NMSA 1978); and

(11) "remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(b) Other definitions applying to this article and the sections in which they appear are:

"acceptance" Section 55-3-409 NMSA 1978;

"accommodated party" Section 55-3-419 NMSA 1978;

"accommodation party" Section 55-3-419 NMSA 1978;

"alteration" Section 55-3-407 NMSA 1978;

"anomalous indorsement" Section 55-3-205 NMSA 1978;

"blank indorsement" Section 55-3-205 NMSA 1978;

"cashier's check" Section 55-3-104 NMSA 1978;

"certificate of deposit" Section 55-3-104 NMSA 1978;

"certified check" Section 55-3-409 NMSA 1978;

"check" Section 55-3-104 NMSA 1978;

"consideration" Section 55-3-303 NMSA 1978;

"draft" Section 55-3-104 NMSA 1978;

"holder in due course" Section 55-3-302 NMSA 1978;

"incomplete instrument" Section 55-3-115 NMSA 1978;

"indorsement" Section 55-3-204 NMSA 1978;

"indorser" Section 55-3-204 NMSA 1978;

"instrument" Section 55-3-104 NMSA 1978;

"issue" Section 55-3-105 NMSA 1978;

"issuer" Section 55-3-105 NMSA 1978;

"negotiable instrument" Section 55-3-104 NMSA 1978;

"negotiation" Section 55-3-201 NMSA 1978;

"note" Section 55-3-104 NMSA 1978;

"payable at a definite time" Section 55-3-108 NMSA 1978;

"payable on demand" Section 55-3-

108 NMSA 1978;

"payable to bearer" Section 55-3-109 NMSA 1978;

"payable to order" Section 55-3-109 NMSA 1978;

"payment" Section 55-3-602 NMSA 1978;

"person entitled to enforce" Section 55-3-301 NMSA 1978;

"presentment" Section 55-3-501 NMSA 1978;

"reacquisition" Section 55-3-207 NMSA 1978;

"special indorsement" Section 55-3-205 NMSA 1978;

"teller's check" Section 55-3-104 NMSA 1978;

"transfer of instrument" Section 55-3-203 NMSA 1978;

"traveler's check" Section 55-3-104 NMSA 1978; and

"value" Section 55-3-303 NMSA 1978.

(c) The following definitions in other articles apply to this article:

"bank" Section 55-4-105 NMSA 1978;

"banking day" Section 55-4-104 NMSA 1978;

"clearing house" Section 55-4-104 NMSA 1978;

"collecting bank" Section 55-4-105 NMSA 1978;

"depositary bank" Section 55-4-105 NMSA 1978;

"documentary draft" Section 55-4-104 NMSA 1978;

"intermediary bank" Section 55-4-105 NMSA 1978;

"item" Section 55-4-104 NMSA 1978;

"payor bank" Section 55-4-105 NMSA 1978; and

"suspends payments" Section 55-4-104 NMSA 1978.

(d) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1978 Comp., § 55-3-103, enacted by Laws 1992, ch. 114, § 90.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3-102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier's check: a draft with respect to which the drawer and the drawee are the same bank or branches of the same bank. Former Section 3-118(a) treated a cashier's check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier's check as a promise by the issuing bank to pay rather than an order to pay, a cashier's check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section 3-412 [55-3-412 NMSA 1978].

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3-501(b)(1) [55-3-501 NMSA 1978] provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgement of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. Subsection (a)(4) introduces a definition of good faith to apply to Articles 3 and 4. Former Articles 3 and 4 used the definition in Section 1-201(19) [55-1-201 NMSA 1978]. The definition in Subsection (a)(4) is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact, but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978], are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4-104(c) [55-4-104 NMSA 1978]. The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant business prevailing in the area in which the person is located. The second sentence of Subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4-406 [55-4-406 NMSA 1978] and it is discussed in Comment 4 to that section. Nothing in Section 3-103(a)(7) [55-3-103 NMSA 1978] is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. In subsection (c) reference is made to a new definition of "bank" in amended Article 4.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-103 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-103, relating to limitations on scope of article, effective July 1, 1992. Laws 1992, ch. 114, § 90, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-102 NMSA 1978.

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For comment, "Negotiable Instruments - A Cause of Action on a Cashier's Check Accrues from the Date of Issuance," see 4 N.M. L. Rev. 253 (1974).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 48, 114, 139, 140, 269, 525, 589, 609.

Construction and effect of U.C.C. Article 3, dealing with commercial paper, 23 A.L.R.3d 932, 67 A.L.R.3d 144 , 78 A.L.R.3d 1020 , 88 A.L.R.3d 1100, 97 A.L.R.3d 798, 97 A.L.R.3d 1114, 23 A.L.R.4th 855, 36 A.L.R.4th 212, 42 A.L.R.5th 137.

82 C.J.S. Statutes § 315.

55-3-104. Negotiable instrument.

(a) Except as provided in Subsections (c) and (d), "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) is payable on demand or at a definite time; and

(3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "Instrument" means a negotiable instrument.

(c) An order that meets all of the requirements of Subsection (a), except Paragraph (1), and otherwise falls within the definition of "check" in Subsection (f) is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this article.

(e) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument falls within the definition of both "note" and "draft", a person entitled to enforce the instrument may treat it as either.

(f) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as "money order".

(g) "Cashier's check" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) "Teller's check" means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "Traveler's check" means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) "Certificate of deposit" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

History: 1978 Comp., § 55-3-104, enacted by Laws 1992, ch. 114, § 91.

ANNOTATIONS

OFFICIAL COMMENT

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section 3-102 [55-3-102 NMSA 1978] states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) [55-3-104 NMSA 1978] incorporates other definitions in Article 3. An instrument is either a "promise," defined in Section 3-103(a)(9) [55-3-103 NMSA 1978], or "order," defined in Section 3-103(a)(6) [55-3-103 NMSA 1978]. A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of money. "Money" is defined in Section 1-201(24) [55-1-201 NMSA 1978] and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations.

Five other requirements are stated in Section 3-104(a) [55-3-104 NMSA 1978]: First, the promise or order must be "unconditional." The quoted term is explained in Section 3-106 [55-3-106 NMSA 1978]. Second, the amount of money must be "a fixed amount * * * with or without interest or other charges described in the promise or order." Section 3-112(b) [55-3-112 NMSA 1978] relates to "interest." Third, the promise or order must be "payable to bearer or to order." The quoted phrase is explained in Section 3-109 [55-3-109 NMSA 1978]. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section 3-108 [55-3-108 NMSA 1978]. Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3-104(a)(3) [55-3-104 NMSA 1978] are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b) states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) applies, the effect of subsection (a)(1) and Section 3-102(a) [55-3-102 NMSA 1978] is to exclude from Article 3 any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 that is comparable to former Section 3-805 [repealed]. The Comment to former Section 3-805 [repealed] states that the typical example of a writing covered by that section is a check reading "Pay John Doe." Such a check was governed by former Article 3, but there could not be a holder in due course of the check. Under Section 3-104(c) [55-3-104 NMSA 1978] such a check is governed by revised Article 3 and there can be a holder in due course of the check. But subsection (c) applies only to checks. The Comment to former Section 3-805 [repealed] does not state any example other than the check to illustrate that section. Subsection (c) is based on the belief that it is good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words "to the order of." These words are almost always pre-printed on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use, but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the

absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that that the writing is a negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 because of the requirements of Section 3-104(a) [55-3-104 NMSA 1978] may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3-104 [55-3-104 NMSA 1978] or in Section 3-102 [55-3-102 NMSA 1978] is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3-104(a) [55-3-104 NMSA 1978] is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case #2 in Comment 4 to Section 3-302 [55-3-302 NMSA 1978].

Moreover, consistent with the principle stated in Section 1-102(2)(b) [55-1-102 NMSA 1978], the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 determine their rights and obligations under the writing. Upholding the parties' choice is not inconsistent with Article 3. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement of it arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1-102(2) [55-1-102 NMSA 1978], for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) allows exclusion from Article 3 of a writing that would otherwise be an instrument under subsection (a) by a statement to the effect that the writing is not

negotiable or is not governed by Article 3. For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsection (d) is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) does not, however, apply to a check. If a writing is excluded from Article 3 by subsection (d), a court could, nevertheless, apply Article 3 principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3-104(e) [55-3-104 NMSA 1978]. The term "bill of exchange" is not used in Article 3. It is generally understood to be a synonym for the term "draft." Subsections (f) through (j) define particular instruments that fall within the categories of draft and note. The term "draft," defined in subsection (e), includes a "check" which is defined in subsection (f). "Check" includes a share draft drawn on a credit union payable through a bank because the definition of bank (Section 4-104) [55-4-104 NMSA 1978] includes credit unions. However, a draft drawn on an insurance payable through a bank is not a check because it is not drawn on a bank. "Money orders" are sold both by banks and non-banks. They vary in form and their form determines how they are treated in Article 3. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 and is subject to a stop order by the purchaser-drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller's check, the rules applicable to teller's checks apply. Postal money orders are subject to federal law. "Teller's check" is separately defined in subsection (h). A teller's check is always drawn by a bank and is usually drawn on another bank. In some cases a teller's check is drawn on a nonbank but is made payable at or through a bank. Article 3 treats both types of teller's checks identically, and both are included in the definition of "check." A cashier's check, defined in subsection (g), is also included in the definition of "check." Traveller's checks are issued both by banks and nonbanks and may be in the form of a note or draft. Subsection (i) states the essential characteristics of a traveler's check. The requirement that the instrument be 'drawn on or payable at or through a bank' may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC § 229.2 of the terms "check," "cashier's check," "teller's check," and "traveler's check" are different from the definitions of those terms in Article 3.

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3, Section 3-104(j) [55-3-104 NMSA 1978] treats them as notes.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-104 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-104, relating to form of negotiable instruments, effective July 1, 1992. Laws 1992, ch. 114, § 91, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

I. General Consideration.
II. Scope of "a Writing.".
III. Unconditional Promise or Order to Pay Sum Certain.
IV. Payable on Demand or at Definite Time.

I. GENERAL CONSIDERATION.

No cure available to meet section's requirements. - An instrument which in and of itself did not meet the requirements of this section cannot be made negotiable for Article 3 purposes by reference to another document which purports to cure the defects in the note's negotiability. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

However, defective note negotiable under ordinary contract law. - Even though a note or instrument is not a "negotiable instrument" for Article 3 purposes, it may nevertheless be negotiable between the parties involved under ordinary contract law. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For comment, "Negotiable Instruments - A Cause of Action on a Cashier's Check Accrues from the Date of Issuance," see 4 N.M. L. Rev. 253 (1974).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 457, 538; 11 Am. Jur. 2d Bills and Notes §§ 6, 8, 13, 14, 16, 21, 55, 56, 138, 152, 156, 166, 169, 191, 209.

Place of signature, 20 A.L.R. 394.

Negotiability of instrument payable in "current funds," or "currency,", 36 A.L.R. 1358.

Validity and effect of note payable to maker without words of negotiability, 42 A.L.R. 1067, 50 A.L.R. 426.

Negotiability as affected by provisions for extension of time, 77 A.L.R. 1085.

Negotiability as affected by option of maker to pay or of holder to require something in lieu of payment of money, 100 A.L.R. 824; 104 A.L.R. 1378.

Negotiability as affected by provisions of instrument in relation to collateral other than mortgage, 102 A.L.R. 1095.

What constitutes unconditional promise to pay under Uniform Commercial Code § 3-104(1)(b), 88 A.L.R.3d 1100.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

Provision in draft or note directing payment "on acceptance" as affecting negotiability, 19 A.L.R.4th 1268.

Effect on negotiability of instrument, under terms of UCC § 3-104(1), of statements expressly limiting negotiability or transferability, 58 A.L.R.4th 632.

10 C.J.S. Bills and Notes § 6 et seq.

II. SCOPE OF 'A WRITING.'.

Look only at instrument to test negotiability. - To be a negotiable instrument, a writing "must" meet the definition set out in this section. Moreover, it is clear that in order to determine whether an instrument meets that definition only the instrument itself may be looked to, not other documents, even when other documents are referred to in the instrument. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

Including notations and terms on back of note. - Notations and terms on the back of a note, made contemporaneously with the execution of the note and intended to be part of the note's contract of payment, constitute as much a part of the note as if they were incorporated on its face. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

III. UNCONDITIONAL PROMISE OR ORDER TO PAY SUM CERTAIN.

Restrictions may cancel negotiability. - The words that a note may not be transferred, pledged or otherwise assigned without the written consent of the drawer, even though they appeared on the back of the note, effectively cancelled any implication of negotiability provided by the words "pay to the order of " on the face of the note. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

IV. PAYABLE ON DEMAND OR AT DEFINITE TIME.

Negotiability unaffected by extension proviso in note. - A provision in a note for extensions at or after maturity can have no effect upon the negotiability of the note, since the note at maturity ceases to be negotiable. First Nat'l Bank v. Stover, 21 N.M. 453, 155 P. 905, 1916D L.R.A. 1280 (1915) (decided under former law).

55-3-105. Issue of instrument.

(a) "Issue" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(b) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) "Issuer" applies to issued and unissued instruments and means a maker or drawer of an instrument.

History: 1978 Comp., § 55-3-105, enacted by Laws 1992, ch. 114, § 92.

ANNOTATIONS

OFFICIAL COMMENT

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In revised Article 3, Section 3-105(a) [55-3-105 NMSA 1978] defines "issue" more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. "Delivery" with respect to instruments is defined in Section 1-201(14) [55-1-201 NMSA 1978] as meaning "voluntary transfer of possession."

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or the drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to non-issuance of an incomplete instrument later completed.

3. Subsection (c) defines "issuer" to include the signer of an unissued instrument for convenience of reference in the statute.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-105 NMSA 1978, as enacted by Laws 1967, ch. 186, § 6, relating to when promise or order unconditional, effective July 1, 1992. Laws 1992, ch. 114, § 92, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-106 NMSA 1978.

55-3-106. Unconditional promise or order.

(a) Except as provided in this section, for the purposes of Section 55-3-104(a) NMSA 1978, a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(b) A promise or order is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of Section 55-3-104(a) NMSA 1978. If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of Section 55-3-104(a) NMSA 1978; but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

History: 1978 Comp., § 55-3-106, enacted by Laws 1992, ch. 114, § 93.

ANNOTATIONS

OFFICIAL COMMENT

1. This provision replaces former Section 3-105. Its purpose is to define when a promise or order fulfills the requirement in Section 3-104(a) [55-3-104 NMSA 1978] that it be an "unconditional" promise or order to pay. Under Section 3-106(a) [55-3-106 NMSA 1978] a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to the order of John Doe if he conveys title to Blackacre to me." The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title to Blackacre I promise to pay $100,000 to the order of John Doe." That promise can be an instrument if Section 3-104 [55-3-104 NMSA 1978] is otherwise satisfied. Although the recital of the executory promise to Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3-106(a)(i) [55-3-106 NMSA 1978]. This result is consistent with former Section 3-105(1)(a) and (b). Former Section 3-105(1)(b) is not repeated in Section 3-106 [55-3-106 NMSA 1978] because it is not necessary. It is an example of an implied condition. Former Section 3-105(1)(d), (e), and (f) and the first clause of former Section 3-105(1)(c) are other examples of implied conditions. They are not repeated in Section 3-106 [55-3-106 NMSA 1978] because they are not necessary. The law is not changed.

Section 3-106(a)(ii) and (iii) [55-3-106 NMSA 1978] carry forward the substance of former Section 3-105(2)(a). The only change is the use of "writing" instead of "agreement" and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3-104 [55-3-104 NMSA 1978] if it contains any of the following statements: 1. "This note is subject to a contract of sale dated April 1, 1990 between the payee and the maker of this note." 2. "This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note." 3. "Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note." It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3-104(a)(3) and Section 3-108(b) [55-3-104 and 55-3-108 NMSA 1978, respectively]. In some cases it may be convenient not to include a statement concerning collateral, prepayment or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement, or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b) [55-3-105 NMSA 1978]. Under Section 3-106(a) [55-3-106 NMSA 1978] a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the results of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instrument of this kind. If potential buyers don't want promises or orders that are payable only from a particular source or fund, they won't take them, but Article 3 should apply.

2. Subsection (c) applies to traveler's checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler's checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3. The first sentence of subsection (c) allows a traveler's check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of Section 3-104 [55-3-104 NMSA 1978]. The second sentence states the effects of a

failure to meet the condition. Suppose a thief steals a traveler's check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler's check becomes a holder when the traveler's check is taken. The forged countersignature is a defense to the obligation of the issuer to pay the instrument, and is included in defenses under Section 3-305(a)(2) [55-3-305 NMSA 1978]. These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler's check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to the claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by Statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers' claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3. Most of the provisions of Article 3 are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if the holder-in-due-course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3-104(a) [55-3-104 NMSA 1978] it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-106 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-106, relating to sum certain, effective July 1, 1992. Laws

1992, ch. 114, § 93, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Not conditional to direct charge of particular account. - The inclusion in a check, order or bill of exchange of a direction to charge the amount to a particular account does not make it payable conditionally. Hanna v. McCrory, 19 N.M. 183, 141 P. 996 (1914) (decided under former law).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 54, 72, 141, 147, 151.

Provision in draft or note directing payment "on acceptance" as affecting negotiability, 19 A.L.R.4th 1268.

10 C.J.S. Bills and Notes § 138.

55-3-107. Instrument payable in foreign money.

Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

History: 1978 Comp., § 55-3-107, enacted by Laws 1992, ch. 114, § 94.

ANNOTATIONS

OFFICIAL COMMENT

The definition of instrument in Section 3-104 [55-3-104 NMSA 1978] requires that the promise or order be payable in "money." That term is defined in Section 1-201(24) [55-1-201 NMSA 1978] and is not limited to United States dollars. Section 3-107 [55-3-107 NMSA 1978] states that an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3-107(1) [55-3-107 NMSA 1978] to instruments payable in "currency" or "current funds" has been dropped as superfluous.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-107 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-107, relating to money, effective July 1, 1992. Laws 1992, ch.

114, § 94, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-108. Payable on demand or at definite time.

(a) A promise or order is "payable on demand" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A promise or order is "payable at a definite time" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(c) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

History: 1978 Comp., § 55-3-108, enacted by Laws 1992, ch. 114, § 95.

ANNOTATIONS

OFFICIAL COMMENT

This section is a restatement of former Section 3-108 and Section 3-109. Subsection (b) broadens former Section 3-109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) restates former Section 3-109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not effect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or the acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-108 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-108, relating to payable on demand, effective July 1, 1992. Laws 1992, ch. 114, § 95, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Negotiability not destroyed by acceleration clause. - Where mortgage provided that upon default in payments the entire indebtedness might be declared at once due and payable, the negotiability of promissory notes, which it secured, was not destroyed. Durham v. Rasco, 30 N.M. 16, 227 P. 599, 34 A.L.R. 838 (1924)(decided under former law).

Nor by extension of time proviso. - A provision in a promissory note that any of the parties to it may extend the note without the knowledge or consent of the other parties, retaining the liability of all parties, does not render it nonnegotiable. First Nat'l Bank v. Stover, 21 N.M. 453, 155 P. 905, 1916D L.R.A. 1280 (1915)(decided under former law).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 88, 166, 169 to 178, 186.

Validity of instrument for payment of money as affected by mere fact that payment is postponed until death, 2 A.L.R. 1471.

Negotiability of instrument as affected by incompleteness of the attempt to fix due date, 19 A.L.R. 508.

Negotiability as affected by provisions for extension of time, 77 A.L.R. 1085.

Provision for post-mortem payment or performance as affecting instrument's character and validity as a contract, 1 A.L.R.2d 1178.

10 C.J.S. Bills and Notes §§ 14, 134.

55-3-109. Payable to bearer or to order.

(a) A promise or order is payable to bearer if it:

(1) states that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) does not state a payee; or

(3) states that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to Section 55-3-205(a) NMSA 1978. An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to Section 55-3-205(b) NMSA 1978.

History: 1978 Comp., § 55-3-109, enacted by Laws 1992, ch. 114, § 96.

ANNOTATIONS

OFFICIAL COMMENT

1. Under Section 3-104(a) [55-3-104 NMSA 1978], a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3-104(c) [55-3-104 NMSA 1978] applies. The terms "payable to bearer" and "payable to order" are defined in Section 3-109 [55-3-109 NMSA 1978]. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3-201(b) [55-3-201 NMSA 1978]. An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3-201(b) [55-3-201 NMSA 1978]. An instrument payable to order is payable to an identified person. Section 3-109(b) [55-3-109 NMSA 1978]. Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words "to the order of" printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word "bearer" or "cash," the check reads "to the order of bearer" or "to the order of cash." In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee "John Doe" but will add the words "or bearer." In that case the check is payable to bearer. Subsection (a). Under subsection (b), if an instrument is payable to bearer it can't be payable to order. This is different from former Section 3-110(3) [see now 55-3-109 NMSA 1978]. An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to the bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3-115 [55-3-115 NMSA 1978]. Subsection (a)(3) contains the words "otherwise indicates that it is not

payable to an identified person." The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to "cash." The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as "ABC Corporation" if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not payable to bearer. Negotiation of such an instrument is governed by Section 3-404(b) [55-3-404 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-109 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-109, relating to definite time, effective July 1, 1992. Laws 1992, ch. 114, § 96, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-108 NMSA 1978.

Liability on check drawn to fictitious payee. - A check drawn to a fictitious payee is the same as if it were made payable to bearer; and, since an endorsement on such paper is not necessary to its validity or negotiability, a bank is not liable for paying on a forged endorsement on bearer paper. Airco Supply Co. v. Albuquerque Nat'l Bank, 68 N.M. 195, 360 P.2d 386 (1961).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 105, 107, 113, 116 to 118, 124 to 127, 322, 328.

Liability of bank for diversion to benefit of presenter or third party of proceeds of check drawn to bank's order by drawer not indebted to bank, 69 A.L.R.4th 778.

10 C.J.S. Bills and Notes §§ 13, 128.

55-3-110. Identification of person to whom instrument is payable.

(a) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(b) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the

person who supplied the name or identification of the payee, whether or not authorized to do so.

(c) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(1) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number;

(2) If an instrument is payable to:

(i) a trust, an estate, or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named;

(ii) a person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative;

(iii) a fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) an office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

History: 1978 Comp., § 55-3-110, enacted by Laws 1992, ch. 114, § 97.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-110 [55-3-110 NMSA 1978] states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an

indorsement in the name of the payee. Subsection (a) states the general rule that the person to whom an instrument is payable is determined by the intent of "the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument." "Issuer" means the maker or drawer of the instrument. Section 3-105(c) [55-3-105 NMSA 1978]. If X signs a check as drawer of a check on X's account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y's signature as drawer of a check, the intent of X also controls. Under Section 3-103(a)(3) [55-3-103 NMSA 1978], Y is referred to as the drawer of the check because the signing of Y's name identifies Y as the drawer. But since Y's signature was forged Y has no liability as drawer (Section 3-403(a)) [55-3-403 NMSA 1978] unless some other other provision of Article 3 or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of the Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to "John Smith," since there are many people in the world named "John Smith" it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a), but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person known to the drawer as John Smith. In fact, the person's name is James Smith or John Jones, or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person's correct name or in both names. Section 3-204(d) [55-3-204 NMSA 1978]. The intent of the drawer is also controlling in ficticious payee cases. Section 3-404(b) [55-3-404 NMSA 1978]. The last sentence of subsection (a) refers to the rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check-writing machine. In that case the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check-writing machine is likely to be operated by means of a computer in which is stored information as to the name and address of the payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3-404(b) [55-3-404 NMSA 1978] is also concerned with this issue. See Case #4 in Comment 2 to Section 3-404 [55-3-404 NMSA 1978].

2. Subsection (c) allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) relates to the instruments payable to bank accounts. In some

cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to "X Corporation Account No. 12345 in Bank of Podunk." Under the last sentence of subsection (c)(1), this check is payable to X Corporation and can be negotiated by X Corporation even if Account No. 12345 is some other person's account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) the check is payable to the Creditor and, under Section 1-201(20) [55-1-201 NMSA 1978], Creditor becomes the holder when check is delivered. Under Section 3-201(b) [55-3-201 NMSA 1978], further negotiation of the check requires the indorsement of Creditor. But under Section 4-205(a) [55-4-205 NMSA 1978], if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3-102(b) [55-3-102 NMSA 1978], provisions of Article 4 prevail over those of Article 3. The depositary bank warrants that the amount of the check was credited to the payee's account.

3. Subsection (c)(2) replaces former Section 3-117 and subsections (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) replaces former Section 3-116. An instrument payable to X or Y is governed by the first sentence of subsection (d). And instrument payable to X and Y is governed by the second sentence of subsection (d). If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3-301 [55-3-301 NMSA 1978]. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is "payable to an identified person." The "identified person" is X and Y acting jointly. Section 3-109(b) and Section 1-102(5)(a) [55-3-109 and 55-1-102 NMSA 1978, respectively]. Thus, under Section 1-201(20) [55-1-201 NMSA 1978] X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-110 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-110, relating to payable to order, effective July 1, 1992. Laws 1992, ch. 114, § 97, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-109 NMSA 1978.

55-3-111. Place of payment.

Except as otherwise provided for items in Article 4, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

History: 1978 Comp., § 55-3-111, enacted by Laws 1992, ch. 114, § 98.

ANNOTATIONS

OFFICIAL COMMENT

If an instrument is payable at a bank in the United States, Section 3-501(b)(1) [55-3-501 NMSA 1978] states that presentment must be made at the place of payment, i.e. the bank. The place of presentment of a check is governed by Regulation CC § 229.36.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-111 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-111, relating to payable to bearer, effective July 1, 1992. Laws 1992, ch. 114, § 98, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-109 NMSA 1978.

55-3-112. Interest.

(a) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

History: 1978 Comp., § 55-3-112, enacted by Laws 1992, ch. 114, § 99.

ANNOTATIONS

OFFICIAL COMMENT

1. Under Section 3-104(a) [55-3-104 NMSA 1978] the requirement of a "fixed amount" applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgement rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) replaces subsection (d) of the former Section 3-118.

2. The purpose of subsection (b) is to clarify the meaning of "interest" in the introductory clause of Section 3-104(a) [55-3-104 NMSA 1978]. It is not intended to validate a provision for interest in an instrument if that provision violates other law.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-112 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-112, relating to terms and omissions not affecting negotiability, effective July 1, 1992. Laws 1992, ch. 114, § 99, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-113. Date of instrument.

(a) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in Subsection (c) of Section 55-4-401 NMSA 1978, an instrument payable on demand is not payable before the date of the instrument.

(b) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

History: 1978 Comp., § 55-3-113, enacted by Laws 1992, ch. 114, § 100.

ANNOTATIONS

OFFICIAL COMMENT

This section replaces former Section 3-114. Subsections (1) and (3) of former Section 3-114 are deleted as unnecessary. Section 3-113 (a) [55-3-113 NMSA 1978] is based in part on subsection (2) of former Section 3-114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4-401(c) [55-4-401 NMSA 1978] which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-113 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-113, relating to seal, effective July 1, 1992. Laws 1992, ch. 114, § 100, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 553; 11 Am. Jur. 2d Bills and Notes §§ 88, 208, 285 to 287; 12 Am. Jur. 2d Bills and Notes § 1165.

Right of transferee of postdated check, 21 A.L.R. 234.

Extent of bank's liability for paying postdated check, 31 A.L.R.4th 329.

10 C.J.S. Bills and Notes § 86 et seq.

55-3-114. Contradictory terms of instrument.

If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

History: 1978 Comp., § 55-3-114, enacted by Laws 1992, ch. 114, § 101.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-114 [55-3-114 NMSA 1978] replaces subsections (b) and (c) of former Section 3-118.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-114 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-114, relating to date, effective July 1, 1992. Laws 1992, ch. 114, § 101, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-113 NMSA 1978.

55-3-115. Incomplete instrument.

(a) "Incomplete instrument" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to Subsection (c), if an incomplete instrument is an instrument under Section 55-3-104 NMSA 1978, it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under Section 55-3-104 NMSA 1978, but, after completion, the requirements of Section 55-3-104 NMSA 1978 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under Section 55-3-407 NMSA 1978.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

History: 1978 Comp., § 55-3-115, enacted by Laws 1992, ch. 114, § 102.

ANNOTATIONS

OFFICIAL COMMENT

1. This section generally carries forward the rules set out in former Section 3-115. The term "incomplete instrument" applies both to an "instrument," i.e. a writing meeting all the requirements of Section 3-104 [55-3-104 NMSA 1978] , and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3-104 [55-3-104 NMSA 1978] and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete soley because a space on the pre-printed note form for the due date is not filled in:

Case #1. If the incomplete instrument is never completed, the note is payable on demand. Section 3-108(a)(ii) [55-3-108 NMSA 1978] . However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3-117 [55-3-117 NMSA 1978] if the demand for payment is made before the due date agreed to by the parties.

Case #2. If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3-407 [55-3-407 NMSA 1978] governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but it is incomplete. The check is enforceable in its incomplete form and it is payable to the bearer because it does not state a payee. Section 3-109(a)(2) [55-3-109 NMSA 1978]. Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3-104 [55-3-104 NMSA 1978]. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3-104 and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3-407 [55-3-407 NMSA 1978] applies.

4. Section 3-302(a)(1) [55-3-302 NMSA 1978] also bears on the problem of incomplete instruments. Under that section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) of Section 3-115 [55-3-115 NMSA 1978] is based on the last clause of subsection (2) of the former Section 3-115.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-115 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-115, relating to incomplete instruments, effective July 1, 1992. Laws 1992, ch. 114, § 102, enacts the above provision, effective July 1, 1992. For provisions of former section, see 1991 Cumulative Supplement.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 73 to 79, 81, 87, 88, 666; 12 Am. Jur. 2d Bills and Notes §§ 1160, 1297.

Liability of one who signs commercial paper in blank to be used for his own benefit where it is wrongfully used by an agent or employee, 43 A.L.R. 198.

Effect of payee of bill or note, executed in blank as to amount, filling it in for an amount in excess of that authorized, 75 A.L.R. 1389.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

10 C.J.S. Bills and Notes § 32.

55-3-116. Joint and several liability; contribution.

(a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in Section 55-3-419(e) NMSA 1978 or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(c) Discharge of one party having joint and several liability by a person entitled to enforce the instrument does not affect the right under Subsection (b) of a party having the same joint and several liability to receive contribution from the party discharged.

History: 1978 Comp., § 55-3-116, enacted by Laws 1992, ch. 114, § 103.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) replaces subsection (e) of former Section 3-118 [55-3-118 NMSA 1978]. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section 3-419(e) [55-3-419 NMSA 1978]. If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3-419(e) [55-3-419 NMSA 1978] applies. Subsection (c) deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorser have joint and several liability and subsection (b) applies. The other case is that two or more anomalous indorsers. The term is defined in Section 3-205(d) [55-3-205 NMSA 1978]. An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have a joint and several liability and subsection (b) applies.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-115 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-116, relating to instruments payable to two or more persons, effective July 1, 1992. Laws 1992, ch. 114, § 103, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-117. Other agreements affecting instrument.

Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

History: 1978 Comp., § 55-3-117, enacted by Laws 1992, ch. 114, § 104.

ANNOTATIONS

OFFICIAL COMMENT

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co-maker. Y agrees to sign as co-maker on the condition that the Creditor also obtain the signature of Z as co-maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Section 3-412 and 3-419(b) [55-3-412 and 55-3-419 NMSA 1978, respectively], Y is obliged to pay the note, but Section 3-117 [55-3-117 NMSA 1978] applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which the maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3-117, [55-3-117 NMSA 1978] in treating the agreement as a defense, allows Y to assert the agreement against the Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of § 3-106(d) [55-3-106 NMSA 1978], a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger of integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1-103 [55-3-103 NMSA 1978]. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y's obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-117 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-117, relating to instruments payable with words of description, effective July 1, 1992. Laws 1992, ch. 114, § 104, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

No cure available to make defective note negotiable under code. - An instrument which in and of itself did not meet the requirements of former 55-3-104 NMSA 1978 could not be made negotiable for Article 3 purposes by reference to another document which purported to cure the defects in the note's negotiability. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

However still negotiable under ordinary contract law. - Even though a note or instrument is not a "negotiable instrument" for Article 3 purposes, it may nevertheless be negotiable between the parties involved under ordinary contract law. First State Bank v. Clark, 91 N.M. 117, 570 P.2d 1144 (1977).

Extension note generally not novation. - An extension note extending only the due date does not constitute a novation unless a contrary intention is shown. Where the original note contains a provision allowing reasonable attorney's fees for collection, this provision is not altered by the extension note. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

Stock transfer agreement. - All documents executed as part of a stock transfer agreement are to be considered together and the terms of all such documents are binding upon even a holder in due course with notice of them. Color World TV Rental, Inc. v. White (In re Flowers), 25 Bankr. 652 (Bankr. D.N.M. 1982).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 54, 62, 70 to 72, 147, 460; 12 Am. Jur. 2d Bills and Notes § 1241.

Reference to extrinsic agreement as affecting negotiability of bill, note or trade acceptance, 104 A.L.R. 1378.

10 C.J.S. Bills and Notes § 103 et seq.

55-3-118. Statute of limitations.

(a) Except as provided in Subsection (e), an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.

(b) Except as provided in Subsection (d) or (e), if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of ten years.

(c) Except as provided in Subsection (d), an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three years after dishonor of the draft or ten years after the date of the draft, whichever period expires first.

(d) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within three years after demand for payment is made to the acceptor or issuer, as the case may be.

(e) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the six-year period begins when a demand for payment is in effect and the due date has passed.

(f) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this article and not governed by this section must be commenced within three years after the cause of action accrues.

History: 1978 Comp., § 55-3-118, enacted by Laws 1992, ch. 114, § 105.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-118 [55-3-118 NMSA 1978] differs from former Section 3-122 [repealed], which states when a cause of action accrues on an instrument. Section 3-118 [55-3-118 NMSA 1978] does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section 3-118 [55-3-118 NMSA 1978] is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section 3-118 [55-3-118 NMSA 1978] does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1-103 [55-3-103 NMSA 1978].

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) and (b) apply to notes. If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principle are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or forgiven debt. Subsection (b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitation period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller's checks, cashier's checks, certified checks, and traveler's checks are treated

differently under subsection (d) because they are commonly treated as cash equivalents. A great delay in presenting a cashier's check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler's checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier's check or traveler's check. Under subsection (d) the claim is never barred because the three-year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) covers certificates of deposit. The limitations period of six years doesn't start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) also provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn't start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) states that in that case the six-year limitations periods starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six-year limitations period starts to run at the date of the acceptance.

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three-year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

Cross-references. - For limitations of actions generally, see 37-1-1 to 37-1-29 NMSA 1978.

For limitations of actions for contracts, see 37-1-23 NMSA 1978.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-118 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-118, relating to ambiguous terms and rules of construction, effective July 1, 1992. Laws 1992, ch. 114, § 105, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Statute of limitations on cashier's check. - The statute of limitations as to an action against a certifying bank or bank issuing a cashier's check runs from the date of the check, or if undated, from the date of issue, rather than from the making of a demand for payment. Allison v. First Nat'l Bank, 85 N.M. 283, 511 P.2d 769 (Ct. App.), rev'd, 85 N.M. 511, 514 P.2d 30 (1973) (adopting court of appeals' dissenting opinion).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For comment, "Negotiable Instruments - A Cause of Action on a Cashier's Check Accrues from the Date of Issuance," see 4 N.M. L. Rev. 253 (1974).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 466, 602; 11 Am. Jur. 2d Bills and Notes § 286; 12 Am. Jur. 2d Bills and Notes §§ 1032, 1044, 1048, 1050, 1055, 1056.

Rate of interest after maturity of obligation which fixes rate of interest expressly until maturity, 16 A.L.R.2d 902.

Time for which interest is recoverable on demand note or like demand instrument containing no provision as to interest, 45 A.L.R.2d 1202.

10 C.J.S. Bills and Notes §§ 86 et seq., 257.

55-3-119. Notice of right to defend action.

In an action for breach of an obligation for which a third person is answerable over pursuant to this article or Article 4, the defendant may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

History: 1978 Comp., § 55-3-119, enacted by Laws 1992, ch. 114, § 106.

ANNOTATIONS

OFFICIAL COMMENT

This section is a restatement of former Section 3-803 [repealed].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-119 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-119, relating to other writings affecting instrument, effective July 1, 1992. Laws 1992, ch. 114, § 106 enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-117 NMSA 1978.

55-3-120 to 55-3-122. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-120 to 55-3-122 NMSA 1978, as enacted by Laws 1961, ch. 96, §§ 3-120, 3-121, and as amended by Laws 1967, ch. 186, § 8, relating to instruments "payable through" bank, instruments payable at bank, and accrual of cause of action, effective July 1, 1992. For former provisions, see Original Pamphlet.

PART 2 NEGOTIATION, TRANSFER AND INDORSEMENT

55-3-201. Negotiation.

(a) "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

History: 1978 Comp., § 55-3-201, enacted by Laws 1992, ch. 114, § 107.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsections (a) and (b) are based in part on subsection (1) of the former Section 3-202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 to describe this post-issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly of through an agent. But in some cases the transfer of possession is involuntary and in some cases

the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section 1-201(14) [55-1-201 NMSA 1978] to mean voluntary change of possession. Instead, subsections (a) and (b) used the term "transfer of possession" and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or a remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from the Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a) [55-3-105 NMSA 1978]. If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11) [55-3-103 NMSA 1978]. The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 [55-3-306 NMSA 1978] against Seller or a subsequent transferee of the check. Section 3-202(b) [55-3-202 NMSA 1978] provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by holder.

3. Other sections of Article 3 may modify the the rule stated in the first sentence of the subsection (b). See for example, Sections 3-404, 3-405, and 3-406 [55-3-404, 55-3-405, 55-3-406 NMSA 1978, respectively].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-201 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-201, relating to transfer and right to indorsement, effective July 1, 1992. Laws 1992, ch. 114, § 107, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-203 NMSA 1978.

A negotiable instrument may be assigned or transferred without a writing. Goode v. Harris, 77 N.M. 178, 420 P.2d 767 (1966).

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 314 to 317, 320, 323, 325, 328, 351, 353, 360, 367; 12 Am. Jur. 2d Bills and Notes § 1026.

Production of paper purporting to be endorsed in blank by payee or by a special endorsee, as prima facie evidence of plaintiff's title, 11 A.L.R. 952, 85 A.L.R. 304.

Endorsement of bill or note in form of guaranty of payment, 21 A.L.R. 1375, 33 A.L.R. 97, 46 A.L.R. 1516.

Endorsement without words of negotiability, of note payable to maker, as affecting its validity and effect, 42 A.L.R. 1067, 50 A.L.R. 426.

Effect of assignment endorsed on back of commercial paper, 44 A.L.R. 1353.

Construction and application of provision in respect to endorsements which purport to transfer part only of amount payable, 63 A.L.R. 499.

Authority of agent to endorse and transfer commercial paper, 37 A.L.R.2d 453.

Endorsement of negotiable instrument by writing not on instrument itself, 19 A.L.R.3d 1297.

10 C.J.S. Bills and Notes §§ 127, 148.

55-3-202. Negotiation subject to rescission.

(a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(b) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

History: 1978 Comp., § 55-3-202, enacted by Laws 1992, ch. 114, § 108.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is based on former Section 3-207. Subsection (2) of former Section 3-207 prohibited rescission of a negotiation against holders in due course. Subsection (b) of Section 3-202 [55-3-202 NMSA 1978] extends this protection to payor banks.

2. Subsection (a) applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from that person's possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection, or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3-305(c) [55-3-305 NMSA 1978], the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person who pays in good faith and without notice, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitation such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3-202 [55-3-202 NMSA 1978] gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-202 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-202, relating to negotiation, effective July 1, 1992. Laws 1992, ch. 114, § 108, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-201 NMSA 1978.

55-3-203. Transfer of instrument; rights acquired by transfer.

(a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the

transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this article and has only the rights of a partial assignee.

History: 1978 Comp., § 55-3-203, enacted by Laws 1992, ch. 114, § 109.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-203 [55-3-203 NMSA 1978] is based on former Section 3-201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3-201 did not define "transfer." Subsection (a) defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by the principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203 [55-3-203 NMSA 1978]. Moreover, a person who has a ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) [55-3-203 NMSA 1978] until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes issue of an instrument,

defined in Section 3-105 [55-3-105 NMSA 1978], and cases in which a delivery of possession is for some purpose other than the transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the instrument "including any right as a holder in due course." If the transferee is not a holder because the transferor did not indorse; the transferee is nevertheless a person entitled to enforce the instrument under Section 3-301 [55-3-301 NMSA 1978] if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the transferor's rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3-308 [55-3-308 NMSA 1978] that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has aquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3-308 [55-3-308 NMSA 1978].

Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b). A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no negotiation of the instrument until the endorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3-302 [55-3-302 NMSA 1978].

4. The operation of Section 3-203 [55-3-203 NMSA 1978] is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3-305(a)(2) [55-3-305 NMSA 1978].

Case #1. Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X's rights as a holder in due course and takes free of Maker's defense of fraud.

Case #2. Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X's rights as a holder in due course and is subject to Maker's defense of fraud.

Case #3. Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3-301 and succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3-308 Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case #4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of the Maker. Purchaser received possession of the note but payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) restates former Section 3-202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third." Neither A nor B becomes a holder. On the other hand, an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) makes no attempt to state the legal effect of such assignment, which is left to other law. A partial asignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-203 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-203, relating to wrong or misspelled name, effective July 1, 1992. Laws 1992, ch. 114, § 109, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Under this section, negotiation takes place only upon indorsement. Ballengee v. New Mexico Fed. Sav. & Loan Ass'n, 109 N.M. 423, 786 P.2d 37 (1990).

Assignee of a note transferred by assignment and not by indorsement was not a holder in due course and was subject to the defense that the note was an unregistered security. Ballengee v. New Mexico Fed. Sav. & Loan Ass'n, 109 N.M. 423, 786 P.2d 37 (1990).

Defense on transfer without endorsement. - Where a promissory note is payable to a given person or order, and is transferred to another by such person, without endorsement, such note is subject to any defense which existed against the note in the hands of the original payee. Hill v. Hart, 23 N.M. 226, 167 P. 710 (1917) (decided under former law).

Rights of accommodation maker on note. - Where a note and mortgage are assigned to an accommodation maker who then paid up the note, the accommodation maker succeeds to the payee's rights and may sue the maker on the note, and the note was not discharged when paid by the accommodation maker. Simson v. Bilderbeck, Inc., 76 N.M. 667, 417 P.2d 803 (1966).

And notes deemed security without formal assignment. - Evidence justified finding that notes, secured by senior mortgage and in possession of bank which advanced money with which to pay the notes, were held by it as security against junior mortgage, though not formally assigned to the bank. Citizens' Bank v. Brown, 38 N.M. 310, 32 P.2d 755 (1934) (decided under former law).

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision' " see 4 Nat. Resources J. 398 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Assignments § 102; 11 Am. Jur. 2d Bills and Notes §§ 337, 371, 373, 375, 376, 405, 421, 422, 649; 12 Am. Jur. 2d Bills and Notes §§ 1023, 1197.

Necessity of endorsement by all payees before maturity to make a transferee a bona fide holder, 25 A.L.R. 163.

Gift of note to maker by delivery or surrender of instrument, 63 A.L.R.2d 264.

10 C.J.S. Bills and Notes §§ 159, 189.

55-3-204. Indorsement.

(a) "Indorsement" means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) "Indorser" means a person who makes an indorsement.

(c) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(d) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

History: 1978 Comp., § 55-3-204, enacted by Laws 1992, ch. 114, § 110.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i). If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3-205(d)) [55-3-205 NMSA 1978] and is made for the purpose of incurring indorser's liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depositary bank for collection and indorses the check by signing holder's name with the accompanying words "for deposit only" the purpose of the indorsement is both to negotiate the check to the depositary bank and to restrict payment of the check.

The but clause of the first sentence of subsection (a) elaborates on former Section 3-402. In some cases it may not be clear whether a signature was meant to be that of the indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as as an indorser. Intent may be determined by words accompanying the signature, the place of the signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long-established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of the note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler's check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer's obligation to pay and its purpose is to provide a means of verifying the identity of the person negotiating the travel's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser's liability. See Comment 2 to Section 3-106 [55-3-106 NMSA 1978].

The last sentence of subsection (a) is based on subsection (2) of former Section 3-202 [see now 55-3-201 NMSA 1978]. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) of Section 3-203 [55-3-203 NMSA 1978] Creditor takes Payee's rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) of Section 3-204 [55-3-204 NMSA 1978] makes clear that the Payee's indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) is a restatement of former Section 3-203. Section 3-110 (a) [55-3-110 NMSA 1978] states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the

instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) allows a person paying or taking the instrument for value or collection to require indorsement in both names.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-204 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-204, relating to special indorsement or blank indorsement, effective July 1, 1992. Laws 1992, ch. 114, § 110, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-205 NMSA 1978.

55-3-205. Special indorsement; blank indorsement; anomalous indorsement.

(a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement". When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in Section 55-3-110 NMSA 1978 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement". When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(d) "Anomalous indorsement" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

History: 1978 Comp., § 55-3-205, enacted by Laws 1992, ch. 114, § 111.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) is based on subsection (1) of the former Section 3-204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3-110 [55-3-110 NMSA 1978] states rules for identifying the payee of an instrument. Section 3-205(a) [55-3-205 NMSA 1978] incorporates the principles stated in Section 3-110 [55-3-110 NMSA 1978] in identifying an indorsee. The language of Section 3-110 [55-3-110 NMSA 1978] refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3-110 [55-3-110 NMSA 1978] must be read as referring to the language used by the indorser.

2. Subsection (b) is based on subsection (2) of former Section 3-204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words "Pay to the order of" without completing the indorsement by writing the name of the indorsee. The holder's signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3-115 [55-3-115 NMSA 1978].

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection (c) is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section 3-206 [55-3-206 NMSA 1978] can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an "anomalous indorsement," defined in subsection (d), is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3-419 [55-3-419 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-205 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-205, relating to restrictive indorsements, effective July 1, 1992. Laws 1992, ch. 114, § 111, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-206 NMSA 1978.

Indorsement required for negotiation. - Since the note was specially indorsed to the Federal Reserve Bank and transferred to the FDIC and then to the plaintiff company without indorsement by the Federal Reserve Bank, it was not properly negotiated and

the plaintiff was not a holder-in-due-course. Cadle Co. v. Wallach Concrete, Inc., 120 N.M. 56, 897 P.2d 1104 (1995).

55-3-206. Restrictive indorsement.

(a) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(b) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(c) If an instrument bears an indorsement (i) described in Subsection (b) of Section 55-4-201 NMSA 1978, or (ii) in blank or to a particular bank using the words "for deposit", "for collection", or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(1) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(2) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(3) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(4) Except as otherwise provided in Paragraph (3), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(d) Except for an indorsement covered by Subsection (c), if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(1) Unless there is notice of breach of fiduciary duty as provided in Section 55-3-307 NMSA 1978, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(2) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(e) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under Subsection (c) or has notice or knowledge of breach of fiduciary duty as stated in Subsection (d).

(f) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

History: 1978 Comp., § 55-3-206, enacted by Laws 1992, ch. 114, § 112.

ANNOTATIONS

OFFICIAL COMMENT

1. This section replaces former Sections 3-205 and 3-206 and clarifies the law of restrictive indorsements.

2. Subsection (a) provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation. If a payee indorses "Pay A only," A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses "Pay A if A ships goods complying with our contract," the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3-206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3, Section 3-206(b) [55-3-206 NMSA 1978] rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) and (b) are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) which continues previous law. The depositary bank or the payor bank, if it takes the

check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words "For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under Subsection (c), the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) replaces subsection (4) of former Section 3-206. Suppose Payee indorses a check "Pay to T in trust for B." T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3-307 [55-3-307 NMSA 1978] of any breach of fiduciary duty that T may be committing. For example, under subsection (a) of Section 3-307 [55-3-307 NMSA 1978] these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T's personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-206 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-206, relating to effect of restrictive indorsement, effective July 1, 1992. Laws 1992, ch. 114, § 112, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Codified restrictive indorsements exclude common-law exceptions. - The codification of the law of restrictive indorsements contained in the UCC is sufficiently comprehensive and detailed to exclude common-law exceptions which are not mentioned. Rutherford v. Darwin, 95 N.M. 340, 622 P.2d 245 (Ct. App. 1980).

New Mexico does not recognize any doctrine of waiver of restrictive indorsements. Rutherford v. Darwin, 95 N.M. 340, 622 P.2d 245 (Ct. App. 1980).

Words "deposit to the account of" clearly constitute restrictive indorsement. Rutherford v. Darwin, 95 N.M. 340, 622 P.2d 245 (Ct. App. 1980).

Law reviews. - For annual survey of New Mexico law relating to commercial law, see 12 N.M.L. Rev. 173 (1982).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 362, 368.

Undertaking of one who endorses a note without recourse, 2 A.L.R. 216, 91 A.L.R. 399.

Endorsement, "To order of any bank or banker," as a restrictive endorsement, 10 A.L.R. 709.

10 C.J.S. Bills and Notes §§ 154, 155.

55-3-207. Reacquisition.

Reacquisition of an instrument occurs if it is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder.

History: 1978 Comp., § 55-3-207, enacted by Laws 1992, ch. 114, § 113.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-207 [55-3-207 NMSA 1978] restates former Section 3-208 [repealed]. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3-207 [55-3-207 NMSA 1978] allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected by whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

Case #1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X's becoming holder. Section 3-201(a) [55-3-201 NMSA 1978]. The instrument by its terms is payable to Y, not to X. But X can obtain the

status of holder by striking X's indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending on how X originally became holder. In either case X becomes holder. Section 1-201(20).

Case #2. X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y's indorsement. The analysis is the same as that in Case #1. X can obtain holder status by cancelling X's indorsement to Y.

In Case #1 and Case #2, X acquired ownership of the instrument after reacquisition, but X's title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y's indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3-207 [55-3-207 NMSA 1978] is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3-207 [55-3-207 NMSA 1978] is to nullify it. Thus, the person whose indorsement is cancelled is relieved of indorser's liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3-601 and 3-604 [55-3-601 and 55-3-604 NMSA 1978, respectively].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-207 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-207, relating to negotiation effective although it may be rescinded, effective July 1, 1992. Laws 1992, ch. 114, § 113, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 319, 393, 529.

Effect of endorsement and delivery of note to comakers, 51 A.L.R. 936.

10 C.J.S. Bills and Notes §§ 158, 244 et seq.

55-3-208. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-208 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-208, relating to reacquisition, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

PART 3
ENFORCEMENT OF INSTRUMENTS

55-3-301. Person entitled to enforce instrument.

"Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to Section 55-3-309 or 55-3-418(d) NMSA 1978. A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

History: 1978 Comp., § 55-3-301, enacted by Laws 1992, ch. 114, § 114.

ANNOTATIONS

OFFICIAL COMMENT

This section replaces former Section 3-301 that stated the rights of a holder. The rights stated in former Section 3-301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3. In revised Article 3, Section 3-301 [55-3-301 NMSA 1978] defines "person entitled to enforce" an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3-309. It also includes a person in possession of an instrument who is not the holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a) [55-3-203 NMSA 1978]. It also includes any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-301 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-301, relating to rights of a holder, effective July 1, 1992. Laws 1992, ch. 114, § 114, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-302. Holder in due course.

(a) Subject to Subsection (c) and Section 55-3-106(d) NMSA 1978, "holder in due course" means the holder of an instrument if:

(1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 55-3-306 NMSA 1978, and (vi) without notice that any party has a defense or claim in recoupment described in Section 55-3-305(a) NMSA 1978.

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under Subsection (a), but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under Section 55-3-303(a)(1) NMSA 1978, the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

History: 1978 Comp., § 55-3-302, enacted by Laws 1992, ch. 114, § 115.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course doctrine to an instrument that is so incomplete or irregular "as to call into question its authenticity." The term "authenticity" is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3-304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1).

2. Subsection (a)(2) restates subsection (1) of former Section 3-302. Section 3-305(a) [55-3-305 NMSA 1978] makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or the drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section 3-305 [55-3-305 NMSA 1978].

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3-305(a)(1) [55-3-305 NMSA 1978], discharge is not expressed in Article 3 as a defense and is not included in Section 3-305(a)(2) [55-3-305 NMSA 1978]. Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3-415(d) [55-3-415 NMSA 1978]. Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3-601(b) [55-3-601 NMSA 1978]. Notice of a defense under Section 3-305(a)(1) [55-3-305 NMSA 1978] of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3-304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: "A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position of payee as such which made it impossible for him to be a holder in due course." The courts were divided, however, about whether the payee of an instrument could be the holder in due course under N.I.L.. Some courts read N.I.L. § 52(4) to mean that a person could be a holder in due course only if the instrument was "negotiated" to that person. N.I.L. § 30 stated that "an instrument is negotiated when it is transferred

from one person to another in such manner as to constitute the transferee the holder thereof." Normally, an instrument is "issued" to the payee; it is not transferred to the payee. N.I.L. § 191 defined "issue" as the "first delivery of the instrument * * * to a person who takes it as a holder." Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that the payee could be a holder in due course. Professor Britton states on p. 318: "The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor * * * against a surety co-maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee."

Former Section 3-302(2) stated: "A payee may be a holder in due course." This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under N.I.L. was caused by the particular wording of N.I.L. § 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3-302(2) has been omitted in revised Article 3 because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3-305) [55-3-305 NMSA 1978] and of claims to the instrument (Section 3-306) [55-3-306 NMSA 1978]. The holder-in-due-course doctrine assumes the following cases as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor's obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3-303(b) [55-3-303 NMSA 1978]. Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection (a) are met, Holder may enforce the instrument against Obligor free of the defense. Section 3-305(b) [55-3-305 NMSA 1978]. In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due in due course is an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder-in-due-course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case #1. Buyer pays for goods bought from Seller by giving to Seller a cashier's check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer endorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the order of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3-103(a)(11) [55-3-103 NMSA 1978]. At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3-201 [55-3-201 NMSA 1978]. The rights of seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case #2 is similar to Case #1. In each case the payee of the instrument has given value to the the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case #2 that the note does not meet the requirements of Section 3-104(a) [55-3-104 NMSA 1978] and thus is not a negotiable instrument covered by Article 3. In that case, Bank cannot be a holder in due course but the result should be the same. Bank's rights are determined by general principles of contract law. Restatement Second, Contracts § 164(2) governs the case. If Y is induced to enter into a contract with Bank by fraudulent misrepresentation by X, the contract is voidable by Y unless Bank "in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction." Comment e to § 164(2) states:

"This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by misrepresentation. See Uniform Commercial Code § 2-403(1), 3-305 [55-2-403, 55-3-305 NMSA 1978, respectively]. In the cases that fall

within [§ 164(2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

The same result follows in Case #2 if Y had been induced to sign the note as an accommodation party (Section 3-419) [55-3-419 NMSA 1978]. If Y signs as co-maker of a note for the benefit of X, Y is a surety with respect of the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3-419(b) [55-3-419 NMSA 1978]. If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3-305(b) [55-3-305 NMSA 1978]. But the result is the same without resort to holder-in-due-course doctrine. If the note is not a negotiable instrument governed by Article 3, general rules of suretyship apply. Restatement, Security § 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor "without knowledge of the fraud * * * extended credit to the principal on the security of the surety's promise * * *." The underlying principle of § 119 is the same as that of § 164(2) of Restatement Second, Contracts.

Case #3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of officer's personal debt, or the check is delivered to Bank for deposit to the officer's personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of the Corporation's claim. Section 3-306 [55-3-306 NMSA 1978]. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3-307 [55-3-307 NMSA 1978].

Case #4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom the Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of the employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

5. Subsection (c) is based on former Section 3-302(3). Like former Section 3-302(3), subsection (c) is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights.

But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver, or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) applies to a sale by a state bank commissioner of the assets of an insolvent bank. However, subsection (c) may be preempted by federal law if the Federal Deposit Insurance Corporation takes over an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsection (d) and (e) clarify two matters not specifically addressed by former Article 3:

Case #5. Payee negotiates a $1,000 note to Holder who agrees to pay $900 for it. After paying $500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) Holder may assert rights as a holder in due course to the extent of $555.55 ($500 ö $900 = .555 x $1,000 = $555.55). This formula rewards holder with a ratable portion of the bargained for profit.

Case #6. Payee negotiates a note of Maker for $1,000 to Holder as security for payment of Payee's debt to Holder of $600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) applies. Holder may assert rights as a holder in due course only to the extent of $600. Payee does not get the benefit of the holder-in-due-course status of Holder. With respect to $400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) subordinates Article 3 to that law and any other similar law that may evolve in the future. Section 3-106(d) [55-3-106 NMSA 1978] also

relates to statutory or administrative law intended to restrict use of the holder-in-due-course doctrine. See Comment 3 to Section 3-106 [55-3-106 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-302 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-302, relating to holder in due course, effective July 1, 1992. Laws 1992, ch. 114, § 115, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

I. General Consideration.
II. Holder for Value.
III. Holder Without Notice.

I. GENERAL CONSIDERATION.

Holder's burden when maker shows fraud. - Where the maker shows fraud in the inception of the instrument, the burden on the holder to show that he is a holder in due course may be removed by showing that he acquired title in accordance with this section. Gebby v. Carrillo, 25 N.M. 120, 177 P. 894 (1918) (decided under former law).

And clear evidence needed for verdict. - To justify directing a verdict in favor of the holder, or in setting aside a verdict against holder, the bona fides of the holder must be established without substantial evidence to impeach it, and by evidence so clear as to leave no room for difference of opinion concerning it among fair-minded men. Gebby v. Carrillo, 25 N.M. 120, 177 P. 894 (1918) (decided under former law).

Bank issuing cashier's check. - In issuing a cashier's check, a bank acts as both drawer and drawee, since a cashier's check constitutes a draft drawn by the bank upon itself, and upon the subsequent presentment of the check, the bank is not a holder in due course. Casarez v. Garcia, 99 N.M. 508, 660 P.2d 598 (Ct. App. 1983).

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 337, 339, 376, 397, 403, 414, 418, 419, 424, 426, 486, 495, 498; 12 Am. Jur. 2d Bills and Notes § 1326.

Crediting the proceeds of negotiable paper to holder's deposit account as constituting bank a holder in due course, 6 A.L.R. 252, 59 A.L.R.2d 1173.

Effect of fraud in the inception of a bill or note to throw upon a subsequent holder the burden of proving that he is a holder in due course, 18 A.L.R. 18, 34 A.L.R. 300, 57 A.L.R. 1083.

One taking bill or note as a gift or in consideration of love and affection as a holder for value or in due course protected against defenses between prior parties, 48 A.L.R. 237.

Endorsee of bill or note based on executed consideration, who knows of circumstances which might result in rescission as between original parties, as holder in due course, 59 A.L.R. 1026.

Notice which has been forgotten as affecting status as holder in due course, 89 A.L.R.2d 1330.

Payee as holder in due course, 2 A.L.R.3d 1151.

Who is holder of instrument for "value" under UCC § 3-303, 97 A.L.R.3d 1114.

What constitutes taking instrument in good faith, and without notice of infirmities or defenses, to support holder-in-due-course status, under U.C.C. § 3-302, 36 A.L.R.4th 212.

10 C.J.S. Bills and Notes § 169.

II. HOLDER FOR VALUE.

Additional credit deemed sufficient value. - Where credit was requested by appellant on behalf of the corporation, and appellee extended it on the condition that appellant and corporation as accommodation maker and maker, respectively, execute a note in favor of appellee for the entire amount of the open account plus the amount of additional credit requested, appellee was deemed to be a holder for value as the additional credit was extended to the corporation in reliance on appellant's promise to execute the note. Hutchison v. Boney, 72 N.M. 194, 382 P.2d 525 (1963).

And executory contract. - Where the consideration for a note is an executory contract, knowledge of the transaction by a purchaser of the note, who acquires it by transfer before its maturity, will not prevent recovery thereon upon subsequent failure of consideration, by a breach of the executory contract. Azar v. Slack, 29 N.M. 528, 224 P. 398 (1924) (decided under former law).

III. HOLDER WITHOUT NOTICE.

Generally. - Where the president of a bank alone discounted notes for it, and as such discounted a note which he had made as treasurer of a corporation, and his authority to make it is denied, the bank was not a holder for value without notice. Oak Grove & Sierra Verde Cattle Co. v. Foster, 7 N.M. 650, 41 P. 522 (1895) (decided under former law).

Where note was in conventional form except that it provided that this note is not binding on any of the signers until signed by not less than 10 men, but was unconditionally delivered to payee when only seven men had signed it, it was invalid and payee was not holder in due course, even though three more men signed it after such delivery. Wood v. Eminger, 44 N.M. 636, 107 P.2d 557 (1940) (decided under former law).

The buyer of air conditioner under conditional sales contract was not "estopped" from denying liability for unpaid portion of purchase price evidenced by installment note, and from claiming damages for breach of warranty, because prior to acquisition of the note by a holder in due course who simultaneously acquired rights under the sale contract, the buyer had written in a letter that conditioner was satisfactory, where no evidence was introduced to show that the holder-purchaser relied upon the buyer's letter in making the purchase. State Nat'l Bank v. Cantrell, 47 N.M. 389, 143 P.2d 592, 152 A.L.R. 1216 (1943) (decided under former law).

55-3-303. Value and consideration.

(a) An instrument is issued or transferred for value if:

(1) the instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(2) the transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) the instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) the instrument is issued or transferred in exchange for a negotiable instrument; or

(5) the instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(b) "Consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in Subsection (a), the instrument is also issued for consideration.

History: 1978 Comp., § 55-3-303, enacted by Laws 1992, ch. 114, § 116.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) is a restatement of former Section 3-303 and subsection (b) replaces former Section 3-408. The distinction between value and consideration in Article 3 is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) as "any consideration sufficient to support a simple contract." The definition of value in Section 1-201(44) [55-1-201 NMSA 1978], which doesn't apply to Article 3, includes "any consideration sufficient to support a simple contract." Thus, outside Article 3, anything that is consideration is also value. A different rule applies in Article 3. Subsection (b) of Section 3-303 [55-3-303 NMSA 1978] states that if an instrument is issued for value it is also issued for consideration.

Case #1. X owes Y $1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) X's note is issued for value. Under subsection (b) the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case #2. X issues a check to Y in consideration of Y's promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1).

Case #3. X issues a note to Y in consideration of Y's promise to perform services. If at the due date of the note Y's performance is not yet due, Y may enforce the note because it was issued for consideration. But if at the due date of the note, Y's performance is due and has not been performed, X has a defense. Subsection (b).

2. Subsection (a), which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1). The policy basis for subsection (a)(1) is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of the dishonor of the

instrument. When Seller took delivery of the check on April 1, Buyer's obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3-310(b) [55-3-310 NMSA 1978]. If payment for goods is due at or before delivery and the Buyer fails to make the payment, the Seller is excused from performing the promise to deliver the goods. Section 2-703. Thus, Seller is protected from an out-of-pocket loss even if the check is not enforceable. Holder-in-due-course status is not necessary to protect Seller.

3. Subsection (a)(2) equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term "security interest" covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4-210. The acquisition of a common-law or statutory banker's lien is also value under subsection (a)(2). An attaching creditor or other person who acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2).

4. Subsection (a)(3) follows former Section 3-303(b) in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Subsection (a)(3) applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) and (5) restate former Section 3-303(c). They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-303 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-303, relating to taking for value, effective July 1, 1992. Laws 1992, ch. 114, § 116, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Presumption of consideration unless evidence to contrary. - Upon proof of execution of a note consideration is presumed to exist and when evidence is offered which shows or tends to show lack of consideration, it is then incumbent upon the holder to show by a fair preponderance of the evidence that there was consideration. Hutchison v. Boney, 72 N.M. 194, 382 P.2d 525 (1963).

And additional credit deemed sufficient value. - Where credit was requested by appellant on behalf of the corporation, and appellee extended it on the condition that

appellant and corporation as accommodation maker and maker, respectively, execute a note in favor of appellee for the entire amount of the open account plus the amount of additional credit requested, appellee was deemed to be a holder for value as the additional credit was extended to the corporation in reliance on appellant's promise to execute the note. Hutchison v. Boney, 72 N.M. 194, 382 P.2d 525 (1963).

When failure of consideration defense against bona fide purchaser. - In order for a defense of failure of consideration to be available against a bona fide purchaser, before maturity, there must be proof that the failure occurred prior to the transfer of the note. Azar v. Slack, 29 N.M. 528, 224 P. 398 (1924) (decided under former law).

Law reviews. - For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 215, 241, 334, 337 to 339, 347, 348, 428, 498.

One taking bill or note as gift, or in consideration of love and affection, as a holder for value, 48 A.L.R. 237.

Exchange of negotiable paper as supporting status as holder in due course, 69 A.L.R. 408.

Unperformed obligation as value, as regards one's status as a bona fide purchaser freed from prior equities, 124 A.L.R. 1259.

Crediting proceeds of negotiable paper to depositor's account, as constituting bank a holder in due course, 59 A.L.R.2d 1173.

Who is holder of instrument for "value" under UCC § 3-303, 97 A.L.R.3d 1114.

10 C.J.S. Bills and Notes §§ 185 et seq., 284 et seq.

55-3-304. Overdue instrument.

(a) An instrument payable on demand becomes overdue at the earliest of the following times:

(1) on the day after the day demand for payment is duly made;

(2) if the instrument is a check, ninety days after its date; or

(3) if the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(b) With respect to an instrument payable at a definite time the following rules apply:

(1) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(2) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(3) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(c) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

History: 1978 Comp., § 55-3-304, enacted by Laws 1992, ch. 114, § 117.

ANNOTATIONS

OFFICIAL COMMENT

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3-302(a)(2)(iii) [55-3-302 NMSA 1978]. Section 3-304 [55-3-304 NMSA 1978] replaces subsection (3) of former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3-304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken "more than a reasonable length of time after its issue." In substitution for this test, subsection (a)(3) requires the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending upon the facts of the particular case.

2. Subsections (b) and (c) cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-304 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-304, relating to notice to purchaser, effective July 1, 1992. Laws 1992, ch. 114, § 117, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-305. Defenses and claims in recoupment.

(a) Except as stated in Subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in Subsection (a)(1), but is not subject to defenses of the obligor stated in Subsection (a)(2) or claims in recoupment stated in Subsection (a)(3) against a person other than the holder.

(c) Except as stated in Subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 55-3-306 NMSA 1978) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under Subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

History: 1978 Comp., § 55-3-305, enacted by Laws 1992, ch. 114, § 118.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable

opportunity all relevant factors are to be taken into account, including intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) [55-1-201 NMSA 1978] and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b) [55-3-601 NMSA 1978].

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)) [55-3-105 NMSA 1978]; failure to countersign a traveler's check (Section 3-106(c)) [55-3-106 NMSA 1978]; modification of the obligation by separate agreement (Section 3-117) [55-3-117 NMSA 1978]; payment that violates a restrictive indorsement (Section 3-206(f)) [55-3-206 NMSA 1978]; instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)) [55-3-303 NMSA 1978], and breach of warranty when a draft is accepted (Section 3-417(b)) [55-3-417 NMSA 1978]. The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302 [55-3-302 NMSA 1978].

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and take the check free of Bank's defense of fraud. This case is discussed as Case #1 in Comment 4 to Section 3-302 [55-3-302 NMSA 1978]. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller

"dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer of Bank. The quoted language is not included in Section 3-305 [55-3-305 NMSA 1978]. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of the defense of an obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b) [55-3-303 NMSA 1978]. This defense is included in Section 3-305(a)(2) [55-3-305 NMSA 1978]. That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b) [55-3-303 NMSA 1978]. Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment * * * against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv)) [55-3-302 NMSA 1978] and Buyer may assert the claim against Holder (Section 3-305(a)(3)) [55-3-305 NMSA 1978] but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to the Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If holder had no notice of

Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b) [55-3-305 NMSA 1978].

The result under Section 3-305 [55-3-305 NMSA 1978] is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section 3-305 (a)(3) [55-3-305 NMSA 1978] is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3) [55-3-305 NMSA 1978]. Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) [55-3-106 NMSA 1978] and Comment 3 to Section 3-106 [55-3-106 NMSA 1978]. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the but clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3-306 [55-3-306 NMSA 1978] based

on a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) [55-3-202 NMSA 1978] and Comment 2 to Section 3-201 [55-3-201 NMSA 1978]. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3-419) [55-3-419 NMSA 1978] and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in recoupment is good against the indorser. Section 3-416(a)(4) [55-3-416 NMSA 1978]. Thus, if the indorsee sues the indorser because of a dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-205 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-305, relating to rights of a holder in due course, effective July 1, 1992. Laws 1992, ch. 114, § 118, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

I. General Consideration.
II. Defenses Holder in Due Course Free from.
III. Defenses Holder in Due Course Not Free from.

I. GENERAL CONSIDERATION.

Law reviews. - For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 255, 263, 264, 275, 279, 333, 398, 421, 652, 666, 670, 672, 676, 679, 690, 693, 695, 715, 716, 719, 720, 725; 12 Am. Jur. 2d Bills and Notes §§ 1158, 1170.

Deception as to character of paper signed as defense as against bona fide holder of negotiable paper, 160 A.L.R. 1295.

Insanity of maker, drawer or endorser as defense against holder in due course, 24 A.L.R.2d 1380.

Fraud in the inducement and fraud in the factum as defenses under U.C.C. § 3-305 against holder in due course, 78 A.L.R.3d 1020.

Economic duress or business compulsion in execution of promissory note, 79 A.L.R.3d 598.

What constitutes "dealing" under UCC § 3-305(2), providing that holder in due course takes instrument free from all defenses of any party to instrument with whom holder has not dealt, 42 A.L.R.5th 137.

10 C.J.S. Bills and Notes § 190 et seq.

II. DEFENSES HOLDER IN DUE COURSE FREE FROM.

Notes not voided by lack of knowledge. - Plaintiffs, who signed contract for installation of aluminum siding on their home under the mistaken impression they would get a discount price as a "show home," but failed to read the contract itself, may not have notes and mortgages in hands of a holder in due course cancelled and voided on ground they did not have knowledge or reasonable opportunity to understand the notes. Burchett v. Allied Concord Fin. Corp., 74 N.M. 575, 396 P.2d 186 (1964).

Because loss on person who occasions it. - The reason for the rule is that when one or two innocent persons must suffer by the act of a third, the loss must be borne by the one who enables the third person to occasion it. Burchett v. Allied Concord Fin. Corp., 74 N.M. 575, 396 P.2d 186 (1964).

But failure of consideration may be defense. - Knowledge on the part of an endorsee of a promissory note that it had been given in consideration of some executory contract of the payee which said payee afterwards fails to perform will not deprive such endorsee of his character of a bona fide holder in due course, unless he had actual notice of the breach prior to acquiring the note. Azar v. Slack, 29 N.M. 528, 224 P. 398 (1924)(decided under former law).

III. DEFENSES HOLDER IN DUE COURSE NOT FREE FROM.

Fraud in the inception nullifies instrument. - Although a holder in due course holds an instrument free from any defect of title, and free from defenses available to prior parties among themselves insofar as a voidable instrument is concerned, where fraud in the inception is present, such fraud makes the instrument an absolute nullity and not

merely voidable. United States v. Castillo, 120 F. Supp. 522 (D.N.M. 1954)(decided under former law).

Must be mistaken belief induced by payee. - To completely invalidate the enforceability of a negotiable promissory note, the fraud perpetrated must have been such as to induce the maker of the note to execute the same under the mistaken belief that the instrument being signed was something other than a promissory note and must have come about as a direct result of misrepresentation on the part of the payee or his agent. United States v. Castillo, 120 F. Supp. 522 (D.N.M. 1954)(decided under former law).

However, maker must exercise reasonable prudence. - The maker cannot be guilty of negligence in signing a written instrument and then defend upon the ground of lack of knowledge where in the exercise of reasonable prudence the attempted fraud could be discovered; and it is not a defense to the enforcement of an obligation to insist that a fraud has been wrought where the maker did not take the care to read the instrument being signed, inasmuch as such an omission generally constitutes negligence. United States v. Castillo, 120 F. Supp. 522 (D.N.M. 1954).

Failure to read an instrument is not negligence per se but is to be considered in light of all surrounding facts and circumstances with particular emphasis on the maker's intelligence and literacy. United States v. Castillo, 120 F. Supp. 522 (D.N.M. 1954).

And illiteracy deemed not negligence. - Where defendants are nearly illiterate in the English language and had no reason to believe the agent of the payee in question was misrepresenting the character of the paper signed, they were not guilty of negligence in failing to verify that the instrument was in fact a note rather than a contract for repairs as fraudulently represented, and the sued upon instrument was void from its inception. United States v. Castillo, 120 F. Supp. 522 (D.N.M. 1954).

Bill won at gambling unenforceable. - The Uniform Negotiable Instruments Law is merely declaration of the law merchant heretofore in effect and is not intended to modify the gaming law so as to allow enforcement by holder in due course of note or bill won at gambling. Farmers' State Bank v. Clayton Nat'l Bank, 31 N.M. 344, 245 P. 543, 46 A.L.R. 952 (1925)(decided under former law).

55-3-306. Claims to an instrument.

A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

History: 1978 Comp., § 55-3-306, enacted by Laws 1992, ch. 114, § 119.

ANNOTATIONS

OFFICIAL COMMENT

This section expands on the reference to "claims to" the instrument mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property of possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3-202(b) [55-3-202 NMSA 1978] for rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3-306 [55-3-306 NMSA 1978] are different from claims in recoupment referred to in Section 3-305(a)(3) [55-3-305 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-306 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-306, relating to rights of one not holder in due course, effective July 1, 1992. Laws 1992, ch. 114, § 119, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-307. Notice of breach of fiduciary duty.

(a) In this section:

(1) "fiduciary" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument; and

(2) "represented person" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in Paragraph (1) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

History: 1978 Comp., § 55-3-307, enacted by Laws 1992, ch. 114, § 120.

ANNOTATIONS

OFFICIAL COMMENT

1. This section states rules for determining when a person who has taken an instrument from a fiduciary has notice of a breach of fiduciary duty that occurs as a result of the transaction with the fiduciary. Former Section 3-304(2) and (4)(e) related to this issue, but those provisions were unclear in their meaning. Section 3-307 [55-3-307 NMSA 1978] is intended to clarify the law by stating rules that comprehensively cover the issue of when the taker of an instrument has notice of breach of a fiduciary duty and thus notice of a claim to the instrument or its proceeds.

2. Subsection (a) defines the terms "fiduciary" and "represented person" and the introductory paragraph of subsection (b) describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) states that notice of breach of fiduciary duty is notice of the represented person's claim to the instrument or its proceeds.

Under Section 3-306 [55-3-306 NMSA 1978], a person taking an instrument is subject to a claim to the instrument or its proceeds, unless the taker has rights of a holder in due course. Under Section 3-302(a)(2)(v) [55-3-302 NMSA 1978], the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3-306 [55-3-306 NMSA 1978]. Section 3-307 [55-3-307 NMSA 1978] applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3-306 [55-3-306 NMSA 1978].

Section 3-307 [55-3-307 NMSA 1978] states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

Section 3-307(b) [55-3-307 NMSA 1978] applies only if the person dealing with the fiduciary "has knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge is not enough to cause Section 3-307 [55-3-307 NMSA 1978] to apply. "Knowledge" is defined in Section 1-201(25) [55-1-201 NMSA 1978]. In most cases, the "taker" referred to in Section 3-307 [55-3-307 NMSA 1978] will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section 1-201(27) [55-1-201 NMSA 1978]. In many cases, the individual who receives and processes an instrument on behalf of the organization that is the taker of the instrument "for payment or collection or for value" is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section 3-307 [55-3-307 NMSA 1978] doesn't apply because, under Section 1-201(27) [55-1-201 NMSA 1978], knowledge of the organization is determined by the knowledge of the "individual conducting that transaction," i.e. the clerk who receives and processes the instrument. Furthermore, paragraphs (2) and (4) each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the represented person or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the fiduciary or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section 3-307 [55-3-307 NMSA 1978] to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

3. Subsection (b)(2) applies to instruments payable to the represented person or the fiduciary as such. For example, a check payable to Corporation is indorsed in the name of Corporation by Doe as its President. Doe gives the check to Bank as partial repayment of a personal loan that Bank had made to Doe. The check was indorsed either in blank or to Bank. Bank collects the check and applies the proceeds to reduce the amount owed on Doe's loan. If the person acting for Bank in the transaction knows that Doe is a fiduciary and that the check is being used to pay a personal obligation of Doe, subsection (b)(2) applies. If Corporation has a claim to the proceeds of the check because the use of the check by Doe was a breach of fiduciary duty, Bank has notice of the claim and did not take the check as a holder in due course. The same result follows

if Doe had indorsed the check to himself before giving it to Bank. Subsection (b)(2) follows Uniform Fiduciaries Act § 4 in providing that if the instrument is payable to the fiduciary, as such, or to the represented person, the taker has notice of a claim if the instrument is negotiated for the fiduciary's personal debt. If fiduciary funds are deposited to a personal account of the fiduciary or to an account that is not an account of the represented person or of the fiduciary, as such, there is a split of authority concerning whether the bank is on notice of a breach of fiduciary duty. Subsection (b)(2)(iii) states that the bank is given notice of breach of fiduciary duty because of the deposit. The Uniform Fiduciaries Act § 9 states that the bank is not on notice unless it has knowledge of facts that makes its receipt of the deposit an act of bad faith.

The rationale of subsection (b)(2) is that it is not normal for an instrument payable to the represented person or the fiduciary, as such, to be used for the personal benefit of the fiduciary. It is likely that such use reflects an unlawful use of the proceeds of the instrument. If the fiduciary is entitled to compensation from the represented person for services rendered or for expenses incurred by the fiduciary the normal mode of payment is by a check drawn on the fiduciary account to the order of the fiduciary.

4. Subsection (b)(3) is based on Uniform Fiduciaries Act § 6 and applies when the instrument is drawn by the represented person or the fiduciary as such to the fiduciary personally. The term "personally" is used as it is used in the Uniform Fiduciaries Act to mean that the instrument is payable to the payee as an individual and not as a fiduciary. For example, Doe as President of Corporation writes a check on Corporation's account to the order of Doe personally. The check is then indorsed over to Bank as in Comment 3. In this case there is no notice of breach of fiduciary duty because there is nothing unusual about the transaction. Corporation may have owed Doe money for salary, reimbursement for expenses incurred for the benefit of Corporation, or for any other reason. If Doe is authorized to write checks on behalf of Corporation to pay debts of Corporation, the check is a normal way of paying a debt owed to Doe. Bank may assume that Doe may use the instrument for his personal benefit.

5. Subsection (b)(4) can be illustrated by as hypothetical case. Corporation draws a check payable to an organization. X, an officer or employee of Corporation, delivers the check to a person acting for the organization. The person signing the check on behalf of Corporation is X or another person. If the person acting for the organization in the transaction knows that X is a fiduciary, the organization is on notice of a claim by Corporation if it takes the instrument under the same circumstances stated in subsection (b)(2). If the organization is a bank and the check is taken in repayment of a personal loan of the bank to X, the case is like the case discussed in Comment 3. It is unusual for Corporation, the represented person, to pay a personal debt of Doe by issuing a check to the bank. It is more likely that the use of the check by Doe reflects an unlawful use of the proceeds of the check. The same analysis applies if the check is made payable to an organization in payment of goods or services. If the person acting for the organization knew of the fiduciary status of X and that the goods or services were for X's personal benefit, the organization is on notice of a claim by Corporation to the proceeds of the check. See the discussion in the last paragraph of Comment 2.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-307 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-307, relating to burden of establishing signatures, effective July 1, 1992. Laws 1992, ch. 114, § 120, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-308 NMSA 1978.

55-3-308. Proof of signatures and status as holder in due course.

(a) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under Section 55-3-402(a) NMSA 1978.

(b) If the validity of signatures is admitted or proved and there is compliance with Subsection (a), a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under Section 55-3-301 NMSA 1978, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

History: 1978 Comp., § 55-3-308, enacted by Laws 1992, ch. 114, § 121.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-308 [55-3-308 NMSA 1978] is a modification of former Section 3-307. The first two sentences of subsection (a) are a restatement of former Section 3-307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant's claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an opportunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section 1-201 [55-1-201 NMSA 1978]. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). "Presumed" is defined in Section 1-201 [55-1-201 NMSA 1978] and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or authorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section 1-201 [55-1-201 NMSA 1978] and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) is a new provision that is necessary to take into account Section 3-402(a) [55-3-402 NMSA 1978] that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) restates former Section 3-307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves "entitlement to enforce the instrument" because under Section 3-301 [55-3-301 NMSA 1978] a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3-301 [55-3-301 NMSA 1978]. That person must prove a transfer giving that person such rights under Section 3-203(b) [55-3-203 NMSA 1978] or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under Section 3-203(b) [55-3-203 NMSA 1978] or by

subrogation or succession. All elements of Section 3-302(a) [55-3-302 NMSA 1978] must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Holder's burden when maker shows fraud. - In a suit by the holder of a negotiable instrument acquired from the payee before maturity, where the maker shows fraud in the inception of the instrument, the burden is upon the holder to show that he acquired title to the paper in due course. Gebby v. Carrillo, 25 N.M. 120, 177 P. 894 (1918)(decided under former law).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 333; 12 Am. Jur. 2d Bills and Notes §§ 1137, 1155, 1158, 1167, 1187, 1213, 1296, 1297, 1301, 1319.

Direction of verdict based on testimony of party or interested witness as to good faith of holder, 72 A.L.R. 61.

Taking negotiable paper in payment of pre-existing indebtedness as sustaining one's character as holder in due course, 80 A.L.R. 671.

10 C.J.S. Bills and Notes § 284 et seq.

55-3-309. Enforcement of lost, destroyed, or stolen instrument.

(a) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under Subsection (a) must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, Section 55-3-308 NMSA 1978 applies to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

History: 1978 Comp., § 55-3-309, enacted by Laws 1992, ch. 114, § 122.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-309 [55-3-309 NMSA 1978] is a modification of former Section 3-804 [repealed]. The rights stated are those of "a person entitled to enforce the instrument" at the time of loss rather than those of an "owner" as in former Section 3-804 [repealed]. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3-804 [repealed] allowed the court to "require security indemnifying the defendant against loss." Under Section 3-309 [55-3-309 NMSA 1978] adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-3-310. Effect of instrument on obligation for which taken.

(a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in Subsection (a), if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same

extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in Paragraph (4), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in Subsection (a) or (b) is taken for an obligation, the effect is (i) that stated in Subsection (a) if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in Subsection (b) in any other case.

History: 1978 Comp., § 55-3-310, enacted by Laws 1992, ch. 114, § 123.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-310 [55-3-310 NMSA 1978] is a modification of former Section 3-802 [repealed]. As a practical matter, application of former Section 3-802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) and (b) of Section 3-310 [55-3-310 NMSA 1978] are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the

exception in former Section 3-802 [repealed] for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3-802(1)(a) [repealed] the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3-802(1)(b) [repealed] that the buyer's obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

The last sentence of subsection (b)(3) applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer's liability as indorser is discharged. Section 3-415(e) [55-3-415 NMSA 1978]. Under the last sentence of Section 3-310(b)(3) [55-3-310 NMSA 1978] Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3-802 [repealed] to the case in which the check given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section 3-602(a) [55-3-602 NMSA 1978]. The payee's cause of action is against the depositary bank or payor bank in conversion under Section 3-420 [55-3-420 NMSA 1978] or against the drawer under Section 3-309 [55-3-309 NMSA 1978]. In the latter case, the drawer's obligation under Section 3-414(b) [55-3-414 NMSA 1978] is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3-504(a)(i) and, under Section 3-502(e) [55-3-504 and 55-3-502 NMSA 1978, respectively], dishonor occurs without presentment if the check is not paid. The payee cannot merely ignore the

instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b). If the creditor then loses the check, what are the creditor's rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3-309 [55-3-309 NMSA 1978] to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) applies and the obligation is discharged. In any other case subsection (b) applies.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-3-311. Accord and satisfaction by use of instrument.

(a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply:

(b) Unless Subsection (c) applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(c) Subject to Subsection (d), a claim is not discharged under Subsection (b) if either of the following applies:

(1) The claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(2) The claimant, whether or not an organization, proves that within 90 days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not

apply if the claimant is an organization that sent a statement complying with Paragraph (1)(i).

(d) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

History: 1978 Comp., § 55-3-311, enacted by Laws 1992, ch. 114, § 124.

ANNOTATIONS

OFFICIAL COMMENT

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

Case #1. The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.

Case #2. A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case #1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated

by the buyer, but the seller can't accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1-207 [55-1-207 NMSA 1978] changed the common law rule. The Restatement states that section "need not be read as changing this well-established rule."

3. As part of the revision of Article 3, Section 1-207 [55-1-207 NMSA 1978] has been amended to add subsection (2) stating that Section 1-207 [55-1-207 NMSA 1978] "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3, Section 3-311 [55-3-311 NMSA 1978] governs full satisfaction checks. Section 3-311 [55-3-311 NMSA 1978] follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3-311 [55-3-311 NMSA 1978] there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section 3-311 [55-3-311 NMSA 1978] is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) states three requirements for application of Section 3-311 [55-3-311 NMSA 1978]. "Good faith" in subsection (a)(i) is defined in Section 3-103(a)(4) [55-3-103 NMSA 1978] as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of "fair dealing" will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i).

Section 3-311 [55-3-311 NMSA 1978] does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii). Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) are met. If that person also proves that the statement required by subsection (b) was given, the claim is discharged unless subsection (c) applies. Normally the statement required by subsection (b) is written on the check. Thus, the canceled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) requires a "conspicuous" statement that the instrument was tendered in full satisfaction of the claim. "Conspicuous" is defined in Section 1-201(10) [55-1-201 NMSA 1978]. The statement is conspicuous if "it is so written that a reasonable person against whom it is to operate ought to have noticed it." If the claimant can reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant's indorsement of the check, the claimant "ought to have noticed" the statement.

5. Subsection (c)(1) is a limitation on subsection (b) in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4-205(a) [55-4-205 NMSA 1978]. Subsection (c)(1) allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) applies.

6. Subsection (c)(2) is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1). Some organizations may be reluctant to use subsection (c)(1)

because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2). If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) is subject to subsection (d). If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by "the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation," the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1), or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2).

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant "has actual knowledge" of that fact. Section 1-201(25) [55-1-201 NMSA 1978]. Under Section 1-201(27) [55-1-201 NMSA 1978], if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is

"brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

With respect to an attempted accord and satisfaction the "individual conducting that transaction" is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1), that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain store subsection (d) would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a

customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive's personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer's account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full-satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of "due diligence" under Section 1-201(27) [55-1-201 NMSA 1978] if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3-311(c) [55-3-311 NMSA 1978] is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) or (2) without burdening the check-processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the "agent of the claimant" in subsection (d) refers to an agent of the assignee.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-3-312. Lost, destroyed or stolen cashier's check, teller's check or certified check.

(a) In this section:

(1) "check" means a cashier's check, teller's check, or certified check;

(2) "claimant" means a person who claims the right to receive the amount of a cashier's check, teller's check, or certified check that was lost, destroyed, or stolen;

(3) "declaration of loss" means a written statement, made under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier's check or teller's check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed,

its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process; and

(4) "obligated bank" means the issuer of a cashier's check or teller's check or the acceptor of a certified check.

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the ninetieth day following the date of the check, in the case of a cashier's check or teller's check, or the ninetieth day following the date of the acceptance, in the case of a certified check.

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to Section 55-4-302 NMSA 1978, payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under Subsection (b)(4) of this section and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under Subsection (b) of this section and is also a person entitled to enforce a cashier's check, teller's check, or certified check which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or Section 55-3-309 NMSA 1978.

History: 1978 Comp., § 55-3-312, enacted by Laws 1992, ch. 114, § 125.

ANNOTATIONS

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 4
LIABILITY OF PARTIES

55-3-401. Signature.

(a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under Section 55-3-402 NMSA 1978.

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

History: 1978 Comp., § 55-3-401, enacted by Laws 1992, ch. 114, § 126.

ANNOTATIONS

OFFICIAL COMMENT

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3-402 [55-3-402 NMSA 1978]. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay * * *" without any other signature. It may be made by mark, or even by thumb-print. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3-204(d) [55-3-204 NMSA 1978].

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-401 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-401, relating to signature, effective July 1, 1992. Laws 1992, ch. 114, § 126, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

A rubber stamp endorsement is valid and sufficient to transfer title to the instrument endorsed, when made by one having authority. Cooper v. Albuquerque Nat'l Bank, 75 N.M. 295, 404 P.2d 125 (1965).

Liability of partnership generally. - Where one partner executes a negotiable note in his own name, even though for partnership purposes, the firm is not liable thereon. Harris v. Singh, 34 N.M. 470, 283 P. 910 (1929) (decided under former law).

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

Cooper v. Albuquerque Nat'l Bank, 75 N.M. 295, 404 P.2d 125 (1965), commented on in 6 Nat. Resources J. 142 (1966).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 209, 210, 212, 556.

Sufficiency of signing or endorsing a bill or note by printing or stamping, 7 A.L.R. 672, 46 A.L.R. 1498.

Place of maker's signature on bill or note, 20 A.L.R. 394.

Construction and effect of statutes as to doing business under an assumed or fictitious name or designation not showing the names of the persons interested, 42 A.L.R.2d 516.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

10 C.J.S. Bills and Notes § 27 et seq.; 80 C.J.S. Signatures § 1 et seq.

55-3-402. Signature by representative.

(a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented

person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to Subsection (c), if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

History: 1978 Comp., § 55-3-402, enacted by Laws 1992, ch. 114, § 127.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states when the represented person is bound on an instrument if the instrument is signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3-401(1) stated that "no person is liable on an instrument unless his signature appears thereon." This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P's behalf and A signed A's name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the

person entitled to enforce the note can also prove that P authorized A to sign on P's behalf, why shouldn't P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former Section 3-401(1) if an authorized agent signed "as agent" but the note did not identify the principal. If the dispute was between the agent and the payee of the note, the agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3-403(2)(b). Under the prevailing interpretation of former Section 3-401(1), the principal was not liable on the note under former Section 3-401(1) because the principal's name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3-402(a) [55-3-402 NMSA 1978] the principal would be liable on the note.

2. Subsection (b) concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3-403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) states that if the form of the signature unambiguously shows that it is made on behalf of an identifed represented person (for example, "P, by A, Treasurer") the agent is not liable. This is a workable standard for a court to apply. Subsection (b)(2) partly changes former Section 3-403(2). Subsection (b)(2) relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1). The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case #1. Doe signs "John Doe" without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case #2. Doe signs "John Doe, Agent" but the note does not identify Richard Roe as the represented person.

Case #3. The name "Richard Roe" is written on the note and immediately below that name Doe signs "John Doe" without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases does Doe's signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a). If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3-403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent's name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3-403(2)(a) even though both parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) changes the result of those cases, and is consistent with Section 3-117 [55-3-117 NMSA 1978] which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3-403 spoke of the represented person being "named" in the instrument. Section 3-402 [55-3-402 NMSA 1978] speaks of the represented person being "identified" in the instrument. This change in terminology is intended to reject decisions under former Section 3-403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule cases decided under former Article 3 such as Griffin v. Ellinger, 538 S.W.2d 97 (Texas 1976).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-402 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-402, relating to signature in ambiguous capacity, effective July 1, 1992. Laws 1992, ch. 114, § 127 enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Treasurer not presumptively signing for corporation. - The treasurer of a corporation is not such an officer thereof as makes his signing a promissory note presumptively or prima facie the act of the corporation and the burden of showing he acted with authority is upon the plaintiff. Oak Grove & Sierra Verde Cattle Co. v. Foster, 7 N.M. 650, 41 P. 522 (1895) (decided under former law).

But when corporation unable to deny authority of president. - In suit by the payee of a note which was signed by the man who was president of a corporation as "Cox Bros., Inc., by Hal R. Cox," in the presence of his brother who was treasurer, the corporation will be estopped to deny its signature or the authority of the president to sign for the corporation, the payee having no knowledge of any limitation of authority; especially in view of the fact that similar transactions and similar notes had been acknowledged and paid. Timberlake v. Cox Bros., 39 N.M. 183, 43 P.2d 924 (1935).

Parol evidence is admissible to prove fraud on underlying transaction concerning a promissory note where a representative claims to have signed the instrument under the influence of fraudulent misrepresentations as to personal liability. Hot Springs Nat'l Bank v. Stoops, 94 N.M. 568, 613 P.2d 710 (1980).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 328, 466, 550, 555, 556, 558 to 560, 562, 566, 575; 12 Am. Jur. 2d Bills and Notes § 1241.

Authority of agent to endorse and transfer commercial paper, 12 A.L.R. 111, 37 A.L.R.2d 453.

Liability of principal for overdraft drawn by agent and paid by bank, 58 A.L.R. 816.

Personal liability of one who signs or endorses without qualification commercial paper of corporation, 82 A.L.R.2d 424.

Construction and application of UCC § 3-403(2) dealing with personal liability of authorized representative who signs negotiable instrument in his own name, 97 A.L.R.3d 798.

2A C.J.S. Agency § 233 et seq.; 10 C.J.S. Bills and Notes § 12.

55-3-403. Unauthorized signature.

(a) Unless otherwise provided in this article or Article 4, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this article.

(b) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(c) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this article which makes the unauthorized signature effective for the purposes of this article.

History: 1978 Comp., § 55-3-403, enacted by Laws 1992, ch. 114, § 128.

ANNOTATIONS

OFFICIAL COMMENT

1. "Unauthorized" signature is defined in Section 1-201(43) [55-1-201 NMSA 1978] as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the * * * lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3-403(a) [55-3-403 NMSA 1978] deals with the problem by removing the preclusion language that appeared in former Section 3-404.

2. The except clause of the first sentence of subsection (a) states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer's liability is not in damages for breach of warranty of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume

liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) clarifies the meaning of "unauthorized" in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section 4-406(f)) [55-4-406 NMSA 1978] barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) refers to "the authorized signature of an organization." The definition of "organization" in Section 1-201(28) [55-1-201 NMSA 1978] is very broad. It covers not only commercial entities but also "two or more persons having a joint or common interest." Hence subsection (b) would apply when a husband and wife are both required to sign an instrument.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-403 NMSA 1978, as enacted by Laws 1967, ch. 186, § 9, relating to signature by authorized representative, effective July 1, 1992. Laws 1992, ch. 114, § 128, enacts the above provision, effective July 1, 1992. For provisions of former section, see 1991 Cumulative Supplement. For present comparable provisions, see 55-3-402 NMSA 1978.

Compiler's note. - The cases in the following notes were decided under former law.

Effect of denial of signature by alleged maker. - A denial by the alleged maker of a promissory note, under oath, of the signature thereto, coupled with an allegation that the signature was a forgery, placed in issue the genuineness and due execution of the same. Wight v. Citizens' Bank, 17 N.M. 71, 124 P. 478 (1912).

Not affirmative defense. - Where alleged maker of a promissory note, under oath, denied the signature thereto, and alleged that the signature was a forgery, it did not constitute an affirmative defense, casting upon the defendant the burden to establish by

a preponderance of the evidence that he did not make and execute the note in question. Wight v. Citizens' Bank, 17 N.M. 71, 124 P. 478 (1912).

But where corporation unable to deny authority of president. - Where the president of a corporation signed the corporation's name to a note, the treasurer being present and making no objection, the corporation was estopped to claim the signature as inadvertent, it having paid two other notes to the same payee, signed by the president. Timberlake v. Cox Bros., 39 N.M. 183, 43 P.2d 924 (1935).

Liability on forged instrument generally. - Where a bank, in good faith and for value, purchases from an endorser or holder a check upon another bank, and endorses and forwards same to its collection agency for collection, and the collection agency on presenting same to drawee bank receives payment, the drawee bank on discovery of the check to be forged cannot recover the money back from bank to whom it was paid without proving negligence by the latter. State Nat'l Bank v. Bank of Magdalena, 21 N.M. 653, 157 P. 498, 1916E L.R.A. 1296 (1916).

If endorsement of the payee be treated as a forgery, the bank as subsequent endorsee acquired no rights under it, and it is liable on its guarantee on an adjusted service certificate issued pursuant to World War Adjusted Compensation Act [38 U.S.C. § 591 et seq.] unless the United States is by its laches precluded from asserting the guaranty. United States v. First Nat'l Bank, 131 F.2d 985 (10th Cir. 1942), cert. denied, 318 U.S. 774, 63 S. Ct. 830, 87 L. Ed. 1144 (1943).

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 3 Am. Jur. 2d Agency §§ 81, 152; 10 Am. Jur. 2d Banks § 624; 11 Am. Jur. 2d Bills and Notes §§ 704, 709, 710, 712 to 714.

Payment of check upon forged or unauthorized endorsement as affecting the right of true owner against the bank, 14 A.L.R. 764, 69 A.L.R. 1076, 137 A.L.R. 874.

Right of drawee of forged check or draft to recover amount paid thereon, 121 A.L.R. 1056.

Right of owner of check against one who cashes it on a forged or unauthorized endorsement and procures its payment by drawee, 100 A.L.R.2d 670.

What constitutes ratification of unauthorized signature under U.C.C. § 3-404, 93 A.L.R.3d 967.

10 C.J.S. Bills and Notes § 27 et seq.

55-3-404. Impostors; fictitious payees.

(a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (Section 55-3-110(a) or (b) NMSA 1978) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under Subsection (a) or (b), an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which Subsection (a) or (b) applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

History: 1978 Comp., § 55-3-404, enacted by Laws 1992, ch. 114, § 129.

ANNOTATIONS

OFFICIAL COMMENT

1. Under former Article 3, the impostor cases were governed by former Section 3-405(1)(a) and the fictitious payee cases were governed by Section 3-405(1)(b). Section 3-404 [55-3-404 NMSA 1978] replaces former Section 3-405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3-405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 rejects this result. Section 3-404(c) [55-3-404 NMSA 1978] requires only that the indorsement be made in a name "substantially similar" to that of the payee. Subsection (c) also recognizes the fact that checks may be deposited without indorsement. Section 4-205(a) [55-4-205 NMSA 1978].

Subsection (a) changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3-405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3-405. In revised Article 3, Section 3-404(a) [55-3-404 NMSA 1978] gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) is based in part on former Section 3-405(1)(b) and in part on N.I.L. § 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b):

Case #1. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a non-existent company. Subsection (b) applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer indorses the check in the name "Supplier Co." and deposits it in Depositary Bank. Under subsection (b)(2) and (c)(i), the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3-301.

Case #2. Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3-405 [55-3-405 NMSA 1978] rather than Section 3-404(b) [55-3-404 NMSA 1978], but the result is the same. See Case #6 in Comment 3 to Section 3-405 [55-3-405 NMSA 1978].

Case #3. Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer obtains possession of the check after it is signed. Subsection (b) applies because Treasurer is "a person whose intent determines to whom an instrument is payable" and Treasurer does not intend Supplier Co. to have

any interest in the check. Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name "Supplier Co."

Case #4. Checks of Corporation are signed by a check-writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check-writing machine to produce a check payable to Supplier Co., a non-existent company. Subsection (b)(ii) applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1). Under Section 3-301 [55-3-301 NMSA 1978] Thief, as holder, is the "person entitled to enforce the instrument" even though Thief does not have title to the check and is in wrongful possession of it. Thief indorses the check in the name "Supplier Co." and deposits it in an account in Depositary Bank which Thief opened in the name "Supplier Co." Depositary Bank takes the check in good faith and credits the "Supplier Co." account. Under subsection (b)(2) and (c)(i), the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation's account if there was an agreement with Corporation allowing the bank to debit Corporation's account for payment of checks produced by the check-writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) applies. Under Section 3-110(b) [55-3-110 NMSA 1978] Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) [55-3-417 or 55-4-208 NMSA 1978, respectively] because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case #5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case #4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name "Supplier Co." Thief either indorses the check in a name other than "Supplier Co." or does not indorse the check at all. Under Section 4-205(a) [55-4-205 NMSA 1978] a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer indorses. Subsection (c)(ii) treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under

Section 3-417(a)(1) or 4-208(a)(1) [55-3-417 or 55-4-208 NMSA 1978, respectively] because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe's signature, there is no breach of warranty under Section 3-417(a)(3) or 4-208(a)(3) [55-3-417 or 55-4-208 NMSA 1978, respectively]. Because the check was a forged check the drawee bank is not entitled to charge Corporation's account unless Section 3-406 or Section 4-406 [55-3-406 or 55-4-406 NMSA 1978, respectively] applies.

3. In cases governed by subsection (a) the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section 3-418 [55-3-418 NMSA 1978] the drawee bank is not entitled to recover form Depositary Bank on the basis of payment by mistake because Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3-417(a)(1) or (3) or 4-208(a)(1) or (3) [55-3-417 or 55-4-208 NMSA 1978, respectively]. Unless Section 3-406 [55-3-406 NMSA 1978] applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the drawer of the check rather than on the drawee or the Depositary Bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978]. An example of the type of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in

Comment 4 to Section 3-405 [55-3-405 NMSA 1978]. That comment addresses the last sentence of Section 3-405(b) [55-3-405 NMSA 1978] which is similar to Section 3-404(d) [55-3-404 NMSA 1978].

In Case #1, Case #2, and Case #3, there was no forgery of the drawer's signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3-418 and Sections 3-417(a)(3) and 4-208(a)(3) [55-3-418 and 55-3-417 and 55-4-208 NMSA 1978, respectively]. This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) applies to those cases. If the depositary bank failed to excercise ordinary care and the failure substantially contributed to the loss, the drawer in Case #4 or the drawee bank in Case #5 has a cause of action against the depositary bank under subsection (d). Comment 4 to Section 3-405 [55-3-405 NMSA 1978] can be used as a guide to the type of conduct that could give rise to recovery under Section 3-404(d) [55-3-404 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-404 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-404, relating to unauthorized signatures, effective July 1, 1992. Laws 1992, ch. 114, § 129, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-403 NMSA 1978.

Section is exception to general rule of nonliability. - As a general rule, forged indorsements are ineffective to pass title or to authorize a drawee to pay. But this section operates as an exception to the general rule. Western Cas. & Sur. Co. v. Citizens Bank, 676 F.2d 1344 (10th Cir. 1982).

In certain factual situations, this section treats anyone's indorsement in the name of the payee as effective to pass title to the instrument, leaving the drawer liable on the instrument despite the forged indorsement. Western Cas. & Sur. Co. v. Citizens Bank, 676 F.2d 1344 (10th Cir. 1982).

Purpose of the indorsement requirement in this section is primarily to ensure that the check presents a normal appearance and that the person negotiating it can reasonably be identified as the intended payee. Western Cas. & Sur. Co. v. Citizens Bank, 676 F.2d 1344 (10th Cir. 1982).

Subsection (1)(c) covers apparently normal business transaction. - Subsection (1)(c) covers situations in which an employee starts the wheels of normal business procedure in motion to produce a check for a nonauthorized transaction. Western Cas. & Sur. Co. v. Citizens Bank, 676 F.2d 1344 (10th Cir. 1982).

Negligence of bank not relevant under Subsection (1)(c). - A court need not consider allegations of negligence on the part of the bank in a factual situation falling within Subsection (1)(c). Western Cas. & Sur. Co. v. Citizens Bank, 676 F.2d 1344 (10th Cir. 1982).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 638 to 640; 11 Am. Jur. 2d Bills and Notes § 331.

Who must bear loss as between drawer or endorser who delivers check to an impostor and one who purchases, cashes or pays it upon the impostor's endorsement, 81 A.L.R.2d 1365.

Nominal payee rule of U.C.C. § 3-405(1)(b), 92 A.L.R.3d 268.

Construction and application of U.C.C. § 3-405(1)(a) involving issuance of negotiable instrument induced by impostor, 92 A.L.R.3d 608.

10 C.J.S. Bills and Notes §§ 13, 128, 150 et seq.

55-3-405. Employer's responsibility for fraudulent indorsement by employee.

(a) In this section:

(1) "employee" includes an independent contractor and employee of an independent contractor retained by the employer;

(2) "fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee; and

(3) "responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to

supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are a part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under Subsection (b), an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person.

History: 1978 Comp., § 55-3-405, enacted by Laws 1992, ch. 114, § 130.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-405 [55-3-405 NMSA 1978] is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3-405 [55-3-405 NMSA 1978] adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3-405 [55-3-405 NMSA 1978] is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b) allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss.

"Ordinary care" is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978]. The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3-405 [55-3-405 NMSA 1978] are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3-405 [55-3-405 NMSA 1978] includes cases that were covered by former Section 3-405(1)(c). The scope of Section 3-405 [55-3-405 NMSA 1978] in revised Article 3 is, however, somewhat wider. It covers some cases not covered by former Section 3-405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case #6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3-405 [55-3-405 NMSA 1978]. The key provision is the definition of "responsibility" in subsection (a)(1) which identifies the kind of responsibility delegated to an employee which will cause the employer to take responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3-405 [55-3-405 NMSA 1978] - fraudulent endorsements of the name of the employer to instruments payable to the employer - were covered in former Article 3 by Section 3-406. Under former Section 3-406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3, Section 3-406 [55-3-406 NMSA 1978] need not be used with respect to forgeries of the employer's indorsement. Section 3-405 [55-3-405 NMSA 1978] imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3-405(1)(c), Section 3-405 [55-3-405 NMSA 1978] is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3-405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised section 3-405 [55-3-405 NMSA 1978] the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3-404(b) and Section 3-405 [55-3-404 and 55-3-405 NMSA 1978, respectively] both apply to cases of employee fraud. Section 3-404(b) [55-3-404 NMSA 1978] is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3-405 [55-3-405 NMSA 1978]. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case #1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer's offices. Janitor forges Employer's indorsement on the check and obtains payment. Since Janitor was not entrusted with "responsibility" with respect to the check, Section 3-405 [55-3-405 NMSA 1978] does not apply. Section 3-406 [55-3-406 NMSA 1978] might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for

conversion against the depositary or payor bank under Section 3-420 [55-3-420 NMSA 1978].

Case #2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section 3-402(a) [55-3-402 NMSA 1978]. Section 3-405 [55-3-405 NMSA 1978] does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3-110(a) [55-3-110 NMSA 1978].

Case #3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer's indorsement. The check is deposited by employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer's indorsement because Employee's duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with "responsibility" with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4-205(a) [55-4-205 NMSA 1978]. Under subsection (c) deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case #4. Employee's duties include stamping Employer's unrestricted blank indorsement on checks received by Employer and depositing them in Employer's bank account. After stamping Employer's unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee's personal bank account. Section 3-405 doesn't apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer's checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3-307 [55-3-307 NMSA 1978].

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a check to be issued to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had

entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co., and deposited it to an account in Depositary Bank which Employee opened in the name "Supplier Co." The check was honored by the drawee bank. The indorsement is effective under Section 3-405(b) [55-3-405 NMSA 1978] because Employee's duties allowed Employee to supply information determining the address of payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3-417(a)(1) or 4-208(a)(1) [55-3-417 or 55-4-208 NMSA 1978, respectively].

Case #6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to "Supplier Co.", a company that sold goods to Corporation. The check was issued to pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name "Supplier Co." and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name "Supplier Co.". The indorsement is effective under Section 3-405(b) [55-3-405 NMSA 1978]. Section 3-404(b) [55-3-404 NMSA 1978] does not apply to this case.

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk's duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co., a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(i) [55-3-404 NMSA 1978] does not apply to this case because Clerk, under Section 3-110(a) [55-3-110 NMSA 1978], is not the person whose intent determines to whom the check is payable. But Section 3-405 [55-3-405 NMSA 1978] does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3-404(b)(ii) [55-3-404 NMSA 1978] applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3-417(1)(a) [55-3-417 NMSA 1978].

4. The last sentence of subsection (b) is similar to subsection (d) of Section 3-404 [55-3-404 NMSA 1978] which is discussed in Comment 3 to Section 3-404 [55-3-404 NMSA 1978]. In Case #5, Case #6, or Case #7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name "Supplier Co.", to deposit checks payable to "Supplier Co." in that account, or to

withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check. If the trier of fact finds that there was such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) can be illustrated by an example. Suppose in Case #5 that the check is not payable to an obscure "Supplier Co." but rather to a well-known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation's board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-405 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-405, relating to impostors, effective July 1, 1992. Laws 1992, ch. 114, § 130, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-404 NMSA 1978.

55-3-406. Negligence contributing to forged signature or alteration of instrument.

(a) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) Under Subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(c) Under Subsection (a), the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under Subsection (b), the burden of proving failure to exercise ordinary care is on the person precluded.

History: 1978 Comp., § 55-3-406, enacted by Laws 1992, ch. 114, § 131.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-406(a) [55-3-406 NMSA 1978] is based on former Section 3-406. With respect to alteration, Section 3-406 [55-3-406 NMSA 1978] adopts the doctrine of *Young v. Grote*, 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3-406 [55-3-406 NMSA 1978] the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any "person who, in good faith, pays the instrument or takes it for value or for collection." Section 3-406 [55-3-406 NMSA 1978] rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3-407 [55-3-407 NMSA 1978] a person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substantially contributes to an alteration, this section gives the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute "failure to exercise ordinary care [that] substantially contributes to an alteration." Rather, "ordinary care" is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978] in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3-406 [55-3-406 NMSA 1978] does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3-406 [55-3-406 NMSA 1978] applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3-406 [55-3-406 NMSA 1978] refers to "forged signature" rather than "unauthorized signature" that appeared in former Section 3-406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3-406 is not necessary in those cases.

The "substantially contributes" test of former Section 3-406 is continued in this section in preference to a "direct and proximate cause" test. The "substatially contributes" test is meant to be less stringent than a "direct and proximate cause" test. Under the less stringent test the preclusion should be easier to establish. Conduct "substantially contributes" to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of "substantially contributes" in former Section 3-406 by the court in *Thompson Maple Products v. Citizens National Bank of Corry*, 234 A.2d 32 (Pa.Super.Ct.1967), states what is intended by the use of the same words in revised Section 3-406(b) [55-3-406 NMSA 1978]. Since Section 3-404(d) and Section 3-405(b) [55-3-404 and 55-3-405 NMSA 1978, respectively] also use the words "substantially contributes" the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3-406(a) [55-3-406 NMSA 1978]:

Case #1. Employer signs checks drawn on Employer's account by use of a rubber stamp of Employer's signature. Employer keeps the rubber stamp along with Employer's personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer's account. The checks are signed by use of the rubber stamp. If Employer demands that Employer's account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer's signature by the unauthorized use of the rubber stamp.

Case #2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3-110(a) [55-3-110 NMSA 1978]. The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case #3. A company writes a check for $10. The figure "10" and the word "ten" are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the check, using a typewriter with a typeface similar to that used on the check, writes the word "thousand" after the word "ten" and a comma and three zeros after the figure "10". The drawee bank in good faith pays $10,000 when the check is presented for payment and debits the account of the drawer

in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check of collection. An example is a case like Case #1 of Comment 3 to Section 3-405 [55-3-405 NMSA 1978]. If the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) of Section 3-406 [55-3-406 NMSA 1978] applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a). But suppose the forger opened an account in the depositary bank in a name identical to that of the employer, the payee of the check, and then deposited the check in the account. Subsection (b) may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-406 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-406, relating to negligence contributing to alteration or unauthorized signature, effective July 1, 1992. Laws 1992, ch. 114, § 131, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-407. Alteration.

(a) "Alteration" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(b) Except as provided in Subsection (c), an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is

precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(c) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

History: 1978 Comp., § 55-3-407, enacted by Laws 1992, ch. 114, § 132.

ANNOTATIONS

OFFICIAL COMMENT

1. This provision restates former Section 3-407. Former Section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3-407 [55-3-407 NMSA 1978] refers to such a change as an alteration. As under subsection (2) of former Section 3-407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase "or is precluded from asserting the alteration" in subsection (b) recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-407 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-407, relating to alteration, effective July 1, 1992. Laws 1992, ch. 114, § 132, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Generally. - Defense of alteration of an instrument is not available under pleadings alleging fraud. Schmidt v. Bank of Commerce, 234 U.S. 64, 34 S. Ct. 730, 58 L. Ed. 1214 (1914) (decided under former law).

Defense of alteration of instrument by addition of other signatures must be pleaded to be available to other comakers. Schmidt v. Bank of Commerce, 234 U.S. 64, 34 S. Ct. 730, 58 L. Ed. 1214 (1914) (decided under former law).

This section is not applicable unless the alteration made by the holder was fraudulent; and where there is no evidence from which an inference of fraud could be drawn, there is no question of fact for the jury concerning discharge of the maker. Bank of N.M. v. Rice, 78 N.M. 170, 429 P.2d 368 (1967).

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 4 Am. Jur. 2d Alteration of Instruments § 29; 11 Am. Jur. 2d Bills and Notes §§ 78, 666.

Alteration of commercial paper by reducing the amount, 9 A.L.R. 1087.

Liability of party to commercial paper so drawn as to be easily alterable as to amount, 22 A.L.R. 1139, 36 A.L.R. 327, 39 A.L.R. 1380.

Rights and liabilities of bank with respect to certified check or draft fraudulently altered, 22 A.L.R. 1157.

Detachment of paper used to conceal the nature or terms of a bill or note which one signed or endorsed, as an alteration, 34 A.L.R. 532.

Alteration of note before delivery to payee as affecting parties who do not personally consent, 44 A.L.R. 1244.

Erasing endorsement of payment as an alteration of instrument, 44 A.L.R. 1540.

Alteration of instrument by agent as binding on principal, 51 A.L.R. 1229.

Rights and liabilities of drawee bank, as to persons other than drawer, with respect to uncertified check which was altered, 75 A.L.R.2d 611.

What constitutes "fraudulent and material" alteration of negotiable instrument under U.C.C. § 3-407(2)(a), 88 A.L.R.3d 905.

3A C.J.S. Alteration of Instruments § 5 et seq.; 10 C.J.S. Bills and Notes §§ 33, 997.

55-3-408. Drawee not liable on unaccepted draft.

A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

History: 1978 Comp., § 55-3-408, enacted by Laws 1992, ch. 114, § 133.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is a restatement of former section 3-409(1). Subsection (2) of former Section 3-409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): "It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument." In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1-103 [55-1-103 NMSA 1978] is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4-302 [55-4-302 NMSA 1978] imposes liability on a payor bank for late return of an item.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-408 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-408, relating to consideration, effective July 1, 1992. Laws 1992, ch. 114, § 133, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-409. Acceptance of draft; certified check.

(a) "Acceptance" means the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(b) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(c) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(d) "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in Subsection (a) or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

History: 1978 Comp., § 55-3-409, enacted by Laws 1992, ch. 114, § 134.

ANNOTATIONS

OFFICIAL COMMENT

1. The first three subsections of Section 3-409 [55-3-409 NMSA 1978] are a restatement of former Section 3-410. Subsection (d) adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3-408. Any liability is for breach of the separate agreement.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-409 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-409, relating to draft not an assignment, effective July 1,

1992. Laws 1992, ch. 114, § 134, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Under former law, oral acceptance is not binding upon the drawee. Clayton Townsite Co. v. Clayton Drug Co., 20 N.M. 185, 147 P. 460 (1915); Hanna v. McCrory, 19 N.M. 183, 141 P. 996 (1914).

Mere act of stamping bill of exchange "paid" by payee is not acceptance. Hanna v. McCrory, 19 N.M. 183, 141 P. 996 (1914) (decided under former law).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 500, 503, 504, 506, 507, 510; 12 Am. Jur. 2d Bills and Notes § 1241.

Acceptance of checks by telegraph or telephone, 2 A.L.R. 1146, 13 A.L.R. 989.

Ratification by corporation of unauthorized acceptance of commercial paper by officer by acceptance and retention of benefits, 7 A.L.R. 1472.

Clearinghouse transactions as payment or acceptance of checks, 12 A.L.R. 998, 30 A.L.R. 1028.

What amounts to acceptance extrinsic to check, 26 A.L.R. 312.

Acceptance of cashier's check from debtor as absolute or conditional payment, 36 A.L.R. 470, 42 A.L.R. 1353, 45 A.L.R. 1487.

Bank's acceptance of check as affected by attempt to pay it otherwise than in cash, 38 A.L.R. 185.

Drawee's mere writing of his name on bill as an acceptance thereof, 48 A.L.R. 760.

Discharge of drawer or endorser of check by holder's acceptance therefor of something other than money, 52 A.L.R. 994, 87 A.L.R. 442.

Destruction of or refusal to return bill as an acceptance, 63 A.L.R. 1138.

Uniform Commercial Code: bank's right to stop payment on its own uncertified check or money order, 97 A.L.R.3d 714.

Provision in draft or note directing payment "on acceptance" as affecting negotiability, 19 A.L.R.4th 1268.

3A C.J.S. Alteration of Instruments § 66; 10 C.J.S. Bills and Notes § 37 et seq.

55-3-410. Acceptance varying draft.

(a) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(b) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(c) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

History: 1978 Comp., § 55-3-410, enacted by Laws 1992, ch. 114, § 135.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is a restatement of former Section 3-412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee's obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) the effect of the holder's assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-

501(b)(1) [55-3-501 NMSA 1978] states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3-111) [55-3-111 NMSA 1978] which in this case is at the designated bank.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-410 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-410, relating to definition and operation of acceptance, effective July 1, 1992. Laws 1992, ch. 114, § 135, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-409 NMSA 1978.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 515, 517, 518, 520.

10 C.J.S. Bills and Notes §§ 38, 160.

55-3-411. Refusal to pay cashier's checks, teller's checks, and certified checks.

(a) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(b) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment of a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(c) Expenses or consequential damages under Subsection (b) are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

History: 1978 Comp., § 55-3-411, enacted by Laws 1992, ch. 114, § 136.

ANNOTATIONS

OFFICIAL COMMENT

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor's check, but more frequently the debtor buys from a bank a cashier's check or teller's check payable to the

creditor. The check is taken by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which the check is given in payment. In the case of a certified check or cashier's check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3-602) [55-3-602 NMSA 1978]. It is also clear that the bank that sells a teller's check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3-411 [55-3-411 NMSA 1978] is designed to discourage this practice.

2. The term "obligated bank" refers to the issuer of the cashier's check or teller's check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3-202 [55-3-202 NMSA 1978]. See Comment 2 to Section 3-201 [55-3-201 NMSA 1978]. The bank can assert that claim if there is compliance with Section 3-305(c) [55-3-305 NMSA 1978], but the bank is not protected from damages under subsection (b) if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3-602(b)(1) [55-3-602 NMSA 1978]. Subsection (c)(iii) refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier's check is payable to "Supplier Co." The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-411 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-411, relating to certification of a check, effective July 1, 1992.

Laws 1992, ch. 114, § 136, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-412. Obligation of issuer of note or cashier's check.

The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 55-3-115 and 55-3-407 NMSA 1978. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under Section 55-3-415 NMSA 1978.

History: 1978 Comp., § 55-3-412, enacted by Laws 1992, ch. 114, § 137.

ANNOTATIONS

OFFICIAL COMMENT

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3-412 [55-3-412 NMSA 1978] states the obligation of the maker of a note and is consistent with former Section 3-413(1). Section 3-412 [55-3-412 NMSA 1978] also applies to the issuer of a cashier's check or other draft drawn on the drawer. Under former Section 3-118(a), since a cashier's check or other draft drawn on the drawer was "effective as a note," the drawer was liable under former Section 3-413(1) as a maker. Under Sections 3-103(a)(6) and 3-104(f) [55-3-103 and 55-3-104 NMSA 1978, respectively] a cashier's check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3-412 [55-3-412 NMSA 1978] as being the same as that of the maker of a note rather than that of the drawer of a draft. Thus, Section 3-412 [55-3-412 NMSA 1978] does not in substance change former law.

2. Under Section 3-105(b) [55-3-105 NMSA 1978] nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3-406 [55-3-406 NMSA 1978], the maker is precluded from asserting the alteration.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-412 NMSA 1978, as enacted by Laws 1967, ch. 186, § 10, relating to acceptance varying draft, effective July 1, 1992. Laws 1992, ch. 114, § 137, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-410 NMSA 1978.

Compiler's note. - Laws 1967, ch. 186, § 11, is compiled as 55-3-504 NMSA 1978.

55-3-413. Obligation of acceptor.

(a) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in Sections 55-3-115 and 55-3-407 NMSA 1978. The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under Section 55-3-414 or 55-3-415 NMSA 1978.

(b) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

History: 1978 Comp., § 55-3-413, enacted by Laws 1992, ch. 114, § 138.

ANNOTATIONS

OFFICIAL COMMENT

Subsection (a) is consistent with former Section 3-413(1). Subsection (b) has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-413 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-413, relating to contract of maker, drawer and acceptor, effective July 1, 1992. Laws 1992, ch. 114, § 138, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Maker of promissory note is "primarily liable" thereon although he signs only for accommodation. First Sav. Bank & Trust Co. v. Flournoy, 24 N.M. 256, 171 P. 793 (1917) (decided under former law).

Effect of acceptance of bill of exchange is to constitute the acceptor the principal debtor. By the act of acceptance, he assumes to pay the order or bill, and becomes the principal debtor for the amount specified; the acceptance being an admission of

everything essential to the existence of such liability. Clayton Townsite Co. v. Clayton Drug Co., 20 N.M. 185, 147 P. 460 (1915) (decided under former law).

Unauthorized grant of extension. - Although a surety or accommodation party to a note may be discharged when the holder unauthorizedly grants an extension, the maker of the note does not have this defense available. Sunwest Bank v. Kennedy, 109 N.M. 400, 785 P.2d 740 (1990).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 586, 589, 593, 597, 1005.

Insanity of drawer or indorser as defense against holder in due course, 24 A.L.R.2d 1380.

10 C.J.S. Bills and Notes § 12 et seq.

55-3-414. Obligation of drawer.

(a) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 55-3-115 and 55-3-407 NMSA 1978. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under Section 55-3-415 NMSA 1978.

(c) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(d) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under Section 55-3-415(a) and (c) NMSA 1978.

(e) If a draft states that it is drawn "without recourse" or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under Subsection (b) to pay the draft if the draft is not a check. A disclaimer of the liability stated in Subsection (b) is not effective if the draft is a check.

(f) If (i) a check is not presented for payment or given to a depositary bank for collection within thirty days after its date, (ii) the drawee suspends payments after expiration of the thirty-day period without paying the check, and (iii) because of the suspension of

payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds.

History: 1978 Comp., § 55-3-414, enacted by Laws 1992, ch. 114, § 139.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) excludes cashier's checks because the obligation of the issuer of a cashier's check is stated in Section 3-412 [55-3-412 NMSA 1978].

2. Subsection (b) states the obligation of the drawer on an unaccepted draft. It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to indorser's liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).

3. Under subsection (c) the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3-205(d) [55-3-205 NMSA 1978].

4. Subsection (d) states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3-408 [55-3-408 NMSA 1978]. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an indorser, and subsection (d) states the drawer's liability that way. The drawer is liable to pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3-415 [55-3-415 NMSA 1978]. The drawer in this case is discharged if notice of dishonor is required by Section 3-503 [55-3-503 NMSA 1978] and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3-413(a) [55-3-413 NMSA 1978].

5. Subsection (e) does not permit the drawer of a check to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is

effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3-502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the $1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3-502(e) [55-3-502 NMSA 1978]. If the suspension of payments by the drawee bank will result in payment to X of less than the full amount of the $1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds $100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-414 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-414, relating to contract of indorser and order of liability, effective July 1, 1992. Laws 1992, ch. 114, § 139, enacts the above provision, effective July 1, 1992. For provisions of former section, see 1991 Cumulative Supplement. For present comparable provisions, see 55-3-415 NMSA 1978.

55-3-415. Obligation of indorser.

(a) Subject to Subsections (b), (c), and (d) and to Section 55-3-419(d) NMSA 1978, if an instrument is dishonored, an indorser is obliged to pay the amount due on the

instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in Sections 55-3-115 and 55-3-407 NMSA 1978. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(b) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under Subsection (a) to pay the instrument.

(c) If notice of dishonor of an instrument is required by Section 55-3-503 NMSA 1978 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under Subsection (a) is discharged.

(d) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under Subsection (a) is discharged.

(e) If an indorser of a check is liable under Subsection (a) and the check is not presented for payment, or given to a depositary bank for collection, within thirty days after the day the indorsement was made, the liability of the indorser under Subsection (a) is discharged.

History: 1978 Comp., § 55-3-415, enacted by Laws 1992, ch. 114, § 140.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsections (a) and (b) restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an indorser. It is covered in subsection (c). Regulation CC § 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3-503 [55-3-503 NMSA 1978] states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3-503 [55-3-503 NMSA 1978], subsection (c) of Section 3-415 [55-3-415 NMSA 1978] states that the effect is to discharge the indorser's obligation.

3. Subsection (d) is similar in effect to Section 3-414(c) [55-3-414 NMSA 1978] if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3-414 [55-3-414 NMSA 1978]. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a).

4. Subsection (e) modified former Sections 3-503(2)(b) and 3-502(1)(a) by stating a 30-day rather than a seven-day period, and stating it as an absolute rather than a presumptive period.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-415 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-415, relating to contract of accommodation party, effective July 1, 1992. Laws 1992, ch. 114, § 140, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 334, 349, 351, 363, 599, 607, 611, 617 to 620, 628, 629; 12 Am. Jur. 2d Bills and Notes §§ 1241, 1268, 1271, 1274.

Undertaking of one who endorses a note without recourse, 2 A.L.R. 216, 91 A.L.R. 399.

Admissibility of parol evidence to vary or explain the contract implied from the regular endorsement of a bill or note, 4 A.L.R. 764, 11 A.L.R. 637, 22 A.L.R. 527, 35 A.L.R. 1120, 54 A.L.R. 999, 92 A.L.R. 721.

Necessity of express agreement between endorsers to be jointly and not successively liable, in order to give a right of contribution as between themselves, 11 A.L.R. 1332, 90 A.L.R. 305.

Endorsement of bill or note in form of guaranty as transferring title, 21 A.L.R. 1375, 33 A.L.R. 97, 46 A.L.R. 1516.

Endorsement without recourse as affecting character of endorsee or subsequent holder as holder in due course, 77 A.L.R. 487.

Insanity of endorser as defense against holder in due course, 24 A.L.R.2d 1380.

10 C.J.S. Bills and Notes § 154 et seq.

55-3-416. Transfer warranties.

(a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(1) the warrantor is a person entitled to enforce the instrument;

(2) all signatures on the instrument are authentic and authorized;

(3) the instrument has not been altered;

(4) the instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) A person to whom the warranties under Subsection (a) are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in Subsection (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under Subsection (b) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

History: 1978 Comp., § 55-3-416, enacted by Laws 1992, ch. 114, § 141.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) is taken from subsection (2) of former Section 3-417. Subsections (3) and (4) of former Section 3-417 are deleted. Warranties under subsection (a) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If

there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3-203(a)) [55-3-203 NMSA 1978] is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument, (Section 3-301) [55-3-301 NMSA 1978]. Under Section 3-203(b) [55-3-203 NMSA 1978] transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the instrument the issue of the holder-in-due-course status of the transferee. Subsection (3) of former Section 3-417 which limits this warranty is deleted. The rationale is that while the purpose of a "no recourse" indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1-201(22) [55-1-201 NMSA 1978] have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor's liability, to be effective, must appear in the indorsement with words such as "without warranties" or some other specific reference to warranties. But in the case of a check, subsection (c) of Section 3-416 [55-3-416 NMSA 1978] provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) states the measure of damages for breach of warranty. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase "expenses * * * incurred as a result of the breach." The intention is to leave to other state law the issue as to when attorney's fees are recoverable.

7. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection

(d) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-416 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-416, relating to contract of guarantor, effective July 1, 1992. Laws 1992, ch. 114, § 141, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-417. Presentment warranties.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the drawer of the draft is unauthorized.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under Subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 55-3-404 or 55-3-405 NMSA 1978 or the drawer is precluded under Section 55-3-406 or 55-4-406 NMSA 1978 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in Subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under Subsection (b) or (d) is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

History: 1978 Comp., § 55-3-417, enacted by Laws 1992, ch. 114, § 142.

ANNOTATIONS

OFFICIAL COMMENT

1. This section replaces subsection (1) of former Section 3-417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3-417 [55-3-417 NMSA 1978], presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a). All other presentment warranties are stated in subsection (d).

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements. "Person entitled to enforce" is defined in Section 3-301 [55-3-301 NMSA 1978]. Subsection (a)(2) is a warranty that there is no alteration. Subsection (a)(3) is a warranty of no knowledge that there is a forged drawer's signature. Subsection (a) states that the warranties are made to the drawee and subsection (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In Sun 'N Sand, Inc. v. United California Bank, 582 P.2d 920 (Cal.1978), the court held that under former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) retains the rule of Price v. Neal, 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) applies to presentment for payment in all cases not covered by subsection (a). It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d), there is only one warranty and it is the same as that stated in subsection (a)(1). There are no warranties comparable to subsections (a)(2) and (a)(3) because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to the drawee when the draft was presented for acceptance (Section 3-417(a)(2) and (3)) [55-3-417 NMSA 1978] and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3-417(b) [55-3-417 NMSA 1978]. Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented for payment. Former Section 3-417(1)(b)(iii) and (c)(iii) are not included in revised Section 3-417 [55-3-417 NMSA 1978] because they are unnecessary. Former Section 3-417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3-416(a)(2) and (3) [55-3-416 NMSA 1978].

5. The measure of damages for breach of warranty under subsection (a) is stated in subsection (b). There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the breach." Subsection (b) provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in Hartford Accident & Indemnity Co. v. First Pennsylvania Bank, 859 F.2d 295 (3d Cir.1988).

6. Subsection (c) applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3-404, 3-405, 3-406, or 4-406 [55-3-404, 55-3-405, 55-3-406 and 55-4-406 NMSA 1978,

respectively]. If the drawer's conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer of warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (f) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-417 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-417, relating to warranties on presentment and transfer, effective July 1, 1992. Laws 1992, ch. 114, § 142, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 617, 646, 649, 650, 998, 999, 1004 to 1008, 1012 to 1014; 12 Am. Jur. 2d Bills and Notes §§ 1090, 1241, 1268.

Transferee of commercial paper given by purchaser of chattel and secured by conditional sale, retention of title, or chattel mortgage, as subject to defenses which chattel purchaser could assert against seller, 44 A.L.R.2d 8, 39 A.L.R.3d 518.

10 C.J.S. Bills and Notes §§ 39 et seq., 154 et seq.

55-3-418. Payment or acceptance by mistake.

(a) Except as provided in Subsection (c), if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to Section 55-4-403 NMSA 1978 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in Subsection (c), if an instrument has been paid or accepted by mistake and the case is not covered by Subsection (a), the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by Subsection (a) or (b) may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by Section 55-3-417 or 55-4-407 NMSA 1978.

(d) Notwithstanding Section 55-4-215 NMSA 1978, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under Subsection (a) or (b), the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

History: 1978 Comp., § 55-3-418, enacted by Laws 1992, ch. 114, § 143.

ANNOTATIONS

OFFICIAL COMMENT

1. This section covers payment or acceptance by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1-103 [55-1-103 NMSA 1978]. Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section 3-418 [55-3-418 NMSA 1978] specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsection (a) and (c) are consistent with former Section 3-418 and the rule of Price v. Neal. The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee

bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee's account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier's check or teller's check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer's check to Bank for payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for $10,000 payable to Seller. The teller failed to discover Buyer's stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section 4-215 [55-4-215 NMSA 1978], Buyer's check was paid by Bank at the time it delivered its cashier's check to Seller. See Comment 3 to Section 4-215 [55-4-215 NMSA 1978]. Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was issued for consideration because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover $10,000, the amount of Buyer's check, from Seller under Section 3-418(a) [55-3-418 NMSA 1978]. Bank paid Buyer's check by mistake. Seller did not give value for Buyer's check because the promise to deliver goods to Buyer was never performed. Section 3-303(a)(1) [55-3-303 NMSA 1978]. And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section 3-418(c) [55-3-418 NMSA 1978] does not apply and Seller is obliged to return $10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section 3-418(a) [55-3-418 NMSA 1978]. This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section 3-305(a)(3) [55-3-305 NMSA 1978].

If Bank recovers from Seller under Section 3-418(a), the payment of Buyer's check is treated as unpaid and dishonored. Section 3-418(d) [55-3-418 NMSA 1978]. One consequence is that Seller may enforce Buyer's obligation as drawer to pay the check. Section 3-414 [55-3-414 NMSA 1978]. Another consequence is that Seller's rights against Buyer on the contract of sale are also preserved. Under Section 3-310(b) [55-3-310 NMSA 1978] Buyer's obligation to pay for the goods was suspended when Seller took Buyer's check and remains suspended until the check is either dishonored or paid. Under Section 3-310(b)(2) [55-3-310 NMSA 1978] the obligation is discharged when the check is paid. Since Section 3-418(d) [55-3-418 NMSA 1978] treats Buyer's check as

unpaid and dishonored, Buyer's obligation is not discharged and suspension of the obligation terminates. Under Section 3-310(b)(3) [55-3-310 NMSA 1978], Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer.

If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3-418(a) [55-3-418 NMSA 1978] because Seller in that case gave value for Buyer's check. Section 3-418(c) [55-3-418 NMSA 1978]. In this case Bank's sole remedy is under Section 4-407 [55-4-407 NMSA 1978] by subrogation.

3. Subsection (b) covers cases of payment or acceptance by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution § 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the check, the bank is entitled to restitution. But § 29 is subject to Restatement of Restitution § 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father's account to cover the check, caused Daughter's account to be credited for $10,000. In fact, Father's account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from father. Thus, Bank should be permitted to reverse the credit to Daughter's account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check-kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer's credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3-418 [55-3-418 NMSA 1978] to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3-418 [55-3-418 NMSA 1978] is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4-215, it may have a right to recover the payment under Section 3-418. National Savings & Trust Co. v. Park Corp., 722 F.2d 1303 (6th Cir.1983), cert. denied, 466 U.S. 939 (1984), correctly states the law on the issue under former Article 3. Revised Article 3 does not change the previous law.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-418 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-418, relating to finality of payment or acceptance, effective July 1, 1992. Laws 1992, ch. 114, § 143, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-419. Instruments signed for accommodation.

(a) If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation".

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to Subsection (d), is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in Section 55-3-605 NMSA 1978, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

History: 1978 Comp., § 55-3-419, enacted by Laws 1992, ch. 114, § 144.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-419 [55-3-419 NMSA 1978] replaces former Sections 3-415 and 3-416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co-maker or anomalous indorser. Subsection (a) distinguished between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X's direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) of Section 3-419 [55-3-419 NMSA 1978] takes the view stated in Comment 3 to former Section 3-415 that there need be no consideration running to the accommodation party: "The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession."

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co-maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co-maker or indorser. This is relevant to Section 3-605(h) [55-3-605 NMSA 1978]. But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

4. Subsection (b) states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather that payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3-416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in Section 3-415 and in Section 3-416 [55-3-415 and 55-3-416 NMSA 1978, respectively]. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 eliminates that confusion by stating in Section 3-419 [55-3-419 NMSA 1978] the obligation of a person who uses words of guaranty. Portions of former Section 3-416 are preserved. Former Section 3-416(2) is reflected in Section 3-419(d) [55-3-419 NMSA 1978] and former Section 3-416(4) is reflected in Section 3-419(c) [55-3-419 NMSA 1978].

5. Subsection (e) restates subsection (5) of present Section 3-415 [55-3-415 NMSA 1978]. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-419 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-419, relating to conversion of instrument and innocent representative, effective July 1, 1992. Laws 1992, ch. 114, § 144, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-420 NMSA 1978.

55-3-420. Conversion of instrument.

(a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.

(b) In an action under Subsection (a), the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

History: 1978 Comp., § 55-3-420, enacted by Laws 1992, ch. 114, § 145.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-420 [55-3-520 NMSA 1978] is a modification of former Section 3-419. The first sentence of Section 3-420(a) [55-3-520 NMSA 1978] states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3-419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter's right to possession has been denied. The second sentence of Section 3-420(a) [55-3-420 NMSA 1978] states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, e.g., a check payable to John and Jane Doe. Under Section 3-110(d) [55-3-110 NMSA 1978] the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John's account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3-110(d) [55-3-110 NMSA 1978] and Comment 4 to Section 3-110 [55-3-110 NMSA 1978]. Depositary Bank does not get any greater rights under Section 4-205(1) [55-4-205 NMSA 1978]. If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3-420(a) [55-3-420 NMSA 1978] resolves the conflict by following the rule stated in Stone & Webster Engineering Corp. v. First National Bank & Trust Co., 184 N.E.2d 358 (Mass.1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against

the payor bank for recredit of the drawer's account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3, under the last sentence of Section 3-420(a) [55-3-420 NMSA 1978], the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3-301 [55-3-301 NMSA 1978]. Nor is the payee injured by the fraud. Normally the drawer of a check intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee's right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer's account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) [55-3-417 or 55-4-208 NMSA 1978, respectively]. The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3-310(b)(4) [55-3-310 NMSA 1978] provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are restricted to enforcement of the payee's rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee's possession, as for example when it is put into the payee's mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee's indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never deliverd to B. Rather, Thief steals the envelope, forges B's indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check

to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A's property not B's.

2. Subsection (2) of former Section 3-419 is amended because it is not clear why the former law distinguished between the liability of the drawee and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3-419(2) [55-3-419 NMSA 1978] what face amount meant. If a note for $10,000 is payable in a year at 10% interest, it is common to refer to $10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3, Section 3-420(b) [55-3-420 NMSA 1978], by referring to "amount payable on the instrument," allows the full amount due under the instrument to be recovered.

The "but" clause in subsection (b) addresses the problem of conversion actions in multiple payee checks. Section 3-110(d) [55-3-110 NMSA 1978] states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3-110(d) [55-3-110 NMSA 1978]. The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection. See Knesz v. Central Jersey Bank & Trust Co., 477 A.2d 806 (N.J.1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4-208(a)(1) [55-4-208 NMSA 1978] and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense provided by Section 3-420(c) [55-3-420 NMSA 1978] is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

No liability for paying on forged endorsement on bearer paper. - A check drawn to a fictitious payee is the same as if it were made payable to bearer; and, since an endorsement on such paper is not necessary to its validity or negotiability, a bank is not liable for paying on a forged endorsement on bearer paper. Airco Supply Co. v. Albuquerque Nat'l Bank, 68 N.M. 195, 360 P.2d 386 (1961) (decided under former law).

Drawee bank has no right to debit account of depositor on a check which bears a forged signature of the drawer. Airco Supply Co. v. Albuquerque Nat'l Bank, 68 N.M. 195, 360 P.2d 386 (1961) (decided under former law).

Generally, bank converts instrument when pays over unauthorized indorsement. - Absent negligence on the part of an indorser, a bank converts an instrument when it pays over an unauthorized indorsement. Casarez v. Garcia, 99 N.M. 508, 660 P.2d 598 (Ct. App. 1983).

And cashier check's true owner entitled to sue bank. - The true owner of a cashier's check has a right to bring an action for conversion or negligence against a bank as drawee when it pays on an unauthorized indorsement. Casarez v. Garcia, 99 N.M. 508, 660 P.2d 598 (Ct. App. 1983).

Law reviews. - For comment on Jomack Lumber Co. v. Grants State Bank, 75 N.M. 787, 411 P.2d 759 (1966), see 7 Nat. Resources J. 106 (1967).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 101, 510.

Nature of property rights other than tangible chattels which may be subject of conversion, 44 A.L.R.2d 927.

Payee's right of recovery, in conversion under UCC § 3-419(1)(c), for money paid on unauthorized indorsement, 23 A.L.R.4th 855.

Bank's "reasonable commercial standards" defense under UCC § 3-419(3), 49 A.L.R.4th 888.

9 C.J.S. Banks and Banking § 382 et seq.; 10 C.J.S. Bills and Notes §§ 12 et seq., 139; 89 C.J.S. Trover and Conversion § 13 et seq.

PART 5
DISHONOR

55-3-501. Presentment.

(a) "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to

pay the instrument or, in the case of a note or accepted draft payable at the bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to Article 4, agreement of the parties, and clearing-house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt for the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not earlier than 2:00 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cut-off hour.

History: 1978 Comp., § 55-3-501, enacted by Laws 1992, ch. 114, § 146.

ANNOTATIONS

OFFICIAL COMMENT

Subsection (a) defines presentment. Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) restates former Section 3-505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) [repealed] is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cut-off hour for receipt of instruments presented.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-501 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-501, relating to when presentment, notice of dishonor and protest necessary or permissible, effective July 1, 1992. Laws 1992, ch. 114, § 146, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 167, 187, 743, 744, 753, 789, 790, 883 to 887, 897; 12 Am. Jur. 2d Bills and Notes § 1225.

Who must bear loss of funds from failure of bank, at which bill or note is payable, during delay in presenting it, 2 A.L.R. 1381.

Duty of collecting bank as to notices of protest or dishonor which it receives from its correspondent, 4 A.L.R. 534.

Necessity of protest and notice as between coendorsers of negotiable paper, 9 A.L.R. 1188, 32 A.L.R. 190.

Stopping payment as affecting necessity of presentment of check, 14 A.L.R. 562.

Duty of holder of note containing endorsement in form of guaranty, to make demand for payment and give notice of nonpayment, 21 A.L.R. 1390, 33 A.L.R. 97, 46 A.L.R. 1516.

When instrument deemed payable at a "special place" within provision making willingness and ability to pay at such place equivalent to tender, 24 A.L.R. 1050.

Validity and effect of agreement to give bank all, or part, of fees of notary for protesting paper, 25 A.L.R. 170.

Insolvency or bankruptcy of party primarily liable on commercial paper, as excusing demand and notice of dishonor, 25 A.L.R. 962, 87 A.L.R. 1394.

Right of notary who protests paper to change or contradict his certificate, 28 A.L.R. 543.

Effect of delay in presentation of check given for payment of taxes, 44 A.L.R. 1236, 124 A.L.R. 1155.

Duty of holder as regards presentation of check to drawee bank as affected by run on bank or other indications of impending closing of doors, 88 A.L.R. 479.

Time within which check must be presented to prevent discharge of drawer in event of bank's insolvency, 91 A.L.R. 1181.

Necessity of notice of nonpayment of note or bill upon which corporation is primary obligor, in order to hold officer, director or stockholder as endorser, 123 A.L.R. 1367.

Duties of collecting bank with respect to presenting draft or bill of exchange for acceptance, 39 A.L.R.2d 1296.

Pledgee's liability for failure to make demand, 45 A.L.R.3d 248.

10 C.J.S. Bills and Notes § 202 et seq.

55-3-502. Dishonor.

(a) Dishonor of a note is governed by the following rules:

(1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(3) If the note is not payable on demand and Paragraph (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under Section 55-4-301 NMSA 1978 or 55-4-302 NMSA 1978, or becomes accountable for the amount of the check under Section 55-4-302 NMSA 1978.

(2) If a draft is payable on demand and Paragraph (1) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(3) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(4) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary draft occurs according to the rules stated in Subsection (b)(2), (3), and (4), except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(d) Dishonor of an accepted draft is governed by the following rules:

(1) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(2) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(e) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under Section 55-3-504 NMSA 1978, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(f) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored.

History: 1978 Comp., § 55-3-502, enacted by Laws 1992, ch. 114, § 147.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-415 [55-3-415 NMSA 1978] provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3-414 [55-3-414 NMSA 1978], the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3-414(d) [55-3-414 NMSA 1978]. Part 5 tells when an instrument is dishonored (Section 3-502) [55-3-502 NMSA 1978] and what it means to give notice of dishonor (Section 3-503) [55-3-503 NMSA 1978]. Often dishonor does not occur until presentment (Section 3-501) [55-3-501 NMSA 1978], and frequently presentment and notice of dishonor are excused (Section 3-504) [55-3-504 NMSA 1978].

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the

note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3-502(1)(a)) unless the holder made presentment to the maker on the exact day and note was due (former Section 3-503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3-508(2)) [repealed]. These provisions are omitted from Revised Article 3 as inconsistent with practice which seldom involves face-to-face dealings.

3. Subsection (a) applies to notes. Subsection (a)(1) applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) applies to all other notes. If the note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. When a check is presented for payment through the check-collection system, the drawee bank normally makes settlement for the amount of the check to the presenting bank. Under Section 4-301 [55-4-301 NMSA 1978] the drawee bank may recover this settlement if it returns the check within its midnight deadline (Section 4-104) [55-4-104 NMSA 1978]. In that case the check is not paid and dishonor occurs under Section 3-502(b)(1) [55-3-502 NMSA 1978]. If the drawee bank does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check. Section 4-215 [55-4-215 NMSA 1978]. Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline. In some cases the drawee bank might not settle for the check when it is received. Under Section 4-302 [55-4-302 NMSA 1978] if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank becomes "accountable" for the amount of the check, i.e. it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank is accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor within the midnight deadline. In all cases in which the drawee bank becomes accountable, the check has not been paid and, under Section 3-502(b)(1) [55-3-502 NMSA 1978], the check is dishonored. The fact that the bank is obliged to pay the check does not mean that the check has been paid. When a check is presented for

payment, the person presenting the check is entitled to payment not just the obligation of the drawee to pay. Until that payment is made, the check is dishonored. To say that the drawee bank is obliged to pay the check necessarily means that the check has not been paid. If the check is eventually paid, the drawee bank no longer is accountable.

Subsection (b)(2) applies to demand drafts other than those governed by subsection (b)(1). It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) and (4) applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3-501(1)(a) [55-3-501 NMSA 1978].

5. Subsection (c) gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5-112 [55-5-112 NMSA 1978] in cases in which a letter of credit is involved.

6. Subsection (d) governs accepted drafts. If the acceptor's obligation is to pay on demand the rule, stated in subsection (d)(1), is the same as for that of a demand note stated in subsection (a)(1). If the acceptor's obligation is to pay at a definite time the rule, stated in subsection (d)(2), is the same as that of a time note payable at a bank stated in subsection (b)(2).

7. Subsection (e) is a limitation on subsection (a)(1) and (2), subsection (b), subsection (c), and subsection (d). Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3-504 [55-3-504 NMSA 1978], dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) and (4) if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f), the late

acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-502 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-502, relating to unexcused delay and discharge, effective July 1, 1992. Laws 1992, ch. 114, § 147, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-503. Notice of dishonor.

(a) The obligation of an indorser stated in Section 55-3-415(a) NMSA 1978 and the obligation of a drawer stated in Section 55-3-414(d) NMSA 1978 may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under Section 55-3-504(b) NMSA 1978.

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to Section 55-3-504(c) NMSA 1978, with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within thirty days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within thirty days following the day on which dishonor occurs.

History: 1978 Comp., § 55-3-503, enacted by Laws 1992, ch. 114, § 148.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3-414 [55-3-414 NMSA 1978]. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3-414(b)) [55-3-414 NMSA 1978] before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability.

Subsection (b), which states how notice of dishonor is given, is based on former Section 3-508(3) [repealed].

2. Subsection (c) replaces former Section 3-508(2) [repealed]. It differs from that section in that it provides a 30-day period for a person other than a collecting bank to give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3-504(c) [55-3-504 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-503 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-503, relating to time of presentment, effective July 1, 1992. Laws 1992, ch. 114, § 148, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-504. Excused presentment and notice of dishonor.

(a) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

History: 1978 Comp., § 55-3-504, enacted by Laws 1992, ch. 114, § 149.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-504 [55-3-504 NMSA 1978] is largely a restatement of former Section 3-511 [repealed]. Subsection (4) of former Section 3-511 is replaced by Section 3-502(f) [55-3-502 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-504 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-504, relating to how presentment made, effective July 1, 1992. Laws 1992, ch. 114, § 149, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-505. Evidence of dishonor.

(a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) a document regular in form as provided in Subsection (b) which purports to be a protest;

(2) a purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor; and

(3) a book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

History: 1978 Comp., § 55-3-505, enacted by Laws 1992, ch. 114, § 150.

ANNOTATIONS

OFFICIAL COMMENT

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives,

interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-505 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-505, relating to rights of party to whom presentment is made, effective July 1, 1992. Laws 1992, ch. 114, § 150, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

55-3-506 to 55-3-511. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-506 to 55-3-511 NMSA 1978, as enacted by Laws 1961, ch. 96, §§ 3-506 to 3-511, effective July 1, 1992. For former provisions, see Original Pamphlet.

PART 6
DISCHARGE AND PAYMENT

55-3-601. Discharge and effect of discharge.

(a) The obligation of a party to pay the instrument is discharged as stated in this article or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

History: 1978 Comp., § 55-3-601, enacted by Laws 1992, ch. 114, § 151.

ANNOTATIONS

OFFICIAL COMMENT

Subsection (a) replaces subsections (1) and (2) of former Section 3-601. Subsection (b) restates former Section 3-602 [see now 55-3-601 NMSA 1978]. Notice of discharge is not treated as notice of a defense that prevents holder in due course status. Section 3-302(b) [55-3-302 NMSA 1978]. Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a canceled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-601 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-601, relating to discharge of parties, effective July 1, 1992. Laws 1992, ch. 114, § 151, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Discharge of endorser. - Where payee used part of advance made at time of execution of note in paying accrued interest owing by maker, contrary to agreement, endorser of note, who was president of corporation which was maker of the note, was discharged from liability on his endorsement notwithstanding his failure to protest such diversion on learning of it two months later, and benefit derived by him in use by maker of part of advance in discharging another of its obligations which he had guaranteed. Pacific Nat'l Agrl. Credit Corp. v. Hagerman, 39 N.M. 549, 51 P.2d 857, 101 A.L.R. 1301 (1935)(decided under former law).

Discharge of principal debtor does not include discharge by limitations, and a surety is not released from his liability to pay, by such limitations, against the principal. Romero v. Hopewell, 28 N.M. 259, 210 P. 231 (1922)(decided under former law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 525, 901, 904, 912, 929, 930, 933, 952, 961, 963.

Endorsing payment upon note before maturity as releasing surety or endorser, 37 A.L.R. 477.

Taking of demand note in renewal as releasing surety or endorser, 48 A.L.R. 1222.

Payment voidable under bankruptcy act as discharge of surety, guarantor or endorser, 56 A.L.R. 1363.

Agreement by holder with principal not to put paper in course of collection for a specified time as releasing endorser, 63 A.L.R. 1532.

Failure or delay by holder of note to enforce collateral security as releasing endorser, 74 A.L.R. 129.

Mortgagee's purchase of equity of redemption as releasing endorser on secured note, 82 A.L.R. 764.

Consent of party secondarily liable to release of party primarily liable as affecting release of former, 169 A.L.R. 753.

Renewal note signed by one comaker as discharge of nonsigning comakers, 43 A.L.R.3d 246.

10 C.J.S. Bills and Notes § 231 et seq.

55-3-602. Payment.

(a) Subject to Subsection (b), an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under Section 55-3-306 NMSA 1978 by another person.

(b) The obligation of a party to pay the instrument is not discharged under Subsection (a) if:

(1) a claim to the instrument under Section 55-3-306 NMSA 1978 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) the person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

History: 1978 Comp., § 55-3-602, enacted by Laws 1992, ch. 114, § 152.

ANNOTATIONS

OFFICIAL COMMENT

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) means, by reference to Section 3-306 [55-3-306 NMSA 1978], a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) is added to conform to Section 3-411 [55-3-411 NMSA 1978]. Section 3-411 [55-3-411 NMSA 1978] is intended to discourage an obligated bank from refusing payment of a cashier's check, certified check or dishonored teller's check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3-411 [55-3-411 NMSA 1978]. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3-602(b)(1)(ii) and Section 3-411 [55-3-602 and 55-3-411 NMSA 1978, respectively], read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in

connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3-411(c)(iv) [55-3-411 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-602 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-602, relating to effect of discharge against holder in due course, effective July 1, 1992. Laws 1992, ch. 114, § 152, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-601 NMSA 1978.

I. General Consideration.
II. Payment or Satisfaction.
III. By Any Person.

I. GENERAL CONSIDERATION.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 506, 531, 963 to 965, 970, 973.

Acceptance of renewal note made or endorsed by personal representative of obligor in original paper as payment or novation of that paper, 12 A.L.R. 1546.

Right to have usurious payments made on previous obligation applied as payment of principal on renewal, 13 A.L.R. 1244.

Rights and remedies of accommodation party to paper as against accommodated party after payment, 36 A.L.R. 553, 77 A.L.R. 668.

Renewal note as discharging original obligation or indebtedness, 52 A.L.R. 1416.

10 C.J.S. Bills and Notes § 231 et seq.

II. PAYMENT OR SATISFACTION.

Presentment at time of payment. - A party making payment upon a negotiable promissory note should insist upon the presentation of the paper by the party to whom the payment is made in order to make sure that it is at the time in his possession and

not outstanding in another, and if he fails to do so the payment is wholly at payor's risk. Hayden v. Speakman, 20 N.M. 513, 150 P. 292 (1914) (decided under former law).

When payment deemed made. - The mere act of stamping a bill of exchange "paid" by the payee, in and of itself, does not constitute payment. Payment could only be made by delivery of the actual cash, or an adjustment of accounts, by agreement of the parties, so that the payee would be obligated to the holder of the bill. Hanna v. McCrory, 19 N.M. 183, 141 P. 996 (1914) (decided under former law).

And presumption of payment may not arise. - Even though a note may be 20 years past due, a presumption of payment does not arise if within 20 years prior to suit thereon, payment on the principal or interest is made, or it is otherwise definitely and unequivocally recognized as an existing obligation. Heisel v. York, 46 N.M. 210, 125 P.2d 717 (1942) (decided under former law).

Bank action compromising and settling note balance amounts to complete discharge of all parties, insofar as the bank is concerned; the bank does not thereby discharge a claim of contribution resulting between parties. Farmington Nat'l Bank v. Basin Plastics, Inc., 94 N.M. 668, 615 P.2d 985 (1980).

III. BY ANY PERSON.

Note of third person to debt generally. - The note of a third person given for a prior debt will be held a satisfaction, where it was agreed by the creditor to receive it absolutely as payment, and to run the risk of its being paid. The onus of establishing that it was so received is on the debtor. But there must be a clear and special agreement that the creditor shall take the paper absolutely as payment, or it will be no payment if it afterwards turns out to be of no value. A receipt in full of an account does not establish an agreement on the part of the creditor to accept as absolute payment at his own risk the note of a third person for the debt. Lindberg v. Ferguson Trucking Co., 74 N.M. 246, 392 P.2d 586 (1964).

Accommodation maker may sue maker on note. - Where a note and mortgage are assigned to an accommodation maker who then paid up the note, the accommodation maker succeeds to the payee's rights and may sue the maker on the note, because the note was not discharged when paid by the accommodation maker. Simson v. Bilderbeck, Inc., 76 N.M. 667, 417 P.2d 803 (1966).

And foreclose assigned mortgage. - An accommodation maker's payment of a note will not extinguish the lien of mortgage assigned to the accommodation maker and the accommodation maker may foreclose mortgage upon his payment of the note. Simson v. Bilderbeck, Inc., 76 N.M. 667, 417 P.2d 803 (1966).

55-3-603. Tender of payment.

(a) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

History: 1978 Comp., § 55-3-603, enacted by Laws 1992, ch. 114, § 153.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-603 [55-3-603 NMSA 1978] replaces former Section 3-604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) replaces former Section 3-604(1) and (3).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-603 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-603, relating to payment or satisfaction, effective July 1, 1992. Laws 1992, ch. 114, § 153, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-602 NMSA 1978.

55-3-604. Discharge by cancellation or renunciation.

(a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(b) Cancellation or striking out of an indorsement pursuant to Subsection (a) does not affect the status and rights of a party derived from the indorsement.

History: 1978 Comp., § 55-3-604, enacted by Laws 1992, ch. 114, § 154.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-604 [55-3-604 NMSA 1978] replaces former Section 3-605.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-604 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-604, relating to tender of payment, effective July 1, 1992. Laws 1992, ch. 114, § 154, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-603 NMSA 1978.

Mistaken, unauthorized, or unintentional cancellation. - A cancellation, release, or surrender of the instrument is ineffective if it is unauthorized, unintentional, or done by mistake. Los Alamos Credit Union v. Bowling, 108 N.M. 113, 767 P.2d 352 (1989).

Bank action compromising and settling note balance amounts to complete discharge of all parties, insofar as the bank is concerned; the bank does not thereby discharge a claim of contribution resulting between parties. Farmington Nat'l Bank v. Basin Plastics, Inc., 94 N.M. 668, 615 P.2d 985 (1980).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 934, 935, 948 to 950, 952.

Accord and satisfaction by endorsement and transfer of commercial paper by agent having no authority to compromise, 46 A.L.R. 1523.

What constitutes renunciation by surrender of negotiable instrument under U.C.C. § 3-605, 96 A.L.R.3d 1144.

Unintentional cancellation of negotiable instrument under UCC Article 3, 59 A.L.R.4th 617.

10 C.J.S. Bills and Notes § 231 et seq.

55-3-605. Discharge of indorsers and accommodation parties.

(a) In this section, the term "indorser" includes a drawer having the obligation described in Section 55-3-414(d) NMSA 1978.

(b) Discharge, under Section 55-3-604 NMSA 1978, of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(c) If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party proves that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(d) If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(e) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(f) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under Subsection (e), the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(g) Under Subsection (e) or (f), impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value, (iii) failure to

perform a duty to preserve the value of collateral owed, under Article 9 or other law, to a debtor or surety or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(h) An accommodation party is not discharged under Subsection (c), (d), or (e) unless the person entitled to enforce the instrument knows of the accommodation or has notice under Section 55-3-419(c) NMSA 1978 that the instrument was signed for accommodation.

(i) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.

History: 1978 Comp., § 55-3-605, enacted by Laws 1992, ch. 114, § 155.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 3-605 [55-3-605 NMSA 1978], which replaces former Section 3-606 [repealed], can be illustrated by an example. Bank lends $10,000 to Borrower who signs a note under which Borrower is obliged to pay $10,000 to Bank on a due date stated in the note. Bank insists, however, that Accommodation Party also become liable to pay the note. Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the accommodated party. Rights and obligations of Accommodation Party in this case are stated in Section 3-419 [55-3-419 NMSA 1978]. Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower may discharge Borrower's $10,000 obligation to pay the note by paying Bank $3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section 3-605 [55-3-605 NMSA 1978] is concerned with this kind of problem in the context of a negotiable instrument to which the principal debtor and the surety are parties. But Section 3-605 [55-3-605 NMSA 1978] has a wider scope. It also applies to indorsers who are not accommodation parties. Unless an indorser signs without recourse, the indorser's liability under Section 3-415(a) [55-3-415 NMSA 1978] is that of a guarantor of a payment. If Bank in our hypothetical case indorsed the note and transferred it to Second Bank, Bank has rights given to an indorser under Section 3-605 [55-3-605 NMSA 1978] if it is Second Bank that modifies rights and obligations of

Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section 3-605 [55-3-605 NMSA 1978] is also widened by subsection (e) which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the note or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section 3-605(i) [55-3-605 NMSA 1978] allows waiver. Thus, Section 3-605 [55-3-605 NMSA 1978] applies to the occasional case in which the creditor did not include a waiver clause in the instrument or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) addresses the effect of discharge under Section 3-604 [55-3-604 NMSA 1978] of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release Accommodation Party. As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes $3,000 and releases Borrower from the $10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3-419(e). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b) changes the law stated in former Section 3-606 [repealed] but the change relates largely to formalities rather than substance. Under former Section 3-606 [repealed], Bank could settle with and release Borrower without releasing Accommodation Party, but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 [repealed] that any notice be given to Accommodation Party. The reservation of rights doctrine is abolished in Section 3-605 [55-3-605 NMSA 1978] with respect to rights on instruments.

4. Subsection (c) relates to extensions of the due date of the instrument. In most cases an extension of time to pay a note is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) [repealed] did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment

note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 [repealed] surety was discharged if consent was not given unless the payee expressly reserved rights against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. Wilmington Trust Co. v. Gesullo, 29 U.C.C. Rep. 144 (Del.Super.Ct. 1980). Under subsection (c) an extension of time results in discharge only to the extent the surety proves that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss, subsection (c) more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

5. Former Section 3-606 [repealed] applied to extensions of the due date of a note but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 [repealed] did not follow general suretyship law in covering both. Under Section 3-605(d) [55-3-605 NMSA 1978] a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the instrument proves that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

6. Subsection (e) deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b) [repealed]. Subsection (g) states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as maker of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 [repealed] applied to release the grantor if the holder released or extended the obligation of the grantee. Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section 3-605(e) [55-3-605 NMSA 1978] does not apply because the holder has not discharged the obligation of a "party," a term defined in Section 3-103(a)(8) [55-3-103 NMSA 1978] as "party to an instrument." The assuming grantee is not a party to the instrument.

7. Subsection (f) is illustrated by the following case. X and Y sign a note for $1,000 as co-makers. Neither is an accommodation party. X grants a security interest in X's property to secure the note. The collateral is worth more than $1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subrogation. If the security interest had been perfected, Y could have realized on the collateral to the extent of $500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is $500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section 3-419(c) [55-3-419 NMSA 1978]. In that event Y is not discharged under subsection (e), but subsection (f) applies because X an Y are jointly and severally liable on the note. Under subsection (f), Y is treated as a co-maker wih a right of contribution rather than an accommodation party with a right of reimbursement. Y is discharged to the extent of $500. If Y is the principal debtor and X is the accommodation party subsection (f) doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been obliged to reimburse X for the entire $1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-3-605 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-605, relating to cancellation and renunciation, effective July 1, 1992. Laws 1992, ch. 114, § 155, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet. For present comparable provisions, see 55-3-604 NMSA 1978.

55-3-606. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-606 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-606, relating to impairment of recourse or collateral, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

PART 7
ADVICE OF INTERNATIONAL SIGHT DRAFT

(Repealed by Laws 1992, ch. 114, § 237.)

55-3-701. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-701 NMSA 1978, as enacted by Laws 1961, ch. 96, § 3-701, relating to letter of advice of international sight draft, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

PART 8
MISCELLANEOUS

(Repealed by Laws 1992, ch. 114, § 237.)

55-3-801 to 55-3-805. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237A repeals 55-3-801 to 55-3-805 NMSA 1978, as enacted by Laws 1961, ch. 96, §§ 3-801 to 3-805, effective July 1, 1992. For former provisions, see Original Pamphlet.

ARTICLE 4
BANK DEPOSITS AND COLLECTIONS

Part 1

General Provisions and Definitions.

Part 2

Collection of Items - Depositary and Collecting Banks.

Part 3

Collection of Items - Payor Banks.

Part 4

Relationship Between Payor Bank and Its Customer.

Part 5

Collection of Documentary Drafts.

ANNOTATIONS

Compiler's notes. - Following each section in Article 4 appear "Official Comments", which were copyrighted in 1990 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and are reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1 GENERAL PROVISIONS AND DEFINITIONS

55-4-101. Short title.

This article may be cited as Uniform Commercial Code - Bank Deposits and Collections.

History: 1953 Comp., § 50A-4-101, enacted by Laws 1961, ch. 96, § 4-101; 1992, ch. 114, § 156.

ANNOTATIONS

OFFICIAL COMMENT

1. The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years. This Article meets that need.

2. In 1950 at the time Article 4 was drafted, 6.7 billion checks were written annually. By the time of the 1990 revision of Article 4 annual volume was estimated by the American Bankers Association to be about 50 billion checks. The banking system could not have coped with this increase in check volume had it not developed in the late 1950s and early 1960s an automated system for check collection based on encoding checks with machine-readable information by Magnetic Ink Character Recognition (MICR). An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check

collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. An additional goal of the 1990 revision of Article 4 is to remove any statutory barriers in the Article to the ultimate adoption of programs allowing the presentment of checks to payor banks by electronic transmission of information captured from the MICR line on the checks. The potential of these programs for saving the time and expense of transporting the huge volume of checks from depositary to payor banks is evident.

3. Article 4 defines rights between parties with respect to bank deposits and collections. It is not a regulatory statute. It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions in Article 4 are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. This may raise consumer problems which enacting jurisdictions may wish to address in individual legislation. For example, with respect to Section 4-401(c) [55-4-401 NMSA 1978], jurisdictions may wish to examine their unfair and deceptive practices laws to determine whether they are adequate to protect drawers who postdate checks from unscrupulous practices that may arise on the part of persons who induce drawers to issue postdated checks in the erroneous belief that the checks will not be immediately payable. Another example arises from the fact that under various truncation plans customers will no longer receive their cancelled checks and will no longer have the cancelled check to prove payment. Individual legislation might provide that a copy of a bank statement along with a copy of the check is prima facie evidence of payment.

The 1992 amendment, effective July, 1, 1992, deleted "shall be known and" following "article".

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 694 et seq.

9 C.J.S. Banks and Banking § 382 et seq.

55-4-102. Applicability.

(a) To the extent that items within this article are also within Articles 3 and 8, they are subject to those articles. If there is conflict, this article governs Article 3, but Article 8 governs this article.

(b) The liability of a bank for action or non-action with respect to an item handled by it for purposes of presentment, payment or collection is governed by the law of the place where the bank is located. In the case of action or non-action by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

History: 1953 Comp., § 50A-4-102, enacted by Laws 1961, ch. 96, § 4-102; 1992, ch. 114, § 157.

ANNOTATIONS

OFFICIAL COMMENT

1. The rules of Article 3 governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See Section 3-102(b) [55-3-102 NMSA 1978].

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see Sections 8-304 and 8-306) [55-8-304 and 55-8-306 NMSA 1978] may conflict with provisions of this Article (Sections 4-205, 4-207, and 4-208) [55-4-205, 55-4-207 and 55-4-208 NMSA 1978, respectively]. In the case of conflict, Article 8 governs.

Section 4-210 [55-4-210 NMSA 1978] deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. Sections 4-301 and 4-302 [55-4-301 and 55-4-302 NMSA 1978, respectively] are consistent with Section 5-112 [55-5-112 NMSA 1978]. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See Section 4-104(a)(9) [55-4-104 NMSA 1978].

In Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the Kimbell test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In Kimbell the Court adopted the priorities rules of Article 9.

In addition, applicable federal law may supersede provisions of this Article. One federal law that does so is the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., and its implementing Regulation CC, 12 CFR Pt. 229. In some instances this law is alluded to in the statute, e.g., Section 4-215(e) and (f) [55-4-215 NMSA 1978]. In other instances, although not referred to in this Article, the provisions of the EFAA and Regulation CC control with respect to checks. For example, except between the depositary bank and its customer, all settlements are final and not provisional (Regulation CC, Section 229.36(d)), and the midnight deadline may be extended (Regulation CC, Section 229.30(c)). The Comments to this Article suggest in most instances the relevant Regulation CC provisions.

2. Subsection (b) is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or non-action with respect to any item handled by it for purposes of presentment, payment, or collection" is intended to make the conflicts rule of subsection (b) apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of Weissman v. Banque de Bruxelles, 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see Section 4-202(c)) [55-4-202 NMSA 1978], and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of St. Nicholas Bank of New York v. State Nat. Bank, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see Sections 4-215(a), 4-301, 4-302, 4-303) [55-4-215, 55-4-301, 55-4-302, 55-4-303 NMSA 1978, respectively] as well as action or non-action of a collecting bank (Sections 4-201 through 4-216) [55-4-201 to 55-4-216 NMSA 1978, respectively]; to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (Section 4-216) [55-4-216 NMSA 1978]; to action or non-action of a bank with respect to an item under the rule of Part 4 of Article 4.

d. In a case in which subsection (b) makes this Article applicable, Section 4-103(a) [55-4-103 NMSA 1978] leaves open the possibility of an agreement with respect to applicable law. This freedom of agreement follows the general policy of Section 1-105 [55-1-105 NMSA 1978].

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations and made minor stylistic changes throughout the section.

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 694, 700.

Construction and effect of U.C.C. Art. 4, dealing with bank deposits and collections, 18 A.L.R.3d 1376, 97 A.L.R.3d 714, 22 A.L.R.4th 10, 29 A.L.R.4th 631, 88 A.L.R.4th 568, 88 A.L.R.4th 613, 88 A.L.R.4th 644.

9 C.J.S. Banks and Banking § 382.

55-4-103. Variation by agreement; measure of damages; action constituting ordinary care.

(a) The effect of the provisions of this article may be varied by agreement but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

(b) Federal reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements under Subsection (a), whether or not specifically assented to by all parties interested in items handled.

(c) Action or non-action approved by this article or pursuant to federal reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by this article, is prima facie the exercise of ordinary care.

(d) The specification or approval of certain procedures by this article is not disapproval of other procedures that may be reasonable under the circumstances.

(e) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith it includes any other damages the party suffered as a proximate consequence.

History: 1953 Comp., § 50A-4-103, enacted by Laws 1961, ch. 96, § 4-103; 1992, ch. 114, § 158.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 1-102 [55-1-102 NMSA 1978] states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4-103 [55-4-103 NMSA 1978] states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical

complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of the effect of provisions of the Article by agreement.

2. Subsection (a) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for the lack or failure, but this subsection like Section 1-102(3) [55-1-102 NMSA 1978] approves the practice of parties determining by agreement the standards by which the responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1-201(3) [55-1-201 NMSA 1978]. The agreement may be direct, as between the owner and the depositary bank; or indirect, as in the case in which the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement." See Section 1-201(3) [55-1-201 NMSA 1978]. First Nat. Bank of Denver v. Federal Reserve Bank, 6 F.2d 339 (8th Cir. 1925) (deposit slip); Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co., 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); Semingson v. Stock Yards Nat. Bank, 162 Minn. 424, 203 N.W. 412 (1925) (passbook); Farmers State Bank v. Union Nat. Bank, 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (a) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. Since it is recognized that banks handle a great number of items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all nonbank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items. In total, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided

in Federal Reserve Bank of Richmond v. Malloy, 264 U.S. 160, at 167, 44 S. Ct. 296, at 298, 68 L. Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (b) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating circulars, clearing-house rules, and the like, have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations. Various sections of the Federal Reserve Act (12 U.S.C. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and Section 13 (12 U.S.C. § 342) authorizes each Federal Reserve bank to receive deposits from nonmember banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Subpart A - Collection of Checks and Other Items). Under the supremacy clause of the Constitution, federal regulations prevail over state statutes. Moreover, the Expedited Funds Availability Act, 12 U.S.C. Section 4007(b) provides that the Act and Regulation CC, 12 CFR 229, supersede "any provision of the law of any State, including the Uniform Commercial Code as in effect in such State, which is inconsistent with this chapter or such regulations." See Comment 1 to Section 4-102 [55-4-102 NMSA 1978].

Federal Reserve operating circulars. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate operating circulars covering operating details. Regulation J, for example, provides that "Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its handling of items and other matters deemed appropriate by the Reserve Bank." This Article recognizes that "operating circulars" issued pursuant to the regulations and concerned with operating details as appropriate may, within their proper sphere, vary the effect of the Article.

Clearing-House Rules. Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized these rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (b) in recognizing clearing-house rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing-house rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating circulars" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing-house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other agencies or associations of this kind may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open possibilities for future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (b).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in Section 3-103(a)(4) [55-3-103 NMSA 1978]. The term "ordinary care" is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978]. These definitions are made to apply to Article 4 by Section 4-104(c) [55-4-104 NMSA 1978]. Section 4-202 [55-4-202 NMSA 1978] states respects in which collecting banks must use ordinary care. Subsection (c) of Section 4-103 [55-4-103 NMSA 1978] provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating circulars constitutes the exercise of ordinary care. Federal Reserve regulations and operating circulars constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (c) further provides that, absent special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearing-house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1-205(2) [55-1-205 NMSA 1978]. In a case in which the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of Section 1-205(3) [55-1-205 NMSA 1978], action or non-action consistent with clearing-house rules or the like or with banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and although there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is prima facie only, thus conferring on the courts the ultimate power to determine ordinary care in any case in which it should appear desirable to do so. The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair as used by the particular bank.

5. Subsection (d), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If this procedure is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (e) sets forth a rule for determining the measure of damages for failure to exercise ordinary care which, under subsection (a), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. The term "bad faith" is not defined; the connotation is the absence of good faith (Section 3-103) [55-3-103 NMSA 1978]. When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, if bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (e) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection desgnations; substituted "operating circulars, clearing-house rules" for "operating letters, clearing hours" in Subsection (b); substituted "circulars" for "letters" in Subsection (c); and made minor stylistic changes throughout the section.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 567, 702, 737, 838, 839.

Admissibility, in action for negligence against bank by depositor, of evidence as to custom of banks in locality in handling and dealing with checks and other items, 8 A.L.R.2d 446.

Effect on bank depositor's rights and those of bank, of printed rules in passbook not expressly accepted, 60 A.L.R.2d 708.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

Bank's liability for breach of implied contract of good faith and fair dealing, 55 A.L.R.4th 1026.

9 C.J.S. Banks and Banking § 383 et seq.

55-4-104. Definitions and index of definitions.

(a) In this article, unless the context otherwise requires:

(1) "account" means any deposit or credit account with a bank including a demand, time, savings, passbook, share draft or like account, other than an account evidenced by a certificate of deposit;

(2) "afternoon" means the period of a day between noon and midnight;

(3) "banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions;

(4) "clearing-house" means an association of banks or other payors regularly clearing items;

(5) "customer" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank;

(6) "documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities (Section 55-8-102 NMSA 1978) or instructions for uncertificated securities (Section 55-8-102 NMSA 1978), or other certificates, statements or the like are to be received by the drawee or other payor before acceptance or payment of the drafts;

(7) "draft" means a draft as defined in Section 55-3-104 NMSA 1978 or an item, other than an instrument, that is an order;

(8) "drawee" means a person ordered in a draft to make payment;

(9) "item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by Article 4A [Chapter 55, Article 4A NMSA 1978] or a credit or debit card slip;

(10) "midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(11) "settle" means to pay in cash, by clearing-house settlement, in a charge or credit or by remittance or otherwise as agreed. A settlement may be either provisional or final; and

(12) "suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business.

(b) Other definitions applying to this article and the sections in which they appear are:

"agreement for electronic presentment" Section 55-4-110 NMSA 1978;

"bank" Section 55-4-105 NMSA 1978;

"collecting bank" Section 55-4-105 NMSA 1978;

"depositary bank" Section 55-4-105 NMSA 1978;

"intermediary bank" Section 55-4-105 NMSA 1978;

"payor bank" Section 55-4-105 NMSA 1978;

"presenting bank" Section 55-4-105 NMSA 1978; and

"presentment notice" Section 55-4-110 NMSA 1978.

(c) The following definitions in other articles apply to this article:

"acceptance" Section 55-3-409 NMSA 1978;

"alteration" Section 55-3-407 NMSA 1978;

"cashier's check" Section 55-3-104 NMSA 1978;

"certificate of deposit" Section 55-3-104 NMSA 1978;

"certified check" Section 55-3-409 NMSA 1978;

"check" Section 55-3-104 NMSA 1978;

"good faith" Section 55-3-103 NMSA 1978;

"holder in due course" Section 55-3-302 NMSA 1978;

"instrument" Section 55-3-104 NMSA 1978;

"notice of dishonor" Section 55-3-503 NMSA 1978;

"order" Section 55-3-103 NMSA 1978;

"ordinary care" Section 55-3-103 NMSA 1978;

"person entitled to enforce" Section 55-3-301 NMSA 1978;

"presentment" Section 55-3-501 NMSA 1978;

"promise" Section 55-3-103 NMSA 1978;

"prove" Section 55-3-103 NMSA 1978;

"teller's check" Section 55-3-104 NMSA 1978; and

"unauthorized signature" Section 55-3-403 NMSA 1978.

(d) In addition, Article 1 [Chapter 55, Article 1 NMSA 1978] contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1953 Comp., § 50A-4-104, enacted by Laws 1961, ch. 96, § 4-104; 1977, ch. 340, § 2; 1987, ch. 102, § 2; 1992, ch. 114, § 159; 1996, ch. 47, § 3.

ANNOTATIONS

OFFICIAL COMMENT

1. Paragraph (a)(1): "Account" is defined to include both asset accounts in which a customer has deposited money and accounts from which a customer may draw on a line of credit. The limiting factor is that the account must be in a bank.

2. Paragraph (a)(3): "Banking day." Under this definition that part of a business day when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

3. Paragraph (a)(4): "Clearing house." Occasionally express companies, governmental agencies and other nonbanks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

4. Paragraph (a)(5): "Customer." It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical nonbank customer or depositor.

5. Paragraph (a)(6): "Documentary draft" applies even though the documents do not accompany the draft but are to be received by the drawee or other payor before acceptance or payment of the draft.

6. Paragraph (a)(7): "Draft" is defined in Section 3-104 as a form of instrument. Since Article 4 applies to items that may not fall within the definition of instrument, the term is defined here to include an item that is a written order to pay money, even though the item may not qualify as an instrument. The term "order" is defined in Section 3-103 [55-3-103 NMSA 1978].

7. Paragraph (a)(8): "Drawee" is defined in Section 3-103 [55-3-103 NMSA 1978] in terms of an Article 3 draft which is a form of instrument. Here "drawee" is defined in terms of an Article 4 draft which includes items that may not be instruments.

8. Paragraph (a)(9): "Item" is defined broadly to include an instrument, as defined in Section 3-104, as well as promises or orders that may not be within the definition of "instrument." The terms "promise" and "order" are defined in Section 3-103 [55-3-103 NMSA 1978]. A promise is a written undertaking to pay money. An order is a written instruction to pay money. But see Section 4-110(c) [55-4-110 NMSA 1978]. Since bonds and other investment securities under Article 8 may be within the term "instrument" or "promise," they are items and when handled by banks for collection are subject to this Article. See Comment 1 to Section 4-102 [55-4-102 NMSA 1978]. The functional

limitation on the meaning of this term is the willingness of the banking system to handle the instrument, undertaking or instruction for collection or payment.

9. Paragraph (a)(10): "Midnight deadline." The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible terminating points, such as the close of the banking day or business day.

10. Paragraph (a)(11): The term "settle" has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating circulars, in clearing-house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop-payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment."

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, if qualified by the adjective "provisional" its tentative nature is intended, and if qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

11. Paragraph (a)(12): "Suspends payments." This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

The 1977 amendment inserted "excluding Saturday, Sunday and legal holidays for banks as set forth in Section 48-2-21A NMSA 1953," in the definition of "banking day" in Subsection (1) and made minor changes in form and punctuation in that subsection.

The 1987 amendment, effective June 19, 1987, in Subsection (1), in Paragraph (c) substituted "58-5-7 NMSA 1978" for "48-2-21A NMSA 1953," inserted Paragraph (f) and relettered the subsequent paragraphs accordingly; and, in Subsections (2) and (3), substituted the NMSA 1978 section references for the UCC references.

The 1992 amendment, effective July 1, 1992, revised the subsection and paragraph designations; made minor stylistic changes and deleted the former definitions of "day" and "properly payable" in Subsection (a); rewrote Subsection (a)(1); deleted "excluding Saturday, Sunday and legal holidays for banks as set forth in Section 58-5-7 NMSA 1978" following "a day" in Subsection (a)(3); rewrote Subsection (a)(6); added Subsections (a)(7) and (a)(8); rewrote Subsection (a)(9); substituted "agreed" for "instructed" in Subsection (a)(11); and rewrote Subsections (b) and (c).

The 1996 amendment, substituted "Section 55-8-102" for "Section 55-8-308" near the middle of Subsection (a)(6). Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

"Customer". - In a suit brought by plaintiff and the estate of her deceased husband against a bank to recover funds paid by the bank to the sole signatory of an account which plaintiff and her husband allegedly had an interest in, there was sufficient evidence for the jury to find that plaintiff's husband was a "customer" of the bank, as defined by Subsection (1)(e) of this section with references to the account in question, where the bank was aware of a possible relation between the name of the account and the ranch owned by plaintiff's husband, and that he had a possible beneficial interest in the account. Lietzman v. Ruidoso State Bank, 113 N.M. 480, 827 P.2d 1294 (1992).

Partnership deemed "customer". - Pursuant to 55-1-201 NMSA 1978, Subsections 28 and 30, a partnership may be a customer to whom the bank is required to respond in damages for any wrongful dishonor. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

Documentary drafts. - A draft written on an envelope is a documentary draft when it purports to contain title certificates to motor vehicles that were to be delivered when the draft was honored. Therefore, because the instruments received by the bank purported to contain documents necessary to the sale of an automobile, they were documentary

drafts as defined by this section. Shannon v. Sunwest Bank, 118 N.M. 749, 887 P.2d 285 (1994).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 694, 700, 704, 706, 710, 713, 720, 724, 748, 756, 838; 11 Am. Jur. 2d Bills and Notes §§ 889, 893, 895.

Banks: What is "documentary draft" under UCC § 4-104(1)(f), 65 A.L.R.4th 1095.

9 C.J.S. Banks and Banking § 2; 82 C.J.S. Statutes § 315.

55-4-105. "Bank"; "depositary bank"; "intermediary bank"; "collecting bank"; "payor bank"; "presenting bank".

In this article:

(1) "bank" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union or trust company;

(2) "depositary bank" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter;

(3) "payor bank" means a bank that is the drawee of a draft;

(4) "intermediary bank" means a bank to which an item is transferred in course of collection except the depositary or payor bank;

(5) "collecting bank" means a bank handling an item for collection except the payor bank; and

(6) "presenting bank" means a bank presenting an item except a payor bank.

History: 1953 Comp., § 50A-4-105, enacted by Laws 1961, ch. 96, § 4-105; 1992, ch. 114, § 160.

ANNOTATIONS

OFFICIAL COMMENT

1. The definitions in general exclude a bank to which an item is issued, as this bank does not take by transfer except in the particular case covered in which the item is issued to a payee for collection, as in the case in which a corporation is transferring

balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable if a check is given in payment of a mortgage. This bank has the status of a payee under Article 3 on Negotiable Instruments and not that of a collecting bank.

2. Paragraph (1): "Bank" is defined in Section 1-201(4) as meaning "any person engaged in the business of banking." The definition in paragraph (1) makes clear that "bank" includes savings banks, savings and loan associations, credit unions and trust companies, in addition to the commercial banks commonly denoted by use of the term "bank."

3. Paragraph (2): A bank that takes an "on us" item for collection, for application to a customer's loan, or first handles the item for other reasons is a depositary bank even though it is also the payor bank. However, if the holder presents the item for immediate payment over the counter, the payor bank is not a depositary bank.

4. Paragraph (3): The definition of "payor bank" is clarified by use of the term "drawee." That term is defined in Section 4-104 [55-4-104 NMSA 1978] as meaning "a person ordered in a draft to make payment." An "order" is defined in Section 3-103 [55-3-103 NMSA 1978] as meaning "a written instruction to pay money . . . . An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." The definition of order is incorporated into Article 4 by Section 4-104(c). Thus a payor bank is one instructed to pay in the item. A bank does not become a payor bank by being merely authorized to pay or by being given an instruction to pay not contained in the item.

5. Paragraph (4): The term "intermediary bank" includes the last bank in the collection process if the drawee is not a bank. Usually the last bank is also a presenting bank.

The 1992 amendment, effective July 1, 1992, inserted "Bank" at the beginning of the section catchline and deleted "remitting bank" at the end of the section catchline; deleted "unless the context otherwise requires" at the end of the introductory paragraph; revised the subsection designations; added the definition of "bank"; rewrote Subsections (2) and (3); made minor stylistic changes in Subsections (4) through (6); and deleted the former definition of "remitting bank".

Law reviews. - For note, "New Mexico's Uniform Commercial Code: Presentment Warranties and the Myth of the 'Shelter Provision'," see 4 Nat. Resources J. 398 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 703, 704, 706, 710, 720, 724, 748; 15A Am. Jur. 2d Commercial Code §§ 72, 74.

9 C.J.S. Banks and Banking §§ 2, 382; 82 C.J.S. Statutes § 315.

55-4-106. Payable through or payable at bank; collecting bank.

(a) If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(b) If an item states that it is "payable at" a bank identified in the item, the item is equivalent to a draft drawn on the bank.

History: 1978 Comp., § 55-4-106, enacted by Laws 1992, ch. 114, § 161.

ANNOTATIONS

OFFICIAL COMMENT

1. This section replaces former Sections 3-120 and 3-121 [repealed]. Some items are made "payable through" a particular bank. Subsection (a) states that such language makes the bank a collecting bank and not a payor bank. An item identifying a "payable through" bank can be presented for payment to the drawee only by the "payable through" bank. The item cannot be presented to the drawee over the counter for immediate payment or by a collecting bank other than the "payable through" bank.

2. Subsection (b) retains the alternative approach of the present law. Under Alternative A a note payable at a bank is the equivalent of a draft drawn on the bank and the midnight deadline provisions of Sections 4-301 and 4-302 [55-4-301 and 55-4-302 NMSA 1978, respectively] apply. Under Alternative B a "payable at" bank is in the same position as a "payable through" bank under subsection (a).

3. Subsection (c) rejects the view of some cases that a bank named below the name of a drawee is itself a drawee. The commercial understanding is that this bank is a collecting bank and is not accountable under Section 4-302 [55-4-302 NMSA 1978] for holding an item beyond its deadline. The liability of the bank is governed by Sections 4-202(a) and 4-103(e) [55-4-202 and 55-4-103 NMSA 1978, respectively].

Recompilations. - Laws 1992, ch. 114, § 162 recompiles former 55-4-106 NMSA 1978, relating to separate office of a bank, as 55-4-107 NMSA 1978, effective July 1, 1992.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4-107. Separate office of a bank.

A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders must be given under this article and under Article 3.

History: 1953 Comp., § 50A-4-106, enacted by Laws 1961, ch. 96, § 4-106; 1967, ch. 186, § 12; 1978 Comp., § 55-4-106, recompiled as 1978 Comp., § 55-4-107 by Laws 1992, ch. 114, § 162.

ANNOTATIONS

Compiler's note. - New Mexico did not adopt the optional language, "maintaining its own deposit ledgers," which follows the first "bank" in the uniform act.

OFFICIAL COMMENT

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices. The decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.

2. In many states and for many purposes a branch or separate office of the bank should be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true if branch banking is permitted throughout a state or in different towns and cities. Similarly, if there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provided simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Sections 4-207 and 4-208 [55-4-207 and 55-4-208 NMSA 1978, respectively] (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, in cases in which the Article provides a number of

time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop-payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, the notice or order would be effective at the proper branch from the time it was or should have been received. See Section 1-201(27) [55-1-201 NMSA 1978].

5. The bracketed language ("maintaining its own deposit ledger") in former Section 4-106 [see now 55-4-107 NMSA 1978] is deleted. Today banks keep records on customer accounts by electronic data storage. This has led most banks with branches to centralize to some degree their record keeping. The place where records are kept has little meaning if the information is electronically stored and is instantly retrievable at all branches of the bank. Hence, the inference to be drawn from the deletion of the bracketed language is that where record keeping is done is no longer an important factor in determining whether a branch is a separate bank.

The 1992 amendment, effective July 1, 1992, substituted "must" for "shall".

Recompilations. - Laws 1992, ch. 114, § 163 recompiles former 55-4-107 NMSA 1978, relating to time of receipt of items, as 55-4-108 NMSA 1978, effective July 1, 1992.

Compiler's note. - Laws 1967, ch. 186, § 13, is compiled as 55-4-204 NMSA 1978.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 326.

Construction of UCC § 4-106 defining separate or branch office of bank, 5 A.L.R.4th 938.

9 C.J.S. Banks and Banking §§ 45, 46, 382 et seq.

55-4-108. Time of receipt of items.

(a) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of two p.m. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(b) An item or deposit of money received on any day after a cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

History: 1953 Comp., § 50A-4-107, enacted by Laws 1961, ch. 96, § 4-107; 1978 Comp., § 55-4-107, recompiled as 1978 Comp., § 55-4-108 by Laws 1992, ch. 114, § 163.

ANNOTATIONS

OFFICIAL COMMENT

1. Each of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed within the time limits imposed by Article 4. Subsection (a) approves a cutoff hour of this type provided it is not earlier than 2 P.M. Subsection (b) provides that if such a cutoff hour is fixed, items received after the cutoff hour may be treated as being received at the opening of the next banking day. If the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P.M. cutoff hour does not involve a large portion of the items received but at the same time permits a bank using such a cutoff hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The provision in subsection (b) that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases in which a bank closes at twelve or one o'clock, e.g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations; and substituted "An item" for "Any item" in Subsection (b).

Recompilations. - Laws 1992, ch. 114, § 164 recompiles former 55-4-108 NMSA 1978, relating to delays, as 55-4-109 NMSA 1978, effective July 1, 1992.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 699.

Liability of bank in connection with night depositor service, 77 A.L.R.3d 597.

9 C.J.S. Banks and Banking §§ 273, 274, 383.

55-4-109. Delays.

(a) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank, and with or without the approval of any person involved, may waive, modify or extend time limits imposed or permitted by the Uniform Commercial Code for a period not exceeding two additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party.

(b) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by the Uniform Commercial Code or by instructions is excused if (i) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment or other circumstances beyond the control of the bank and (ii) the bank exercises such diligence as the circumstances require.

History: 1953 Comp., § 50A-4-108, enacted by Laws 1961, ch. 96, § 4-108; 1978 Comp., § 55-4-108, recompiled as 1978 Comp., § 55-4-109 by Laws 1992, ch. 114, § 164.

ANNOTATIONS

OFFICIAL COMMENT

1. Sections 4-202(b), 4-214, 4-301, and 4-302 [55-4-202, 55-4-214, 55-4-301, and 55-4-302 NMSA 1978, respectively] prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4-103 [55-4-103 NMSA 1978] they may be varied by agreement or by Federal Reserve regulations or operating circular, clearing-house rules, or the like. Subsection (a) permits a very limited extension of these time limits. It authorizes a collecting bank to take additional time in attempting to collect drafts drawn on nonbank payors with or without the approval of any interested party. The right of a collecting bank to waive time limits under subsection (a) does not apply to checks. The two-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

2. An extension granted under subsection (a) is without discharge of drawers or indorsers. It therefore extends the times for presentment or payment as specified in Article 3.

3. Subsection (b) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal regulations or operating circulars, clearing-house rules or the like. The latter time limits are "permitted" by the Code. For example, a payor bank that fails to make timely return of a dishonored item may be accountable for the amount of the item. Subsection (b) excuses a bank from this liability when its failure to meet its midnight deadline resulted from, for example, a computer breakdown that was beyond the control of the bank, so long as the bank exercised the degree of diligence that the circumstances required. In Port City State Bank v. American National Bank, 486 F.2d 196 (10th Cir. 1973), the court held that a bank exercised sufficient diligence to be excused under this subsection. If delay is sought to be excused under this subsection, the bank has the burden of proof on the issue of whether it

exercised "such diligence as the circumstances require." The subsection is consistent with Regulation CC, Section 229.38(e).

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations; substituted "the Uniform Commercial Code" for "this act" and made minor stylistic changes throughout the section; in Subsection (a), inserted "drawn on a payor other than a bank", substituted "two additional banking days" for "an additional banking day", and substituted "drawers or indorsers" for "secondary parties"; and, in Subsection (b), inserted the item designations, and inserted "or computer" and "failure of equipment" in item (i).

Repeals. - Laws 1992, ch. 114, § 237B repeals former 55-4-109 NMSA 1978, as enacted by Laws 1967, ch. 186, § 1, relating to process of posting, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 711.

55-4-110. Electronic presentment.

(a) "Agreement for electronic presentment" means an agreement, clearing-house rule or federal reserve regulation or operating circular providing that presentment of an item may be made by transmission of an image of an item or information describing the item ("presentment notice") rather than delivery of the item itself. The agreement may provide for procedures governing retention, presentment, payment, dishonor and other matters concerning items subject to the agreement.

(b) Presentment of an item pursuant to an agreement for presentment is made when the presentment notice is received.

(c) If presentment is made by presentment notice, a reference to "item" or "check" in this article means the presentment notice unless the context otherwise indicates.

History: 1978 Comp., § 55-4-110, enacted by Laws 1992, ch. 114, § 165.

ANNOTATIONS

OFFICIAL COMMENT

1. "An agreement for electronic presentment" refers to an agreement under which presentment may be made to a payor bank by a presentment notice rather than by presentment of the item. Under imaging technology now under development, the presentment notice might be an image of the item. The electronic presentment agreement may provide that the item may be retained by a depositary bank, other collecting bank, or even a customer of the depositary bank, or it may provide that the item will follow the presentment notice. The identifying characteristic of an electronic presentment agreement is that presentment occurs when the presentment notice is

received. "An agreement for electronic presentment" does not refer to the common case of retention of items by payor banks because the item itself is presented to the payor bank in these cases. Payor bank check retention is a matter of agreement between payor banks and their customers. Provisions on payor bank check retention are found in Section 4-406(b) [55-4-406 NMSA 1978].

2. The assumptions under which the electronic presentment amendments are based are as follows: No bank will participate in an electronic presentment program without an agreement. These agreements may be either bilateral (Section 4-103(a)) [55-4-103 NMSA 1978], under which two banks that frequently do business with each other may agree to depositary bank check retention, or multilateral (Section 4-103(b)) [55-4-103 NMSA 1978], in which large segments of the banking industry may participate in such a program. In the latter case, federal or other uniform regulatory standards would likely supply the substance of the electronic presentment agreement, the application of which could be triggered by the use of some form of identifier on the item. Regulation CC, Section 229.36(c) authorizes truncation agreements but forbids them from extending return times or otherwise varying requirements of the part of Regulation CC governing check collection without the agreement of all parties interested in the check. For instance, an extension of return time could damage a depositary bank which must make funds available to its customers under mandatory availability schedules. The Expedited Funds Availability Act, 12 U.S.C. Section 4008(b)(2), directs the Federal Reserve Board to consider requiring that banks provide for check truncation.

3. The parties affected by an agreement for electronic presentment, with the exception of the customer, can be expected to protect themselves. For example, the payor bank can probably be expected to limit its risk of loss from drawer forgery by limiting the dollar amount of eligible items (Federal Reserve program), by reconcilement agreements (ABA Safekeeping program), by insurance (credit union share draft program), or by other means. Because agreements will exist, only minimal amendments are needed to make clear that the UCC does not prohibit electronic presentment.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4-111. Statute of limitations.

An action to enforce an obligation, duty or right arising under this article must be commenced within three years after the cause of action accrues.

History: 1978 Comp., § 55-4-111, enacted by Laws 1992, ch. 114, § 166.

ANNOTATIONS

OFFICIAL COMMENT

This section conforms to the period of limitations set by Section 3-118(g) [55-3-118 NMSA 1978] for actions for breach of warranty and to enforce other obligations, duties

or rights arising under Article 3. Bracketing "cause of action" recognizes that some states use a different term, such as "claim for relief."

Cross-references. - For limitations of actions for obligations of party to pay note payable at definite time, see 55-3-118 NMSA 1978.

For limitations of actions generally, see 37-1-1 NMSA 1978 et seq.

For limitations of actions for contracts, see 37-1-23 NMSA 1978.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 2 COLLECTION OF ITEMS - DEPOSITARY AND COLLECTING BANKS

55-4-201. Status of collecting banks as agent and provisional status of credits; applicability of article; item indorsed "pay any bank".

(a) Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or sub-agent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment, collection, or return, the relevant provisions of this article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(b) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(1) returned to the customer initiating collection; or

(2) specially indorsed by a bank to a person who is not a bank.

History: 1953 Comp., § 50A-4-201, enacted by Laws 1961, ch. 96, § 4-201; 1992, ch. 114, § 167.

ANNOTATIONS

OFFICIAL COMMENT

1. This section states certain basic rules of the bank collection process. One basic rule, appearing in the last sentence of subsection (a), is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (a) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (a) state a rule of agency status. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or sub-agent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, status may have importance in some residual areas not covered by specific rules. Further, since status has been considered so important in the past, to omit all reference to it might cause confusion. The status of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn." Thus questions heretofore litigated as to whether ordinary indorsements "for deposit," "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not alter the agency status. See A.L.R. references supra in Comment 1.

A contrary intent can change agency status but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provided. Legends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating circulars consistently so provide. The status is consistent with rights of charge-back (Section 4-214 [55-4-214 NMSA 1978] and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4-216 [55-4-216 NMSA 1978] and Section 13 of the ABA Code). The right of charge-back with respect to checks is limited by Regulation CC, Section 226.36(d).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-credit relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although Section 4-215(a) [55-4-215 NMSA 1978] provides that an item is finally paid when the payor bank takes or fails to take certain action with respect to the item, the final payment of the item may or may not result in the simultaneous final settlement for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4-215(c) [55-4-215 NMSA 1978], and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until the remittance draft finally clears. See Section 4-213(c) [55-4-213 NMSA 1978]. The first sentence of subsection (a) provides that the agency status of a collecting bank (whether intermediary or depositary) continues until the settlement given by it for the item is or becomes final. In the case of the series of provisional credits covered by Section 4-215(c) [55-4-215 NMSA 1978], this could be simultaneously with the final payment of the item by the payor bank. In cases in which remittance drafts are used or in straight noncash collections, this would not be until the times specified in Sections 4-213(c) [55-4-213 NMSA 1978] and 4-215(d) [55-4-215 NMSA 1978]. With respect to checks Regulation CC Sections 229.31(c), 229.32(b) and 229.36(d) provide that all settlements between banks are final in both the forward collection and return of checks.

Under Section 4-213(a) [55-4-213 NMSA 1978] settlements for items may be made by any means agreed to by the parties. Since it is impossible to contemplate all the kinds of settlements that will be utilized, no attempt is made in Article 4 to provide when settlement is final in all cases. The guiding principle is that settlements should be final when the presenting person has received usable funds. Section 4-213(c) and (d) [55-4-213 NMSA 1978] and Section 4-215(c) [55-4-215 NMSA 1978] provide when final settlement occurs with respect to certain kinds of settlement, but these provisions are not intended to be exclusive.

A number of practical results flow from the rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4-214 [55-4-214 NMSA 1978]. Offsetting rights favorable to the owner are that pending such final settlement, the owner has the preference rights of Section 4-216 [55-4-216 NMSA 1978] and the direct rights of Section 4-302 [55-4-302 NMSA 1978] against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank. With respect to checks, rights of the parties in insolvency are determined by Regulation CC Section 229.39 and the liability of a bank handling a check to a subsequent bank that does not receive payment because of suspension of payments by another bank is stated in Regulation CC Section 229.35(b).

5. In those cases in which some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e.g., if the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight noncash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (a) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of setoff, would not produce a valid setoff. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Because the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and thus in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or sub-agent but in Section 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. Thus Section 4-201 [55-4-201 NMSA 1978] makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and

then seeks to state appropriate limits and some attributes to the general rules so expressed.

7. Subsection (b) protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4-210 [55-4-210 NMSA 1978], in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3-207) [55-3-207 NMSA 1978]. A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4-103(e) [55-4-103 NMSA 1978], the bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4-206 [55-4-206 NMSA 1978] (e.g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (b) operative by indorsements such as "Pay any bank - X100." Regulation CC Section 229.35(c) states the effect of an indorsement on a check by a bank.

The 1992 amendment, effective July 1, 1992, deleted "Presumption and duration of agency" at the beginning of the section catchline and inserted "as agent" therein; revised the subsection and paragraph designations; in Subsection (a), deleted "(Subsection (3) of Section 4-211 and Sections 4-212 and 4-213)" following "final" in the first sentence, substituted "rights of recoupment or setoff" for "valid rights of setoff" in the second sentence, and inserted "or return" in the last sentence; inserted "until the item has been" in the introductory paragraph of Subsection (b); and made minor stylistic changes throughout the section.

Deposited check presumed for collection. - One who deposits with bank a check drawn on another is presumed to deposit it for collection, in the absence of a special agreement. Bays v. Albuquerque Nat'l Bank, 34 N.M. 656, 288 P. 17 (1930)(decided under former law).

Process of collection is simply attenuated demand for payment. Each collecting bank in the chain of collection becomes an agent for the owner of the item and acts for him to demand payment of the drawee. Engine Parts, Inc. v. Citizens Bank, 92 N.M. 37, 582 P.2d 809 (1978).

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 694, 697, 698; 11 Am. Jur. 2d Bills and Notes § 408.

9 C.J.S. Banks and Banking §§ 383 et seq., 358.

55-4-202. Responsibility for collection or return; when action timely.

(a) A collecting bank must exercise ordinary care in:

(1) presenting an item or sending it for presentment;

(2) sending notice of dishonor or non-payment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted, as the case may be;

(3) settling for an item when the bank receives final settlement; and

(4) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(b) A collecting bank exercises ordinary care under Subsection (a) by taking proper action before its midnight deadline following receipt of an item, notice or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Subject to Subsection (a)(1), a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in the possession of others or in transit.

History: 1953 Comp., § 50A-4-202, enacted by Laws 1961, ch. 96, § 4-202; 1992, ch. 114, § 168.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states the basic responsibilities of a collecting bank. Of course, under Section 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (a) it must also use ordinary care in the exercise of its basic collection tasks. By Section 4-103(a) [55-4-103 NMSA 1978] neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection (a)(1) requires ordinary care with respect both to the time and manner of presentment. (Sections 3-501 and 4-212.) [55-3-501 and 55-4-212 NMSA 1978, respectively] If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4-204) [55-4-204 NMSA 1978], and also in the selection of intermediary banks or other agents.

3. Subsection (a) describes types of basic action with respect to which a collecting bank must use ordinary care. Subsection (b) deals with the time for taking action. It first prescribes the general standard for timely action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is timely. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has taken timely action. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be timely but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is timely. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of Section 4-103 [55-4-103 NMSA 1978], or under the special provisions regarding time of receipt of items (Section 4-108) [55-4-108 NMSA 1978], and regarding delays (Section 4-109) [55-4-109 NMSA 1978]. This subsection (b) deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4-301 and 4-302 [55-4-301 and 55-4-302 NMSA 1978, respectively].

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (c) adopts the Massachusetts rule. But since this is stated to be subject to subsection (a)(1) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them. Regulation CC Section 229.36(d) states the liability of a bank during the forward collection of checks.

The 1992 amendment, effective July 1, 1992, inserted "or return" and substituted "timely" for "seasonable" in the section catchline; revised the subsection and paragraph designations; substituted "exercise" for "use" in the introductory paragraph of Subsection (a); deleted a former paragraph of Subsection (a), which read: "making or providing for any necessary protest"; deleted "or directly to the depositary bank under Subsection (2) of Section 4-212" following "transfer or" in Subsection (a)(2); rewrote Subsection (b); and made minor stylistic changes throughout the section.

When bank not liable for negligence of subagent. - Where a bank has in good faith employed a suitable subagent, for the purpose of making a collection, it is not thereafter liable for default or negligence of that subagent. Bays v. Albuquerque Nat'l Bank, 34 N.M. 656, 288 P. 17 (1930)(decided under former law).

Ordinary care obligates collecting bank to take seasonable action on the item. Engine Parts, Inc. v. Citizens Bank, 92 N.M. 37, 582 P.2d 809 (1978).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 701, 704, 705, 710, 711, 713, 728, 731.

Negligence action against bank by depositor, admissibility of evidence of custom of banks in locality in handling and dealing with checks and other items involved, 8 A.L.R.2d 446.

Duties of collecting bank with respect to presenting draft or bill of exchange for acceptance, 39 A.L.R.2d 1296.

9 C.J.S. Banks and Banking §§ 408 et seq., 358.

55-4-203. Effect of instructions.

Subject to Article 3 concerning conversion of instruments (Section 55-3-420 NMSA 1978) and restrictive indorsements (Section 55-3-206 NMSA 1978) only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it, and a collecting bank is not liable to prior parties for any action taken pursuant to the instructions or in accordance with any agreement with its transferor.

History: 1953 Comp., § 50A-4-203, enacted by Laws 1961, ch. 96, § 4-203; 1992, ch. 114, § 169.

ANNOTATIONS

OFFICIAL COMMENT

This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 concerning conversion of instruments (Section 3-420) [55-3-420 NMSA 1978] and restrictive indorsements (Section 3-206) [55-3-206 NMSA 1978]. Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4-103(a) [55-4-103 NMSA 1978]. If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper

should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

The 1992 amendment, effective July 1, 1992, made section reference substitutions and minor stylistic changes throughout the section.

Collection letter should not be considered in determining whether bank was payor bank. The status of a negotiable instrument is to be determined from its face - from the language used or authorized to be used thereon by its drawer or maker - and not from documents attached thereto by other parties. Engine Parts, Inc. v. Citizens Bank, 92 N.M. 37, 582 P.2d 809 (1978).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 703.

What conduct by drawee of check, before receipt of stop-payment order, renders order ineffectual, 10 A.L.R.2d 428.

9 C.J.S. Banks and Banking § 383 et seq.

55-4-204. Methods of sending and presenting; sending directly to payor bank.

(a) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved and the method generally used by it or others to present those items.

(b) A collecting bank may send:

(1) an item directly to the payor bank;

(2) an item to a non-bank payor if authorized by its transferor; and

(3) an item other than documentary drafts to a non-bank payor, if authorized by federal reserve regulation or operating circular, clearing-house rule or the like.

(c) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made.

History: 1953 Comp., § 50A-4-204, enacted by Laws 1961, ch. 96, § 4-204; 1967, ch. 186, § 13; 1992, ch. 114, § 170.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (b)(1) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases in which a bank is a payor. Since nonbank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing-house procedures to forward certain types of items to certain nonbank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (b)(3) affirmatively approves direct sending of any item other than documentary drafts to any nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule or the like.

On the other hand subsection (b)(2) approves sending any item directly to a nonbank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4-203 [55-4-203 NMSA 1978]. However, if a transferor other than the owner of the item, e.g., a prior collecting bank, authorizes a direct sending to a nonbank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3-501(b) [55-3-501 NMSA 1978] provides where presentment may be made. This provision is expressly subject to Article 4. Section 4-204(c) [55-4-204 NMSA 1978] specifically approves presentment by a presenting bank at any place requested by the payor bank or other payor. The time when a check is received by a payor bank for presentment is governed by Regulation CC Section 229.36(b).

The 1992 amendment, effective July 1, 1992, substituted "directly" for "direct" in the section catchline; revised the subsection and paragraph designations; substituted "operating circular" for "operating letter, clearing letter" in Subsection (b)(3); inserted "or other payor" in Subsection (c); and made minor stylistic changes throughout the section.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 710, 720.

9 C.J.S. Banks and Banking §§ 393 et seq., 247.

55-4-205. Depositary bank holder of unindorsed item.

If a customer delivers an item to a depositary bank for collection:

(1) the depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of Section 55-3-302 NMSA 1978, it is a holder in due course; and

(2) the depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

History: 1978 Comp., § 55-4-205, enacted by Laws 1992, ch. 114, § 171.

ANNOTATIONS

OFFICIAL COMMENT

Section 3-201(b) [55-3-201 NMSA 1978] provides that negotiation of an instrument payable to order requires indorsement by the holder. The rule of former Section 4-205(1) was that the depositary bank may supply a missing indorsement of its customer unless the item contains the words "payee's indorsement required" or the like. The cases have differed on the status of the depositary bank as a holder if it fails to supply its customer's indorsement. Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers, 446 N.Y.S.2d 797 (N.Y.App.Div. 4th Dept. 1981), rev'd, 455 N.Y.S.2d 565 (N.Y. 1982). It is common practice for depositary banks to receive unindorsed checks under so-called "lock-box" agreements from customers who receive a high volume of checks. No function would be served by requiring a depositary bank to run these items through a machine that would supply the customer's indorsement except to afford the drawer and the subsequent banks evidence that the proceeds of the item reached the customer's account. Paragraph (1) provides that the depositary bank becomes a holder when it takes the item for deposit if the depositor is a holder. Whether it supplies the customer's indorsement is immaterial. Paragraph (2) satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account. This warranty runs not only to collecting banks and to the payor bank or nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 237 repeals former 55-4-205 NMSA 1978, as enacted by Laws 1961, ch. 96, § 4-205, relating to supplying missing indorsement, effective July 1, 1992. Laws 1992, ch. 114, § 171, enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 700.

Construction and application of U.C.C. § 4-205(1) allowing depositary bank to supply customer's indorsement on item for collection, 29 A.L.R.4th 631.

9 C.J.S. Banks and Banking § 408 et seq.

55-4-206. Transfer between banks.

Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank.

History: 1953 Comp., § 50A-4-206, enacted by Laws 1961, ch. 96, § 4-206; 1992, ch. 114, § 172.

ANNOTATIONS

OFFICIAL COMMENT

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. If the transfer is between banks, this section takes the place of the more formal requirements of Section 3-201 [55-3-201 NMSA 1978].

The 1992 amendment, effective July 1, 1992, substituted "that" for "which".

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 403, 700.

9 C.J.S. Banks and Banking § 408 et seq.

55-4-207. Transfer warranties.

(a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) the warrantor is a person entitled to enforce the item;

(2) all signatures on the item are authentic and authorized;

(3) the item has not been altered;

(4) the item is not subject to a defense or claim in recoupment (Section 55-3-305(a) NMSA 1978) of any party that can be asserted against the warrantor; and

(5) the warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in Sections 55-3-115 NMSA 1978 and 55-3-407 NMSA 1978. The obligations of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(c) A person to whom the warranties under Subsection (a) are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(d) The warranties stated in Subsection (a) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know if the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(e) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

History: 1978 Comp., § 55-4-207, enacted by Laws 1992, ch. 114, § 173.

ANNOTATIONS

OFFICIAL COMMENT

Except for subsection (b), this section conforms to Section 3-416 [55-3-416 NMSA 1978] and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-416 [55-3-416 NMSA 1978]. Subsection (b) provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a "without recourse" indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

Repeals. - Laws 1992, ch. 114, § 173 repeals former 55-4-207 NMSA 1978, as enacted by Laws 1961, ch. 96, § 4-207, relating to warranties of customer and collecting bank on transfer or presentation of items, and enacts the above provision, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 403, 710; 11 Am. Jur. 2d Bills and Notes §§ 646, 649.

Liability of bank for diversion to benefit of presenter or third party of proceeds of check drawn to bank's order by drawer not indebted to bank, 69 A.L.R.4th 778.

9 C.J.S. Banks and Banking §§ 420, 422 et seq., 430 et seq., 415, 435.

55-4-208. Presentment warranties.

(a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) the warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) the draft has not been altered; and

(3) the warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(c) If a drawee asserts a claim for breach of warranty under Subsection (a) based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under Section 55-3-404 or 55-3-405 NMSA 1978 or the drawer is precluded under Section 55-3-406 or 55-4-406 NMSA 1978 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to

obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within 30 days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

History: 1978 Comp., § 55-4-208, enacted by Laws 1992, ch. 114, § 174.

ANNOTATIONS

OFFICIAL COMMENT

This section conforms to Section 3-417 [55-3-417 NMSA 1978] and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-417 [55-3-417 NMSA 1978]. "Draft" is defined in Section 4-104 [55-4-104 NMSA 1978] as including an item that is an order to pay so as to make clear that the term "draft" in Article 4 may include items that are not instruments within Section 3-104 [55-3-104 NMSA 1978].

Recompilations. - Laws 1992, ch. 114, § 176 recompiles former 55-4-208 NMSA 1978 relating to security interest of collecting bank in items, as 55-4-210 NMSA 1978, effective July 1, 1992.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4-209. Encoding and retention warranties.

(a) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(b) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(c) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

History: 1978 Comp., § 55-4-209, enacted by Laws 1992, ch. 114, § 175.

ANNOTATIONS

OFFICIAL COMMENT

1. Encoding and retention warranties are included in Article 4 because they are unique to the bank collection process. These warranties are breached only by the person doing the encoding or retaining the item and not by subsequent banks handling the item. Encoding and check retention may be done by customers who are payees of a large volume of checks; hence, this section imposes warranties on customers as well as banks. If a customer encodes or retains, the depositary bank is also liable for any breach of this warranty.

2. A misencoding of the amount on the MICR line is not an alteration under Section 3-407(a) [55-3-407 NMSA 1978] which defines alteration as changing the contract of the parties. If a drawer wrote a check for $2,500 and the depositary bank encoded $25,000 on the MICR line, the payor bank could debit the drawer's account for only $2,500. This subsection would allow the payor bank to hold the depositary bank liable for the amount paid out over $2,500 without first pursuing the person who received payment. Intervening collecting banks would not be liable to the payor bank for the depositary bank's error. If a drawer wrote a check for $25,000 and the depositary bank encoded $2,500, the payor bank becomes liable for the full amount of the check. The payor bank's rights against the depositary bank depend on whether the payor bank has suffered a loss. Since the payor bank can debit the drawer's account for $25,000, the payor bank has a loss only to the extent that the drawer's account is less than the full amount of the check. There is no requirement that the payor bank pursue collection against the drawer beyond the amount in the drawer's account as a condition to the payor bank's action against the depositary bank for breach of warranty. See Georgia Railroad Bank & Trust Co. v. First National Bank & Trust, 229 S.E.2d 482 (Ga. App. 1976), aff'd, 235 S.E.2d 1 (Ga. 1977), and First National Bank of Boston v. Fidelity Bank, National Association, 724 F. Supp. 1168 (E.D. Pa. 1989).

3. A person retaining items under an electronic presentment agreement (Section 4-110) [55-4-110 NMSA 1978] warrants that it has complied with the terms of the agreement regarding its possession of the item and its sending a proper presentment notice. If the keeper is a customer, its depositary bank also makes this warranty.

Recompilations. - Laws 1992, ch. 114, § 177 recompiles former 55-4-209 NMSA 1978, relating to when bank gives value for purposes of holder in due course, as 55-4-211 NMSA 1978, effective July 1, 1992.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4-210. Security interest of collecting bank in items, accompanying documents and proceeds.

(a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) in case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) in case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(3) if it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to Article 9, but:

(1) no security agreement is necessary to make the security interest enforceable ((1)(a) of Section 55-9-203 NMSA 1978);

(2) no filing is required to perfect the security interest; and

(3) the security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds.

History: 1953 Comp., § 50A-4-208, enacted by Laws 1961, ch. 96, § 4-208; 1978 Comp., § 55-4-208, recompiled as 1978 Comp., § 55-4-210 by Laws 1992, ch. 114, § 176.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several

collecting banks are agents of the customer (Section 4-201) [55-4-201 NMSA 1978]. A collecting agent may properly make advances on the security of paper held for collection, and acquires at common law a possessory lien for these advances. Subsection (a) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3-303, 4-211) [55-3-303, 55-4-211 NMSA 1978, respectively] and a holder in due course if it satisfies the other requirements for that status (Section 3-302) [55-3-302 NMSA 1978]. Subsection (a) does not derogate from the banker's general common law lien or right of setoff against indebtedness owing in deposit accounts. See Section 1-103 [55-1-103 NMSA 1978]. Rather subsection (a) specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (b) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that the vast majority of items handled for collection are in fact collected. The first sentence of subsection (c) reflects the fact that in the normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of noncollection in which the security interest may be important.

The 1992 amendment, effective July 1, 1992, revised the subsection and paragraph designations; inserted "collecting" and substituted "in an item" for "and an item" in the introductory paragraph of Subsection (a); substituted "(1)(a) of Section 55-9-203" for "Section (1)(b) of Section 9-203" in Subsection (c)(1); and made minor stylistic changes throughout the section.

Recompilations. - Laws 1992, ch. 114, § 178 recompiles former 55-4-210 NMSA 1978, relating to presentment by notice of item not payable by, through or at a bank, as 55-4-212 NMSA 1978, effective July 1, 1992.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 660, 699; 11 Am. Jur. 2d Bills and Notes § 339.

Lien of bank upon commercial paper delivered to it by debtor for collection, 22 A.L.R.2d 478.

9 C.J.S. Banks and Banking § 384.

55-4-211. When bank gives value for purposes of holder in due course.

For purposes of determining its status as a holder in due course, a bank has given value to the extent it has a security interest in an item, if the bank otherwise complies

with the requirements of Section 55-3-302 NMSA 1978 on what constitutes a holder in due course.

History: 1953 Comp., § 50A-4-209, enacted by Laws 1961, ch. 96, § 4-209; 1978 Comp., § 55-4-209, recompiled as 1978 Comp., § 55-4-211 by Laws 1992, ch. 114, § 177.

ANNOTATIONS

OFFICIAL COMMENT

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 (Section 3-303) [55-3-303 NMSA 1978]. The section does not prescribe a security interest under Section 4-210 [55-4-210 NMSA 1978] as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201 [55-1-201 NMSA 1978].

The 1992 amendment, effective July 1, 1992, substituted "Section 55-3-302 NMSA 1978" for "Section 3-302" and made minor stylistic changes throughout the section.

Repeals. - Laws 1992, ch. 114, § 237B repeals former 55-4-211 NMSA 1978, as enacted by Laws 1961, ch. 96, § 4-211, relating to media of remittance, effective July 1, 1992. For provisions of former section, see Original Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 694; 11 Am. Jur. 2d Bills and Notes §§ 337, 339.

Crediting proceeds of negotiable paper to depositor's account, as constituting bank a holder in due course, 59 A.L.R.2d 1173.

9 C.J.S. Banks and Banking § 383 et seq.; 10 C.J.S. Bills and Notes §§ 185, 186.

55-4-212. Presentment by notice of item not payable by, through or at a bank; liability of drawer or indorser.

(a) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under Section 55-3-501 NMSA 1978 by the close of the bank's next banking day after it knows of the requirement.

(b) If presentment is made by notice and payment, acceptance or request for compliance with a requirement under Section 55-3-501 NMSA 1978 is not received by

the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts.

History: 1953 Comp., § 50A-4-210, enacted by Laws 1961, ch. 96, § 4-210; 1978 Comp., § 55-4-210, recompiled as 1978 Comp., § 55-4-212 by Laws 1992, ch. 114, § 178.

ANNOTATIONS

OFFICIAL COMMENT

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on nonbank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges drawers and indorsers. Presentment under this section is good presentment under Article 3. See Section 3-501 [55-3-501 NMSA 1978].

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

The 1992 amendment, effective July 1, 1992, substituted "drawer or indorser" for "secondary parties" in the section catchline; substituted letters for numbers in the subsection designations; in Subsection (b), substituted "payment, acceptance or request" for "honor nor payment" near the beginning of the subsection, and substituted "drawer or indorser" for "secondary party" near the end of the subsection; and made section reference substitutions and minor stylistic changes throughout the section.

Recompilations. - Laws 1992, ch. 114, § 180 recompiles former 55-4-212 NMSA 1978, relating to right of charge-back or refund, as 55-4-214 NMSA 1978, effective July 1, 1992.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 710.

9 C.J.S. Banks and Banking § 408 et seq.

55-4-213. Medium and time of settlement by bank.

(a) With respect to settlement by a bank, the medium and time of settlement may be prescribed by federal reserve regulations or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(1) the medium of settlement is cash or credit to an account in a federal reserve bank of or specified by the person to receive settlement; and

(2) the time of settlement is:

(i) with respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) with respect to tender of settlement by credit in an account in a federal reserve bank, when the credit is made;

(iii) with respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) with respect to tender of settlement by a funds transfer, when payment is made pursuant to Section 55-4A-406(a) NMSA 1978 to the person receiving settlement.

(b) If the tender of settlement is not by a medium authorized by subsection (a) or the time of settlement is not fixed by subsection (a), no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(c) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(1) presents or forwards the check for collection, settlement is final when the check is finally paid; or

(2) fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(d) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

History: 1978 Comp., § 55-4-213, enacted by Laws 1992, ch. 114, § 179.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) sets forth the medium of settlement that the person receiving settlement must accept. In nearly all cases the medium of settlement will be determined by agreement or by Federal Reserve regulations and circulars, clearing-house rules, and the like. In the absence of regulations, rules or agreement, the person receiving settlement may demand cash or credit in a Federal Reserve bank. If the person receiving settlement does not have an account in a Federal Reserve bank, it may specify the account of another bank in a Federal Reserve bank. In the unusual case in which there is no agreement on the medium of settlement and the bank making settlement tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred under subsection (b) unless the person receiving settlement accepts the settlement tendered. For example, if a payor bank, without agreement, tenders a teller's check, the bank receiving the settlement may reject the check and return it to the payor bank or it may accept the check as settlement.

2. In several provisions of Article 4 the time that a settlement occurs is relevant. Subsection (a) sets out a general rule that the time of settlement, like the means of settlement, may be prescribed by agreement. In the absence of agreement, the time of settlement for tender of the common agreed media of settlement is that set out in subsection (a)(2). The time of settlement by cash, cashier's or teller's check or authority to charge an account is the time the cash, check or authority is sent, unless presentment is over the counter in which case settlement occurs upon delivery to the presenter. If there is no agreement on the time of settlement and the tender of settlement is not made by one of the media set out in subsection (a), under subsection (b) the time of settlement is the time the settlement is accepted by the person receiving settlement.

3. Subsections (c) and (d) are special provisions for settlement by remittance drafts and authority to charge an account in the bank receiving settlement. The relationship between final settlement and final payment under Section 4-215 [55-4-215 NMSA 1978] is addressed in subsection (b) of Section 4-215 [55-4-215 NMSA 1978]. With respect to settlement by cashier's checks or teller's checks, other than in response to over-the-counter presentment, the bank receiving settlement can keep the risk that the check will not be paid on the bank tendering the check in settlement by acting to initiate collection of the check within the midnight deadline of the bank receiving settlement. If the bank fails to initiate settlement before its midnight deadline, final settlement occurs at the midnight deadline, and the bank receiving settlement assumes the risk that the check will not be paid. If there is no agreement that permits the bank tendering settlement to tender a cashier's or teller's check, subsection (b) allows the bank receiving the check to reject it, and, if it does, no settlement occurs. However, if the bank accepts the check, settlement occurs and the time of final settlement is governed by subsection (c).

With respect to settlement by tender of authority to charge the account of the bank making settlement in the bank receiving settlement, subsection (d) provides that final settlement does not take place until the account charged has available funds to cover the amount of the item. If there is no agreement that permits the bank tendering settlement to tender an authority to charge an account as settlement, subsection (b)

allows the bank receiving the tender to reject it. However, if the bank accepts the authority, settlement occurs and the time of final settlement is governed by subsection (d).

Recompilations. - Laws 1992, ch. 114, § 181 recompiles former 55-4-213 NMSA 1978, relating to final payment of item by payor bank, as 55-4-215 NMSA 1978, effective July 1, 1992.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4-214. Right of charge-back or refund; liability of collecting bank; return of item.

(a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account or obtain refund from its customer whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (Section 55-4-301 NMSA 1978).

(d) The right to charge back is not affected by:

(1) previous use of a credit given for the item; or

(2) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of the value of an item payable in a foreign money, the dollar amount of any charge-back or refund must be calculated on

the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

History: 1953 Comp., § 50A-4-212, enacted by Laws 1961, ch. 96, § 4-212; 1978 Comp., § 55-4-212, recompiled as 1978 Comp., § 55-4-214 by Laws 1992, ch. 114, § 180.

ANNOTATIONS

Compiler's notes. - New Mexico adopted the optional Subsection 2 of the uniform act.

OFFICIAL COMMENT

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items." Statistically, this practice of settling provisionally first and then awaiting final payment is justified because the vast majority of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment, provision is made in subsection (a) for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund.

2. Various causes of a bank's not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (a). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise."

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item. The second sentence of subsection (a) adopts the view of Appliance Buyers Credit Corp. v. Prospect National Bank, 708 F.2d 290 (7th Cir. 1983), that if the midnight deadline for returning an item or giving notice is not met, a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

4. Subsection (b) states when an item is returned by a collecting bank. Regulation CC, Section 229.31 preempts this subsection with respect to checks by allowing direct return to the depositary bank. Because a returned check may follow a different path than in forward collection, settlement given for the check is final and not provisional except as between the depositary bank and its customer. Regulation CC Section 229.36(d). See also Regulations CC Sections 229.31(c) and 229.32(b). Thus owing to the federal preemption, this subsection applies only to noncheck items.

5. The rule of subsection (d) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even if nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103) [55-1-203 and 55-4-103 NMSA 1978, respectively]. If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(e) [55-4-103 NMSA 1978]; see also Section 4-402) [55-4-402 NMSA 1978].

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(e) [55-4-103 NMSA 1978].

7. Subsection (f) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107 [55-3-107 NMSA 1978]. Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

The 1992 amendment, effective July 1, 1992, added "liability of collecting bank; return of item" at the end of the section catchline; revised the subsection and paragraph designations; in Subsection (a), added the second sentence, and deleted "(Subsection (3) of Section 4-211 and Subsections (2) and (3) of Section 4-213)" following "final" in the last sentence; rewrote Subsection (b); substituted "Section 55-4-301" for "Section 4-301" in Subsection (c); in Subsection (f), twice substituted "money" for "currency" and substituted "bank-offered spot rate" for "buying sight rate"; and made minor stylistic changes throughout the section.

Recompilations. - Laws 1992, ch. 114, § 182 recompiles 55-4-214 NMSA 1978, relating to insolvency and preference, as 55-4-216 NMSA 1978, effective July 1, 1992.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 404, 699; 11 Am. Jur. 2d Bills and Notes § 895.

9 C.J.S. Banks and Banking §§ 383 et seq., 402.

55-4-215. Final payment of item by payor bank; when provisional debits and credits become final; when certain credits become available for withdrawal.

(a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) paid the item in cash;

(2) settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement; or

(3) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule or agreement.

(b) If provisional settlement for an item does not become final, the item is not finally paid.

(c) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(d) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(e) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) if the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time; and

(2) if the bank is both the depositary bank and the payor bank, and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(f) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, the deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

History: 1953 Comp., § 50A-4-213, enacted by Laws 1961, ch. 96, § 4-213; 1978 Comp., § 55-4-213, recompiled as 1978 Comp., § 55-4-215 by Laws 1992, ch. 114, § 181.

ANNOTATIONS

OFFICIAL COMMENT

1. By the definition and use of the term "settle" (Section 4-104(a)(11)) [55-4-104 NMSA 1978] this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (a) defines when settlement for an item constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-payment orders, legal process and setoffs (Section 4-303) [55-4-303 NMSA 1978]. It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See Section 4-215(c) [55-4-215 NMSA 1978]. Final payment of an item by the payor bank fixes preferential rights under Section 4-216.

2. If an item being collected moves through several states, e.g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (a) recognizes that final payment does not take place, in this hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are proceeds of the item.

3. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Subsection (a)(1) recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4-104(a)(11) [55-4-104 NMSA 1978] defines "settle" as meaning "to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final." Subsection (a)(2) of Section 4-215 [55-4-215 NMSA 1978] provides that an item is finally paid by a payor bank when the bank has "settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement." Former subsection (1)(b) is modified by subsection (a)(2) to make clear that a payor bank cannot make settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from a statute (e.g., Section 4-301) [55-4-301 NMSA 1978], clearing-house rule or other

agreement. Subsection (a)(2) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If under statute, clearing-house rule or agreement, a right of revocation of the settlement exists, the settlement is provisional. Conversely, if there is an absence of a right to revoke under statute, clearing-house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4-301 [55-4-301 NMSA 1978]. The underlying theory and reason for deferred posting statutes (Section 4-301) [55-4-301 NMSA 1978] is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case in which Section 4-301 [55-4-301 NMSA 1978] is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (a)(2) of Section 4-215 [55-4-215 NMSA 1978] does not operate, and such provisional settlement does not constitute final payment of the item. With respect to checks, Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of this provision to Article 4 is discussed in the Commentary to that section.

A second important example of a right to revoke a settlement is that arising under clearing-house rules. It is very common for clearing-house rules to provide that items exchanged and settled for in a clearing (e.g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than 2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e.g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of an agreement allowing the payor bank to revoke a settlement is a case in which the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, the agreement keeps the receipt or credit provisional and avoids its being either final settlement or final payment.

The most important application of subsection (a)(2) is that in which presentment of an item has been made over the counter for immediate payment. In this case Section 4-301(a) [55-4-301 NMSA 1978] does not apply to make the settlement provisional, and final payment has occurred unless a rule or agreement provides otherwise.

5. Former Section 4-213(1)(c) provided that final payment occurred when the payor bank completed the "process of posting." The term was defined in former Section 4-109.

In the present Article, Section 4-109 has been deleted and the process-of-posting test has been abandoned in Section 4-215(a) [55-4-215 NMSA 1978] for determining when final payment is made. Difficulties in determining when the events described in former Section 4-109 take place make the process-of-posting test unsuitable for a system of automated check collection or electronic presentment.

6. The last sentence of former Section 4-213(1) [see now 55-4-215 NMSA 1978] is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 [55-4-302 NMSA 1978] stating that the payor bank can defend against liability for accountability by showing that it has already settled for the item. But, at least with respect to former Section 4-213(1)(c) [see now 55-4-215 NMSA 1978], such a provision was needed because under the process-of-posting test a payor bank may have paid an item without settling for it. Now that Article 4 has abandoned the process-of-posting test, the sentence is no longer needed. If the payor bank has neither paid the item nor returned it within its midnight deadline, the payor bank is accountable under Section 4-302 [55-4-302 NMSA 1978].

7. Subsection (a)(3) covers the situation in which the payor bank makes a provisional settlement for an item, and this settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing-house rule or agreement. An example of this type of situation is the clearing-house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing-house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (a)(3) provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4-301 [55-4-301 NMSA 1978]. In this situation subsection (a)(3) of Section 4-215 [55-4-215 NMSA 1978] provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4-301 [55-4-301 NMSA 1978], the item is finally paid at midnight on Tuesday. With respect to checks, Regulation CC Section 229.30 (c) allows an extension of the midnight deadline under certain circumstances. If a bank does not expeditiously return a check liability may accrue under Regulation CC Section 229.38. For the relationship of that liability to responsibility under this Article, see Regulation CC Sections 229.30 and 229.38.

8. Subsection (b) relates final settlement to final payment under Section 4-215 [55-4-215 NMSA 1978]. For example, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under Section 4-213(c) [55-4-213 NMSA 1978], subsection (b) provides that final payment has not occurred. If the item is not paid, the drawer remains liable, and under

Section 4-302(a) [55-4-302 NMSA 1978] the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, subsection (b) is an exception to subsection (a)(3). Even if the payor bank has not returned an item by its midnight deadline there is still no final payment if provisional settlement had been made and settlement failed to become final. However, if presentment of the item was over the counter for immediate payment, final payment has occurred under Section 4-215(a)(2) [55-4-215 NMSA 1978]. Subsection (b) does not apply because the settlement was not provisional. Section 4-301(a) [55-4-301 NMSA 1978]. In this case the presenting person, often the payee of the item, has the right to demand cash or the cash equivalent of federal reserve credit. If the presenting person accepts another medium of settlement such as a cashier's or teller's check, the presenting person takes the risk that the payor bank may fail to pay a cashier's check because of insolvency or that the drawee of a teller's check may dishonor it.

9. Subsection (c) states the country-wide usage that when the item is finally paid by the payor bank under subsection (a) this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only if the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place if the payor bank remits for the item by sending some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item by sending a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

10. Subsection (d) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(a) [55-4-201 NMSA 1978]. If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-213) [55-4-213 NMSA 1978].

11. Subsection (e) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (e)(1) deals with the situation in which a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to

receive return of the item and the item has not been received within that time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the indentity and location of the payor of the remittance instrument, the means for clearing such instrument, and other pertinent facts. With respect to checks Regulation CC Sections 229.10-229.13 or similar applicable state law (Section 229.20) control. This is also time for the situation described in Comment 12.

12. Subsection (e)(2) deals with the situation of a bank that is both a depositary bank and a payor bank. The subsection recognizes that if A and B are both customers of a depositary-payor bank and A deposits B's check on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of Section 4-301 [55-4-301 NMSA 1978] to reach the bookkeeper for B's account at some time on Tuesday, and, if there are insufficient funds in B's account, to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check, the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (e)(2) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

The 1992 amendment, effective July 1, 1992, rewrote this section to the extent that a detailed comparison would be impracticable.

Bank not liable for refusing withdrawals against drafts before settlement. - Defendant was not entitled as a matter of right to make withdrawals as against the uncollected drafts before settlement became final, and in view of the condition of the account with respect to unpaid credits at the time of the presentation of the draft, the bank incurred no liability in declining payment. Merchant v. Worley, 79 N.M. 771, 449 P.2d 787 (Ct. App. 1969).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 494, 699, 838, 841.

Crediting proceeds of negotiable paper to depositor's account, as constituting bank a holder in due course, 59 A.L.R.2d 1173.

What constitutes final payment under UCC § 4-213, 23 A.L.R.4th 203.

55-4-216. Insolvency and preference.

(a) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(b) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(c) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement's becoming final if the finality occurs automatically upon the lapse of certain time or the happening of certain events.

(d) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against the collecting bank.

History: 1953 Comp., § 50A-4-214, enacted by Laws 1961, ch. 96, § 4-214; 1978 Comp., § 55-4-214, recompiled as 1978 Comp., § 55-4-216 by Laws 1992, ch. 114, § 182.

ANNOTATIONS

OFFICIAL COMMENT

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in the process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank

collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. On the other hand, some law previous to this Act may be relevant. See Note, Uniform Commercial Code: Stopping Payment of an Item Deposited with an Insolvent Depositary Bank, 40 Okla. L. Rev. 689 (1987). Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216, 55 S. Ct. 394, 79 L. Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108 [55-1-108 NMSA 1978].

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations; deleted "(Subsection (3) of Section 4-211, Subsections (1)(d) and (2) and (3) of Section 4-213)" at the end of Subsection (c); and made minor stylistic changes throughout the section.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 704, 748, 756.

9 C.J.S. Banks and Banking §§ 174, 405 et seq.

PART 3
COLLECTION OF ITEMS - PAYOR BANKS

55-4-301. Deferred posting; recovery of payment by return of items; time of dishonor; return of items by payor bank.

(a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it:

(1) returns the item; or

(2) sends written notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in Subsection (a).

(c) Unless previous notice of dishonor has been sent an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to his instructions.

History: 1953 Comp., § 50A-4-301, enacted by Laws 1961, ch. 96, § 4-301; 1992, ch. 114, § 183.

ANNOTATIONS

OFFICIAL COMMENT

1. The term "deferred posting" appears in the caption of Section 4-301 [55-4-301 NMSA 1978]. This refers to the practice permitted by statute in most of the states before the UCC under which a payor bank receives items on one day but does not post the items to the customer's account until the next day. Items dishonored were then returned after the posting on the day after receipt. Under Section 4-301 [55-4-301 NMSA 1978] the concept of "deferred posting" merely allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. With respect to checks Regulation CC Section 229.30(c) extends the midnight deadline under the UCC under certain circumstances. See the Commentary to Regulation CC Section 229.38(d) on the relationship between the UCC and Regulation CC on settlement.

2. The function of this section is to provide the circumstances under which a payor bank that has made timely settlement for an item may return the item and revoke the settlement so that it may recover any settlement made. These circumstances are: (1) the item must be a demand item other than a documentary draft; (2) the item must be presented otherwise than for immediate payment over the counter; and (3) the payor bank must return the item (or give notice if the item is unavailable for return) before its midnight deadline and before it has paid the item. With respect to checks, see Regulation CC Section 229.31(f) on notice in lieu of return an Regulation CC Section 229.33 as to the different requirement of notice of nonpayment. An instance of when an

item may be unavailable for return arises under a collecting bank check retention plan under which presentment is made by a presentment notice and the item is retained by the collecting bank. Subsection 4-215(a)(2) provides that final payment occurs if the payor bank has settled for an item without a right to revoke the settlement under statute, clearing-house rule or agreement. In any case in which Section 4-301(a) is applicable, the payor bank has a right to revoke the settlement by statute; therefore, Section 4-215(a)(2) is inoperable, and the settlement is provisional. Hence, if the settlement is not over the counter and the payor bank settles in a manner that does not constitute final payment, the payor bank can revoke the settlement by returning the item before its midnight deadline.

3. The relationship of Section 4-301(a) [55-4-301 NMSA 1978] to final settlement and final payment under Section 4-215 [55-4-215 NMSA 1978] is illustrated by the following case. Depositary Bank sends by mail an item to Payor Bank with instructions to settle by remitting a teller's check drawn on a bank in the city where Depositary Bank is located. Payor Bank sends the teller's check on the day the item was presented. Having made timely settlement, under the deferred posting provisions of Section 4-301(a) [55-4-301 NMSA 1978], Payor Bank may revoke that settlement by returning the item before its midnight deadline. If it fails to return the item before its midnight deadline, it has finally paid the item if the bank on which the teller's check was drawn honors the check. But if the teller's check is dishonored there has been no final settlement under Section 4-213(c) [55-4-213 NMSA 1978] and no final payment under Section 4-215(b) [55-4-215 NMSA 1978]. Since the Payor Bank has neither paid the item nor made timely return, it is accountable for the item under Section 4-302(a) [55-4-302 NMSA 1978].

4. The time limits for action imposed by subsection (a) are adopted by subsection (b) for cases in which the payor bank is also the depositary bank, but in this case the requirement of a settlement on the day of receipt is omitted.

5. Subsection (c) fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3-503 [55-3-503 NMSA 1978].

6. Subsection (d) leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned." For definition of "sent" as used in paragraphs (1) and (2) see Section 1-201(38) [55-1-201 NMSA 1978]. Obviously the subsection assumes that the item has not been "finally paid" under Section 4-215(a) [55-4-215 NMSA 1978]. If it has been, this provision has no operation.

7. The fact that an item has been paid under proposed Section 4-215 [55-4-215 NMSA 1978] does not preclude the payor bank from asserting rights of restitution or revocation under Section 3-418 [55-3-218 NMSA 1978]. National Savings and Trust Co. v. Park Corp., 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), is the correct interpretation of the present law on this issue.

The 1992 amendment, effective July 1, 1992, added "return of items by payor bank" at the end of the section catchline; revised the subsection and paragraph designations; rewrote the introductory paragraph of Subsection (a); deleted "held for protest or is otherwise" following "is" in Subsection (a)(2); substituted "presented" for "received" and "clearing-house rules" for "its rules" in Subsection (d)(1); and made minor stylistic changes throughout the section.

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 699, 838, 841; 11 Am. Jur. 2d Bills and Notes § 893.

Construction and effect of UCC §§ 4-301 and 4-302 making payor bank accountable for failure to act promptly on item presented for payment, 22 A.L.R.4th 10.

9 C.J.S. Banks and Banking § 397 et seq.

55-4-302. Payor bank's responsibility for late return of item.

(a) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(1) a demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(2) any other properly payable item unless within the time allowed for acceptance or payment of that item the bank either accepts or pays the item or returns it and accompanying documents.

(b) The liability of a payor bank to pay an item pursuant to Subsection (a) is subject to defenses based on breach of a presentment warranty (Section 55-4-208 NMSA 1978) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.

History: 1953 Comp., § 50A-4-302, enacted by Laws 1961, ch. 96, § 4-302; 1992, ch. 114, § 184.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a)(1) continues the former law distinguishing between cases in which the payor bank is not also the depositary bank and those in which the payor bank is also the depositary bank ("on us" items). For "on us" items the payor bank is accountable if it retains the item beyond its midnight deadline without settling for it. If the payor bank is not the depositary bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. It may avoid accountability either by settling for the item on the day of receipt and returning the item before its midnight deadline under Section 4-301 [55-4-301 NMSA 1978] or by returning the item on the day of receipt. This rule is consistent with the deferred posting practice authorized by Section 4-301 [55-4-301 NMSA 1978] which allows the payor bank to make provisional settlement for an item on the day of receipt and to revoke that settlement by returning the item on the next day. With respect to checks, Regulation CC Section 229.36(d) provides that settlements between banks for forward collection of checks are final when made. See the Commentary on that provision for its effect on the UCC.

2. If the settlement given by the payor bank does not become final, there has been no payment under Section 4-215(b) [55-4-215 NMSA 1978], and the payor bank giving the failed settlement is accountable under subsection (a)(1) of Section 4-302 [55-4-302 NMSA 1978]. For instance, the payor bank makes provisional settlement by sending a teller's check that is dishonored. In such a case settlement is not final under Section 4-213(c) [55-4-213 NMSA 1978] and no payment occurs under Section 4-215(b) [55-4-215 NMSA 1978]. Payor bank is accountable on the item. The general principle is that unless settlement provides the presenting bank with usable funds, settlement has failed and the payor bank is accountable for the amount of the item.

3. Subsection (b) is an elaboration of the deleted introductory language of former Section 4-302 [55-4-302 NMSA 1978]: "In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of Section 4-207) [55-4-207 NMSA 1978], settlement effected or the like . . . ." A payor bank can defend an action against it based on accountability by showing that the item contained a forged indorsement or a fraudulent alteration. Subsection (b) drops the ambiguous "or the like" language and provides that the payor bank may also raise the defense of fraud. Decisions that hold an accountable bank's liability to be "absolute" are rejected. A payor bank that makes a late return of an item should not be liable to a defrauder operating a checkkiting scheme. In Bank of Leumi Trust Co. v. Bally's Park Place Inc., 528 F. Supp. 349 (S.D.N.Y. 1981), and American National Bank v. Foodbasket, 497 P.2d 546 (Wyo. 1972), banks that were accountable under Section 4-302 [55-4-302 NMSA 1978] for missing their midnight deadline were successful in defending against parties who initiated collection knowing that the check would not be paid. The "settlement effected" language is deleted as unnecessary. If a payor bank is accountable for an item it is liable to pay it. If it has made final payment for an item, it is no longer accountable for the item.

The 1992 amendment, effective July 1, 1992, revised the subsection and paragraph designations; rewrote the introductory paragraph of Subsection (a); made stylistic changes in Subsection (a)(1); and added Subsection (b).

Liability created by this section is independent of negligence and is absolute or strict liability for the full amount of the items which a payor bank fails to return. Even where a draft is arguably ambiguous as to whether the bank is the drawee or someone else is, where it handles the item which it in fact is obligated to pay, it takes the risk of loss if it fails to comply with this section. Engine Parts, Inc. v. Citizens Bank, 92 N.M. 37, 582 P.2d 809 (1978).

Midnight deadline not applicable for documentary drafts. - If instruments are documentary drafts, banks are not bound by a midnight deadline. Shannon v. Sunwest Bank, 118 N.M. 749, 887 P.2d 285 (1994).

Award of interest justified. - Where a bank held drafts for an unreasonable period a petitioner is entitled to interest on its claim at the legal rate. Not to award interest where there has been an unreasonable and unjustified delay would be an abuse of discretion. Engine Parts, Inc. v. Citizens Bank, 92 N.M. 37, 582 P.2d 809 (1978).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 494, 568, 704.

Construction and effect of UCC §§ 4-301 and 4-302 making payor bank accountable for failure to act promptly on item presented for payment, 22 A.L.R.4th 10.

9 C.J.S. Banks and Banking §§ 328, 329, 337, 341, 397, 398, 405.

55-4-303. When items subject to notice, stop-payment order, legal process or setoff; order in which items may be charged or certified.

(a) Any knowledge, notice or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(1) the bank accepts or certifies the item;

(2) the bank pays the item in cash;

(3) the bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement;

(4) the bank becomes accountable for the amount of the item under Section 55-4-302 NMSA 1978 dealing with the payor bank's responsibility for late return of items; or

(5) with respect to checks, a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(b) Subject to Subsection (a), items may be accepted, paid, certified or charged to the indicated account of its customer in any order.

History: 1953 Comp., § 50A-4-303, enacted by Laws 1961, ch. 96, § 4-303; 1992, ch. 114, § 185.

ANNOTATIONS

OFFICIAL COMMENT

1. While a payor bank is processing an item presented for payment, it may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (a) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-payment order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. With respect to the effect of the customer's bankruptcy, the bank's rights are governed by Bankruptcy Code Section 542(c) which codifies the result of Bank of Marin v. England, 385 U.S. 99 (1966). Section 4-405 [55-4-405 NMSA 1978] applies to the death or incompetence of the customer.

3. Once a payor bank has accepted or certified an item or has paid the item in cash, the event has occurred that determines priorities between the item and the various legal events usually described as the "four legals." Paragraphs (1) and (2) of subsection (a) so provide. If a payor bank settles for an item presented over the counter for immediate payment by a cashier's check or teller's check which the presenting person agrees to accept, paragraph (3) of subsection (a) would control and the event determining priority has occurred. Because presentment was over the counter, Section 4-301(a) [55-4-301 NMSA 1978] does not apply to give the payor bank the statutory right to revoke the settlement. Thus the requirements of paragraph (3) have been met unless a clearing-house rule or agreement of the parties provides otherwise.

4. In the usual case settlement for checks is by entries in bank accounts. Since the process-of-posting test has been abandoned as inappropriate for automated check collection, the determining event for priorities is a given hour on the day after the item is received. (Paragraph (5) of subsection (a).) The hour may be fixed by the bank no earlier than one hour after the opening on the next banking day after the bank received the check and no later than the close of that banking day. If an item is received after the payor bank's regular Section 4-108 [55-4-108 NMSA 1978] cutoff hour, it is treated as received the next banking day. If a bank receives an item after its regular cutoff hour on Monday and an attachment is levied at noon on Tuesday, the attachment is prior to the item if the bank had not before that hour taken the action described in paragraphs (1), (2), and (3) of subsection (a). The Commentary to Regulation CC Section 229.36(d) explains that even though settlement by a paying bank for a check is final for Regulation CC purposes, the paying bank's right to return the check before its midnight deadline under the UCC is not affected.

5. Another event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under Section 4-302 [55-4-302 NMSA 1978] dealing with the payor bank's responsibility for late return of items." Expiration of the deadline under Section 4-302 [55-4-302 NMSA 1978] with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-payment orders, legal process or setoff.

6. In the case of knowledge, notice, stop-payment orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the accounting department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403 [55-1-201 and 55-4-403 NMSA 1978, respectively]. In the case of setoff the effective time is when the setoff is actually made.

7. As between one item and another no priority rule is stated. This is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer's account; the possible methods of receipt; and other variables. Further, the drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor or bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302 [55-4-302 NMSA 1978]. Under subsection (b) the bank has the right to pay items for which it is itself liable ahead of those for which it is not.

The 1992 amendment, effective July 1, 1992, rewrote this section to the extent that a detailed comparison would be impracticable.

Where bank controls order of payment of items. - Where a draft and two checks issued to a bank were presented against defendant's account, and the account contained insufficient funds to cover the three items, the bank, in good faith, can charge items against the account in any order convenient to it. Merchant v. Worley, 79 N.M. 971, 449 P.2d 787 (Ct. App. 1969).

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 494, 542, 641.

Stipulation relieving bank from, or limiting its liability for disregard of, stop payment order, 1 A.L.R.2d 1155.

What conduct of drawee of check, before receipt of stop payment order, renders order ineffectual, 10 A.L.R.2d 428.

Bank's liability for payment of check drawn by one depositor after stop payment order by joint depositor, 55 A.L.R.2d 975.

Uniform Commercial Code: bank's right to stop payment on its own uncertified check or money order, 97 A.L.R.3d 714.

Special bank deposits as subject of attachment or garnishment to satisfy depositor's general obligations, 8 A.L.R.4th 998.

9 C.J.S. Banks and Banking §§ 326, 352 et seq.

PART 4 RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

55-4-401. When bank may charge customer's account.

(a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(c) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in Subsection (b) of Section 55-4-403 NMSA 1978 for stop-payment orders, and must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check described in Section 55-4-303 NMSA 1978. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under Section 55-4-402 NMSA 1978.

(d) A bank that in good faith makes payment to a holder may charge the indicated account of its customer according to:

(1) the original terms of the altered item; or

(2) the terms of the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

History: 1953 Comp., § 50A-4-401, enacted by Laws 1961, ch. 96, § 4-401; 1992, ch. 114, § 186.

ANNOTATIONS

OFFICIAL COMMENT

1. An item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. For an example of a payment held to violate an agreement with a customer, see Torrance National Bank v. Enesco Federal Credit Union, 285 P.2d 737 (Cal.App. 1955). An item drawn for more than the amount of a customer's account may be properly payable. Thus under subsection (a) a bank may charge the customer's account for an item even though payment results in an overdraft. An item containing a forged drawer's signature or forged indorsement is not properly payable. Concern has arisen whether a bank may require a customer to execute a stop-payment order when the customer notifies the bank of the loss of an unindorsed or specially indorsed check. Since such a check cannot be properly payable from the customer's account, it is inappropriate for a bank to require stop-payment order in such a case.

2. Subsection (b) adopts the view of case authority holding that if there is more than one customer who can draw on an account, the nonsigning customer is not liable for an overdraft unless that person benefits from the proceeds of the item.

3. Subsection (c) is added because the automated check collection system cannot accommodate postdated checks. A check is usually paid upon presentment without

respect to the date of the check. Under the former law, if a payor bank paid a postdated check before its stated date, it could not charge the customer's account because the check was not "properly payable." Hence, the bank might have been liable for wrongfully dishonoring subsequent checks of the drawer that would have been paid had the postdated check not been prematurely paid. Under subsection (c) a customer wishing to postdate a check must notify the payor bank of its postdating in time to allow the bank to act on the customer's notice before the bank has to commit itself to pay the check. If the bank fails to act on the customer's timely notice, it may be liable for damages for the resulting loss which may include damages for dishonor of subsequent items. This Act does not regulate fees that banks charge their customers for a notice of postdating or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. Perdue v. Crocker National Bank, 38 Cal.3d 913 (1985) (unconscionability); Best v. United Bank of Oregon, 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 [55-1-203 NMSA 1978] provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Section 3-407(c) [55-3-407 NMSA 1978] states that a payor bank or drawee which pays a fraudulently altered instrument in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. Section 4-401(d) [55-4-401 NMSA 1978] follows the rule stated in Section 3-407(c) [55-3-407 NMSA 1978] by applying it to an altered item and allows the bank to enforce rights with respect to the altered item by charging the customer's account.

The 1992 amendment, effective July 1, 1992, revised the subsection and paragraph designations; added the second sentence of Subsection (a); added Subsections (b) and (c); substituted "terms" for "tenor" in Subsections (d)(1) and (d)(2); and made minor stylistic changes throughout the section.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 494.

Effect on bank depositor's rights and those of bank of printed rules in passbook not expressly accepted, 60 A.L.R.2d 708.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

Recovery by bank of money paid out to customer by mistake, 10 A.L.R.4th 524.

Bank's liability for paying postdated check, 31 A.L.R.4th 329.

Nondrawing cosigner's liability for joint checking account overdraft, 48 A.L.R.4th 1136.

9 C.J.S. Banks and Banking § 341 et seq.

55-4-402. Bank's liability to customer for wrongful dishonor; time of determining insufficiency of account.

(a) Except as otherwise provided in this article, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(b) A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

(c) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful.

History: 1953 Comp., § 50A-4-402, enacted by Laws 1961, ch. 96, § 4-402; 1992, ch. 114, § 187.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states positively what has been assumed under the original Article: that if a bank fails to honor a properly payable item it may be liable to its customer for wrongful dishonor. Under subsection (b) the payor bank's wrongful dishonor of an item gives rise to a statutory cause of action. Damages may include consequential damages. Confusion has resulted from the attempts of courts to reconcile the first and second sentences of former Section 4-402. The second sentence implied that the bank was liable for some form of damages other than those proximately caused by the dishonor if the dishonor was other than by mistake. But nothing in the section described what these noncompensatory damages might be. Some courts have held that in distinguishing

between mistaken dishonors and nonmistaken dishonors, the so-called "trader" rule has been retained that allowed a "merchant or trader" to recover substantial damages for wrongful dishonor without proof of damages actually suffered. Comment 3 to former Section 4-402 indicated that this was not the intent of the drafters. White & Summers, Uniform Commercial Code, Section 18-4 (1988), states: "The negative implication is that when wrongful dishonors occur not 'through mistake' but willfully, the court may impose damages greater than 'actual damages' . . . . Certainly the reference to 'mistake' in the second sentece of 4-402 [55-4-402 NMSA 1978] invites a court to adopt the relevant pre-Code distinction." Subsection (b) by deleting the reference to mistake in the second sentence precludes any inference that Section 4-402 [55-4-402 NMSA 1978] retains the "trader" rule. Whether a bank is liable for noncompensatory damages, such as punitive damages, must be decided by Section 1-103 and Section 1-106 [55-1-103 and 55-1-106 NMSA 1978, respectively] ("by other rule of law").

2. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in Section 4-103(e) [55-4-103 NMSA 1978]. By the same token, if a dishonor comes within this section, the measure of damages of this section applies and not another measure of damages. If the wrongful refusal of the beneficiary's bank to make funds available from a funds transfer causes the beneficiary's check to be dishonored, no specific guidance is given as to whether recovery is under this section or Article 4A. In each case this issue must be viewed in its factual context, and it was thought unwise to seek to establish certainty at the cost of fairness.

3. The second and third sentences of the subsection (b) reject decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer and leave to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

4. Banks commonly determine whether there are sufficient funds in an account to pay an item after the close of banking hours on the day of presentment when they post debit and credit items to the account. The determination is made on the basis of credits available for withdrawal as of right or made available for withdrawal by the bank as an accommodation to its customer. When it is determined that payment of the item would overdraw the account, the item may be returned at any time before the bank's midnight deadline the following day. Before the item is returned new credits that are withdrawable as of right may have been added to the account. Subsection (c) eliminates uncertainty under Article 4 as to whether the failure to make a second determination before the item is returned on the day following presentment is a wrongful dishonor if new credits were added to the account on that day that would have covered the amount of the check.

5. Section 4-402 [55-4-402 NMSA 1978] has been construed to preclude an action for wrongful dishonor by a plaintiff other than the bank's customer. Loucks v. Albuquerque National Bank, 418 P.2d 191 (N.Mex. 1966). Some courts have allowed a plaintiff other than the customer to sue when the customer is a business entity that is one and the same with the individual or individuals operating it. Murdaugh Volkswagen, Inc. v. First

National Bank, 801 F.2d 719 (4th Cir. 1986) and Karsh v. American City Bank, 113 Cal.App.3d 419, 169 Cal.Rptr. 851 (1980). However, where the wrongful dishonor impugns the reputation of an operator of the business, the issue is not merely, as the court in Koger v. East First National Bank, 443 So.2d 141 (Fla.App. 1983), put it, one of a literal versus a liberal interpretation of Section 4-402 [55-4-402 NMSA 1978]. Rather the issue is whether the statutory cause of action in Section 4-402 [55-4-402 NMSA 1978] displaces, in accordance with Section 1-103 [55-1-103 NMSA 1978], any cause of action that existed at common law in a person who is not the customer whose reputation was damaged. See Marcum v. Security Trust and Savings Co., 221 Ala. 419, 129 So. 74 (1930). While Section 4-402 should not be interpreted to displace the latter cause of action, the section itself gives no cause of action to other than a "customer," however that definition is construed, and thus confers no cause of action on the holder of a dishonored item. First American National Bank v. Commerce Union Bank, 692 S.W.2d 642 (Tenn.App. 1985).

The 1992 amendment, effective July 1, 1992, added "time of determining insufficiency of account" at the end of the section catchline; designated the formerly undesignated provisions as Subsection (b), while adding Subsections (a) and (c); and rewrote the former second and third sentences of Subsection (b) so as to constitute the present second sentence of that subsection.

I. General Consideration.
II. Customer.
III. Dishonor.
IV. Damages.

I. GENERAL CONSIDERATION.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For comment on Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966), see 8 Nat. Resources J. 169 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 567, 575, 576.

Necessity of pleading that maker or drawer was given notice of dishonor of check, 6 A.L.R.2d 985.

Liability for negligently causing arrest or prosecution of another, 99 A.L.R.3d 1113.

Liability of check printer for errors in identification or routing codes printed on check, 18 A.L.R.4th 923.

What constitutes wrongful dishonor of check rendering payor bank liable to drawer under UCC § 4-402, 88 A.L.R.4th 568.

Who may recover for wrongful dishonor of check under UCC § 4-402, 88 A.L.R.4th 613.

Damages recoverable for wrongful dishonor of check under UCC § 4-402, 88 A.L.R.4th 644.

9 C.J.S. Banks and Banking §§ 341, 380.

II. CUSTOMER.

Partnership deemed customer through contract with bank. - The relationship between a bank and its depositor is a contractual relationship of debtor and creditor and a partnership can enter into the contractual relationship of debtor and creditor, as a customer of the bank, in accordance with the express provisions of the code. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

But not individual partners. - Although tortious conduct may be tortious as to two or more persons, and these persons may be a partnership and one or more of the individual partners, where the relationship, in connection with which the wrongful conduct of the bank arose, was the relationship between the bank and the partnership, the partnership was the customer and any damages arising from the dishonor belonged to the partnership and not to the partners individually. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

Therefore action on injury to partner properly dismissed. - Claim for loss of income in the amount allegedly sustained by the partnership as a result of the illness and disability of a partner by reason of his ulcer was properly dismissed even if the court were to assume that a tortious act had been committed by defendants, because the right to recover for the injuries would be in the partner alone, not in the partnership. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

III. DISHONOR.

"Wrongful dishonor" means a dishonor done in a wrong manner, unjustly, unfair, in a manner contrary to justice. Allison v. First Nat'l Bank, 85 N.M. 283, 511 P.2d 769 (Ct. App.), rev'd on other grounds, 85 N.M. 511, 514 P.2d 30 (1973).

"Mistaken dishonor" means a dishonor done erroneously, unintentionally, a state of mind that is not in accord with the facts. Allison v. First Nat'l Bank, 85 N.M. 283, 511 P.2d 769 (Ct. App.), rev'd on other grounds, 85 N.M. 511, 514 P.2d 30 (1973).

IV. DAMAGES.

Damages recoverable by customer. - The provisions of this section limit the damages of a customer, whose checks are wrongfully dishonored, to those proximately caused by the wrongful dishonor, and such includes any consequential damages so proximately caused. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

"Consequential damage" is defined as such damage, loss or injury as does not flow directly and immediately from the act of the party, but only from the consequences or results of such act and it includes injuries to credit as a result of wrongful dishonor. Allison v. First Nat'l Bank, 85 N.M. 283, 511 P.2d 769 (Ct. App.), rev'd on other grounds, 85 N.M. 511, 514 P.2d 30 (1973).

And damages recoverable for injury to credit compensatory. - Damages recoverable for injuries to credit as a result of a wrongful dishonor are more than mere nominal damages and are referred to as compensatory, general, substantial, moderate or temperate, damages as would be fair and reasonable compensation for the injury which the depositor must have sustained, but not harsh or inordinate damages. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

If dishonor occurs through mistake, damages are limited to actual damages proved. Loucks v. Albuquerque Nat'l Bank, 76 N.M. 735, 418 P.2d 191 (1966).

However willful dishonor permits punitive damages. - This section does not deal with intentional or willful or malicious dishonor; however, intentional, willful or malicious dishonor permits an award of punitive damages. Allison v. First Nat'l Bank, 85 N.M. 283, 511 P.2d 769 (Ct. App.), rev'd on other grounds, 85 N.M. 511, 514 P.2d 30 (1973).

55-4-403. Customer's right to stop payment; burden of proof of loss.

(a) A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in Section 55-4-303 NMSA 1978. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(b) A stop-payment order is effective for six months, but it lapses after fourteen calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for additional six-month periods by a writing given to the bank within a period during which the stop-payment order is effective.

(c) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may

include damages for dishonor of subsequent items under Section 55-4-402 NMSA 1978.

History: 1953 Comp., § 50A-4-403, enacted by Laws 1961, ch. 96, § 4-403; 1992, ch. 114, § 188.

ANNOTATIONS

OFFICIAL COMMENT

1. The position taken by this section is that stopping payment or closing an account is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop or close should be borne by the banks as a cost of the business of banking.

2. Subsection (a) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3-602 [55-3-602 NMSA 1978]. The sole exception to this rule is found in Section 4-405 [55-4-405 NMSA 1978] on payment after notice of death, by which any person claiming an interest in the account can stop payment.

3. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. If the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 4-106) [55-4-106 NMSA 1978] the maker may stop payment of the note. By analogy the rule extends to drawees other than banks.

4. A cashier's check or teller's check purchased by a customer whose account is debited in payment for the check is not a check drawn on the customer's account within the meaning of subsection (a); hence, a customer purchasing a cashier's check or teller's check has no right to stop payment of such a check under subsection (a). If a bank issuing a cashier's check or teller's check refuses to pay the check as an accommodation to its customer or for other reasons, its liability on the check is governed by Section 3-411 [55-3-411 NMSA 1978] . There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3-411 and 4-303 [55-3-411 and 55-4-303 NMSA 1978]. The acceptance is the drawee's own engagement to pay, and it is not required to impair its credit by refusing payment for the convenience of the drawer.

5. Subsection (a) makes clear that if there is more than one person authorized to draw on a customer's account any one of them can stop payment of any check drawn on the account or can order the account closed. Moreover, if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check. In describing the item, the customer, in the absence of a contrary agreement, must meet the standard of what

information allows the bank under the technology then existing to identify the item with reasonable certainty.

6. Under subsection (b), a stop-payment order is effective after the order, whether written or oral, is received by the bank and the bank has a reasonable opportunity to act on it. If the order is written it remains in effect for six months from that time. If the order is oral it lapses after 14 days unless there is written confirmation. If there is written confirmation within the 14-day period, the six-month period dates from the giving of the oral order. A stop-payment order may be renewed any number of times by written notice given during a six-month period while a stop order is in effect. A new stop-payment order may be given after a six-month period expires, but such a notice takes effect from the date given. When a stop-payment order expires it is as though the order had never been given, and the payor bank may pay the item in good faith under Section 4-404 [55-4-404 NMSA 1978] even though a stop-payment order had once been given.

7. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(a) [55-4-103 NMSA 1978] if in paying the item over the stop-payment order the bank has failed to exercise ordinary care. An agreement to the contrary which is imposed upon a customer as part of a standard form contract would have to be evaluated in the light of the general obligation of good faith. Sections 1-203 and 4-104(c) [55-1-203 and 55-4-104 NMSA 1978, respectively]. The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4-407) [55-4-407 NMSA 1978]; retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop-payment order (Section 1-103) [55-1-103 NMSA 1978]; and retains common law rights, e.g., to recover money paid under a mistake under Section 3-418 [55-3-418 NMSA 1978]. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (Sections 3-305, 3-414) [55-3-305, 55-3-414 NMSA 1978, respectively] and the drawee, if it pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4-407 [55-4-407 NMSA 1978]. The relationship between Section 4-403 and 4-407 [55-4-403 and 55-4-407 NMSA 1978, respectively] is discussed in the Comments to Section 4-407 [55-4-407 NMSA 1978]. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder were bringing the action.

The 1992 amendment, effective July 1, 1992, rewrote this section to the extent that a detailed comparison would be impracticable.

Bank making erroneous payment over stop order can recover from drawer or payee: if the drawer has no defense to payment of the check, the bank recovers by charging the drawer's account; if the drawer has a defense, then the bank recovers as a subrogee to the drawer's right against the payee. Swiss Credit Bank v. Balink, 614 F.2d 1269 (10th Cir. 1980).

Bank should bear cost of litigation stemming from negligent cashing of check. Ward v. First Nat'l Bank, 94 N.M. 701, 616 P.2d 414 (1980).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 641, 645, 653.

Stipulation relieving bank from or limiting its liability for disregard of stop payment order, 1 A.L.R.2d 1155.

What conduct by drawee of check before receipt of stop payment order renders order ineffectual, 10 A.L.R.2d 428.

Liability of bank for payment of check drawn by one depositor after stop payment order by joint depositor, 55 A.L.R.2d 975.

Uniform Commercial Code: bank's right to stop payment on its own uncertified check or money order, 97 A.L.R.3d 714.

Recovery by bank of money paid out to customer by mistake, 10 A.L.R.4th 524.

Banks and banking: construction and effect of U.C.C. § 4-403(2) regulating oral or written nature of stop-payment order, 29 A.L.R.4th 228.

Sufficiency of description of check in stop-payment order under UCC § 4-403, 35 A.L.R.4th 985.

9 C.J.S. Banks and Banking §§ 326, 352 et seq.

55-4-404. Bank not obliged to pay check more than six months old.

A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

History: 1953 Comp., § 50A-4-404, enacted by Laws 1961, ch. 96, § 4-404; 1992, ch. 114, § 189.

ANNOTATIONS

OFFICIAL COMMENT

This section incorporates a type of statute that had been adopted in 26 jurisdictions before the Code. The time limit is set at six months because banking and commercial

practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the section because thay are the primary obligation of the certifying bank (Sections 3-409 and 3-413) [55-3-409 and 55-3-413 NMSA 1978, respectively]. The obligation runs directly to the holder of the check. The customer's account was presumably charged when the check was certified.

The 1992 amendment, effective July 1, 1992, substituted "obliged" for "obligated" in the section catchline.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 552.

Bank's liability for paying postdated checks, 31 A.L.R.4th 329.

9 C.J.S. Banks and Banking §§ 328 et seq., 337, 341, 351, 357, 358, 405.

55-4-405. Death or incompetence of customer.

(a) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(b) Even with knowledge, a bank may for ten days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.

History: 1953 Comp., § 50A-4-405, enacted by Laws 1961, ch. 96, § 4-405; 1992, ch. 114, § 190.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) follows existing decisions holding that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any rule that required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

2. Subsection (b) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that these checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

3. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is "colorable." But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations; and made minor stylistic changes throughout the section.

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of the Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 559, 648.

9 C.J.S. Banks and Banking §§ 326, 352, 383 et seq.

55-4-406. Customer's duty to discover and report unauthorized signature or alteration.

(a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount and date of payment.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item.

(c) If a bank sends or makes available a statement of account or items pursuant to Subsection (a), the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(d) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by Subsection (c), the customer is precluded from asserting against the bank:

(1) the customer's unauthorized signature or any alteration on the item if the bank also proves that it suffered a loss by reason of the failure; and

(2) the customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding thirty days, in which to examine the item or statement of account and notify the bank.

(e) If Subsection (d) applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with Subsection (c) and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under Subsection (d) does not apply.

(f) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (Subsection (a)) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under Section 55-4-208 NMSA 1978 with respect to the unauthorized signature or alteration to which the preclusion applies.

History: 1953 Comp., § 50A-4-406, enacted by Laws 1961, ch. 96, § 4-406; 1992, ch. 114, § 191.

ANNOTATIONS

OFFICIAL COMMENT

1. In order to impose on its customer the duty stated in subsection (c) to examine a statement or the returned items and report unauthorized signatures of the customer or alterations, the bank must comply with subsection (a) in sending or making available to the customer a statement of the account. Whether the bank returns to the customer the items paid is a matter for bank-customer agreement. If the agreement is that the bank does not return the items paid, a general standard is stated that the customer must be given information "sufficient to allow the customer reasonably to identify the items paid." If the bank supplies its customer with an image of an item, it complies with this standard. But a safeharbor rule is provided. If the item is described by item number, amount, and date of payment, the bank does comply. This information was chosen because it can be obtained by the bank's computer from the check's MICR line without examination of the items involved. The other two items of information that the customer would normally want to know - the name of the payee and the date of the item - cannot currently be obtained from the MICR line. The safeharbor rule is important in determining the feasibility of payor or collecting bank check retention plans. A customer who keeps a record of items written will have sufficient information to identify the item on the basis of item number, amount and date of payment. But customers who don't keep records may not. The policy decision is that accommodating these customers is not as desirable as accommodating others who keep more careful records at less cost to the check collection system and, thus, to all customers of the system. It is expected that technological advances may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendation for an amendment revising the safe harbor requirements in the light of those advances.

2. Subsection (b) applies if the items are not returned to the customer. Check retention plans may include a simple payor bank check retention plan or the kind of check retention plan that would be authorized by a truncation agreement in which a collecting bank or the payee may retain the items. Even after agreeing to a check retention plan, a customer may need to see one or more checks for litigation or other purposes. The

customer's request for the check may always be made to the payor bank. Under subsection (b) retaining banks may destroy items but must maintain the capacity to furnish legible copies for seven years. A legible copy may include an image of an item. This Act does not define the length of the reasonable period of time for a bank to provide the check or copy of the check. What is reasonable depends on the capacity of the bank and the needs of the customer. This Act does not specify sanctions for failure to retain or furnish the items or legible copies; this is left to other laws regulating banks. See Comment 3 to Section 4-101 [55-4-101 NMSA 1978]. Moreover, this Act does not regulate fees that banks charge their customers for furnishing items or copies or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. Perdue v. Crocker National Bank, 38 Cal.3d 913 (1985) (unconscionability); Best v. United Bank of Oregon, 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 [55-1-203 NMSA 1978] provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

3. Subsection (c) imposes on the customer the duty to examine for and report unauthorized payments. Subsection (d)(2) changes former subsection (2)(b) by adopting a 30-day period in place of a 14-day period. Although the 14-day period may have been sufficient when the original version of Article 4 was drafted in the 1950s, given the much greater volume of checks at the time of the revision, a longer period was viewed as more appropriate. The rule of subsection (d)(2) follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subsection (d)(2) is prescribed, and to avoid dispute a specific time limit, 30 days, is designated for cases to which the subsection applies. These considerations are not present if there are no losses resulting from the payment of additional items. In these circumstances, a reasonable period for the customer to comply with its duties under subsection (c) would depend on the circumstances (Section 1-204(2)) [55-1-204 NMSA 1978] and the subsection (d)(2) time limit should not be imported by analogy into subsection (c).

4. Subsection (e) replaces former subsection (3) and poses a modified comparative negligence test for determining liability. See the discussion on this point in the Comments to Sections 3-404, 3-405 and 3-406 [55-3-404, 55-3-405 and 55-3-406 NMSA 1978, respectively]. The term "good faith" is defined in Section 3-103(a)(4) [55-3-103 NMSA 1978] as including "observance of reasonable commercial standards of fair dealing." The connotation of this standard is fairness and not absence of negligence.

The term "ordinary care" used in subsection (e) is defined in Section 3-103(a)(7) [55-3-103 NMSA 1978], made applicable to Article 4 by Section 4-104(c) [55-4-104 NMSA 1978], to provide that sight examination by a payor bank is not required if its procedure is reasonable and is commonly followed by other comparable banks in the area. The case law is divided on this issue. The definition of "ordinary care" in Section 3-103 [55-3-103 NMSA 1978] rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law. The effect of the definition of "ordinary care" on Section 4-406 [55-4-406 NMSA 1978] is only to provide that in the small percentage of cases in which a customer's failure to examine its statement or returned items has led to loss under subsection (d) a bank should not have to share that loss solely because it has adopted an automated collection or payment procedure in order to deal with the great volume of items at a lower cost to all customers.

5. Several changes are made in former Section 4-406(5) [55-4-406 NMSA 1978]. First, former subsection (5) is deleted and its substance is made applicable only to the one-year notice preclusion in former subsection (4) (subsection (f)). Thus if a drawer has not notified the payor bank of an unauthorized check or material alteration within the one-year period, the payor bank may not choose to recredit the drawer's account and pass the loss to the collecting banks on the theory of breach of warranty. Second, the reference in former subsection (4) to unauthorized indorsements is deleted. Section 4-406 [55-4-406 NMSA 1978] imposes no duties on the drawer to look for unauthorized indorsements. Section 4-111 [55-4-111 NMSA 1978] sets out a statute of limitations allowing a customer a three-year period to seek a credit to an account improperly charged by payment of an item bearing an unauthorized indorsement. Third, subsection (c) is added to Section 4-208 [55-4-208 NMSA 1978] to assure that if a depositary bank is sued for breach of a presentment warranty, it can defend by showing that the drawer is precluded by Section 3-406 or Section 4-406(c) and (d) [55-3-406 and 55-4-406 NMSA 1978, respectively].

The 1992 amendment, effective July 1, 1992, rewrote this section to the extent that a detailed comparison would be impracticable.

Compiler's note. - This section was enacted as 55-5-406 NMSA 1978 due to a typographical error, but has been set out by the compiler as 55-4-406 NMSA 1978.

Bank not insulated from own negligence. - It is certainly not the intention of this section to allow a bank to be insulated from the effect of its own negligence. Rutherford v. Darwin, 95 N.M. 340, 622 P.2d 245 (Ct. App. 1980).

Law reviews. - For comment on Cooper v. Albuquerque Nat'l Bank, 75 N.M. 295, 404 P.2d 125 (1965), see 6 Nat. Resources J. 142 (1966).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 1 Am. Jur. 2d Accounts and Accounting § 40; 10 Am. Jur. 2d Banks §§ 511, 515 to 519.

Construction and effect of statutes relieving bank from its liability to depositor for payment of forged or raised check unless within a specified time after the return of a voucher representing payment he notifies the bank as to the forgery or raising, 50 A.L.R.2d 1115.

Bank's liability for payment or withdrawal on less than required number of signatures, 7 A.L.R.4th 655.

Construction and application of UCC § 4-406, requiring customer to discover and report unauthorized signature, in cases involving bank's payment of check or withdrawal on less than required number of signatures, 7 A.L.R.4th 1111.

9 C.J.S. Banks and Banking §§ 417, 418, 424, 434, 435, 437, 438.

55-4-407. Payor bank's right to subrogation on improper payment.

If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights:

(1) of any holder in due course on the item against the drawer or maker;

(2) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(3) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

History: 1953 Comp., § 50A-4-407, enacted by Laws 1961, ch. 96, § 4-407; 1992, ch. 114, § 192.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 4-403 [55-4-403 NMSA 1978] states that a stop-payment order or an order to close an account is binding on a bank. If a bank pays an item over such an order it is prima facie liable, but under subsection (c) of Section 4-403 [55-4-403 NMSA 1978] the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-payment order is that the drawer or maker suffered no loss because it would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the

sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and paragraph (1) of this section state this rule.

2. Paragraph (2) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course by still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods it is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Paragraph (3) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103) [55-1-103 NMSA 1978]. Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop-payment order or right to recover money paid under a mistake.

The 1992 amendment, effective July 1, 1992, substituted "order of the drawer or maker to stop payment, or after an account has been closed" for "stop payment order of the drawer or maker" near the beginning of the introductory paragraph, substituted "is" for "shall be" near the end of that paragraph, and substituted numbers for letters in the paragraph designations.

This section is intended to provide broad, liberal remedy that incorporates and is based upon the common-law equitable principles of unjust enrichment and restitution and is to be applied even where the technical mechanical requirements of common-law subrogation have not been met. Swiss Credit Bank v. Balink, 614 F.2d 1269 (10th Cir. 1980).

Bank making erroneous payment over stop order can recover from drawer or payee: if the drawer has no defense to payment of the check, the bank recovers by charging the drawer's account; if the drawer has a defense, then the bank recovers as a subrogee to the drawer's right against the payee. Swiss Credit Bank v. Balink, 614 F.2d 1269 (10th Cir. 1980).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who Is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 654.

Rights and liabilities of drawee bank, as to persons other than drawer with respect to uncertified paid check which was altered, 75 A.L.R.2d 611.

Extent of bank's liability for paying postdated check, 31 A.L.R.4th 329.

83 C.J.S. Subrogation § 22.

PART 5 COLLECTION OF DOCUMENTARY DRAFTS

55-4-501. Handling of documentary drafts; duty to send for presentment and to notify customer of dishonor.

A bank that takes a documentary draft for collection shall present or send the draft and accompanying documents for presentment and, upon learning that the draft has not been paid or accepted in due course, shall seasonably notify its customer of the fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.

History: 1953 Comp., § 50A-4-501, enacted by Laws 1961, ch. 96, § 4-501; 1992, ch. 114, § 193.

ANNOTATIONS

OFFICIAL COMMENT

This section states the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104 [55-4-104 NMSA 1978]. The duty stated exists even if the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned the customer should know it promptly.

The 1992 amendment, effective July 1, 1992, made minor stylistic changes.

Seasonable return of documentary drafts. - Payor banks should seasonably return documentary drafts. Shannon v. Sunwest Bank, 118 N.M. 749, 887 P.2d 285 (1994).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 713.

Duties of collecting bank with respect to presenting draft for acceptance, 39 A.L.R.2d 1296.

9 C.J.S. Banks and Banking § 414.

55-4-502. Presentment of "on arrival" drafts.

If a draft or the relevant instructions require presentment "on arrival", "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

History: 1953 Comp., § 50A-4-502, enacted by Laws 1961, ch. 96, § 4-502; 1992, ch. 114, § 194.

ANNOTATIONS

OFFICIAL COMMENT

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival." The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

The 1992 amendment, effective July 1, 1992, made minor stylistic changes.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 713.

9 C.J.S. Banks and Banking §§ 414 et seq., 342.

55-4-503. Responsibility of presenting bank for documents and goods; report of reasons for dishonor; referee in case of need.

Unless otherwise instructed and except as provided in Article 5 a bank presenting a documentary draft:

(1) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment; and

(2) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or if the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor and must request instructions.

However the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for those expenses.

History: 1953 Comp., § 50A-4-503, enacted by Laws 1961, ch. 96, § 4-503; 1992, ch. 114, § 195.

ANNOTATIONS

OFFICIAL COMMENT

1. This section states the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of documentary draft. The section should be read in connection with Section 2-514 [55-2-514 NMSA 1978] on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5-109 through 5-114 [55-5-109 to 55-5-114 NMSA 1978, respectively].

The 1992 amendment, effective July 1, 1992, substituted numbers for letters in the paragraph designations and made minor stylistic changes throughout the section.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks §§ 706, 713.

9 C.J.S. Banks and Banking § 414 et seq.

55-4-504. Privilege of presenting bank to deal with goods; security interest for expenses.

(a) A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(b) For its reasonable expenses incurred by action under Subsection (a) the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

History: 1953 Comp., § 50A-4-504, enacted by Laws 1961, ch. 96, § 4-504; 1992, ch. 114, § 196.

ANNOTATIONS

OFFICIAL COMMENT

The section gives the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

The 1992 amendment, effective July 1, 1992, substituted letters for numbers in the subsection designations and made minor stylistic changes throughout the section.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 10 Am. Jur. 2d Banks § 706.

9 C.J.S. Banks and Banking § 414 et seq.

ARTICLE 4A
FUNDS TRANSFERS

Part 1

Subject Matter and Definitions.

Part 2

Issue and Acceptance of Payment Order.

Part 3

Execution of Sender's Payment Order by Receiving Bank.

Part 4

Payment.

Part 5

Miscellaneous Provisions.

ANNOTATIONS

Compiler's notes. - Following each section in Article 4A appear "Official Comments", which were copyrighted in 1989 by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, and are reprinted with permission of the Permanent Editorial Board of the Uniform Commercial Code.

PART 1 SUBJECT MATTER AND DEFINITIONS

55-4A-101. Short title.

This article may be cited as the Uniform Commerical [Commercial] Code - Funds Transfers.

History: 1978 Comp., § 55-4A-101, enacted by Laws 1992, ch. 114, § 197.

ANNOTATIONS

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-102. Subject matter.

Except as otherwise provided in Section 55-4A-108 NMSA 1978, this article applies to funds transfers defined in Section 55-4A-104 NMSA 1978.

History: 1978 Comp., § 55-4A-102, enacted by Laws 1992, ch. 114, § 198.

ANNOTATIONS

OFFICIAL COMMENT

Article 4A governs a specialized method of payment referred to in the Article as a funds transfer but also commonly referred to in the commercial community as a wholesale wire transfer. A funds transfer is made by means of one or more payment orders. The scope of Article 4A is determined by the definitions of "payment order" and "funds transfer" found in Section 4A-103 and Section 4A-104 [55-4A-103 and 55-4A-104 NMSA 1978, respectively].

The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes. Before this Article was drafted there was no comprehensive body of law - statutory or judicial - that defined the juridical nature of a funds transfer or the rights and obligations flowing from payment orders. Judicial

authority with respect to funds transfers is sparse, undeveloped and not uniform. Judges have had to resolve disputes by referring to general principles of common law or equity, or they have sought guidance in statutes such as Article 4 which are applicable to other payment methods. But attempts to define rights and obligations in funds transfers by general principles or by analogy to rights and obligations in negotiable instrument law or the law of check collection have not been satisfactory.

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

Funds transfers involve competing interests - those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-103. Payment order; definitions.

(a) In this article:

(1) "payment order" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) the instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from the sender, and

(iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank;

(2) "beneficiary" means the person to be paid by the beneficiary's bank;

(3) "beneficiary's bank" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account;

(4) "receiving bank" means the bank to which the sender's instruction is addressed; and

(5) "sender" means the person giving the instruction to the receiving bank.

(b) If an instruction complying with Subsection (a)(1) is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank.

History: 1978 Comp., § 55-4A-103, enacted by Laws 1992, ch. 114, § 199.

ANNOTATIONS

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-104 [55-4A-104 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-104. Funds transfer; definitions.

In this article:

(a) "funds transfer" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order;

(b) "intermediary bank" means a receiving bank other than the originator's bank or the beneficiary's bank;

(c) "originator" means the sender of the first payment order in a funds transfer; and

(d) "originator's bank" means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank.

History: 1978 Comp., § 55-4A-104, enacted by Laws 1992, ch. 114, § 200.

ANNOTATIONS

OFFICIAL COMMENT

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary") or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to pay the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A-103 [55-4A-103 NMSA 1978] and "Funds transfer" stated in Section 4A-104 [55-4A-104 NMSA 1978]. These definitions, other related definitions, and the scope of Article 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y's account in Bank A. Bank A carries out X's instruction by making a credit of $1,000,000 to Y's account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A-103(a)(1) and (c) [55-4A-103 NMSA 1978]. X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A-103(a)(5) and (a)(4) [55-4A-103 NMSA 1978]. Y is the "beneficiary" of the payment order and Bank A is the "beneficiary's bank." Section 4A-103(a)(2) and (a)(3) [55-4A-103 NMSA 1978]. When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A-209(b)(1) [55-4A-209 NMSA 1978]. When Bank A accepted the order it incurred an obligation to Y to pay the amount of the order. Section 4A-404(a) [55-4A-404 NMSA 1978]. When Bank A accepted X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(b) [55-4A-402 NMSA 1978]. Payment from X to Bank A would normally be made by a debit to X's account in Bank A. Section 4A-403(a)(3) [55-4A-403 NMSA 1978]. At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A-406(a) [55-4A-406 NMSA 1978]. Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y's account. Section 4A-405(a) [55-4A-405 NMSA 1978]. The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A-104(a) [55-4A-104 NMSA 1978]. In this case only one payment order was involved in the funds transfer. A one-payment-order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank's debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition

to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A-104(c) [55-4A-104 NMSA 1978]. Bank A is the "originator's bank" in the funds transfer as well as the beneficiary's bank. Section 4A-104(d) [55-4A-104 NMSA 1978].

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y's account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X's order by instructing Bank B to pay $1,000,000 to Y's account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X's order. Section 4A-301(a) [55-4A-301 NMSA 1978]. In the funds transfer, X is the originator, Bank A is the originator's bank, and Bank B is the beneficiary's bank. When Bank A executed X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(c) [55-4A-402 NMSA 1978]. When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A-404(a)) [55-4A-404 NMSA 1978] and Bank A incurs an obligation to pay Bank B. Section 4A-402(b) [55-4A-402 NMSA 1978]. Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A-406(a) [55-4A-406 NMSA 1978]. In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X's payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y's account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving Bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y's account in Bank B. With respect to Bank C's payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator's bank, Bank B is the beneficiary's bank, and Bank C is an "intermediary bank." Section 4A-104(b) [55-4A-104 NMSA 1978]. In some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator's payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account

of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator's bank.

2. "Payment order" is defined in Section 4A-103(a)(1) [55-4A-103 NMSA 1978] as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A-103(a)(4) [55-4A-103 NMSA 1978]. "Bank" is defined in Section 4A-105(a)(2) [55-4A-105 NMSA 1978]. The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short-term credit granted by the receiving bank to the sender of the payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer-based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1) [55-4A-103 NMSA 1978]. Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although

the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107) [55-4A-107 NMSA 1978], payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) [55-4A-209 NMSA 1978] by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)) [55-4A-406 NMSA 1978]. But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a)(1) of Section 4A-103 [55-4A-103 NMSA 1978] is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X's instruction given to Bank A, Bank A will be reimbursed by debiting X's account or otherwise receiving payment from X. With respect to Bank A's instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A. In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor's bank account by issuing an instruction to pay to the debtor's bank. If the debtor's bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder's bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder's account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary's bank to pay the parent from the subsidiary's account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation's account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation's account in Bank A for the purpose of transferring funds into Corporation's account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer's account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wire-transfer business as a "draw-down transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B's warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A-103 [55-4A-103 NMSA 1978] is to exclude from Article 4A payments made by check or credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the credit card slip is to be presented is contained in the check or credit card slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor's bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator's Bank to pay $10,000 to the account of Beneficiary in Beneficiary's Bank. Since the amount of Originator's payment order is small, if Originator's Bank and Beneficiary's Bank do not have an account relationship, Originator's Bank may execute Originator's order by issuing a teller's check payable to Beneficiary's Bank for $10,000 along with instructions to credit Beneficiary's account in that amount. The instruction to Beneficiary's Bank to credit Beneficiary's account is a payment order. The check is the means by which Originator's Bank pays its obligation as sender of the payment order. The instruction of Originator's Bank to Beneficiary's Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary's Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary's Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator's Bank pays its obligation under § 4A-402(b) [55-4A-402 NMSA 1978] to Beneficiary's Bank and the means by which the instruction to Beneficiary's Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender.

Transmission may be by letter or other written communication, oral communication or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT or an automated clearing house.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-105. Other definitions.

(a) In this article:

(1) "authorized account" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank; if a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account;

(2) "bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union and trust company; a branch or separate office of a bank is a separate bank for purposes of this article;

(3) "customer" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders;

(4) "funds-transfer business day" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing and transmittal of payment orders and cancellations and amendments of payment orders;

(5) "funds-transfer system" means a wire transfer network, automated clearing house or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed;

(6) "good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing; and

(7) "prove" with respect to a fact means to meet the burden of establishing the fact (Subsection (8) of Section 55-1-201 NMSA 1978).

(b) Other definitions applying to this article and the sections in which they appear are:

"Acceptance" Section 55-
4A-209 NMSA 1978

"Beneficiary" Section 55-
4A-103 NMSA 1978

"Beneficiary's bank" Section 55-
4A-103 NMSA 1978

"Executed" Section 55-
4A-301 NMSA 1978

"Execution date" Section 55-
4A-301 NMSA 1978

"Funds transfer" Section 55-
4A-104 NMSA 1978

"Funds-transfer system rule" Section 55-
4A-501 NMSA 1978

"Intermediary bank" Section 55-
4A-104 NMSA 1978

"Originator" Section 55-
4A-104 NMSA 1978

"Originator's bank" Section 55-
4A-104 NMSA 1978

"Payment by beneficiary's bank to

beneficiary" Section 55-
4A-405 NMSA 1978

"Payment by originator to

beneficiary" Section 55-
4A-406 NMSA 1978

"Payment by sender to receiving

bank" Section 55-
4A-403 NMSA 1978

"Payment date" Section 55-4A-401 NMSA 1978

"Payment order" Section 55-4A-103 NMSA 1978

"Receiving bank" Section 55-4A-103 NMSA 1978

"Security procedure" Section 55-4A-201 NMSA 1978

"Sender" Section 55-4A-103 NMSA 1978

(c) The following definitions in Chapter 55, Article 4 NMSA 1978 apply to this article:

"Clearing house" Section 55-4-104 NMSA 1978

"Item" Section 55-4-104 NMSA 1978

"Suspends payments" Section 55-4-104 NMSA 1978

(d) In addition Chapter 55, Article 1 NMSA 1978 contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1978 Comp., § 55-4A-105, enacted by Laws 1992, ch. 114, § 201.

ANNOTATIONS

OFFICIAL COMMENT

1. The definition of "bank" in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries the definition also covers foreign banks. The definition also includes Federal Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A-107 [55-4A-107 NMSA 1978].

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4-104(1)(c) [55-4A-104 NMSA 1978] cannot be used to describe when a bank is open for funds transfer business.

Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank's computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A-206 [55-4A-206 NMSA 1978]. The Comment to that section and the Comment to Section 4A-107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A-501 [55-4A-501 NMSA 1978], may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article 1 as well as principles of construction and interpretation stated in that Article. Included is Section 1-103 [55-1-103 NMSA 1978]. The last paragraph of the Comment to Section 4A-102 [55-4A-102 NMSA 1978] is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-106. Time payment order is received.

(a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a notice stated in Subsection (27) of Section 55-1-201 NMSA 1978. A receiving bank may fix a cut-off time or times on a funds-transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cut-off times may apply to payment orders, cancellations or amendments. A cut-off time may apply to senders generally or different cut-off times may apply to different senders or categories of payment orders. If a payment order or communication canceling or

amending a payment order is received after the close of a funds-transfer business day or after the appropriate cut-off time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this article.

History: 1978 Comp., § 55-4A-106, enacted by Laws 1992, ch. 114, § 202.

ANNOTATIONS

OFFICIAL COMMENT

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301 [55-4A-401 and 55-4A-301 NMSA 1978, respectively]. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-201(27) [55-1-201 NMSA 1978]. Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-107. Federal reserve regulations and operating circulars.

Regulations of the board of governors of the federal reserve system and operating circulars of the federal reserve banks supersede any inconsistent provision of this article to the extent of the inconsistency.

History: 1978 Comp., § 55-4A-107, enacted by Laws 1992, ch. 114, § 203.

ANNOTATIONS

OFFICIAL COMMENT

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay $1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of $1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of $1,000,000 to the

account of Reserve Bank X and an equal credit to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) [55-4A-105 NMSA 1978] includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1) [55-4A-103 NMSA 1978]. Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d) [55-4A-104 NMSA 1978]. Reserve Bank X, an intermediary bank under Section 4A-104(b) [55-4A-104 NMSA 1978], executes Bank A's order by sending a payment order to Reserve Bank Y instructing that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment order to Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A may execute Originator's order by means of Fedwire which simultaneously transfers $1,000,000 from Bank A to Bank B and carries a message instructing Bank B to pay $1,000,000 to the account of Y. The Fedwire transfer is carried out as described in the previous paragraph, except that the beneficiary of the funds transfer is Beneficiary rather than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account it will also instruct Bank B to pay to the account of Beneficiary. The instruction is a payment order to Bank B which is the beneficiary's bank. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account Bank B receives payment of the payment order issued to it by Reserve Bank Y. Section 4A-403(a)(1) [55-4A-403 NMSA 1978]. The payment order is automatically accepted by Bank B at the time it receives the payment order of Reserve Bank Y. Section 4A-209(b)(2) [55-4A-209 NMSA 1978]. At the time of acceptance by Bank B payment by Originator to Beneficiary also occurs. Thus, in a Fedwire transfer, payment to the beneficiary's bank, acceptance by the beneficiary's bank and payment by the originator to the beneficiary all occur simultaneously by operation of law at the time the payment order to the beneficiary's bank is received.

If originator orders payment to the account of Beneficiary in Bank C rather than Bank B, the analysis is somewhat modified. Bank A may not have any relationship with Bank C and may not be able to make payment directly to Bank C. In that case, Bank A could send a Fedwire instructing Bank B to instruct Bank C to pay Beneficiary. The analysis is the same as the previous case except that Bank B is an intermediary bank and Bank C is the beneficiary's bank.

2. A funds transfer can also be made through a Federal Reserve Bank in an automated clearing house transaction. In a typical case, Originator instructs Originator's Bank to pay to the account of Beneficiary in Beneficiary's Bank. Originator's instruction to pay a particular beneficiary is transmitted to Originator's Bank along with many other instructions for payment to other beneficiaries by many different beneficiary's banks. All

of these instructions are contained in a magnetic tape or other electronic device. Transmission of instructions to the various beneficiary's banks requires that Originator's instructions be processed and repackaged with instructions of other originators so that all instructions to a particular beneficiary's bank are transmitted together to that bank. The repackaging is done in processing centers usually referred to as automated clearing houses. Automated clearing houses are operated either by Federal Reserve Banks or by other associations of banks. If Originator's Bank chooses to execute Originator's instructions by transmitting them to a Federal Reserve Bank for processing by the Federal Reserve Bank, the transmission to the Federal Reserve Bank results in the issuance of payment orders by Originator's Bank to the Federal Reserve Bank, which is an intermediary bank. Processing by the Federal Reserve Bank will result in the issuance of payment orders by the Federal Reserve Bank to Beneficiary's Bank as well as payment orders to other beneficiary's banks making payments to carry out Originator's instructions.

3. Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 4A-107 [55-4A-107 NMSA 1978] states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 4A to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 4A-107 [55-4A-107 NMSA 1978] treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-108. Exclusion of consumer transactions governed by federal law.

This article does not apply to a funds transfer any part of which is governed by the Electronic Fund Transfer Act of 1978 (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. Section 1693 et seq.) as amended from time to time.

History: 1978 Comp., § 55-4A-108, enacted by Laws 1992, ch. 114, § 204.

ANNOTATIONS

OFFICIAL COMMENT

The Electronic Fund Transfer Act of 1978 is a federal statute that covers a wide variety of electronic funds transfers involving consumers. The types of transfers covered by the federal statute are essentially different from the wholesale wire transfers that are the primary focus of Article 4A. Section 4A-108 [55-4A-108 NMSA 1978] excludes a funds transfer from Article 4A if any part of the transfer is covered by the federal law. Existing procedures designed to comply with federal law will not be affected by Article 4A. The effect of Section 4A-108 [55-4A-108 NMSA 1978] is to make Article 4A and EFTA mutually exclusive. For example, if a funds transfer is to a consumer account in the beneficiary's bank and the funds transfer is made in part by use of Fedwire and in part by means of an automated clearing house, EFTA applies to the ACH part of the transfer but not to the Fedwire part. Under Section 4A-108 [55-4A-108 NMSA 1978], Article 4A does not apply to any part of the transfer. However, in the absence of any law to govern the part of the funds transfer that is not subject to EFTA, a court might apply appropriate principles from Article 4A by analogy.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 2
ISSUE AND ACCEPTANCE OF PAYMENT ORDER

55-4A-201. Security procedure.

"Security procedure" means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or canceling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

History: 1978 Comp., § 55-4A-201, enacted by Laws 1992, ch. 114, § 205.

ANNOTATIONS

OFFICIAL COMMENT

A large percentage of payment orders and communications amending or cancelling payment orders are transmitted electronically and it is standard practice to use security procedures that are designed to assure the authenticity of the message. Security procedures can also be used to detect error in the content of messages or to detect payment orders that are transmitted by mistake as in the case of multiple transmission of the same payment order. Security procedures might also apply to communications that are transmitted by telephone or in writing. Section 4A-201 [55-4A-201 NMSA 1978] defines these security procedures. The definition of security procedure limits the term to

a procedure "established by agreement of a customer and a receiving bank." The term does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders. The question of whether loss that may result from the transmission of a spurious or erroneous payment order will be borne by the receiving bank or the sender or purported sender is affected by whether a security procedure was or was not in effect and whether there was or was not compliance with the procedure. Security procedures are referred to in Sections 4A-202 and 4A-203 [55-4A-202 and 55-4A-203 NMSA 1978, respectively], which deal with authorized and verified payment orders, and Section 4A-205 [55-4A-205 NMSA 1978], which deals with erroneous payment orders.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-202. Authorized and verified payment orders.

(a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term "sender" in this article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under Subsection (a), or it is effective as the orders of the customer under Subsection (b).

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in Section 55-4A-203(a)(1) NMSA 1978, rights and obligations arising under this section or Section 55-4A-203 NMSA 1978 may not be varied by agreement.

History: 1978 Comp., § 55-4A-202, enacted by Laws 1992, ch. 114, § 206.

ANNOTATIONS

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-203 [55-4A-203 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-203. Unenforceability of certain verified payment orders.

(a) If an accepted payment order is not, under Section 55-4A-202(a) NMSA 1978, an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to Section 55-4A-202(b) NMSA 1978, the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders.

History: 1978 Comp., § 55-4A-203, enacted by Laws 1992, ch. 114, § 207.

ANNOTATIONS

OFFICIAL COMMENT

1. Some person will always be identified as the sender of a payment order. Acceptance of the order by the receiving bank is based on a belief by the bank that the order was authorized by the person identified as the sender. If the receiving bank is the beneficiary's bank acceptance means that the receiving bank is obliged to pay the beneficiary. If the receiving bank is not the beneficiary's bank, acceptance means that the receiving bank has executed the sender's order and is obliged to pay the bank that accepted the order issued in execution of the sender's order. In either case the receiving bank may suffer a loss unless it is entitled to enforce payment of the payment order that it accepted. If the person identified as the sender of the order refuses to pay on the ground that the order was not authorized by that person, what are the rights of the receiving bank? In the absence of a statute or agreement that specifically addresses the issue, the question usually will be resolved by the law of agency. In some cases, the law of agency works well. For example, suppose the receiving bank executes a payment order given by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the receiving bank acts solely on the basis of the letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and the officer was authorized to act for the corporation in the issuance of payment orders, or some other agency doctrine such as apparent authority or estoppel causes the corporation to be bound. Estoppel can be illustrated by the following example. Suppose P is aware that A, who is unauthorized to act for P, has fraudulently misrepresented to T that A is authorized to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision. Restatement, Second, Agency § 8B. Other equitable principles such as subrogation or restitution might also allow a receiving bank to recover with respect to an unauthorized payment order that it accepted. In Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep.Serv.2d 171 (D.Md. 1986), a joint venturer not authorized to order payments from the account of the joint venture, ordered a funds transfer from the account. The transfer paid a bona fide debt of the joint venture. Although the transfer was unauthorized the court refused to require recredit of the account because the joint venture suffered no loss. The result can be rationalized on the basis of subrogation of the receiving bank to the right of the beneficiary of the funds transfer to receive the payment from the joint venture.

But in most cases these legal principles give the receiving bank very little protection in the case of an authorized payment order. Cases like those just discussed are not typical of the way that most payment orders are transmitted and accepted, and such cases are likely to become even less common. Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201 [55-4A-201 NMSA 1978].

In a very large percentage of cases covered by Article 4A, transmission of the payment order is made electronically. The receiving bank may be required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. There is no way of determining the identity or the authority of the person who caused the message to be sent. The receiving bank is not relying on the authority of any particular person to act for the purported sender. The case is not comparable to payment of a check by the drawee bank on the basis of a signature that is forged. Rather, the receiving bank relies on a security procedure pursuant to which the authenticity of the message can be "tested" by various devices which are designed to provide certainty that the message is that of the sender identified in the payment order. In the wire transfer business the concept of "authorized" is different from that found in agency law. In that business a payment order is treated as the order of the person in whose name it is issued if it is properly tested pursuant to a security procedure and the order passes the test.

Section 4A-202 [55-4A-202 NMSA 1978] reflects the reality of the wire transfer business. A person in whose name a payment order is issued is considered to be the sender of the order if the order is "authorized" as stated in subsection (a) or if the order is "verified" pursuant to a security procedure in compliance with subsection (b). If subsection (b) does not apply, the question of whether the customer is responsible for the order is determined by the law of agency. The issue is one of actual or apparent authority of the person who caused the order to be issued in the name of the customer. In some cases the law of agency might allow the customer to be bound by an unauthorized order if conduct of the customer can be used to find an estoppel against the customer to deny that the order was unauthorized. If the customer is bound by the order under any of these agency doctrines, subsection (a) treats the order as authorized and thus the customer is deemed to be the sender of the order. In most cases, however, subsection (b) will apply. In that event there is no need to make an agency law analysis to determine authority. Under Section 4A-202 [55-4A-202 NMSA 1978] , the issue of liability of the purported sender of the payment order will be determined by agency law only if the receiving bank did not comply with subsection (b).

2. The scope of Section 4A-202 [55-4A-202 NMSA 1978] can be illustrated by the following cases.

Case #1. A payment order purporting to be that of Customer is received by Receiving Bank but the order was fraudulently transmitted by a person who had no authority to act for Customer.

Case #2. An authentic payment order was sent by Customer, but before the order was received by Receiving Bank the order was fraudulently altered by an unauthorized person to change the beneficiary.

Case #3. An authentic payment order was received by Receiving Bank, but before the order was executed by Receiving Bank a person who had no authority to act for

Customer fraudulently sent a communication purporting to amend the order by changing the beneficiary.

In each case Receiving Bank acted on the fraudulent communication by accepting the payment order. These cases are all essentially similar and they are treated identically by Section 4A-202 [55-4A-202 NMSA 1978]. In each case Receiving Bank acted on a communication that it thought was authorized by Customer when in fact the communication was fraudulent. No distinction is made between Case #1 in which Customer took no part at all in the transaction and Case #2 and Case #3 in which an authentic order was fraudulently altered or amended by an unauthorized person. If subsection (b) does not apply, each case is governed by subsection (a). If there are no additional facts on which an estoppel might be found, Customer is not responsible in Case #1 for the fraudulently issued payment order, in Case #2 for the fraudulent alteration or in Case #3 for the fraudulent amendment. Thus, in each case Customer is not liable to pay the order and Receiving Bank takes the loss. The only remedy of Receiving Bank is to seek recovery from the person who received payment as beneficiary of the fraudulent order. If there was verification in compliance with subsection (b), Customer will take the loss unless Section 4A-203 [55-4A-203 NMSA 1978] applies.

3. Subsection (b) of Section 4A-202 [55-4A-202 NMSA 1978] is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to "test" a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and "in compliance with the security procedure." If the fraud was not detected because the bank's employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the

receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not required to follow an instruction that violates a written agreement. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 [55-4A-201 NMSA 1978] apply.

Subsection (b)(i) assures that the interests of the customer will be protected by providing an incentive to a bank to make available to the customer a security procedure that is commercially reasonable. If a commercially reasonable security procedure is not made available to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking practice may require that security procedures be utilized in virtually all cases except for those in which personal contact between the customer and the bank eliminates the possibility of an unauthorized order. The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine what security procedures can be used and are in the best position to evaluate the efficacy of the procedures offered to customers to combat fraud. The burden on the customer is to supervise its employees to assure compliance with the security procedure and to safeguard confidential security information and access to transmitting facilities so that the security procedure cannot be breached.

4. The principal issue that is likely to arise in litigation involving subsection (b) is whether the security procedure in effect when a fraudulent payment order was accepted was commercially reasonable. The concept of what is commercially reasonable in a given case is flexible. Verification entails labor and equipment costs that can vary greatly depending upon the degree of security that is sought. A customer that transmits very large numbers of payment orders in very large amounts may desire and may reasonably expect to be provided with state-of-the-art procedures that provide maximum security. But the expense involved may make use of a state-of-the-art procedure infeasible for a customer that normally transmits payment orders infrequently or in relatively low amounts. Another variable is the type of receiving bank. It is reasonable to require large money center banks to make available state-of-the-art security procedures. On the other hand, the same requirement may not be reasonable for a small country bank. A receiving bank might have several security procedures that are designed to meet the varying needs of different customers. The type of payment order is another variable. For example, in a wholesale wire transfer, each payment order is normally transmitted electronically and individually. A testing procedure will be individually applied to each payment order. In funds transfers to be made by means of an automated clearing house many payment orders are incorporated into an electronic device such as a magnetic tape that is physically delivered. Testing of the individual payment orders is not feasible. Thus, a different kind of security procedure must be adopted to take into account the different mode of transmission.

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk. It is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

5. The effect of Section 4A-202(b) [55-4A-202 NMSA 1978] is to place the risk of loss on the customer if an unauthorized payment order is accepted by the receiving bank after verification by the bank in compliance with a commercially reasonable security procedure. An exception to this result is provided by Section 4A-203(a)(2) [55-4A-203 NMSA 1978]. The customer may avoid the loss resulting from such a payment order if the customer can prove that the fraud was not committed by a person described in that subsection. Breach of a commercially reasonable security procedure requires that the person committing the fraud have knowledge of how the procedure works and knowledge of codes, identifying devices, and the like. That person may also need access to transmitting facilities through an access device or other software in order to breach the security procedure. This confidential information must be obtained either from a source controlled by the customer or from a source controlled by the receiving bank. If the customer can prove that the person committing the fraud did not obtain the confidential information from an agent or former agent of the customer or from a source controlled by the customer, the loss is shifted to the bank. "Prove" is defined in Section 4A-105(a)(7) [55-4A-105 NMSA 1978]. Because of bank regulation requirements, in this

kind of case there will always be a criminal investigation as well as an internal investigation of the bank to determine the probable explanation for the breach of security. Because a funds transfer fraud usually will involve a very large amount of money, both the criminal investigation and the internal investigation are likely to be thorough. In some cases there may be an investigation by bank examiners as well. Frequently, these investigations will develop evidence of who is at fault and the cause of the loss. The customer will have access to evidence developed in these investigations and that evidence can be used by the customer in meeting its burden of proof.

6. The effect of Section 4A-202(b) [55-4A-202 NMSA 1978] may also be changed by an agreement meeting the requirements of Section 4A-203(a)(1) [55-4A-203 NMSA 1978]. Some customers may be unwilling to take all or part of the risk of loss with respect to unauthorized payment orders even if all of the requirements of Section 4A-202(b) [55-4A-202 NMSA 1978] are met. By virtue of Section 4A-203(a)(1) [55-4A-203 NMSA 1978], a receiving bank may assume all of the risk of loss with respect to unauthorized payment orders or the customer and bank may agree that losses from unauthorized payment orders are to be divided as provided in the agreement.

7. In a large majority of cases the sender of a payment order is a bank. In many cases in which there is a bank sender, both the sender and the receiving bank will be members of a funds transfer system over which the payment order is transmitted. Since Section 4A-202(f) [55-4A-202 NMSA 1978] does not prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202 [55-4A-202 NMSA 1978], a rule of the funds transfer system can determine how loss due to an unauthorized payment order from a participating bank to another participating bank is to be allocated. A funds transfer system rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-501(b) [55-4A-501 NMSA 1978]. Section 4A-202(f) [55-4A-202 NMSA 1978] also prevents variation by agreement except to the extent stated.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-204. Refund of payment and duty of customer to report with respect to unauthorized payment order.

(a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under Section 55-4A-202 NMSA 1978, or (ii) not enforceable, in whole or in part, against the customer under Section 55-4A-203 NMSA 1978, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding ninety days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the

order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under Subsection (a) may be fixed by agreement as stated in Subsection (1) of Section 55-1-204 NMSA 1978, but the obligation of a receiving bank to refund payment as stated in Subsection (a) may not otherwise be varied by agreement.

History: 1978 Comp., § 55-4A-204, enacted by Laws 1992, ch. 114, § 208.

ANNOTATIONS

OFFICIAL COMMENT

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A-204 [55-4A-204 NMSA 1978] applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2) [55-4A-203 NMSA 1978], that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A-203(a)(1) [55-4A-203 NMSA 1978] agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer's account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A-204 [55-4A-204 NMSA 1978] states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A-204 [55-4A-204 NMSA 1978] is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding 90 days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly unauthorized, the customer should normally discover it in far less than 90 days. If a $1,000,000 payment order was authorized but the name of the beneficiary was

fraudulently changed, a much longer period may be necessary to discover the fraud. But in any event, if the customer delays more than 90 days the customer's duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer's account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A-506 [55-4A-506 NMSA 1978]. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-205. Erroneous payment orders.

(a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to Section 55-4A-206 NMSA 1978 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in Paragraphs (2) and (3).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in Clause (i) or (iii) of Subsection (a), the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in Clause (ii) of Subsection (a), the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in Subsection (a) is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not

exceeding ninety days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders.

History: 1978 Comp., § 55-4A-205, enacted by Laws 1992, ch. 114, § 209.

ANNOTATIONS

OFFICIAL COMMENT

1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. *Case #1.* The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. *Case #2.* The error is in the amount of the order. For example, Sender intends to wire $1,000 to Beneficiary. Through error, the payment order instructs payment of $1,000,000. *Case #3.* A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402 [55-4A-402 NMSA 1978]. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 [55-4A-201 NMSA 1978] as "a procedure established by agreement of a customer and a receiving bank for the purpose of * * * detecting error * * *," Section 4A-205 [55-4A-205 NMSA 1978] does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a $1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some

beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) [55-4A-206 NMSA 1978] complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a)(1) applies, the position of the receiving bank is comparable to that of a receiving bank that erroneously executes a payment order as stated in Section 4A-303 [55-4A-303 NMSA 1978]. However, failure of the sender to timely report the error is covered by Section 4A-205(b) [55-4A-205 NMSA 1978] rather than by Section 4A-304 [55-4A-304 NMSA 1978] which applies only to erroneous execution under Section 4A-303 [55-4A-303 NMSA 1978]. A receiving bank to which the risk of loss is shifted by subsection (a)(1) or (2) is entitled to recover the amount erroneously paid to the beneficiary to the extent allowed by the law of mistake and restitution. Rights of the receiving bank against the beneficiary are similar to those of a receiving bank that erroneously executes a payment order as stated in Section 4A-303 [55-4A-303 NMSA 1978]. Those rights are discussed in Comment 2 to Section 4A-303 [55-4A-303 NMSA 1978].

2. A security procedure established for the purpose of detecting error is not effective unless both sender and receiving bank comply with the procedure. Thus, the bank undertakes a duty of complying with the procedure for the benefit of the sender. This duty is recognized in subsection (a)(1). The loss with respect to the sender's error is shifted to the bank if the bank fails to comply with the procedure and the sender (or an agent under Section 4A-206) [55-4A-206 NMSA 1978] does comply. Although the customer may have been negligent in transmitting the erroneous payment order, the loss is put on the bank on a last-clear-chance theory. A similar analysis applies to subsection (b). If the loss with respect to an error is shifted to the receiving bank and the sender is notified by the bank that the erroneous payment order was accepted, the sender has a duty to exercise ordinary care to discover the error and notify the bank of the relevant facts within a reasonable time not exceeding 90 days. If the bank can prove that the sender failed in this duty it is entitled to compensation for the loss incurred as a result of the failure. Whether the bank is entitled to recover from the sender depends upon whether the failure to give timely notice would have made any difference. If the bank could not have recovered from the beneficiary that received payment under the erroneous payment order even if timely notice had been given, the sender's failure to notify did not cause any loss of the bank.

3. Section 4A-205 [55-4A-205 NMSA 1978] is subject to variation by agreement under Section 4A-501 [55-4A-501 NMSA 1978]. Thus, if a receiving bank and its customer have agreed to a security procedure for detection of error, the liability of the receiving bank for failing to detect an error of the customer as provided in Section 4A-205 [55-4A-205 NMSA 1978] may be varied as provided in an agreement of the bank and the customer.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-206. Transmission of payment order through funds-transfer or other communication system.

(a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the federal reserve banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders.

History: 1978 Comp., § 55-4A-206, enacted by Laws 1992, ch. 114, § 210.

ANNOTATIONS

OFFICIAL COMMENT

1. A payment order may be issued to a receiving bank directly by delivery of a writing or electronic device or by an oral or electronic communication. If an agent of the sender is employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted by the agent on the basis of agency law. Section 4A-206 [55-4A-206 NMSA 1978] is an application of that principle to cases in which a funds transfer or communication system acts as an intermediary in transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for the purpose of transmitting payment orders and related messages for the sender. Section 4A-206 [55-4A-206 NMSA 1978] deals with error by the intermediary.

2. Transmission by an automated clearing house of an association of banks other than the Federal Reserve Banks is an example of a transaction covered by Section 4A-206 [55-4A-206 NMSA 1978]. Suppose Originator orders Originator's Bank to cause a large number of payments to be made to many accounts in banks in various parts of the country. These payment orders are electronically transmitted to Originator's Bank and stored in an electronic device that is held by Originator's Bank. Or, transmission of the various payment orders is made by delivery to Originator's Bank of an electronic device containing the instruction to the bank. In either case the terms of the various payment orders by Originator are determined by the information contained in the electronic device. In order to execute the various orders, the information in the electronic device must be processed. For example, if some of the orders are for payments to accounts in Bank X and some to accounts in Bank Y, Originator's Bank will execute these orders of Originator by issuing a series of payment orders to Bank X covering all payments to

accounts in that bank, and by issuing a series of payment orders to Bank Y covering all payments to accounts in that bank. The orders to Bank X may be transmitted together by means of an electronic device, and those to Bank Y may be included in another electronic device. Typically, this processing is done by an automated clearing house acting for a group of banks including Originator's Bank. The automated clearing house is a funds transfer system. Section 4A-105(a)(5) [55-4A-105 NMSA 1978]. Originator's Bank delivers Originator's electronic device or transmits the information contained in the device to the funds transfer system for processing into payment orders of Originator's Bank to the appropriate beneficiary's banks. The processing may result in an erroneous payment order. Originator's Bank, by use of Originator's electronic device, may have given information to the funds transfer system instructing payment of $100,000 to an account in Bank X, but because of human error or an equipment malfunction the processing may have converted that instruction into an instruction to Bank X to make a payment of $1,000,000. Under Section 4A-206 [55-4A-206 NMSA 1978], Originator's Bank issued a payment order for $1,000,000 to Bank X when the erroneous information was sent to Bank X. Originator's Bank is responsible for the error of the automated clearing house. The liability of the funds transfer system that made the error is not governed by Article 4A. It is left to the law of contract, a funds transfer system rule, or other applicable law.

In the hypothetical case just discussed, if the automated clearing house is operated by a Federal Reserve Bank, the analysis is different. Section 4A-206 [55-4A-206 NMSA 1978] does not apply. Originator's Bank will execute Originator's payment orders by delivery or transmission of the electronic information to the Federal Reserve Bank for processing. The result is that Originator's Bank has issued payment orders to the Federal Reserve Bank which, in this case, is acting as an intermediary bank. When the Federal Reserve Bank has processed the information given to it by Originator's Bank it will issue payment orders to the various beneficiary's banks. If the processing results in an erroneous payment order, the Federal Reserve Bank has erroneously executed the payment order of Originator's Bank and the case is governed by Section 4A-303 [55-4A-303 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-207. Misdescription of beneficiary.

(a) Subject to Subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in Subsection (c), if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in Subsection (b) is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by Paragraph (1) of Subsection (b), the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by Paragraph (1) of Subsection (b), if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) if the originator is obliged to pay its payment order as stated in Subsection (c), the originator has the right to recover; or

(2) if the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover.

History: 1978 Comp., § 55-4A-207, enacted by Laws 1992, ch. 114, § 211.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts. Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c) [55-4A-402 NMSA 1978], a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

2. Subsection (b), which takes precedence over subsection (a), deals with the problem of payment orders in which the description of the beneficiary does not allow identification of the beneficiary because the beneficiary is described by name and by an identifying number or an account number and the name and number refer to different persons. A very large percentage of payment orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account. The processing of the order by the beneficiary's bank and the crediting of the beneficiary's account are done by use of the identifying or bank account number without human reading of the payment order itself. The process is comparable to that used in automated payment of checks. The standard format, however, may also allow the inclusion of the name of the beneficiary and other information which can be useful to the beneficiary's bank and the beneficiary but which plays no part in the process of payment. If the beneficiary's bank has both the account number and name of the beneficiary supplied by the originator of the funds transfer, it is possible for the beneficiary's bank to determine whether the name and number refer to the same person, but if a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost. Manual handling of payment orders is both expensive and subject to human error. If payment orders can be handled on an automated basis there are substantial economies of operation and the possibility of clerical error is reduced. Subsection (b) allows banks to utilize automated processing by allowing banks to act on the basis of the number without regard to the name if the bank does not know that the name and number refer to different persons. "Know" is defined in Section 1-201(25) [55-1-201 NMSA 1978] to mean actual knowledge, and Section 1-201(27) [55-1-201 NMSA 1978] states rules for determining when an organization has knowledge of information received by the organization. The time of payment is the pertinent time at which knowledge or lack of knowledge must be determined.

Although the clear trend is for beneficiary's banks to process payment orders by automated means, Section 4A-207 [55-4A-207 NMSA 1978] is not limited to cases in which processing is done by automated means. A bank that processes by semi-automated means or even manually may rely on number as stated in Section 4A-207 [55-4A-207 NMSA 1978].

In cases covered by subsection (b) the erroneous identification would in virtually all cases be the identifying or bank account number. In the typical case the error is made

by the originator of the funds transfer. The originator should know the name of the person who is to receive payment and can further identify that person by an address that would normally be known to the originator. It is not unlikely, however, that the originator may not be sure whether the identifying or account number refers to the person the originator intends to pay. Subsection (b)(1) deals with the typical case in which the beneficiary's bank pays on the basis of the account number and is not aware at the time of payment that the named beneficiary is not the holder of the account which was paid. In some cases the false number will be the result of error by the originator. In other cases fraud is involved. For example, Doe is the holder of shares in Mutual Fund. Thief, impersonating Doe, requests redemption of the shares and directs Mutual Fund to wire the redemption proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund originates a funds transfer by issuing a payment order to Originator's Bank to make the payment to Doe's account #12345 in Beneficiary's Bank. Originator's Bank executes the order by issuing a conforming payment order to Beneficiary's Bank which makes payment to account #12345. That account is the account of Roe rather than Doe. Roe might be a person acting in concert with Thief or Roe might be an innocent third party. Assume that Roe is a gem merchant that agreed to sell gems to Thief who agreed to wire the purchase price to Roe's account in Beneficiary's Bank. Roe believed that the credit to Roe's account was a transfer of funds from Thief and released the gems to Thief in good faith in reliance on the payment. The case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. See Securities Fund Services, Inc. v. American National Bank, 542 F. Supp. 323 (N.D.Ill.1982) and Bradford Trust Co. v. Texas American Bank, 790 F.2d 407 (5th Cir. 1986). Section 4A-207 resolves the issue.

If Beneficiary's Bank did not know about the conflict between the name and number, subsection (b)(1) applies. Beneficiary's Bank has no duty to determine whether there is a conflict and it may rely on the number as the proper identification of the beneficiary of the order. When it accepts the order, it is entitled to payment from Originator's Bank. Section 4A-402(b) [55-4A-402 NMSA 1978]. On the other hand, if Beneficiary's Bank knew about the conflict between the name and number and nevertheless paid Roe, subsection (b)(2) applies. Under that provision, acceptance of the payment order of Originator's Bank did not occur because there is no beneficiary of that order. Since acceptance did not occur Originator's Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b) [55-4A-402 NMSA 1978]. Similarly, Mutual Fund is excused from its obligation to pay Originator's Bank. Section 4A-402(c) [55-4A-402 NMSA 1978]. Thus, Beneficiary's Bank takes the loss. Its only cause of action is against Thief. Roe is not obliged to return the payment to the beneficiary's bank because Roe received the payment in good faith and for value. Article 4A makes irrelevant the issue of whether Mutual Fund was or was not negligent in issuing its payment order.

3. Normally, subsection (b)(1) will apply to the hypothetical case discussed in Comment 2. Beneficiary's Bank will pay on the basis of the number without knowledge of the conflict. In that case subsection (c) places the loss on either Mutual Fund or Originator's Bank. It is not unfair to assign the loss to Mutual Fund because it is the person who

dealt with the impostor and it supplied the wrong account number. It could have avoided the loss if it had not used an account number that it was not sure was that of Doe. Mutual Fund, however, may not have been aware of the risk involved in giving both name and number. Subsection (c) is designed to protect the originator, Mutual Fund, in this case. Under that subsection, the originator is responsible for the inconsistent description of the beneficiary if it had notice that the order might be paid by the beneficiary's bank on the basis of the number. If the originator is a bank, the originator always has that responsibility. The rationale is that any bank should know how payment orders are processed and paid. If the originator is not a bank, the originator's bank must prove that its customer, the originator, had notice. Notice can be proved by any admissible evidence, but the bank can always prove notice by providing the customer with a written statement of the required information and obtaining the customer's signature to the statement. That statement will then apply to any payment order accepted by the bank thereafter. The information need not be supplied more than once.

In the hypothetical case if Originator's Bank made the disclosure stated in the last sentence of subsection (c)(2), Mutual Fund must pay Originator's Bank. Under subsection (d)(1), Mutual Fund has an action to recover from Roe if recovery from Roe is permitted by the law governing mistake and restitution. Under the assumed facts Roe should be entitled to keep the money as a person who took it in good faith and for value since it was taken as payment for the gems. In that case, Mutual Fund's only remedy is against Thief. If Roe was not acting in good faith, Roe has to return the money to Mutual Fund. If Originator's Bank does not prove that Mutual Fund had notice as stated in subsection (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the risk of loss falls on Originator's Bank whose remedy is against Roe or Thief as stated above. Subsection (d)(2).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-208. Misdescription of intermediary bank or beneficiary's bank.

(a) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by Paragraph (1) of this Subsection (b), as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in Section 55-4A-302(a)(1) NMSA 1978.

History: 1978 Comp., § 55-4A-208, enacted by Laws 1992, ch. 114, § 212.

ANNOTATIONS

OFFICIAL COMMENT

1. This section addresses an issue similar to that addressed by Section 4A-207 [55-4A-207 NMSA 1978]. Because of automation in the processing of payment orders, a payment order may identify the beneficiary's bank or an intermediary bank by an identifying number. The bank identified by number might or might not also be identified by name. The following two cases illustrate Section 4A-208(a) and (b) [55-4A-208 NMSA 1978]:

Case #1. Originator's payment order to Originator's Bank identifies the beneficiary's bank as Bank A and instructs payment to Account #12345 in that bank. Originator's Bank executes Originator's order by issuing a payment order to Intermediary Bank. In the payment order of Originator's Bank the beneficiary's bank is identified as Bank A but

is also identified by number, #67890. The identifying number refers to Bank B rather than Bank A. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank, in executing the order, will rely on the identifying number and will issue a payment order to Bank B rather than Bank A. If there is an Account #12345 in Bank B, the payment order of Intermediary Bank would normally be accepted and payment would be made to a person not intended by Originator. In this case, Section 4A-208(b)(1) [55-4A-208 NMSA 1978] puts the risk of loss on Originator's Bank. Intermediary Bank may rely on the number #67890 as the proper identification of the beneficiary's bank. Intermediary Bank has properly executed the payment order of Originator's Bank. By using the wrong number to describe the beneficiary's bank, Originator's Bank has improperly executed Originator's payment order because the payment order of Originator's Bank provides for payment to the wrong beneficiary, the holder of Account #12345 in Bank B rather than the holder of Account #12345 in Bank A. Section 4A-302(a)(1) and Section 4A-303(c) [55-4A-302 and 55-4A-303 NMSA 1978, respectively]. Originator's Bank is not entitled to payment from Originator but is required to pay Intermediary Bank. Section 4A-303(c) and Section 4A-402(c) [55-4A-303 and 55-4A-402 NMSA 1978, respectively]. Intermediary Bank is also entitled to compensation for any loss and expenses resulting from the error by Originator's Bank.

If there is no Account #12345 in Bank B, the result is that there is no beneficiary of the payment order issued by Originator's Bank and the funds transfer will not be completed. Originator's Bank is not entitled to payment from Originator and Intermediary Bank is not entitled to payment from Originator's Bank. Section 4A-402(c) [55-4A-402 NMSA 1978]. Since Originator's Bank improperly executed Originator's payment order it may be liable for damages under Section 4A-305 [55-4A-305 NMSA 1978]. As stated above, Intermediary Bank is entitled to compensation for loss and expenses resulting from the error by Originator's Bank.

Case #2. Suppose the same payment order by Originator to Originator's Bank as in Case #1. In executing the payment order Originator's Bank issues a payment order to Intermediary Bank in which the beneficiary's bank is identified only by number, #67890. That number does not refer to Bank A. Rather, it identifies a person that is not a bank. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank will rely on the number #67890 to identify the beneficiary's bank. Intermediary Bank has no duty to determine whether the number identifies a bank. The funds transfer cannot be completed in this case because no bank is identified as the beneficiary's bank. Subsection (a) puts the risk of loss on Originator's Bank. Originator's Bank is not entitled to payment from Originator. Section 4A-402(c) [55-4A-402 NMSA 1978]. Originator's Bank has improperly executed Originator's payment order and may be liable for damages under Section 4A-305 [55-4A-305 NMSA 1978]. Originator's Bank is obliged to compensate Intermediary Bank for loss and expenses resulting from the error by Originator's Bank.

Subsection (a) also applies if #67890 identifies a bank, but the bank is not Bank A. Intermediary Bank may rely on the number as the proper identification of the

beneficiary's bank. If the bank to which Intermediary Bank sends its payment order accepts the order, Intermediary Bank is entitled to payment from Originator's Bank, but Originator's Bank is not entitled to payment from Originator. The analysis is similar to that in Case #1.

2. Subsection (b)(2) of Section 4A-208 [55-4A-208 NMSA 1978] addresses cases in which an erroneous identification of a beneficiary's bank or intermediary bank by name and number is made in a payment order of a sender that is not a bank. Suppose Originator issues a payment order to Originator's Bank that instructs that bank to use an intermediary bank identified as Bank A and by an identifying number, #67890. The identifying number refers to Bank B. Originator intended to identify Bank A as intermediary bank. If Originator's Bank relied on the number and issued a payment order to Bank B the rights of Originator's Bank depend upon whether the proof of notice stated in subsection (b)(2) is made by Originator's Bank. If proof is made, Originator's Bank's rights are governed by subsection (b)(1) of Section 4A-208 [55-4A-208 NMSA 1978]. Originator's Bank is not liable for breach of Section 4A-302(a)(1) [55-4A-302 NMSA 1978] and is entitled to compensation from Originator for any loss and expenses resulting from Originator's error. If notice is not proved, Originator's Bank may not rely on the number in executing Originator's payment order. Since Originator's Bank does not get the benefit of subsection (b)(1) in that case, Originator's Bank improperly executed Originator's payment order and is in breach of the obligation stated in Section 4A-302(a)(1) [55-4A-302 NMSA 1978]. If notice is not given, Originator's Bank can rely on the name if it is not aware of the conflict in name and number. Subsection (b)(3).

3. Although the principal purpose of Section 4A-208 [55-4A-208 NMSA 1978] is to accommodate automated processing of payment orders, Section 4A-208 applies regardless of whether processing is done by automation, semi-automated means or manually.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-209. Acceptance of payment order.

(a) Subject to Subsection (d), a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to Subsections (c) and (d), a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) when the bank (i) pays the beneficiary as stated in Section 55-4A-405(a) or 55-4A-405(b) NMSA 1978, or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(2) when the bank receives payment of the entire amount of the sender's order pursuant to Section 55-4A-403(a)(1) or 55-4A-403(a)(2) NMSA 1978; or

(3) the opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under Paragraph (2) or (3) of Subsection (b) if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently canceled pursuant to Section 55-4A-211(b) NMSA 1978, the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution.

History: 1978 Comp., § 55-4A-209, enacted by Laws 1992, ch. 114, § 213.

ANNOTATIONS

OFFICIAL COMMENT

1. This section treats the sender's payment order as a request by the sender to the receiving bank to execute or pay the order and that request can be accepted or rejected by the receiving bank. Section 4A-209 [55-4A-209 NMSA 1978] defines when acceptance occurs. Section 4A-210 [55-4A-210 NMSA 1978] covers rejection. Acceptance of the payment order imposes an obligation on the receiving bank to the sender if the receiving bank is not the beneficiary's bank, or to the beneficiary if the receiving bank is the beneficiary's bank. These obligations are stated in Section 4A-302 and Section 4A-404 [55-4A-302 and 55-4A-404 NMSA 1978, respectively].

2. Acceptance by a receiving bank other than the beneficiary's bank is defined in Section 4A-209(a) [55-4A-209 NMSA 1978]. That subsection states the only way that a bank other than the beneficiary's bank can accept a payment order. A payment order to a bank other than the beneficiary's bank is, in effect, a request that the receiving bank execute the sender's order by issuing a payment order to the beneficiary's bank or to an intermediary bank. Normally, acceptance occurs at the time of execution, but there is an exception stated in subsection (d) and discussed in Comment 9. Execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's order. Section 4A-301(a) [55-4A-301 NMSA 1978]. In some cases the payment order issued by the receiving bank may not conform to the sender's order. For example, the receiving bank might make a mistake in the amount of its order, or the order might be issued to the wrong beneficiary's bank or for the benefit of the wrong beneficiary. In all of these cases there is acceptance of the sender's order by the bank when the receiving bank issues its order intended to carry out the sender's order, even though the bank's payment order does not in fact carry out the instruction of the sender. Improper execution of the sender's order may lead to liability to the sender for damages or it may mean that the sender is not obliged to pay its payment order. These matters are covered in Section 4A-303, Section 4A-305, and Section 4A-402 [55-4A-303, 55-4A-305, and 55-4A-402 NMSA 1978, respectively].

3. A receiving bank has no duty to accept a payment order unless the bank makes an agreement, either before or after issuance of the payment order, to accept it, or acceptance is required by a funds transfer system rule. If the bank makes such an agreement it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates the agreement. In many cases a bank will enter into an agreement with its customer to govern the rights and obligations of the parties with respect to payment orders issued to the bank by the customer or, in cases in which the sender is also a bank, there may be a funds transfer system rule that governs the obligations of a receiving bank with respect to payment orders transmitted over the system. Such agreements or rules can specify the circumstances under which a receiving bank is obliged to execute a payment order and can define the extent of liability of the receiving bank for breach of the agreement or rule. Section 4A-305(d) [55-4A-305 NMSA 1978] states the liability for breach of an agreement to execute a payment order.

4. In the case of a payment order issued to the beneficiary's bank, acceptance is defined in Section 4A-209(b) [55-4A-209 NMSA 1978]. The function of a beneficiary's bank that receives a payment order is different from that of a receiving bank that receives a payment order for execution. In the typical case, the beneficiary's bank simply receives payment from the sender of the order, credits the account of the beneficiary and notifies the beneficiary of the credit. Acceptance by the beneficiary's bank does not create any obligation to the sender. Acceptance by the beneficiary's bank means that the bank is liable to the beneficiary for the amount of the order. Section 4A-404(a) [55-4A-404 NMSA 1978]. There are three ways in which the beneficiary's bank can accept a payment order which are described in the following comments.

5. Under Section 4A-209(b)(1) [55-4A-209 NMSA 1978], the beneficiary's bank can accept a payment order by paying the beneficiary. In the normal case of crediting an account of the beneficiary, payment occurs when the beneficiary is given notice of the right to withdraw the credit, the credit is applied to a debt of the beneficiary, or "funds with respect to the order" are otherwise made available to the beneficiary. Section 4A-405(a) [55-4A-405 NMSA 1978]. The quoted phrase covers cases in which funds are made available to the beneficiary as a result of receipt of a payment order for the benefit of the beneficiary but the release of funds is not expressed as payment of the order. For example, the beneficiary's bank might express a release of funds equal to the amount of the order as a "loan" that will be automatically repaid when the beneficiary's bank receives payment by the sender of the order. If the release of funds is designated as a loan pursuant to a routine practice of the bank, the release is conditional payment of the order rather than a loan, particularly if normal incidents of a loan such as the signing of a loan agreement or note and the payment of interest are not present. Such a release of funds is payment to the beneficiary under Section 4A-405(a) [55-4A-405 NMSA 1978]. Under Section 4A-405(c) the bank cannot recover the money from the beneficiary if the bank does not receive payment from the sender of the payment order that it accepted. Exceptions to this rule are stated in § 4A-405(d) and (e) [55-4A-405 NMSA 1978]. The beneficiary's bank may also accept by notifying the beneficiary that the order has been received. "Notifies" is defined in Section 1-201(26) [55-1-201 NMSA 1978]. In some cases a beneficiary's bank will receive a payment order during the day but settlement of the sender's obligation to pay the order will not occur until the end of the day. If the beneficiary's bank wants to defer incurring liability to the beneficiary until the beneficiary's bank receives payment, it can do so. The beneficiary's bank incurs no liability to the beneficiary with respect to a payment order that it receives until it accepts the order. If the bank does not accept pursuant to subsection (b)(1), acceptance does not occur until the end of the day when the beneficiary's bank receives settlement. If the sender settles, the payment order will be accepted under subsection (b)(2) and the funds will be released to the beneficiary the next morning. If the sender doesn't settle, no acceptance occurs. In either case the beneficiary's bank suffers no loss.

6. In most cases the beneficiary's bank will receive a payment order from another bank. If the sender is a bank and the beneficiary's bank receives payment from the sender by final settlement through the Federal Reserve System or a funds transfer system (Section 4A-403(a)(1)) [55-4A-403 NMSA 1978] or, less commonly, through credit to an account of the beneficiary's bank with the sender or another bank (Section 4A-403(a)(2)) [55-4A-403 NMSA 1978], acceptance by the beneficiary's bank occurs at the time payment is made. Section 4A-209(b)(2) [55-4A-209 NMSA 1978]. A minor exception to this rule is stated in Section 4A-209(c) [55-4A-209 NMSA 1978]. Section 4A-209(b)(2) [55-4A-209 NMSA 1978] results in automatic acceptance of payment orders issued to a beneficiary's bank by means of Fedwire because the Federal Reserve account of the beneficiary's bank is credited and final payment is made to that bank when the payment order is received.

Subsection (b)(2) would also apply to cases in which the beneficiary's bank mistakenly pays a person who is not the beneficiary of the payment order issued to the

beneficiary's bank. For example, suppose the payment order provides for immediate payment to Account #12345. The beneficiary's bank erroneously credits Account #12346 and notifies the holder of that account of the credit. No acceptance occurs in this case under subsection (b)(1) because the beneficiary of the order has not been paid or notified. The holder of Account #12345 is the beneficiary of the order issued to the beneficiary's bank. But acceptance will normally occur if the beneficiary's bank takes no other action, because the bank will normally receive settlement with respect to the payment order. At that time the bank has accepted because the sender paid its payment order. The bank is liable to pay the holder of Account #12345. The bank has paid the holder of Account #12346 by mistake, and has a right to recover the payment if the credit is withdrawn, to the extent provided in the law governing mistake and restitution.

7. Subsection (b)(3) covers cases of inaction by the beneficiary's bank. It applies whether or not the sender is a bank and covers a case in which the sender and the beneficiary both have accounts with the receiving bank and payment will be made by debiting the account of the sender and crediting the account of the beneficiary. Subsection (b)(3) is similar to subsection (b)(2) in that it bases acceptance by the beneficiary's bank on payment by the sender. Payment by the sender is effected by a debit to the sender's account if the account balance is sufficient to cover the amount of the order. On the payment date (Section 4A-401) [55-4A-401 NMSA 1978] of the order the beneficiary's bank will normally credit the beneficiary's account and notify the beneficiary of receipt of the order if it is satisfied that the sender's account balance covers the order or is willing to give credit to the sender. In some cases, however, the bank may not be willing to give credit to the sender and it may not be possible for the bank to determine until the end of the day on the payment date whether there are sufficient good funds in the sender's account. There may be various transactions during the day involving funds going into and out of the account. Some of these transactions may occur late in the day or after the close of the banking day. To accommodate this situation, subsection (b)(3) provides that the status of the account is determined at the opening of the next funds transfer business day of the beneficiary's bank after the payment date of the order. If the sender's account balance is sufficient to cover the order, the beneficiary's bank has a source of payment and the result in almost all cases is that the bank accepts the order at that time if it did not previously accept under subsection (b)(1). In rare cases, a bank may want to avoid acceptance under subsection (b)(3) by rejecting the order as discussed in Comment 8.

8. Section 4A-209 [55-4A-209 NMSA 1978] is based on a general principle that a receiving bank is not obliged to accept a payment order unless it has agreed or is bound by a funds transfer system rule to do so. Thus, provision is made to allow the receiving bank to prevent acceptance of the order. This principle is consistently followed if the receiving bank is not the beneficiary's bank. If the receiving bank is not the beneficiary's bank, acceptance is in the control of the receiving bank because it occurs only if the order is executed. But in the case of the beneficiary's bank acceptance can occur by passive receipt of payment under subsection (b)(2) or (3). In the case of a payment made by Fedwire acceptance cannot be prevented. In other cases the beneficiary's

bank can prevent acceptance by giving notice of rejection to the sender before payment occurs under Section 4A-403(a)(1) or (2) [55-4A-403 NMSA 1978]. A minor exception to the ability of the beneficiary's bank to reject is stated in Section 4A-502(c)(3) [55-4A-502 NMSA 1978].

Under subsection (b)(3) acceptance occurs at the opening of the next funds transfer business day of the beneficiary's bank following the payment date unless the bank rejected the order before that time or it rejects within one hour after that time. In some cases the sender and the beneficiary's bank may not be in the same time zone or the beginning of the business day of the sender and the funds transfer business day of the beneficiary's bank may not coincide. For example, the sender may be located in California and the beneficiary's bank in New York. Since in most cases notice of rejection would be communicated electronically or by telephone, it might not be feasible for the bank to give notice before one hour after the opening of the funds transfer business day in New York because at that hour, the sender's business day may not have started in California. For that reason, there are alternative deadlines stated in subsection (b)(3). In the case stated, the bank acts in time if it gives notice within one hour after the opening of the business day of the sender. But if the notice of rejection is received by the sender after the payment date, the bank is obliged to pay interest to the sender if the sender's account does not bear interest. In that case the bank had the use of funds of the sender that the sender could reasonably assume would be used to pay the beneficiary. The rate of interest is stated in Section 4A-506 [55-4A-506 NMSA 1978]. If the sender receives notice on the day after the payment date the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

9. Subsection (d) applies only to a payment order by the originator of a funds transfer to the originator's bank and it refers to the following situation. On April 1, Originator instructs Bank A to make a payment on April 15 to the account of Beneficiary in Bank B. By mistake, on April 1, Bank A executes Originator's payment order by issuing a payment order to Bank B instructing immediate payment to Beneficiary. Bank B credited Beneficiary's account and immediately released the funds to Beneficiary. Under subsection (d) no acceptance by Bank A occurred on April 1 when Originator's payment order was executed because acceptance cannot occur before the execution date which in this case would be April 15 or shortly before that date. Section 4A-301(b) [55-4A-301 NMSA 1978]. Under Section 4A-402(c) [55-4A-402 NMSA 1978], Originator is not obliged to pay Bank A until the order is accepted and that can't occur until the execution date. But Bank A is required to pay Bank B when Bank B accepted Bank A's order on April 1. Unless Originator and Beneficiary are the same person, in almost all cases Originator is paying a debt owed to Beneficiary and early payment does not injure Originator because Originator does not have to pay Bank A until the execution date. Section 4A-402(c) [55-4A-402 NMSA 1978]. Bank A takes the interest loss. But suppose that on April 3, Originator concludes that no debt was owed to Beneficiary or that the debt was less than the amount of the payment order. Under Section 4A-211(b) [55-4A-211 NMSA 1978] Originator can cancel its payment order if Bank A has not accepted. If early execution of Originator's payment order is acceptance, Originator can

suffer a loss because cancellation after acceptance is not possible without the consent of Bank A and Bank B. Section 4A-211(c) [55-4A-211 NMSA 1978]. If Originator has to pay Bank A, Originator would be required to seek recovery of the money from Beneficiary. Subsection (d) prevents this result and puts the risk of loss on Bank A by providing that the early execution does not result in acceptance until the execution date. Since on April 3 Originator's order was not yet accepted, Originator can cancel it under Section 4A-211(b) [55-4A-211 NMSA 1978]. The result is that Bank A is not entitled to payment from Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by mistake. If Originator's payment order is cancelled, Bank A becomes the originator of an erroneous funds transfer to Beneficiary. Bank A has the burden of recovering payment from Beneficiary on the basis of a payment by mistake. If Beneficiary received the money in good faith in payment of a debt owed to Beneficiary by Originator, the law of mistake and restitution may allow Beneficiary to keep all or part of the money received. If Originator owed money to Beneficiary, Bank A has paid Originator's debt and, under the law of restitution, which applies pursuant to Section 1-103 [55-1-103 NMSA 1978], Bank A is subrogated to Beneficiary's rights against Originator on the debt.

If Bank A is the Beneficiary's bank and Bank A credited Beneficiary's account and released the funds to Beneficiary on April 1, the analysis is similar. If Originator's order is cancelled, Bank A has paid Beneficiary by mistake. The right of Bank A to recover the payment from Beneficiary is similar to Bank A's rights in the preceding paragraph.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-210. Rejection of payment order.

(a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable, and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is canceled pursuant to Section 55-4A-211(d) NMSA 1978 or the day the sender receives notice or learns that the order

was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order.

History: 1978 Comp., § 55-4A-210, enacted by Laws 1992, ch. 114, § 214.

ANNOTATIONS

OFFICIAL COMMENT

1. With respect to payment orders issued to a receiving bank other than the beneficiary's bank, notice of rejection is not necessary to prevent acceptance of the order. Acceptance can occur only if the receiving bank executes the order. Section 4A-209(a). But notice of rejection will routinely be given by such a bank in cases in which the bank cannot or is not willing to execute the order for some reason. There are many reasons why a bank doesn't execute an order. The payment order may not clearly instruct the receiving bank because of some ambiguity in the order or an internal inconsistency. In some cases, the receiving bank may not be able to carry out the instruction because of equipment failure, credit limitations on the receiving bank, or some other factor which makes proper execution of the order infeasible. In those cases notice of rejection is a means of informing the sender of the facts so that a corrected payment order can be transmitted or the sender can seek alternate means of completing the funds transfer. The other major reason for not executing an order is that the sender's account is insufficient to cover the order and the receiving bank is not willing to give credit to the sender. If the sender's account is sufficient to cover the order and the receiving bank chooses not to execute the order, notice of rejection is necessary to prevent liability to pay interest to the sender if the case falls within Section 4A-210(b) [55-4A-210 NMSA 1978] which is discussed in Comment 3.

2. A payment order to the beneficiary's bank can be accepted by inaction of the bank. Section 4A-209(b)(2) and (3) [55-4A-209 NMSA 1978]. To prevent acceptance under those provisions it is necessary for the receiving bank to send notice of rejection before acceptance occurs. Subsection (a) of Section 4A-210 [55-4A-210 NMSA 1978] states the rule that rejection is accomplished by giving notice of rejection. This incorporates the definitions in Section 1-201(26) [55-1-201 NMSA 1978]. Rejection is effective when notice is given if it is given by a means that is reasonable in the circumstances. Otherwise it is effective when the notice is received. The question of when rejection is effective is important only in the relatively few cases under subsection (b)(2) and (3) in which a notice of rejection is necessary to prevent acceptance. The question of whether a particular means is reasonable depends on the facts in a particular case. In a very

large percentage of cases the sender and the receiving bank will be in direct electronic contact with each other and in those cases a notice of rejection can be transmitted instantaneously. Since time is of the essence in a large proportion of funds transfers, some quick means of transmission would usually be required, but this is not always the case. The parties may specify by agreement the means by which communication between the parties is to be made.

3. Subsection (b) deals with cases in which a sender does not learn until after the execution date that the sender's order has not been executed. It applies only to cases in which the receiving bank was assured of payment because the sender's account was sufficient to cover the order. Normally, the receiving bank will accept the sender's order if it is assured of payment, but there may be some cases in which the bank chooses to reject. Unless the receiving bank had obligated itself by agreement to accept, the failure to accept is not wrongful. There is no duty of the receiving bank to accept the payment order unless it is obliged to accept by express agreement. Section 4A-212 [55-4A-212 NMSA 1978]. But even if the bank has not acted wrongfully, the receiving bank had the use of the sender's money that the sender could reasonably assume was to be the source of payment of the funds transfer. Until the sender learns that the order was not accepted the sender is denied the use of that money. Subsection (b) obliges the receiving bank to pay interest to the sender as restitution unless the sender receives notice of rejection on the execution date. The time of receipt of notice is determined pursuant to § 1-201(27) [55-1-201 NMSA 1978]. The rate of interest is stated in Section 4A-506 [55-4A-506 NMSA 1978]. If the sender receives notice on the day after the execution date, the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

4. Subsection (d) treats acceptance and rejection as mutually exclusive. If a payment order has been accepted, rejection of that order becomes impossible. If a payment order has been rejected it cannot be accepted later by the receiving bank. Once notice of rejection has been given, the sender may have acted on the notice by making the payment through other channels. If the receiving bank wants to act on a payment order that it has rejected it has to obtain the consent of the sender. In that case the consent of the sender would amount to the giving of a second payment order that substitutes for the rejected first order. If the receiving bank suspends payments (Section 4-104(1)(k)) [55-4-104 NMSA 1978], subsection (c) provides that unaccepted payment orders are deemed rejected at the time suspension of payments occurs. This prevents acceptance by passage of time under Section 4A-209(b)(3) [55-4A-209 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-211. Cancellation and amendment of payment order.

(a) A communication of the sender of a payment order canceling or amending the order may be transmitted to the receiving bank orally, electronically or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is

not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to Subsection (a), a communication by the sender canceling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is canceled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is canceled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A canceled payment order cannot be accepted. If an accepted payment order is canceled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorney's fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with Paragraph (2) of Subsection (c).

History: 1978 Comp., § 55-4A-211, enacted by Laws 1992, ch. 114, § 215.

ANNOTATIONS

OFFICIAL COMMENT

1. This section deals with cancellation and amendment of payment orders. It states the conditions under which cancellation or amendment is both effective and rightful. There is no concept of wrongful cancellation or amendment of a payment order. If the conditions stated in this section are not met the attempted cancellation or amendment is not effective. If the stated conditions are met the cancellation or amendment is effective and rightful. The sender of a payment order may want to withdraw or change the order because the sender has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason. One common situation is that of multiple transmission of the same order. The sender that mistakenly transmits the same order twice wants to correct the mistake by cancelling the duplicate order. Or, a sender may have intended to order a payment of $1,000,000 but mistakenly issued an order to pay $10,000,000. In this case the sender might try to correct the mistake by cancelling the order and issuing another order in the proper amount. Or, the mistake could be corrected by amending the order to change it to the proper amount. Whether the error is corrected by amendment or cancellation and reissue the net result is the same. This result is stated in the last sentence of subsection (e).

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank "orally, electronically, or in writing." The quoted phrase is consistent with the language of Section 4A-103(a) [55-4A-103 NMSA 1978] applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the communication was or was not effective to cancel or amend a previously verified payment order.

3. If the receiving bank has not yet accepted the order, there is no reason why the sender should not be able to cancel or amend the order unilaterally so long as the

requirements of subsections (a) and (b) are met. If the receiving bank has accepted the order, it is possible to cancel or amend but only if the requirements of subsection (c) are met.

First consider the case of a receiving bank other than the beneficiary's bank. If the bank has not yet accepted the order, the sender can unilaterally cancel or amend. The communication amending or cancelling the payment order must be received in time to allow the bank to act on it before the bank issues its payment order in execution of the sender's order. The time that the sender's communication is received is governed by Section 4A-106 [55-4A-106 NMSA 1978]. If a payment order does not specify a delayed payment date or execution date, the order will normally be executed shortly after receipt. Thus, as a practical matter, the sender will have very little time in which to instruct cancellation or amendment before acceptance. In addition, a receiving bank will normally have cut-off times for receipt of such communications, and the receiving bank is not obliged to act on communications received after the cut-off hour. Cancellation by the sender after execution of the order by the receiving bank requires the agreement of the bank unless a funds transfer rule otherwise provides. Subsection (c). Although execution of the sender's order by the receiving bank does not itself impose liability on the receiving bank (under Section 4A-402 [55-4A-402 NMSA 1978] no liability is incurred by the receiving bank to pay its order until it is accepted), it would commonly be the case that acceptance follows shortly after issuance. Thus, as a practical matter, a receiving bank that has executed a payment order will incur a liability to the next bank in the chain before it would be able to act on the cancellation request of its customer. It is unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank.

The statute does not state how or when the agreement of the receiving bank must be obtained for cancellation after execution. The receiving bank's consent could be obtained at the time cancellation occurs or it could be based on a preexisting agreement. Or, a funds transfer system rule could provide that cancellation can be made unilaterally by the sender. By virtue of that rule any receiving bank covered by the rule is bound. Section 4A-501 [55-4A-501 NMSA 1978]. If the receiving bank has already executed the sender's order, the bank would not consent to cancellation unless the bank to which the receiving bank has issued its payment order consents to cancellation of that order. It makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled. Under subsection (c)(1), if a receiving bank consents to cancellation of the payment order after it is executed, the cancellation is not effective unless the receiving bank also cancels the payment order issued by the bank.

4. With respect to a payment order issued to the beneficiary's bank, acceptance is particularly important because it creates liability to pay the beneficiary, it defines when the originator pays its obligation to the beneficiary, and it defines when any obligation for which the payment is made is discharged. Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to

agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree. Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated. The following examples illustrate subsection (c)(2):

Case #1. Originator's Bank executed a payment order issued in the name of its customer as sender. The order was not authorized by the customer and was fraudulently issued. Beneficiary's Bank accepted the payment order issued by Originator's Bank. Under subsection (c)(2) Originator's Bank can cancel the order if Beneficiary's Bank consents. It doesn't make any difference whether the payment order that Originator's Bank accepted was or was not enforceable against the customer under Section 4A-202(b) [55-4A-202 NMSA 1978]. Verification under that provision is important in determining whether Originator's Bank or the customer has the risk of loss, but it has no relevance under Section 4A-211(c)(2) [55-4A-211 NMSA 1978]. Whether or not verified, the payment order was not authorized by the customer. Cancellation of the payment order to Beneficiary's Bank causes the acceptance of Beneficiary's Bank to be nullified. Subsection (e). Beneficiary's Bank is entitled to recover payment from the beneficiary to the extent allowed by the law of mistake and restitution. In this kind of case the beneficiary is usually a party to the fraud who has no right to receive or retain payment of the order.

Case #2. Originator owed Beneficiary $1,000,000 and ordered Bank A to pay that amount to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B, but by mistake issued a duplicate order as well. Bank B accepted both orders. Under subsection (c)(2)(i) cancellation of the duplicate order could be made by Bank A with the consent of Bank B. Beneficiary has no right to receive or retain payment of the duplicate payment order if only $1,000,000 was owed by Originator to Beneficiary. If Originator owed $2,000,000 to Beneficiary, the law of restitution might allow Beneficiary to retain the $1,000,000 paid by Bank B on the duplicate order. In that case Bank B is entitled to reimbursement from Bank A under subsection (f).

Case #3. Originator owed $1,000,000 to X. Intending to pay X, Originator ordered Bank A to pay $1,000,000 to Y's account in Bank B. Bank A issued a complying payment order to Bank B which Bank B accepted by releasing the $1,000,000 to Y. Under subsection (c)(2)(ii) Bank A can cancel its payment order to Bank B with the consent of Bank B if Y was not entitled to receive payment from Originator. Originator can also cancel its order to Bank A with Bank A's consent. Subsection (c)(1). Bank B may recover the $1,000,000 from Y unless the law of mistake and restitution allows Y to retain some or all of the amount paid. If no debt was owed to Y, Bank B should have a right of recovery.

Case #4. Originator owed Beneficiary $10,000. By mistake Originator ordered Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B which accepted by notifying Beneficiary of its right to withdraw $1,000,000. Cancellation is permitted in this case under subsection (c)(2)(iii). If Bank B

paid Beneficiary it is entitled to recover the payment except to the extent the law of mistake and restitution allows Beneficiary to retain payment. In this case Beneficiary might be entitled to retain $10,000, the amount of the debt owed to Beneficiary. If Beneficiary may retain $10,000, Bank B would be entitled to $10,000 from Bank A pursuant to subsection (f). In this case Originator also cancelled its order. Thus Bank A would be entitled to $10,000 from Originator pursuant to subsection (f).

5. Unless constrained by a funds transfer system rule, a receiving bank may agree to cancellation or amendment of the payment order under subsection (c) but is not required to do so regardless of the circumstances. If the receiving bank has incurred liability as a result of its acceptance of the sender's order, there are substantial risks in agreeing to cancellation or amendment. This is particularly true for a beneficiary's bank. Cancellation or amendment after acceptance by the beneficiary's bank can be made only in the four cases stated and the beneficiary's bank may not have any way of knowing whether the requirements of subsection (c) have been met or whether it will be able to recover payment from the beneficiary that received payment. Even with indemnity the beneficiary's bank may be reluctant to alienate its customer, the beneficiary, by denying the customer the funds. Subsection (c) leaves the decision to the beneficiary's bank unless the consent of the beneficiary's bank is not required under a funds transfer system rule or other interbank agreement. If a receiving bank agrees to cancellation or amendment under subsection (c)(1) or (2), it is automatically entitled to indemnification from the sender under subsection (f). The indemnification provision recognizes that a sender has no right to cancel a payment order after it is accepted by the receiving bank. If the receiving bank agrees to cancellation, it is doing so as an accommodation to the sender and it should not incur a risk of loss in doing so.

6. Acceptance by the receiving bank of a payment order issued by the sender is comparable to acceptance of an offer under the law of contracts. Under that law the death or legal incapacity of an offeror terminates the offer even though the offeree has no notice of the death or incapacity. Restatement Second, Contracts § 48. Comment a. to that section states that the "rule seems to be a relic of the obsolete view that a contract requires a 'meeting of minds,' and it is out of harmony with the modern doctrine that a manifestation of assent is effective without regard to actual mental assent." Subsection (g), which reverses the Restatement rule in the case of a payment order, is similar to Section 4-405(1) [55-4-405 NMSA 1978] which applies to checks. Subsection (g) does not address the effect of the bankruptcy of the sender of a payment order before the order is accepted, but the principle of subsection (g) has been recognized in Bank of Marin v. England, 385 U.S. 99 (1966). Although Bankruptcy Code Section 542(c) may not have been drafted with wire transfers in mind, its language can be read to allow the receiving bank to charge the sender's account for the amount of the payment order if the receiving bank executed it in ignorance of the bankruptcy.

7. Subsection (d) deals with stale payment orders. Payment orders normally are executed on the execution date or the day after. An order issued to the beneficiary's bank is normally accepted on the payment date or the day after. If a payment order is not accepted on its execution or payment date or shortly thereafter, it is probable that

there was some problem with the terms of the order or the sender did not have sufficient funds or credit to cover the amount of the order. Delayed acceptance of such an order is normally not comtemplated, but the order may not have been cancelled by the sender. Subsection (d) provides for cancellation by operation of law to prevent an unexpected delayed acceptance.

8. A funds transfer system rule can govern rights and obligations between banks that are parties to payment orders transmitted over the system even if the rule conflicts with Article 4A. In some cases, however, a rule governing a transaction between two banks can affect a third party in an unacceptable way. Subsection (h) deals with such a case. A funds transfer system rule cannot allow cancellation of a payment order accepted by the beneficiary's bank if the rule conflicts with subsection (c)(2). Because rights of the beneficiary and the originator are directly affected by acceptance, subsection (c)(2) severely limits cancellation. These limitations cannot be altered by funds transfer system rule.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-212. Liability and duty of receiving bank regarding unaccepted payment order.

If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in Section 55-4A-209 NMSA 1978, and liability is limited to that provided in this article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this article or by express agreement.

History: 1978 Comp., § 55-4A-212, enacted by Laws 1992, ch. 114, § 216.

ANNOTATIONS

OFFICIAL COMMENT

With limited exceptions stated in this Article, the duties and obligations of receiving banks that carry out a funds transfer arise only as a result of acceptance of payment orders or of agreements made by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and Section 4A-210(b) [55-4A-209 and 55-4A-210 NMSA 1978, respectively]. A receiving bank is not like a collecting bank under Article 4. No receiving bank, whether it be an originator's bank, an intermediary bank or a beneficiary's bank, is an agent for any other party in the funds transfer.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 3
EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK

55-4A-301. Execution and execution date.

(a) A payment order is "executed" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) "Execution date" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date.

History: 1978 Comp., § 55-4A-301, enacted by Laws 1992, ch. 114, § 217.

ANNOTATIONS

OFFICIAL COMMENT

1. The terms "executed," "execution" and "execution date" are used only with respect to a payment order to a receiving bank other than the beneficiary's bank. The beneficiary's bank can accept the payment order that it receives, but it does not execute the order. Execution refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. A receiving bank has executed an order even if the order issued by the bank does not carry out the order received by the bank. For example, the bank may have erroneously issued an order to the wrong beneficiary, or in the wrong amount or to the wrong beneficiary's bank. In each of these cases execution has occurred but the execution is erroneous. Erroneous execution is covered in Section 4A-303 [55-4A-303 NMSA 1978].

2. "Execution date" refers to the time a payment order should be executed rather than the day it is actually executed. Normally the sender will not specify an execution date, but most payment orders are meant to be executed immediately. Thus, the execution date is normally the day the order is received by the receiving bank. It is common for the sender to specify a "payment date" which is defined in Section 4A-401 [55-4A-401 NMSA 1978] as "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank." Except for automated clearing house transfers, if a funds transfer is entirely within the United States and the payment is to be carried out

electronically, the execution date is the payment date unless the order is received after the payment date. If the payment is to be carried out through an automated clearing house, execution may occur before the payment date. In an ACH transfer the beneficiary is usually paid one or two days after issue of the originator's payment order. The execution date is determined by the stated payment date and is a date before the payment date on which execution is reasonably necessary to allow payment on the payment date. A funds transfer system rule could also determine the execution date of orders received by the receiving bank if both the sender and the receiving bank are participants in the funds transfer system. The execution date can be determined by the payment order itself or by separate instructions of the sender or an agreement of the sender and the receiving bank. The second sentence of subsection (b) must be read in the light of Section 4A-106 [55-4A-106 NMSA 1978] which states that if a payment order is received after the cut-off time of the receiving bank it may be treated by the bank as received at the opening of the next funds transfer business day.

3. Execution on the execution date is timely, but the order can be executed before or after the execution date. Section 4A-209(d) and Section 4A-402(c) [55-4A-209 and 55-4A-402 NMSA 1978, respectively] state the consequences of early execution and Section 4A-305(a) [55-4A-305 NMSA 1978] states the consequences of late execution.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-302. Obligations of receiving bank in execution of payment order.

(a) Except as provided in Subsections (b) through (d), if the receiving bank accepts a payment order pursuant to Section 55-4A-209(a) NMSA 1978, the bank has the following obligations in executing the order:

(1) the receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer; if the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator; an intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts; and

(2) if the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly; if a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless Paragraph (2) of Subsection (a) applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner.

History: 1978 Comp., § 55-4A-302, enacted by Laws 1992, ch. 114, § 218.

ANNOTATIONS

OFFICIAL COMMENT

1. In the absence of agreement, the receiving bank is not obliged to execute an order of the sender. Section 4A-212 [55-4A-212 NMSA 1978]. Section 4A-302 [55-4A-302 NMSA 1978] states the manner in which the receiving bank may execute the sender's order if execution occurs. Subsection (a)(1) states the residual rule. The payment order issued by the receiving bank must comply with the sender's order and, unless some other rule is stated in the section, the receiving bank is obliged to follow any instruction of the sender concerning which funds transfer system is to be used, which intermediary banks are to be used, and what means of transmission is to be used. The instruction of the sender may be incorporated in the payment order itself or may be given separately. For example, there may be a master agreement between the sender and receiving bank containing instructions governing payment orders to be issued from time to time by the sender to the receiving bank. In most funds transfers, speed is a paramount consideration. A sender that wants assurance that the funds transfer will be expeditiously completed can specify the means to be used. The receiving bank can follow the instructions literally or it can use an equivalent means. For example, if the sender instructs the receiving bank to transmit by telex, the receiving bank could use

telephone instead. Subsection (c). In most cases the sender will not specify a particular means but will use a general term such as "by wire" or "wire transfer" or "as soon as possible." These words signify that the sender wants a same-day transfer. In these cases the receiving bank is required to use a telephonic or electronic communication to transmit its order and is also required to instruct any intermediary bank to which it issues its order to transmit by similar means. Subsection (a)(2). In other cases, such as an automated clearing house transfer, a same-day transfer is not contemplated. Normally the sender's instruction or the context in which the payment order is received makes clear the type of funds transfer that is appropriate. If the sender states a payment date with respect to the payment order, the receiving bank is obliged to execute the order at a time and in a manner to meet the payment date if that is feasible. Subsection (a)(2). This provision would apply to many ACH transfers made to pay recurring debts of the sender. In other cases, involving relatively small amounts, time may not be an important factor and cost may be a more important element. Fast means, such as telephone or electronic transmission, are more expensive than slow means such as mailing. Subsection (c) states that in the absence of instructions the receiving bank is given discretion to decide. It may issue its payment order by first class mail or by any means reasonable in the circumstances. Section 4A-305 [55-4A-305 NMSA 1978] states the liability of a receiving bank for breach of the obligations stated in Section 4A-302 [55-4A-302 NMSA 1978].

2. Subsection (b) concerns the choice of intermediary banks to be used in completing the funds transfer, and the funds transfer system to be used. If the receiving bank is not instructed about the matter, it can issue an order directly to the beneficiary's bank or can issue an order to an intermediary bank. The receiving bank also has discretion concerning use of a funds transfer system. In some cases it may be reasonable to use either an automated clearing house system or a wire transfer system such as Fedwire or CHIPS. Normally, the receiving bank will follow the instruction of the sender in these matters, but in some cases it may be prudent for the bank not to follow instructions. The sender may have designated a funds transfer system to be used in carrying out the funds transfer, but it may not be feasible to use the designated system because of some impediment such as a computer breakdown which prevents prompt execution of the order. The receiving bank is permitted to use an alternate means of transmittal in a good faith effort to execute the order expeditiously. The same leeway is not given to the receiving bank if the sender designates an intermediary bank through which the funds transfer is to be routed. The sender's designation of that intermediary bank may mean that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized. The receiving bank could choose to route the transfer to another intermediary bank and then to the designated intermediary bank if there was some reason such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but the designated intermediary bank cannot be circumvented. To do so violates the sender's instructions.

3. The normal rule, under subsection (a)(1), is that the receiving bank, in executing a payment order, is required to issue a payment order that complies as to amount with

that of the sender's order. In most cases the receiving bank issues an order equal to the amount of the sender's order and makes a separate charge for services and expenses in executing the sender's order. In some cases, particularly if it is an intermediary bank that is executing an order, charges are collected by deducting them from the amount of the payment order issued by the executing bank. If that is done, the amount of the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's payment order. For example, Originator, in order to pay an obligation of $1,000,000 owed to Beneficiary, issues a payment order to Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank. Originator's Bank issues a payment order to Intermediary Bank for $1,000,000 and debits Originator's account for $1,000,010. The extra $10 is the fee of Originator's Bank. Intermediary Bank executes the payment order of Originator's Bank by issuing a payment order to Beneficiary's Bank for $999,990, but under § 4A-402(c) [55-4A-402 NMSA 1978] is entitled to receive $1,000,000 from Originator's bank. The $10 difference is the fee of Intermediary Bank. Beneficiary's Bank credits Beneficiary's account for $999,990. When Beneficiary's Bank accepts the payment order of Intermediary Bank the result is a payment of $999,990 from Originator to Beneficiary. Section 4A-406(a) [55-4A-406 NMSA 1978]. If that payment discharges the $1,000,000 debt, the effect is that Beneficiary has paid the charges of Intermediary Bank and Originator has paid charges of Originator's Bank. Subsection (d) of Section 4A-302 [55-4A-302 NMSA 1978] allows Intermediary Bank to collect its charges by deducting them from the amount of the payment order, but only if instructed to do so by Originator's Bank. Originator's Bank is not authorized to give that instruction to Intermediary Bank unless Originator authorized the instruction. Thus, Originator can control how the charges of Originator's Bank and Intermediary Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's Bank to Beneficiary.

In the case discussed in the preceding paragraph the $10 charge is trivial in relation to the amount of the payment and it may not be important to Beneficiary how the charge is paid. But it may be very important if the $1,000,000 obligation represented the price of exercising a right such as an option favorable to Originator and unfavorable to Beneficiary. Beneficiary might well argue that it was entitled to receive $1,000,000. If the option was exercised shortly before its expiration date, the result could be loss of the option benefit because the required payment of $1,000,000 was not made before the option expired. Section 4A-406(c) [55-4A-406 NMSA 1978] allows Originator to preserve the option benefit. The amount received by Beneficiary is deemed to be $1,000,000 unless Beneficiary demands the $10 and Originator does not pay it.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-303. Erroneous execution of payment order.

(a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under Section 55-4A-402(c)

NMSA 1978 if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under Section 55-4A-402(c) NMSA 1978 if (i) that subsection is otherwise satisfied, and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution.

History: 1978 Comp., § 55-4A-303, enacted by Laws 1992, ch. 114, § 219.

ANNOTATIONS

OFFICIAL COMMENT

1. Section 4A-303 [55-4A-303 NMSA 1978] states the effect of erroneous execution of a payment order by the receiving bank. Under Section 4A-402(c) [55-4A-402 NMSA 1978] the sender of a payment order is obliged to pay the amount of the order to the receiving bank if the bank executes the order, but the obligation to pay is excused if the beneficiary's bank does not accept a payment order instructing payment to the beneficiary of the sender's order. If erroneous execution of the sender's order causes the wrong beneficiary to be paid, the sender is not required to pay. If erroneous execution causes the wrong amount to be paid the sender is not obliged to pay the receiving bank an amount in excess of the amount of the sender's order. Section 4A-303 [55-4A-303 NMSA 1978] takes precedence over Section 4A-402(c) [55-4A-402 NMSA 1978] and states the liability of the sender and the rights of the receiving bank in various cases of erroneous execution.

2. Subsections (a) and (b) deal with cases in which the receiving bank executes by issuing a payment order in the wrong amount. If Originator ordered Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank, but Originator's

Bank erroneously instructed Beneficiary's Bank to pay $2,000,000 to Beneficiary's account, subsection (a) applies. If Beneficiary's Bank accepts the order of Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank, but Originator's Bank is entitled to receive only $1,000,000 from Originator. Originator's Bank is entitled to recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution. Originator's Bank would normally have a right to recover the overpayment from Beneficiary, but in unusual cases the law of restitution might allow Beneficiary to keep all or part of the overpayment. For example, if Originator owed $2,000,000 to Beneficiary and Beneficiary received the extra $1,000,000 in good faith in discharge of the debt, Beneficiary may be allowed to keep it. In this case Originator's Bank has paid an obligation of Originator and under the law of restitution, which applies through Section 1-103 [55-1-103 NMSA 1978], Originator's Bank would be subrogated to Beneficiary's rights against Originator on the obligation paid by Originator's Bank.

If Originator's Bank erroneously executed Originator's order by instructing Beneficiary's Bank to pay less than $1,000,000, subsection (b) applies. If Originator's Bank corrects its error by issuing another payment order to Beneficiary's Bank that results in payment of $1,000,000 to Beneficiary, Originator's Bank is entitled to payment of $1,000,000 from Originator. If the mistake is not corrected, Originator's Bank is entitled to payment from Originator only in the amount of the order issued by Originator's Bank.

3. Subsection (a) also applies to duplicate payment orders. Assume Originator's Bank properly executes Originator's $1,000,000 payment order and then by mistake issues a second $1,000,000 payment order in execution of Originator's order. If Beneficiary's Bank accepts both orders issued by Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank but Originator's Bank is entitled to receive only $1,000,000 from Originator. The remedy of Originator's Bank is the same as that of a receiving bank that executes by issuing an order in an amount greater than the sender's order. It may recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution and in a proper case as stated in Comment 2 may have subrogation rights if it is not entitled to recover from Beneficiary.

4. Suppose Originator instructs Originator's Bank to pay $1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank erroneously instructs Beneficiary's Bank to pay $1,000,000 to Account #12346 and Beneficiary's Bank accepted. Subsection (c) covers this case. Originator is not obliged to pay its payment order, but Originator's Bank is required to pay $1,000,000 to Beneficiary's Bank. The remedy of Originator's Bank is to recover $1,000,000 from the holder of Account #12346 that received payment by mistake. Recovery based on the law of mistake and restitution is described in Comment 2.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-304. Duty of sender to report erroneously executed payment order.

If the sender of a payment order that is erroneously executed as stated in Section 55-4A-303 NMSA 1978 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding ninety days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under Section 55-4A-402(d) NMSA 1978 for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section.

History: 1978 Comp., § 55-4A-304, enacted by Laws 1992, ch. 114, § 220.

ANNOTATIONS

OFFICIAL COMMENT

This section is identical in effect to Section 4A-204 [55-4A-204 NMSA 1978] which applies to unauthorized orders issued in the name of a customer of the receiving bank. The rationale is stated in Comment 2 to Section 4A-204 [55-4A-204 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-305. Liability for late or improper execution or failure to execute payment order.

(a) If a funds transfer is completed but the execution of a payment order by the receiving bank in breach of Section 55-4A-302 NMSA 1978 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in Subsection (c), additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of Section 55-4A-302 NMSA 1978 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by Subsection (a), resulting from the improper execution. Except as provided in Subsection (c), additional damages are not recoverable.

(c) In addition to the amounts payable under Subsections (a) and (b), damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorney's fees are recoverable if demand for compensation under Subsection (a) or (b) is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under Subsection (d) and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under Subsection (d) is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under Subsections (a) and (b) may not be varied by agreement.

History: 1978 Comp., § 55-4A-305, enacted by Laws 1992, ch. 114, § 221.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a) [55-4A-302 NMSA 1978]. The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506 [55-4A-506 NMSA 1978]. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 [55-4A-302 NMSA 1978] involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the breach, the expenses of the sender

in the funds transfer and attorney's fees. This subsection reflects the judgement that imposition of consequential damages on a bank for commission of an error is not justified.

The leading common law case on the subject of consequential damages is Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), in which Swiss Bank, an intermediary bank, failed to execute a payment order. Because the beneficiary did not receive timely payment the originator lost a valuable ship charter. The lower court awarded the originator $2.1 million for lost profits even though the amount of the payment order was only $27,000. The Seventh Circuit reversed, in part on the basis of the common law rule of Hadley v. Baxendale that consequential damages may not be awarded unless the defendant is put on notice of the special circumstances giving rise to them. Swiss Bank may have known that the originator was paying the shipowner for the hire of a vessel but did not know that a favorable charter would be lost if the payment was delayed. "Electronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry. Swiss Bank did not have enough information to infer that if it lost a $27,000 payment order it would face liability in excess of $2 million." 673 F.2d at 956.

If Evra means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages. In the typical case transmission of the payment order is made electronically. Personnel of the receiving bank that process payment orders are not the appropriate people to evaluate the risk of liability for consequential damages in relation to the price charged for the wire transfer service. Even if notice is received by higher level management personnel who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of payment orders on an individual basis. This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers. Moreover, in Evra the culpable bank was an intermediary bank with which the originator did not deal. Notice to the originator's bank would not bind the intermediary bank, and it seems impractical for the originator's bank to convey notice of this kind to intermediary banks in the funds transfer. The success of the wholesale wire transfer industry has largely been based on its ability to effect payment at low cost and great speed. Both of these essential aspects of the modern wire transfer system would be adversely affected by a rule that imposed on banks liability for consequential damages. A banking industry amicus brief in Evra stated: "Whether banks can continue to make EFT services available on a widespread basis, by charging reasonable rates, depends on whether they can do so without incurring unlimited consequential risks. Certainly, no bank would handle for $3.25 a transaction entailing potential liability in the millions of dollars."

As the court in Evra also noted, the originator of the funds transfer is in the best position to evaluate the risk that a funds transfer will not be made on time and to manage that risk by issuing a payment order in time to allow monitoring of the transaction. The originator, by asking the beneficiary, can quickly determine if the funds transfer has

been completed. If the originator has sent the payment order at a time that allows a reasonable margin for correcting error, no loss is likely to result if the transaction is monitored. The other published cases on this issue reach the Evra result. Central Coordinates, Inc. v. Morgan Guaranty Trust Co., 40 U.C.C. Rep. Serv. 1340 (N.Y.Sup.Ct.1985), and Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep.Serv.2d 171 (D.Md.1986).

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express written agreement of the receiving bank. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212 [55-4A-212 NMSA 1978]. The measure of damages for breach of an agreement to accept a payment order is the same as that stated in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express written agreement of the receiving bank.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsection (a), (b) and (d). If additional damages are recoverable because provided for by an express written agreement, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305 [55-4A-305 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 4
PAYMENT

55-4A-401. Payment date.

"Payment date" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank.

History: 1978 Comp., § 55-4A-401, enacted by Laws 1992, ch. 114, § 222.

ANNOTATIONS

OFFICIAL COMMENT

"Payment date" refers to the day the beneficiary's bank is to pay the beneficiary. The payment date may be expressed in various ways so long as it indicates the day the beneficiary is to receive payment. For example, in ACH transfers the payment date is the equivalent of "settlement date" or "effective date." Payment date applies to the payment order issued to the beneficiary's bank, but a payment order issued to a receiving bank other than the beneficiary's bank may also state a date for payment to the beneficiary. In the latter case, the statement of a payment date is to instruct the receiving bank concerning time of execution of the sender's order. Section 4A-301(b) [55-4A-301 NMSA 1978].

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-402. Obligation of sender to pay receiving bank.

(a) This section is subject to Sections 55-4A-205 and 55-4A-207 NMSA 1978.

(b) With respect to a payment order issued on the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection is subject to Subsection (e) and to Section 55-4A-303 NMSA 1978. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in Sections 55-4A-204 and 55-4A-304 NMSA 1978, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in Subsection (c) and an intermediary bank is obliged to refund payment as stated in Subsection (d) but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in Section 55-4A-302(a)(1) NMSA 1978, to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued

an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in Subsection (d).

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in Subsection (c) or to receive refund under Subsection (d) may not be varied by agreement.

History: 1978 Comp., § 55-4A-402, enacted by Laws 1992, ch. 114, § 223.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (b) states that the sender of a payment order to the beneficiary's bank must pay the order when the beneficiary's bank accepts the order. At that point the beneficiary's bank is obliged to pay the beneficiary. Section 4A-404(a) [55-4A-404 NMSA 1978]. The last clause of subsection (b) covers a case of premature acceptance by the beneficiary's bank. In some funds transfers, notably automated clearing house transfers, a beneficiary's bank may receive a payment order with a payment date after the day the order is received. The beneficiary's bank might accept the order before the payment date by notifying the beneficiary of receipt of the order. Although the acceptance obliges the beneficiary's bank to pay the beneficiary, payment is not due until the payment date. The last clause of subsection (b) is consistent with that result. The beneficiary's bank is also not entitled to payment from the sender until the payment date.

2. Assume that Originator instructs Bank A to order immediate payment to the account of Beneficiary in Bank B. Execution of Originator's payment order by Bank A is acceptance under Section 4A-209(a) [55-4A-209 NMSA 1978]. Under the second sentence of Section 4A-402(c) [55-4A-402 NMSA 1978] the acceptance creates an obligation of Originator to pay Bank A the amount of the order. The last clause of that sentence deals with attempted funds transfers that are not completed. In that event the obligation of the sender to pay its payment order is excused. Originator makes payment to Beneficiary when Bank B, the beneficiary's bank, accepts a payment order for the benefit of Beneficiary. Section 4A-406(a) [55-4A-206 NMSA 1978]. If that acceptance by Bank B does not occur, the funds transfer has miscarried because Originator has not paid Beneficiary. Originator doesn't have to pay its payment order, and if it has already paid it is entitled to refund of the payment with interest. The rate of interest is stated in Section 4A-506 [55-4A-506 NMSA 1978]. This "money-back guarantee" is an important protection of Originator. Originator is assured that it will not lose its money if something goes wrong in the transfer. For example, risk of loss resulting from payment to the wrong beneficiary is borne by some bank, not by Originator. The most likely reason for noncompletion is a failure to execute or an erroneous execution of a payment order by Bank A or an intermediary bank. Bank A may have issued its payment order to the wrong bank or it may have identified the wrong beneficiary in its order. The money-back guarantee is particularly important to Originator if noncompletion of the funds transfer is

due to the fault of an intermediary bank rather than Bank A. In that case Bank A must refund payment to Originator, and Bank A has the burden of obtaining refund from the intermediary bank that it paid.

Subsection (c) can result in loss if an intermediary bank suspends payments. Suppose Originator instructs Bank A to pay to Beneficiary's account in Bank B and to use Bank C as an intermediary bank. Bank A executes Originator's order by issuing a payment order to Bank C. Bank A pays Bank C. Bank C fails to execute the order of Bank A and suspends payments. Under subsections (c) and (d), Originator is not obliged to pay Bank A and is entitled to refund from Bank A of any payment that it may have made. Bank A is entitled to a refund from Bank C, but Bank C is insolvent. Subsection (e) deals with this case. Bank A was required to issue its payment order to Bank C because Bank C was designated as an intermediary bank by Originator. Section 4A-302(a)(1) [55-4A-302 NMSA 1978]. In this case Originator takes the risk of insolvency of Bank C. Under subsection (e), Bank A is entitled to payment from Originator and Originator is subrogated to the right of Bank A under subsection (d) to refund of payment from Bank C.

3. A payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-403. Payment by sender to receiving bank.

(a) Payment of the sender's obligation under Section 55-4A-402 NMSA 1978 to pay the receiving bank occurs as follows:

(1) if the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a federal reserve bank or through a funds-transfer system;

(2) if the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact; and

(3) if the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under Section 55-4A-402 NMSA 1978 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by Subsection (a), the time when payment of the sender's obligation under Section 55-4A-402(b) or 55-4A-402(c) NMSA 1978 occurs is governed by applicable principles of law that determine when an obligation is satisfied.

History: 1978 Comp., § 55-4A-403, enacted by Laws 1992, ch. 114, § 224.

ANNOTATIONS

OFFICIAL COMMENT

1. This section defines when a sender pays the obligation stated in Section 4A-402 [55-4A-402 NMSA 1978]. If a group of two or more banks engage in funds transfers with each other, the participating banks will sometimes be senders and sometimes receiving banks. With respect to payment orders other than Fedwires, the amounts of the various payment orders may be credited and debited to accounts of one bank with another or to a clearing house account of each bank and amounts owed and amounts due are netted. Settlement is made through a Federal Reserve Bank by charges to the Federal Reserve accounts of the net debtor banks and credits to the Federal Reserve accounts of the net creditor banks. In the case of Fedwires the sender's obligation is settled by a debit to the Federal Reserve account of the sender and a credit to the Federal Reserve account of the receiving bank at the time the receiving bank receives the payment order. Both of these cases are covered by subsection (a)(1). When the Federal Reserve settlement becomes final the obligation of the sender under Section 4A-402 [55-4A-402 NMSA 1978] is paid.

2. In some cases a bank does not settle an obligation owed to another bank through a Federal Reserve Bank. This is the case if one of the banks is a foreign bank without access to the Federal Reserve payment system. In this kind of case, payment is usually made by credits or debits to accounts of the two banks with each other or to accounts of the two banks in a third bank. Suppose Bank B has an account in Bank A. Bank A advises Bank B that its account in Bank A has been credited $1,000,000 and that the credit is immediately withdrawable. Bank A also instructs Bank B to pay $1,000,000 to the account of Beneficiary in Bank B. This case is covered by subsection (a)(2). Bank B may want to immediately withdraw this credit. For example, it might do so by instructing Bank A to debit the account and pay some third party. Payment by Bank A to Bank B of Bank A's payment order occurs when the withdrawal is made. Suppose Bank B does not withdraw the credit. Since Bank B is the beneficiary's bank, one of the effects of receipt of payment by Bank B is that acceptance of Bank A's payment order automatically occurs at the time of payment. Section 4A-209(b)(2) [55-4A-209 NMSA 1978]. Acceptance means that Bank B is obliged to pay $1,000,000 to Beneficiary. Section 4A-404(a) [55-4A-404 NMSA 1978]. Subsection (a)(2) of Section 4A-403 [55-4A-403 NMSA 1978] states that payment does not occur until midnight if the credit is not withdrawn. This allows Bank B an opportunity to reject the order if it does not have time to withdraw the credit to its account and it is not willing to incur the liability to Beneficiary before it has use of the funds represented by the credit.

3. Subsection (a)(3) applies to a case in which the sender (bank or nonbank) has a funded account in the receiving bank. If Sender has an account in Bank and issues a payment order to Bank, Bank can obtain payment from Sender by debiting the account of Sender, which pays its Section 4A-402 [55-4A-402 NMSA 1978] obligation to Bank when the debit is made.

4. Subsection (b) deals with multilateral settlements made through a funds transfer system and is based on the CHIPS settlement system. In a funds transfer system such as CHIPS, which allows the various banks that transmit payment orders over the system to settle obligations at the end of each day, settlement is not based on individual payment orders. Each bank using the system engages in funds transfers with many other banks using the system. Settlement for any participant is based on the net credit or debit position of that participant with all other banks using the system. Subsection (b) is designed to make clear that the obligations of any sender are paid when the net position of that sender is settled in accordance with the rules of the funds transfer system. This provision is intended to invalidate any argument, based on common-law principles, that multilateral netting is not valid because mutuality of obligation is not present. Subsection (b) dispenses with any mutuality of obligation requirements. Subsection (c) applies to cases in which two banks send payment orders to each other during the day and settle with each other at the end of the day or at the end of some other period. It is similar to subsection (b) in that it recognizes that a sender's obligation to pay a payment order is satisfied by a setoff. The obligations of each bank as sender to the other as receiving bank are obligations of the bank itself and not as representative of customers. These two sections are important in the case of insolvency

of a bank. They make clear that liability under Section 4A-402 [55-4A-402 NMSA 1978] is based on the net position of the insolvent bank after setoff.

5. Subsection (d) relates to the uncommon case in which the sender doesn't have an account relationship with the receiving bank and doesn't settle through a Federal Reserve Bank. An example would be a customer that pays over the counter for a payment order that the customer issues to the receiving bank. Payment would normally be by cash, check or bank obligation. When payment occurs is determined by law outside Article 4A.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-404. Obligation of beneficiary's bank to pay and give notice to beneficiary.

(a) Subject to Sections 55-4A-211(e), 55-4A-405(d) and 55-4A-405(e) NMSA 1978, if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to be an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in Subsection (a) may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in Subsection (b) may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer.

History: 1978 Comp., § 55-4A-404, enacted by Laws 1992, ch. 114, § 225.

ANNOTATIONS

OFFICIAL COMMENT

1. The first sentence of subsection (a) states the time when the obligation of the beneficiary's bank arises. The second and third sentences state when the beneficiary's bank must make funds available to the beneficiary. They also state the measure of damages for failure, after demand, to comply. Since the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., also governs funds availability in a funds transfer, the second and third sentences of subsection (a) may be subject to preemption by that Act.

2. Subsection (a) provides that the beneficiary of an accepted payment order may recover consequential damages if the beneficiary's bank refuses to pay the order after demand by the beneficiary if the bank at that time had notice of the particular circumstances giving rise to the damages. Such damages are recoverable only to the extent the bank had "notice of the damages." The quoted phrase requires that the bank have notice of the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude. There is no requirement that the bank have notice of the exact or even the approximate amount of the damages, but if the amount of damages is extraordinary the bank is entitled to notice of that fact. For example, in Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), failure to complete a funds transfer of only $27,000 required to retain rights to a very favorable ship charter resulted in a claim for more than $2,000,000 of consequential damages. Since it is not reasonably foreseeable that a failure to make a relatively small payment will result in damages of this magnitude, notice is not sufficient if the beneficiary's bank has notice only that the $27,000 is necessary to retain rights on a ship charter. The bank is entitled to notice that an exceptional amount of damages will result as well. For example, there would be adequate notice if the bank had been made aware that damages of $1,000,000 or more might result.

3. Under the last clause of subsection (a) the beneficiary's bank is not liable for damages if its refusal to pay was "because of a reasonable doubt concerning the right of the beneficiary to payment." Normally there will not be any question about the right of the beneficiary to receive payment. Normally, the bank should be able to determine whether it has accepted the payment order and, if it has been accepted, the first sentence of subsection (a) states that the bank is obliged to pay. There may be uncommon cases, however, in which there is doubt whether acceptance occurred. For example, if acceptance is based on receipt of payment by the beneficiary's bank under Section 4A-403 (a)(1) or (2) [55-4A-403 NMSA 1978], there may be cases in which the bank is not certain that payment has been received. There may also be cases in which there is doubt about whether the person demanding payment is the person identified in the payment order as beneficiary of the order.

The last clause of subsection (a) does not apply to cases in which a funds transfer is being used to pay an obligation and a dispute arises between the originator and the beneficiary concerning whether the obligation is in fact owed. For example, the

originator may try to prevent payment to the beneficiary by the beneficiary's bank by alleging that the beneficiary is not entitled to payment because of fraud against the originator or a breach of contract relating to the obligation. The fraud or breach of contract claim of the originator may be grounds for recovery by the originator from the beneficiary after the beneficiary is paid, but it does not affect the obligation of the beneficiary's bank to pay the beneficiary. Unless the payment order has been cancelled pursuant to Section 4A-211(c) [55-4A-211 NMSA 1978], there is no excuse for refusing to pay the beneficiary and, in a proper case, the refusal may result in consequential damages. Except in the case of a book transfer, in which the beneficiary's bank is also the originator's bank, the originator of a funds transfer cannot cancel a payment order to the beneficiary's bank, with or without the consent of that bank, because the originator is not the sender of that order. Thus, the beneficiary's bank may safely ignore any instruction by the originator to withhold payment to the beneficiary.

4. Subsection (b) states the duty of the beneficiary's bank to notify the beneficiary of receipt of the order. If acceptance occurs under Section 4A-209(b)(1) [55-4A-209 NMSA 1978] the beneficiary is normally notified. Thus, subsection (b) applies primarily to cases in which acceptance occurs under Section 4A-209(b)(2) or (3) [55-4A-209 NMSA 1978]. Notice under subsection (b) is not required if the person entitled to the notice agrees or a funds transfer system rule provides that notice is not required and the beneficiary is given notice of the rule. In ACH transactions the normal practice is not to give notice to the beneficiary unless notice is requested by the beneficiary. This practice can be continued by adoption of a funds transfer system rule. Subsection (a) is not subject to variation by agreement or by a funds transfer system rule.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-405. Payment by beneficiary's bank to beneficiary.

(a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under Section 55-4A-404(a) NMSA 1978 occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under Section 55-4A-404(a) NMSA 1978 occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in Subsections (d) and (e), if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under Section 55-4A-406 NMSA 1978.

(e) This subsection applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under Section 55-4A-406 NMSA 1978, and (iv) subject to Section 55-4A-402(e) NMSA 1978, each sender in the funds transfer is excused from its obligation to pay its payment order under Section 55-4A-402(c) NMSA 1978 because the funds transfer has not been completed.

History: 1978 Comp., § 55-4A-405, enacted by Laws 1992, ch. 114, § 226.

ANNOTATIONS

OFFICIAL COMMENT

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under Section 4A-404 [55-4A-404 NMSA 1978] to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a)(i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a)(ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502 [55-4A-502 NMSA 1978].

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209 [55-4A-209 NMSA 1978], the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a) [55-4A-404 NMSA 1978], the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209) [55-4A-209 NMSA 1978], or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers are made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206 [55-4A-206 NMSA 1978]. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depositary bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes. Section 4A-405(d) [55-4A-405 NMSA 1978] allows the funds transfer system to adopt a rule making payments to beneficiaries provisional. If such a rule is adopted, a beneficiary's bank that releases funds to the beneficiary will be able to recover the payment if it doesn't receive payment of the payment order that it accepted. There are two requirements with respect to the funds transfer system rule. The beneficiary, the beneficiary's bank and the originator's bank must all agree to be bound by the rule and the rule must require that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated. There is no requirement that the notice be given with respect to a particular funds transfer. Once notice of the provisional nature of the payment has been given, the notice is effective for all subsequent payment to or from the person to whom the notice was given. Subsection (d) provides only that the funds transfer system rule must require notice to the beneficiary and the originator. The beneficiary's bank will know what the rule requires, but it has no way of knowing whether the originator's bank complied with the rule. Subsection (d) does not require proof that the originator received notice. If the originator's bank failed to give the required notice and the originator suffered as a result, the appropriate remedy is an action by the originator against the originator's bank based

on that failure. But the beneficiary's bank will not be able to get the benefit of subsection (d) unless the beneficiary had notice of the provisional nature of the payment because subsection (d) requires an agreement by the beneficiary to be bound by the rule. Implicit in an agreement to be bound by a rule that makes a payment provisional is a requirement that notice be given of what the rule provides. The notice can be part of the agreement or separately given. For example, notice can be given by providing a copy of the system's operating rules.

With respect to ACH transfers made through a Federal Reserve Bank acting as an intermediary bank, the Federal Reserve Bank is obliged under Section 4A-402(b) [55-4A-402 NMSA 1978] to pay a beneficiary's bank that accepts the payment order. Unlike Fedwire transfers, under current ACH practice a Federal Reserve Bank that processes a payment order does not obligate itself to pay if the originator's bank fails to pay the Federal Reserve Bank. It is assumed that the Federal Reserve will use its right of preemption which is recognized in Section 4A-107 [55-4A-107 NMSA 1978] to disclaim the Section 4A-402(b) [55-4A-402 NMSA 1978] obligation in ACH transactions if it decides to retain the provisional payment rule.

4. Subsection (e) is another exception to subsection (c). It refers to funds transfer systems having loss-sharing rules described in the subsection. CHIPS has proposed a rule that fits the description. Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to contribute funds to allow the system to settle for payment orders sent over the system during the day in the event that one or more banks are unable to meet their settlement obligations. Subsection (e) applies only if CHIPS fails to settle despite the loss-sharing rule. Since funds under the loss-sharing rule will be instantly available to CHIPS and will be in an amount sufficient to cover any failure that can be reasonably anticipated, it is extremely unlikely that CHIPS would ever fail to settle. Thus, subsection (e) addresses an event that should never occur. If that event were to occur, all payment orders made over the system would be cancelled under the CHIPS rule. Thus, no bank would receive settlement, whether or not a failed bank was involved in a particular funds transfer. Subsection (e) provides that each funds transfer in which there is a payment order with respect to which there is a settlement failure is unwound. Acceptance by the beneficiary's bank in each funds transfer is nullified. The consequences of nullification are that the beneficiary has no right to receive or retain payment by the beneficiary's bank, no payment is made by the originator to the beneficiary and each sender in the funds transfer is, subject to Section 4A-402(e) [55-4A-402 NMSA 1978], not obliged to pay its payment order and is entitled to refund under Section 4A-402(d) [55-4A-402 NMSA 1978] if it has already paid.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-406. Payment by originator to beneficiary; discharge of underlying obligation.

(a) Subject to Sections 55-4A-211(e), 55-4A-405(d) and 55-4A-405(e) NMSA 1978, the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at

the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under Subsection (a) is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under Subsection (a) was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract. If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under Section 55-4A-404(a) NMSA 1978.

(c) For the purpose of determining whether discharge of an obligation occurs under Subsection (b), if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary.

History: 1978 Comp., § 55-4A-406, enacted by Laws 1992, ch. 114, § 227.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states the fundamental rule of Article 4A that payment by the originator to the beneficiary is accomplished by providing to the beneficiary the obligation of the beneficiary's bank to pay. Since this obligation arises when the beneficiary's bank accepts a payment order, the originator pays the beneficiary at the time of acceptance and in the amount of the payment order accepted.

2. In a large percentage of funds transfers, the transfer is made to pay an obligation of the originator. Subsection (a) states that the beneficiary is paid by the originator when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. When that happens the effect under subsection (b) is to substitute the obligation of the beneficiary's bank for the obligation of the originator. The effect is similar to that under Article 3 if a cashier's check payable to the beneficiary had been taken by the

beneficiary. Normally, payment by funds transfer is sought by the beneficiary because it puts money into the hands of the beneficiary more quickly. As a practical matter the beneficiary and the originator will nearly always agree to the funds transfer in advance. Under subsection (b) acceptance by the beneficiary's bank will result in discharge of the obligation for which payment was made unless the beneficiary had made a contract with respect to the obligation which did not permit payment by the means used. Thus, if there is no contract of the beneficiary with respect to the means of payment of the obligation, acceptance by the beneficiary's bank of a payment order to the account of the beneficiary can result in discharge.

3. Suppose Beneficiary's contract stated that payment of an obligation owed by Originator was to be made by a cashier's check of Bank A. Instead Originator paid by a funds transfer to Beneficiary's account in Bank B. Bank B accepted a payment order for the benefit of Beneficiary by immediately notifying Beneficiary that the funds were available for withdrawal. Before Beneficiary had a reasonable opportunity to withdraw the funds Bank B suspended payments. Under the unless clause of subsection (b) Beneficiary is not required to accept the payment as discharging the obligation owed by Originator to Beneficiary if Beneficiary's contract means that Beneficiary was not required to accept payment by wire transfer. Beneficiary could refuse the funds transfer as payment of the obligation and could resort to rights under the underlying contract to enforce the obligation. The rationale is that Originator cannot impose the risk of Bank B's insolvency on Beneficiary if Beneficiary had specified another means of payment that did not entail that risk. If Beneficiary is required to accept Originator's payment, Beneficiary would suffer a loss that would not have occurred if payment had been made by a cashier's check on Bank A, and Bank A has not suspended payments. In this case Originator will have to pay twice. It is obliged to pay the amount of its payment order to the bank that accepted it and has to pay the obligation it owes to Beneficiary which has not been discharged. Under the last sentence of subsection (b) Originator is subrogated to Beneficiary's right to receive payment from Bank B under Section 4A-404(a) [55-4A-404 NMSA 1978].

4. Suppose Beneficiary's contract called for payment by a Fedwire transfer to Bank B, but the payment order accepted by Bank B was not a Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank B suspended payments. The sender of the payment order to Bank B paid the amount of the order to Bank B. In this case the payment order by Originator did not comply with Beneficiary's contract, but the noncompliance did not result in a loss to Beneficiary as required by subsection (b)(iv). A Fedwire transfer avoids the risk of insolvency of the sender of the payment order to Bank B, but it does not affect the risk that Bank B will suspend payments before withdrawal of the funds by Beneficiary. Thus, the unless clause of subsection (b) is not applicable and the obligation owed to Beneficiary is discharged.

5. Charges of receiving banks in a funds transfer normally are nominal in relationship to the amount being paid by the originator to the beneficiary. Wire transfers are normally agreed to in advance and the parties may agree concerning how these charges are to be divided between the parties. Subsection (c) states a rule that applies in the absence

of agreement. In some funds transfers charges of banks that execute payment orders are collected by deducting the charges from the amount of the payment order issued by the bank, i.e. the bank issues a payment order that is slightly less than the amount of the payment order that is being executed. The process is described in Comment 3 to Section 4A-302 [55-4A-302 NMSA 1978]. The result in such a case is that the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's order. Subsection (c) recognizes the principle that a beneficiary is entitled to full payment of a debt paid by wire transfer as a condition to discharge. On the other hand, subsection (c) prevents a beneficiary from denying the originator the benefit of the payment by asserting that discharge did not occur because deduction of bank charges resulted in less than full payment. The typical case is one in which the payment is made to exercise a valuable right such as an option which is unfavorable to the beneficiary. Subsection (c) allows discharge notwithstanding the deduction unless the originator fails to reimburse the beneficiary for the deducted charges after demand by the beneficiary.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

PART 5
MISCELLANEOUS PROVISIONS

55-4A-501. Variation by agreement and effect of funds-transfer system rule.

(a) Except as otherwise provided in this article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) "Funds-transfer system rule" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a federal reserve bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in Sections 55-4A-404(c), 55-4A-405(d) and 55-4A-507(c) NMSA 1978.

History: 1978 Comp., § 55-4A-501, enacted by Laws 1992, ch. 114, § 228.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is designed to give some flexibility to Article 4A. Funds transfer system rules govern rights and obligations between banks that use the system. They may cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank. Funds transfer system rules can be very effective in supplementing the provisions of Article 4A and in filling gaps that may be present in Article 4A. To the extent they do not conflict with Article 4A there is no problem with respect to their effectiveness. In that case they merely supplement Article 4A. Section 4A-501 [55-4A-501 NMSA 1978] goes further. It states that unless the contrary is stated, funds transfer system rules can override provisions of Article 4A. Thus, rights and obligations of a sender bank and a receiving bank with respect to each other can be different from that stated in Article 4A to the extent a funds transfer system rule applies. Since funds transfer system rules are defined as those governing the relationship between participating banks, a rule can have a direct effect only on participating banks. But a rule that affects the conduct of a participating bank may indirectly affect the rights of nonparticipants such as the originator or beneficiary of a funds transfer, and such a rule can be effective even though it may affect nonparticipants without their consent. For example, a rule might prevent execution of a payment order or might allow cancellation of a payment order with the result that a funds transfer is not completed or is delayed. But a rule purporting to define rights and obligations of nonparticipants in the system would not be effective to alter Article 4A rights because the rule is not within the definition of funds transfer system rule. Rights and obligations arising under Article 4A may also be varied by agreement of the affected parties, except to the extent Article 4A otherwise provides. Rights and obligations arising under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A-107 [55-4A-107 NMSA 1978].

2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH transfer is made through an automated clearing house of a Federal Reserve Bank or through an automated clearing house of another association of banks, the rights and obligations of the originator's bank and the beneficiary's bank are governed by uniform rules adopted by various associations of banks in various parts of the nation. With respect to transfers in which a Federal Reserve Bank acts as intermediary bank these rules may be incorporated, in whole or in part, in operating circulars of the Federal Reserve Bank. Even if not so incorporated these rules can still be binding on the association banks. If a transfer is made through a Federal Reserve Bank, the rules are effective under subsection (b)(ii). If the transfer is not made through a Federal Reserve Bank, the association rules are effective under subsection (b)(i).

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-502. Creditor process served on receiving bank; set-off by beneficiary's bank.

(a) As used in this section, "creditor process" means levy, attachment, garnishment, notice of lien, sequestration or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) the bank may credit the beneficiary's account; the amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account;

(2) the bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal; and

(3) if creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process.

History: 1978 Comp., § 55-4A-502, enacted by Laws 1992, ch. 114, § 229.

ANNOTATIONS

OFFICIAL COMMENT

1. When a receiving bank accepts a payment order, the bank normally receives payment from the sender by debiting an authorized account of the sender. In accepting the sender's order the bank may be relying on a credit balance in the account. If creditor process is served on the bank with respect to the account before the bank accepts the order but the bank employee responsible for the acceptance was not aware of the creditor process at the time the acceptance occurred, it is unjust to the bank to allow the creditor process to take the credit balance on which the bank may have relied.

Subsection (b) allows the bank to obtain payment from the sender's account in this case. Under that provision, the balance in the sender's account to which the creditor process applies is deemed to be reduced by the amount of the payment order unless there was sufficient time for notice of the service of creditor process to be received by personnel of the bank responsible for the acceptance.

2. Subsection (c) deals with payment orders issued to the beneficiary's bank. The bank may credit the beneficiary's account when the order is received, but under Section 4A-404(a) [55-4A-404 NMSA 1978] the bank incurs no obligation to pay the beneficiary until the order is accepted pursuant to Section 4A-209(b) [55-4A-209 NMSA 1978]. Thus, before acceptance, the credit to the beneficiary's account is provisional. But under Section 4A-209(b) [55-4A-209 NMSA 1978] acceptance occurs if the beneficiary's bank pays the beneficiary pursuant to Section 4A-405(a) [55-4A-405 NMSA 1978]. Under that provision, payment occurs if the credit to the beneficiary's account is applied to a debt of the beneficiary. Subsection (c)(1) allows the bank to credit the beneficiary's account with respect to a payment order and to accept the order by setting off the credit against an obligation owed to the bank or applying the credit to creditor process with respect to the account.

Suppose a beneficiary's bank receives a payment order for the benefit of a customer. Before the bank accepts the order, the bank learns that creditor process has been served on the bank with respect to the customer's account. Normally there is no reason for a beneficiary's bank to reject a payment order, but if the beneficiary's account is garnished, the bank may be faced with a difficult choice. If it rejects the order, the garnishing creditor's potential recovery of funds of the beneficiary is frustrated. It may be faced with a claim by the creditor that the rejection was a wrong to the creditor. If the bank accepts the order, the effect is to allow the creditor to seize funds of its customer, the beneficiary. Subsection (c)(3) gives the bank no choice in this case. It provides that it may not favor its customer over the creditor by rejecting the order. The beneficiary's bank may rightfully reject only if there is an independent basis for rejection.

3. Subsection (c)(2) is similar to subsection (b). Normally the beneficiary's bank will release funds to the beneficiary shortly after acceptance or it will accept by releasing funds. Since the bank is bound by a garnishment order served before funds are released to the beneficiary, the bank might suffer a loss if funds were released without knowledge that a garnishment order had been served. Subsection (c)(2) protects the bank if it did not have adequate notice of the garnishment when the funds were released.

4. A creditor may want to reach funds involved in a funds transfer. The creditor may try to do so by serving process on the originator's bank, an intermediary bank or the beneficiary's bank. The purpose of subsection (d) is to guide the creditor and the court as to the proper method of reaching the funds involved in a funds transfer. A creditor of the originator can levy on the account of the originator in the originator's bank before the funds transfer is initiated, but that levy is subject to the limitations stated in subsection (b). The creditor of the originator cannot reach any other funds because no property of

the originator is being transferred. A creditor of the beneficiary cannot levy on property of the originator and until the funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary, the beneficiary has no property interest in the funds transfer which the beneficiary's creditor can reach. A creditor of the beneficiary that wants to reach the funds to be received by the beneficiary must serve creditor process on the beneficiary's bank to reach the obligation of the beneficiary's bank to pay the beneficiary which arises upon acceptance by the beneficiary's bank under Section 4A-404(a) [55-4A-404 NMSA 1978].

5. "Creditor process" is defined in subsection (a) to cover a variety of devices by which a creditor of the holder of a bank account or a claimant to a bank account can seize the account. Procedure and nomenclature varies widely from state to state. The term used in Section 4A-502 [55-4A-502 NMSA 1978] is a generic term.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-503. Injunction or restraining order with respect to funds transfer.

For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order or otherwise acting with respect to a funds transfer.

History: 1978 Comp., § 55-4A-503, enacted by Laws 1992, ch. 114, § 230.

ANNOTATIONS

OFFICIAL COMMENT

This section is related to Section 4A-502(d) [55-4A-502 NMSA 1978] and to Comment 4 to Section 4A-502. It is designed to prevent interruption of a funds transfer after it has been set in motion. The initiation of a funds transfer can be prevented by enjoining the originator or the originator's bank from issuing a payment order. After the funds transfer is completed by acceptance of a payment order by the beneficiary's bank, that bank can be enjoined from releasing funds to the beneficiary or the beneficiary can be enjoined from withdrawing the funds. No other injunction is permitted. In particular, intermediary banks are protected, and injunctions against the originator and the originator's bank are limited to issuance of a payment order. Except for the beneficiary's bank, nobody can be enjoined from paying a payment order, and no receiving bank can be enjoined from receiving payment from the sender of the order that it accepted.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-504. Order in which items and payment orders may be charged to account; order of withdrawals from account.

(a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied.

History: 1978 Comp., § 55-4A-504, enacted by Laws 1992, ch. 114, § 231.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) concerns priority among various obligations that are to be paid from the same account. A customer may have written checks on its account with the receiving bank and may have issued one or more payment orders payable from the same account. If the account balance is not sufficient to cover all of the checks and payment orders, some checks may be dishonored and some payment orders may not be accepted. Although there is no concept of wrongful dishonor of a payment order in Article 4A in the absence of an agreement to honor by the receiving bank, some rights and obligations may depend on the amount in the customer's account. Section 4A-209(b)(3) and Section 4A-210(b) [55-4A-209 and 55-4A-210 NMSA 1978, respectively]. Whether dishonor of a check is wrongful also may depend upon the balance in the customer's account. Under subsection (a), the bank is not required to consider the competing items and payment orders in any particular order. Rather it may charge the customer's account for the various items and orders in any order. Suppose there is $12,000 in the customer's account. If a check for $5,000 is presented for payment and the bank receives a $10,000 payment order from the customer, the bank could dishonor the check and accept the payment order. Dishonor of the check is not wrongful because the account balance was less than the amount of the check after the bank charged the account $10,000 on account of the payment order. Or, the bank could pay the check and not execute the payment order because the amount of the order is not covered by the balance in the account.

2. Subsection (b) follows Section 4-208(b) [55-4-208 NMSA 1978] in using the first-in-first-out rule for determining the order in which credits to an account are withdrawn.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-505. Preclusion of objection to debit of customer's account.

If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer.

History: 1978 Comp., § 55-4A-505, enacted by Laws 1992, ch. 114, § 232.

ANNOTATIONS

OFFICIAL COMMENT

This section is in the nature of a statute of repose for objecting to debits made to the customer's account. A receiving bank that executes payment orders of a customer may have received payment from the customer by debiting the customer's account with respect to a payment order that the customer was not required to pay. For example, the payment order may not have been authorized or verified pursuant to Section 4A-202 [55-4A-202 NMSA 1978] or the funds transfer may not have been completed. In either case the receiving bank is obliged to refund the payment to the customer and this obligation to refund payment cannot be varied by agreement. Section 4A-204 and Section 4A-402 [55-4A-204 and 55-4A-402 NMSA 1978, respectively]. Refund may also be required if the receiving bank is not entitled to payment from the customer because the bank erroneously executed a payment order. Section 4A-303 [55-4A-303 NMSA 1978]. A similar analysis applies to that case. Section 4A-402(d) and (f) [55-4A-202 NMSA 1978] require refund and the obligation to refund may not be varied by agreement. Under 4A-505 [55-4A-505 NMSA 1978], however, the obligation to refund may not be asserted by the customer if the customer has not objected to the debiting of the account within one year after the customer received notification of the debit.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-506. Rate of interest.

(a) If, under this article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in Subsection (a), the amount is calculated by multiplying the applicable federal funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable federal funds rate is the average of the federal funds rates published by the federal reserve bank of New York for each of the days for which interest is payable divided by three hundred sixty. The federal funds rate for any day on which a published rate is not available is the same as

the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank.

History: 1978 Comp., § 55-4A-506, enacted by Laws 1992, ch. 114, § 233.

ANNOTATIONS

OFFICIAL COMMENT

1. A receiving bank is required to pay interest on the amount of a payment order received by the bank in a number of situations. Sometimes the interest is payable to the sender and in other cases it is payable to either the originator or the beneficiary of the funds transfer. The relevant provisions are Section 4A-204(a), Section 4A-209(b)(3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section 4A-404(b) [55-4A-204, 55-4A-209, 55-4A-210, 55-4A-305, 55-4A-402 and 55-4A-404 NMSA 1978, respectively]. The rate of interest may be governed by a funds transfer system rule or by agreement as stated in subsection (a). If subsection (a) doesn't apply, the rate is determined under subsection (b). Subsection (b) is illustrated by the following example. A bank is obliged to pay interest on $1,000,000 for three days, July 3, July 4, and July 5. The published Fed Funds rate is .082 for July 3 and .081 for July 5. There is no published rate for July 4 because that day is not a banking day. The rate for July 3 applies to July 4. The applicable Fed Funds rate is .08167 (the average of .082, .082, and .081) divided by 360 which equals .0002268. The amount of interest payable is $1,000,000 X .0002268 X 3 = $680.40.

2. In some cases, interest is payable in spite of the fact that there is no fault by the receiving bank. The last sentence of subsection (b) applies to those cases. For example, a funds transfer might not be completed because the beneficiary's bank rejected the payment order issued to it by the originator's bank or an intermediary bank. Section 4A-402(c) [55-4A-402 NMSA 1978] provides that the originator is not obliged to pay its payment order and Section 4A-402(d) [55-4A-402 NMSA 1978] provides that the originator's bank must refund any payment received plus interest. The requirement to pay interest in this case is not based on fault by the originator's bank. Rather, it is based on restitution. Since the orginator's bank had the use of the originator's money, it is required to pay the originator for the value of that use. The value of that use is not determined by multiplying the interest rate by the refundable amount because the originator's bank is required to deposit with the Federal Reserve a percentage of the bank's deposits as a reserve requirement. Since that deposit does not bear interest, the bank had use of the refundable amount reduced by a percentage equal to the reserve requirement. If the reserve requirement is 12%, the amount of interest payable by the bank under the formula stated in subsection (b) is reduced by 12%.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

55-4A-507. Choice of law.

(a) The following rules apply unless the affected parties otherwise agree or Subsection (c) applies:

(1) the rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located;

(2) the rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located; and

(3) the issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of Subsection (a) have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to Clause (i) is binding on participating banks. A choice of law made pursuant to Clause (ii) is binding on the originator, other sender or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under Subsection (b) and a choice-of-law rule under Subsection (c), the agreement under Subsection (b) prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue.

History: 1978 Comp., § 55-4A-507, enacted by Laws 1992, ch. 114, § 234.

ANNOTATIONS

OFFICIAL COMMENT

1. Funds transfers are typically interstate or international in character. If part of a funds transfer is governed by Article 4A and another part is governed by other law, the rights and obligations of parties to the funds transfer may be unclear because there is no clear consensus in various jurisdictions concerning the juridical nature of the transaction. Unless all of a funds transfer is governed by a single law it may be very difficult to predict the result if something goes wrong in the transfer. Section 4A-507 [55-4A-507 NMSA 1978] deals with this problem. Subsection (b) allows parties to a funds transfer to make a choice-of-law agreement. Subsection (c) allows a funds transfer system to select the law of a particular jurisdiction to govern funds transfers carried out by means of the system. Subsection (a) states residual rules if no choice of law has occurred under subsection (b) or (c).

2. Subsection (a) deals with three sets of relationships. Rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located. If the receiving bank is the beneficiary's bank the rights and obligations of the beneficiary are also governed by the law of the jurisdiction in which the receiving bank is located. Suppose Originator, located in Canada, sends a payment order to Originator's Bank located in a state in which Article 4A has been enacted. The order is for payment to an account of Beneficiary in a bank in England. Under subsection (a)(1), the rights and obligations of Originator and Originator's Bank toward each other are governed by Article 4A if an action is brought in a court in the Article 4A state. If an action is brought in a Canadian court, the conflict of laws issue will be determined by Canadian law which might or might not apply the law of the state in which Originator's Bank is located. If that law is applied, the execution of Originator's order will be governed by Article 4A, but with respect to the payment order of Originator's Bank to the English bank, Article 4A may or may not be applied with respect to the rights and obligations between the two banks. The result may depend upon whether action is brought in a court in the state in which Originator's Bank is located or in an English court. Article 4A is binding only on a court in a state that enacts it. It can have extraterritorial effect only to the extent courts of another jurisdiction are willing to apply it. Subsection (c) also bears on the issues discussed in this Comment.

Under Section 4A-406 [55-4A-406 NMSA 1978] payment by the originator to the beneficiary of the funds transfer occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. A jurisdiction in which Article 4A is not in effect may follow a different rule or it may not have a clear rule. Under Section 4A-507(a)(3) [55-4A-507 NMSA 1978] the issue is governed by the law of the jurisdiction in which the beneficiary's bank is located. Since the payment to the beneficiary is made through the beneficiary's bank it is reasonable that the issue of when payment occurs be governed by the law of the jurisdiction in which the bank is located. Since it is difficult in many

cases to determine where a beneficiary is located, the location of the beneficiary's bank provides a more certain rule.

3. Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties. With respect to commercial transactions, it is often said that "[u]niformity and predictability based upon commercial convenience are the prime considerations in making the choice of governing law ...." R. Leflar, American Conflicts Law, § 185 (1977). Subsection (b) is derived in part from recently enacted choice-of-law rules in the States of New York and California. N.Y. Gen. Obligations Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code § 1646.5. This broad endorsement of freedom of contract is an enhancement of the approach taken by Restatement (Second) of Conflict of Laws § 187(b) (1971). The Restatement recognizes the basic right of freedom of contract, but the freedom granted the parties may be more limited than the freedom granted here. Under the formulation of the Restatement, if there is no substantial relationship to the jurisdiction whose law is selected and there is no "other" reasonable basis for the parties' choice, then the selection of the parties need not be honored by a court. Further, if the choice is violative of a fundamental policy of a state which has a materially greater interest than the chosen state, the selection could be disregarded by a court. Those limitations are not found in subsection (b).

4. Subsection (c) may be the most important provision in regard to creating uniformity of law in funds transfers. Most rights stated in Article 4A regard parties who are in privity of contract such as originator and beneficiary, sender and receiving bank, and beneficiary's bank and beneficiary. Since they are in privity they can make a choice of law by agreement. But that is not always the case. For example, an intermediary bank that improperly executes a payment order is not in privity with either the originator or the beneficiary. The ability of a funds transfer system to make a choice of law by rule is a convenient way of dispensing with individual agreements and to cover cases in which agreements are not feasible. It is probable that funds transfer systems will adopt a governing law to increase the certainty of commercial transactions that are effected over such systems. A system rule might adopt the law of an Article 4A state to govern transfers on the system in order to provide a consistent, unitary, law governing all transfers made on the system. To the extent such system rules develop, individual choice-of-law agreements become unnecessary.

Subsection (c) has broad application. A system choice of law applies not only to rights and obligations between banks that use the system, but may also apply to other parties to the funds transfer so long as some part of the transfer was carried out over the system. The originator and any other sender or receiving bank in the funds transfer is bound if at the time it issues or accepts a payment order it had notice that the funds transfer involved use of the system and that the system chose the law of a particular jurisdiction. Under Section 4A-107 [55-4A-107 NMSA 1978], the Federal Reserve by regulation could make a similar choice of law to govern funds transfers carried out by

use of Federal Reserve Banks. Subsection (d) is a limitation on subsection (c). If parties have made a choice-of-law agreement that conflicts with a choice of law made under subsection (c), the agreement prevails.

5. Subsection (e) addresses the case in which a funds transfer involves more than one funds transfer system and the systems adopt conflicting choice-of-law rules. The rule that has the most significant relationship to the matter at issue prevails. For example, each system should be able to make a choice of law governing payment orders transmitted over that system without regard to a choice of law made by another system.

Effective dates. - Laws 1992, ch. 114, § 238 makes the act effective on July 1, 1992.

ARTICLE 5
LETTERS OF CREDIT

55-5-101. Short title.

Chapter 55, Article 5 NMSA 1978 may be cited as [the] "Uniform Commercial Code - Letters of Credit".

History: 1978 Comp., § 55-5-101, enacted by Laws 1997, ch. 75, § 3.

ANNOTATIONS

OFFICIAL COMMENT

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile,

or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5, but in certain circumstances they will override Article 5.

Repeals and reenactments. - Laws 1997, ch. 75, § 3 repeals 55-5-101 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-101, and enacts the above section, effective July 1, 1997. For present provisions of former section, see 1993 Replacement Pamphlet.

Bracketed material. - The bracketed word "the" in this section was inserted by the compiler; it was not enacted by the legislature and is not a part of the law.

Applicability. - Laws 1997, ch. 75, § 27 makes the provisions of the act applicable to a letter of credit that is issued on or after July 1, 1997.

Saving clauses. - Laws 1997, ch. 75, § 26, provides that a transaction arising out of or associated with a letter of credit that was issued before the effective date of that act and the rights, obligations and interests flowing from that transaction are governed by any statute or other law amended or repealed by that act as if repeal or amendment had not

occurred and may be terminated, completed, consummated or enforced under that statute or other law.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 1 et seq.

55-5-102. Definitions.

(a) In this article:

(1) "adviser" means a person who, at the request of the issuer, a confirmer or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed or amended;

(2) "applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer;

(3) "beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit;

(4) "confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another;

(5) "dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit;

(6) "document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 55-5-108(e) NMSA 1978 and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral;

(7) "good faith" means honesty in fact in the conduct or transaction concerned;

(8) "honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs:

(i) upon payment;

(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or;

(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance;

(9) "issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family or household purposes;

(10) "letter of credit" means a definite undertaking that satisfies the requirements of Section 55-5-104 NMSA 1978 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value;

(11) "nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse;

(12) "presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit;

(13) "presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person;

(14) "record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form; and

(15) "successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator and receiver.

(b) Definitions in other articles applying to this article and the sections in which they appear are:

"accept" or "acceptance" ....Section 55-3-409 NMSA 1978
"value" ....Sections 55-3-303 and 55-4-211 NMSA 1978.

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

History: 1978 Comp., § 55-5-102, enacted by Laws 1997, ch. 75, § 4.

ANNOTATIONS

OFFICIAL COMMENT

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmer" for its own account or as guarantees or contracts outside of Article 5.

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition - which does not include "fair dealing" - is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and issuers with an "unfairness" defense to dishonor even when the

documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d)) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(c)) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking" as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot be an issuer where that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See

Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank, 493 F.2d 1285 (9th Cir. 1974).

The adjective "definite" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., Transparent Products Corp. v. Paysaver Credit Union, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit," but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the "successor of a beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is "by operation of law" - such as the sale of assets by one company to another.

11. "Draft" in Article 5 does not have the same meaning it has in Article 3. For example, a document may be a draft under Article 5 even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e).

Repeals and reenactments. - Laws 1997, ch. 75, § 4 repeals 55-5-102 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-102, relating to scope, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 3 et seq.

What constitutes letter of credit, 30 A.L.R. 1310.

What is a letter of credit under UCC §§ 5-102, 5-103, 44 A.L.R.4th 172.

82 C.J.S. Statutes § 315.

55-5-103. Scope.

(a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, Subsections (a) and (d) of this section, Sections 55-5-102(a)(9) and (10) NMSA 1978, Section 55-5-106(d) NMSA 1978 and Section 55-5-114(d) NMSA 1978, and except to the extent prohibited in Section 55-1-102(3) NMSA 1978 and Section 55-5-117(d) NMSA 1978, the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

History: 1978 Comp., § 55-5-103, enacted by Laws 1997, ch. 75, § 5.

ANNOTATIONS

OFFICIAL COMMENT

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into

letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(3) and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not

"strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

Repeals and reenactments. - Laws 1997, ch. 75, § 5 repeals 55-5-103 NMSA 1978, as amended by Laws 1993, ch. 214, § 4, providing definitions, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 1 et seq.

Construction and effect of U.C.C. Article 5, dealing with letters of credit, 35 A.L.R.3d 1404, 8 A.L.R.5th 463, 13 A.L.R.5th 465.

What is a letter of credit under UCC §§ 5-102, 5-103, 44 A.L.R.4th 172.

55-5-104. Formal requirements.

A letter of credit, confirmation, advice, transfer, amendment or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 55-5-108(e) NMSA 1978.

History: 1978 Comp., § 55-5-104, enacted by Laws 1997, ch. 75, § 6.

ANNOTATIONS

OFFICIAL COMMENT

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser.

An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

Repeals and reenactments. - Laws 1997, ch. 75, § 6 repeals 55-5-104 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-104, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards §§ 8, 14.

55-5-105. Consideration.

Consideration is not required to issue, amend, transfer or cancel a letter of credit, advice or confirmation.

History: 1978 Comp., § 55-5-105, enacted by Laws 1997, ch. 75, § 7.

ANNOTATIONS

OFFICIAL COMMENT

It is not to be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in Pillans v. Van Mierop, 97 Eng.Rep. 1035 (K.B. 1765) in making consideration irrelevant.

Repeals and reenactments. - Laws 1997, ch. 75, § 7 repeals 55-5-105 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-105, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 16.

55-5-106. Issuance, amendment, cancellation and duration.

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

History: 1978 Comp., § 55-5-106, enacted by Laws 1997, ch. 75, § 8.

ANNOTATIONS

OFFICIAL COMMENT

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., Weyerhaeuser Co. v. First Nat. Bank, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); West Va. Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."

Repeals and reenactments. - Laws 1997, ch. 75, § 8 repeals 55-5-106 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-106, relating to time and effect of establishment of credit,and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-107. Confirmer, nominated person and adviser.

(a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment or advice has the rights and obligations of an adviser under Subsection (c) of this section. The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment or advice received by the person who so notifies.

History: 1978 Comp., § 55-5-107, enacted by Laws 1997, ch. 75, § 9.

ANNOTATIONS

OFFICIAL COMMENT

1. A confirmer has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms "confirmer" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of Sound of Market Street v. Continental Bank International, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to

the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

Repeals and reenactments. - Laws 1997, ch. 75, § 9 repeals 55-5-107 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-107, relating to advice of credit, confirmation, and error in statement of terms, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-108. Issuer's rights and obligations.

(a) Except as otherwise provided in Section 55-5-109 NMSA 1978, an issuer shall honor a presentation that, as determined by the standard practice referred to in Subsection (e) of this section, appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 55-5-113 NMSA 1978 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) to honor;

(2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation; or

(3) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in Subsection (d) of this section, an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in Subsection (b) of this section or to mention fraud, forgery or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor, fraud or forgery as described in Section 55-5-109(a) NMSA 1978, or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement or transaction;

(2) an act or omission of others; or

(3) observance or knowledge of the usage of a particular trade other than the standard practice referred to in Subsection (e) of this section.

(g) If an undertaking constituting a letter of credit under Section 55-5-102(a)(10) NMSA 1978 contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) takes the documents free of claims of the beneficiary or presenter;

(3) is precluded from asserting a right of recourse on a draft under Sections 55-3-414 and 55-3-415 NMSA 1978;

(4) except as otherwise provided in Sections 55-5-110 and 55-5-117 NMSA 1978, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

History: 1978 Comp., § 55-5-108, enacted by Laws 1997, ch. 75, § 10.

ANNOTATIONS

OFFICIAL COMMENT

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person

to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in Banco Espanol de Credito v. State Street Bank and Trust Company, 385 F.2d 230 (1st Cir. 1967) and Flagship Cruises Ltd. v. New England Merchants Nat. Bank, 569 F.2d 699 (1st Cir. 1978). Strict compliance does not means lavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in New Braunfels Nat. Bank v. Odiorne, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on "Letter of Credit No. 86-122-5" and letter of credit specified "Letter of Credit No. 86-122-S" holding strict compliance does not demand oppressive perfectionism). The section also indorses the result in Tosco Corp. v. Federal Deposit Insurance Corp., 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105. "The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as American Coleman Co. v. Intrawest Bank, 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-103(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time would be less than seven days. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111, irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106.

The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made. Failure of the

issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in Flagship Cruises Ltd. v. New England Merchants' Nat. Bank, 569 F.2d 699 (1st Cir. 1978) and Wing On Bank Ltd. v. American Nat. Bank & Trust Co., 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice. Assume for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of Flagship and Wing On, the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as Datapoint Corp. v. M & I Bank, 665 F. Supp. 722 (W.D. Wis. 1987) and Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank, 710 F. Supp. 275 (D. Ore. 1989).

The section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor

need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank," or as an "acceptor" or "accepting bank," in other cases as a "negotiating bank," and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated person or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law. A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of Courtaulds of North America Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in Schweibish v. Pontchartrain State Bank, 389 So.2d 731 (La.App. 1980) and Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4).

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination.

Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like Pringle-Associated Mortgage Corp. v. Southern National Bank, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as Sherwood & Roberts, Inc. v. First Security Bank, 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting "shipment on vessels more than 15 years old," are to be disregarded and treated as surplusage. Similarly, a requirement that there be an award by a "duly appointed arbitrator" would not require the issuer to determine whether the arbitrator had been "duly appointed." Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) condones an issuer's ignorance of "any usage of a particular trade"; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a).

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

Repeals and reenactments. - Laws 1997, ch. 75, § 10 repeals 55-5-108 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-108, relating to notation credit and exhaustion of credit, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 35 et seq.

Construction of provision for letter of credit in contract of sale, 38 A.L.R. 608.

9 C.J.S. Banks and Banking § 174 et seq.

55-5-109. Fraud and forgery.

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this state have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under Subsection (a)(1) of this section.

History: 1978 Comp., § 55-5-109, enacted by Laws 1997, ch. 75, § 11.

ANNOTATIONS

OFFICIAL COMMENT

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See Cromwell v. Commerce & Energy Bank, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in Intraworld Indus. v. Girard Trust Bank, 336 A.2d 316 (Pa. 1975), Roman Ceramics Corp. v. People's Nat. Bank, 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in Ground Air Transfer v. Westate's Airlines, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also

explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," Itek, 730 F.2d at 25 (quoting Roman Ceramics Corp. v. Peoples National Bank, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); then a court may enjoin payment.

2. Subsection (a)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in Griffin Cos. v. First Nat. Bank, 374 N.W.2d 768 (Minn.App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8)) in the particular letter of credit to occur upon acceptance and without regard to later

payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance - whether or not the acceptance constitutes honor.

5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see Ground Air Transfer Inc. v. Westates Airlines, Inc., 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against - by bond or otherwise under subsection (b)(2) - includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

Repeals and reenactments. - Laws 1997, ch. 75, § 11 repeals 55-5-109 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-109, relating to an issuer's obligation to its customer, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-110. Warranties.

(a) If its presentation is honored, the beneficiary warrants:

(1) to the issuer, any other person to whom presentation is made and the applicant that there is no fraud or forgery of the kind described in Section 55-5-109(a) NMSA 1978; and

(2) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in Subsection (a) of this section are in addition to warranties arising under Articles 3, 4, 7 and 8 because of the presentation or transfer of documents covered by any of those articles.

History: 1978 Comp., § 55-5-110, enacted by Laws 1997, ch. 75, § 12.

ANNOTATIONS

OFFICIAL COMMENT

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due performance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases - where the damages usually equal the amount of the draw - the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a default of $200,000 and a

draw of $500,000. The damages for breach of warranty would be no more than $300,000.

Repeals and reenactments. - Laws 1997, ch. 75, § 12 repeals 55-5-110 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-110, relating to availability of credit in portions and presenter's reservation of lien or claim, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-111. Remedies.

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation, the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in Subsection (a) or (b) of this section, a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and Subsections (a) and (b) of this section.

(d) An issuer, nominated person or adviser who is found liable under Subsection (a), (b) or (c) of this section shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

History: 1978 Comp., § 55-5-111, enacted by Laws 1997, ch. 75, § 13.

ANNOTATIONS

OFFICIAL COMMENT

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages - at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. Doelger v. Battery Park Bank, 201 A.D. 515, 194 N.Y.S. 582 (1922) and Decorby Nikkei Int'l, Inc. v. Federal Republic of Nigeria, 497 F. Supp. 893 (S.D.N.Y. 1980), aff'd, 647 F.2d 300 (2d Cir. 1981), cert. denied, 454 U.S. 1148 (1982). The last sentence of subsection (c) does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107.

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. What damages "result" from improper honor is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at $100 per ton, but, upon delivery, the market value of conforming goods has decreased to $25 per ton. If the issuer pays over discrepancies, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $100 per ton for goods now worth $25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a). On the other hand a confirming bank that broke its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-111. Neither an issuer nor a confirmer should be treated as a "losing" party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly neither should be liable for fees and expenses in that case.

"Expenses of litigation" is intended to be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) "harm anticipated" must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504.

Repeals and reenactments. - Laws 1997, ch. 75, § 13 repeals 55-5-111 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-111, relating to warranties on transfer and presentment, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 50 Am. Jur. 2d Letters of Credit and Credit Cards § 75 et seq.

Dishonor of draft issued under letter of credit, rights and remedies of holder, 53 A.L.R. 57.

Damages recoverable for wrongful dishonor of letter of credit under UCC § 5-115, 2 A.L.R.4th 665.

9 C.J.S. Banks and Banking § 178 et seq.

55-5-112. Transfer of letter of credit.

(a) Except as otherwise provided in Section 55-5-113 NMSA 1978, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or

(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in Section 55-5-108(e) NMSA 1978 or is otherwise reasonable under the circumstances.

History: 1978 Comp., § 55-5-112, enacted by Laws 1997, ch. 75, § 14.

ANNOTATIONS

OFFICIAL COMMENT

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP (which make elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit

are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

" Transfer" of a letter of credit should be distinguished from "assignment of proceeds." The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit which is not qualified or limited, the applicant may lose control over the identity of the person whose performance will earn payment under the letter of credit.

Repeals and reenactments. - Laws 1997, ch. 75, § 14 repeals 55-5-112 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-112, relating to time allowed for honor and rejection and withholding honor or rejection by consent, and defining "presenter", and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-113. Transfer by operation of law.

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in Subsection (e) of this section, an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in Section 55-5-108(e) NMSA 1978 or, in the absence of

such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under Subsection (a) or (b) of this section has the consequences specified in Section 55-5-108(i) NMSA 1978 even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 55-5-109 NMSA 1978.

(e) An issuer whose rights of reimbursement are not covered by Subsection (d) of this section or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under Subsection (b) of this section.

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

History: 1978 Comp., § 55-5-113, enacted by Laws 1997, ch. 75, § 15.

ANNOTATIONS

OFFICIAL COMMENT

This section affirms the result in Pastor v. Nat. Republic Bank of Chicago, 76 Ill.2d 139, 390 N.E.2d 894 (Ill. 1979) and Federal Deposit Insurance Co. v. Bank of Boulder, 911 F.2d 1466(10th Cir. 1990).

An issuer's requirements for recognition of a successor's status might include presentation of a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of a beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

Repeals and reenactments. - Laws 1997, ch. 75, § 15 repeals 55-5-113 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-113, relating to indemnities, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-114. Assignment of proceeds.

(a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

History: 1978 Comp., § 55-5-114, enacted by Laws 1997, ch. 75, § 16.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (b) expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage - "assignment of proceeds" - to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a

security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "'proceeds' of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds of a letter of credit, subsections (c) and (d) follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has been received, issuers normally have required signatures on a consent form. This practice is reflected in the revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e), to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

Repeals and reenactments. - Laws 1997, ch. 75, § 16 repeals 55-5-114 NMSA 1978, as amended by Laws 1996, ch. 47, § 4, relating to insurer's duty and privilege to honor and right to reimbursement, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1996 Cumulative Supplement.

55-5-115. Statute of limitations.

An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after

the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

History: 1978 Comp., § 55-5-115, enacted by Laws 1997, ch. 75, § 17.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is based upon Sections 4-111 and 2-725(2).

2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this article, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).

3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

Repeals and reenactments. - Laws 1997, ch. 75, § 17 repeals 55-5-115 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-115, relating to remedy for improper dishonor or anticipatory repudiation, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-116. Choice of law and forum.

(a) The liability of an issuer, nominated person or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 55-5-104 NMSA 1978 or by a provision in the person's letter of credit, confirmation or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless Subsection (a) of this section applies, the liability of an issuer, nominated person or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was

issued. For the purpose of jurisdiction, choice of law and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities, and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under Subsection (a) or (b) of this section, (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 55-5-103(c) NMSA 1978.

(d) If there is conflict between this article and Article 3, 4, 4A or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with Subsection (a) of this section.

History: 1978 Comp., § 55-5-116, enacted by Laws 1997, ch. 75, § 18.

ANNOTATIONS

OFFICIAL COMMENT

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law - in the absence of agreement - even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the States of the United States renvoi will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the "liability of an applicant." However, subsection (b) does state a choice of law rule for the liability of an issuer,

nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the "liability of an issuer, nominated person, or adviser," subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized - at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a practice provision purported to free a party from any liability unless it were "grossly negligent" or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

Even though Article 5 is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5's revision, or with other practices that may develop. Rules of practice incorporated in the letter of credit or other undertaking are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. For example, "draft" is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of

reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4.

5. Subsection (e) must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not including letter of credit disputes, subsection (e) does not authorize parties to choose that forum. For example, the parties' agreement under Section 5-116(e) would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) and if - because of other law - that forum will not take jurisdiction, the parties' agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for the clause will take jurisdiction - the former in disregard of the clause and the latter in honor of the clause.

Repeals and reenactments. - Laws 1997, ch. 75, § 18 repeals 55-5-116 NMSA 1978, as amended by Laws 1985, ch. 193, § 4, relating to transfer and assignment, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

55-5-117. Subrogation of issuer, applicant and nominated person.

(a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in Subsection (a) of this section.

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) the applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in Subsections (a) and (b) of this section do not arise until the issuer honors the letter of credit or otherwise pays, and the rights in Subsection (c) of this section do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense or excuse.

History: 1978 Comp., § 55-5-117, enacted by Laws 1997, ch. 75, § 19.

ANNOTATIONS

OFFICIAL COMMENT

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation "were a secondary obligor." (The term "secondary obligor" refers to a surety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995).) If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are "independent" of the underlying obligation. If, for example, a secondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in Tudor Development Group, Inc. v. United States Fidelity and Guaranty, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.

Repeals and reenactments. - Laws 1997, ch. 75, § 19 repeals 55-5-117 NMSA 1978, as enacted by Laws 1961, ch. 96, § 5-117, relating to insolvency of bank holding funds for documentary credit, and enacts the above section, effective July 1, 1997. For provisions of former section, see 1993 Replacement Pamphlet.

ARTICLE 6
BULK TRANSFERS

(Repealed by Laws 1992, ch. 114, § 237C.)

55-6-101 to 55-6-110. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237C repeals 55-6-101 to 55-6-110 NMSA 1978, as enacted by Laws 1961, ch. 96, §§ 6-101 to 6-110, relating to bulk transfers, effective July 1, 1992. For former provisions, see Original Pamphlet.

ARTICLE 7
WAREHOUSE RECEIPTS, BILLS OF LADING AND OTHER DOCUMENTS OF TITLE

Part 1

General.

Part 2

Warehouse Receipts; Special Provisions.

Part 3

Bills of Lading; Special Provisions.

Part 4

Warehouse Receipts and Bills of Lading; General Obligations.

Part 5

Warehouse Receipts and Bills of Lading; Negotiation and Transfer.

Part 6

Warehouse Receipts and Bills of Lading; Miscellaneous Provisions.

Part 7

Warehouse Receipts; Special Penalty Provisions.

Part 8

Bills of Lading; Special Penalty Provisions.

PART 1 GENERAL

55-7-101. Short title.

This article shall be known and may be cited as Uniform Commercial Code - Documents of Title.

History: 1953 Comp., § 50A-7-101, enacted by Laws 1961, ch. 96, § 7-101.

ANNOTATIONS

OFFICIAL COMMENT

This article is a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraces also the provisions of the Uniform Sales Act relating to negotiation of documents of title.

The only substantial omissions of material covered in the previous uniform acts are the criminal provisions found in the Warehouse Receipts and Bills of Lading acts. These criminal provisions are inappropriate to a commercial code, and for the most part duplicate portions of the ordinary criminal law relating to frauds.

The article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damage or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties and in some cases regulatory state laws, which supersede the provisions of this article in case of inconsistency. See Section 7-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 1 et seq.; 78 Am. Jur. 2d Warehouses § 1 et seq.

Construction and effect of U.C.C., art. 7, dealing with warehouse receipts, bills of lading and other documents of title, 21 A.L.R.3d 1339.

13 C.J.S. Carriers §§ 446, 447; 80 C.J.S. Shipping §§ 111 to 114; 93 C.J.S. Warehousemen and Safe Depositaries § 1 et seq.

55-7-102. Definitions and index of definitions.

(1) In this article, unless the context otherwise requires:

(a) "bailee" means the person who by a warehouse receipt, bill of lading or other document of title acknowledges possession of goods and contracts to deliver them;

(b) "consignee" means the person named in a bill to whom or to whose order the bill promises delivery;

(c) "consignor" means the person named in a bill as the person from whom the goods have been received for shipment;

(d) "delivery order" means a written order to deliver goods directed to a warehouseman, carrier or other person who in the ordinary course of business issues warehouse receipts or bills of lading;

(e) "document" means document of title as defined in the general definitions in Article 1 (Section 1-201 [55-1-201 NMSA 1978]);

(f) "goods" means all things which are treated as movable for the purposes of a contract of storage or transportation;

(g) "issuer" means a bailee who issues a document except that in relation to an unaccepted delivery order it means the person who orders the possessor of goods to deliver. Issuer includes any person for whom an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, notwithstanding that the issuer received no goods or that the goods were misdescribed or that in any other respect the agent or employee violated his instructions;

(h) "warehouseman" is a person engaged in the business of storing goods for hire.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"duly negotiate." Section 7-501 [55-7-501 NMSA 1978];

"person entitled under the document." Section 7-403(4) [55-7-403(4) NMSA 1978].

(3) Definitions in other articles applying to this article and the sections in which they appear are:

"contract for sale." Section 2-106 [55-2-106 NMSA 1978];

"overseas." Section 2-323 [55-2-323 NMSA 1978];

"receipt" of goods. Section 2-103 [55-2-103 NMSA 1978].

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

History: 1953 Comp., § 50A-7-102, enacted by Laws 1961, ch. 96, § 7-102.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Sections 1 and 53, Uniform Bills of Lading Act.

Changes. Applicable definitions from the uniform acts have been consolidated and revised and definition of delivery order is new.

Purposes of changes and new matter. - 1. "Bailee" was not defined in the old uniform acts. It is used in this article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when he does not have it he is bound by sections of this article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and Sections 7-203 and 7-301 on liability in case of non-receipt.)

2. The definition of warehouse receipt contained in the general definitions section of this act (Section 1-201) eliminates the requirement of the Uniform Warehouse Receipts Act that the issuing warehouseman be "lawfully engaged" in business. The warehouseman's compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this article. Certainly the issuer's violations of law should not diminish his responsibility on documents he has put in commercial circulation. The Uniform Warehouse Receipts Act requirement that the warehouseman be engaged "for profit" has also been eliminated in view of the existence of state operated and co-operative warehouses. But it is still essential that the business be storing goods "for hire" (Section 1-201 and this section). A person does not become a warehouseman by storing his own goods.

3. Delivery orders, which were included without qualification in the Uniform Sales Act definition of document of title, must be treated differently in this consolidation of provisions from the three uniform acts. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the

ordinary obligation of contract which the bailee may have assumed to the depositor of the goods.

Cross references. - Point 1: Section 7-203 and 7-301.

Point 2: Sections 1-201 and 7-203.

See general comment to document of title in Section 1-201.

Definitional cross references. - "Bill of lading". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.

"Warehouse receipt". Section 1-201.

"Written". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 39, 49; 78 Am. Jur. 2d Warehouses §§ 2, 41, 52.

80 C.J.S. Shipping §§ 111 to 114; 82 C.J.S. Statutes § 315; 93 C.J.S. Warehousemen and Safe Depositaries §§ 1, 16.

55-7-103. Relation of article to treaty, statute, tariff, classification or regulation.

To the extent that any treaty or statute of the United States, regulatory statute of this state or tariff, classification or regulation filed or issued pursuant thereto is applicable, the provisions of this article are subject thereto.

History: 1953 Comp., § 50A-7-103, enacted by Laws 1961, ch. 96, § 7-103.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To make clear what would of course be true without the section, that applicable federal law is paramount.

2. To make clear also that *regulatory* state statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values and limiting liability for loss to the declared value on which the charge was based) are not affected by the article and are controlling on the matters which they cover. Notice that the reference is not only to such statutes, but to tariffs, classifications and regulations filed or issued pursuant to them.

Cross references. - Sections 7-201, 7-202, 7-204, 7-206, 7-309, 7-401 and 7-403.

Definitional cross reference. - "Bill of lading". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 264; 15A Am. Jur. 2d Commercial Code §§ 38, 43; 78 Am. Jur. 2d Warehouses § 1.

Relation of treaty to state and federal law, 4 A.L.R. 1377, 134 A.L.R. 882.

Jurisdiction of state courts in relation to interstate shipments, 64 A.L.R. 333.

82 C.J.S. Statutes § 7; 87 C.J.S. Treaties § 19.

55-7-104. Negotiable and nonnegotiable warehouse receipt, bill of lading or other document of title.

(1) A warehouse receipt, bill of lading or other document of title is negotiable:

(a) if by its terms the goods are to be delivered to bearer or to the order of a named person; or

(b) where recognized in overseas trade, if it runs to a named person or assigns.

(2) Any other document is nonnegotiable. A bill of lading in which it is stated that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against a written order signed by the same or another named person.

History: 1953 Comp., § 50A-7-104, enacted by Laws 1961, ch. 96, § 7-104.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 27 and 76, Uniform Sales Act; Sections 2, 3, 4 and 5, Uniform Warehouse Receipts Act; Sections 2, 3, 4, 5 and 53, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - This article deals with a class of commercial paper representing commodities in storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the article of this act on commercial paper (Article 3) and "investment paper" dealt with in the article of this act on investment securities (Article 8). The class of "commodity paper" is designated "document of title" following the terminology of the Uniform Sales Act Section 76. Section 1-201. The distinctions between negotiable and nonnegotiable documents in this section make the most important subclassification employed in the article, in that the holder of negotiable documents may acquire more rights than his transferor had (See Section 7-502).

A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular kind of receipt in connection with delivery of the goods. Subsections (1) (a) and (2) make it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person.

Cross reference. - Section 7-502.

Definitional cross references. - "Bearer". Section 1-201.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Overseas". Section 2-323.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

Law reviews. - For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 8, 11, 47; 13 Am. Jur. 2d Carriers § 265; 15A Am. Jur. 2d Commercial Code §§ 56, 57, 65; 68A Am. Jur. 2d Secured Transactions § 49; 78 Am. Jur. 2d Warehouses § 59.

Character of bill of lading contemplated by a guaranty of payment of a draft with bill of lading attached, 13 A.L.R. 166.

Provision in bill of lading prohibiting or limiting consignee's right to inspect goods shipped, 25 A.L.R. 770.

Jurisdiction of state courts in relation to interstate shipments, 64 A.L.R. 333.

Applicability of provision in receipt limiting liability, to conversion of property by warehouseman, 99 A.L.R. 266.

Stipulation in warehouseman's receipt fixing valuation of property as basis of responsibility, validity and applicability, 142 A.L.R. 776.

Necessity of bringing to bailor's attention provision in warehouse receipt limiting liability of warehouseman, 160 A.L.R. 1112.

Warehouseman's liability for loss occasioned by failure to issue proper receipt to depositor, 168 A.L.R. 945.

Construction and effect of U.C.C., art. 7, dealing with warehouse receipts, bills of lading and other documents of title, 21 A.L.R.3d 1339.

80 C.J.S. Shipping §§ 111 to 114; 93 C.J.S. Warehousemen and Safe Depositaries § 25.

55-7-105. Construction against negative implication.

The omission from either Part 2 or Part 3 of this article of a provision corresponding to a provision made in the other part does not imply that a corresponding rule of law is not applicable.

History: 1953 Comp., § 50A-7-105, enacted by Laws 1961, ch. 96, § 7-105.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - To avoid any impairment, for example, of any common law right of indemnity a warehouseman may have corresponding to Section 7-301(5), or of any contractual security interest a carrier might have corresponding to Section 7-209(2).

Cross references. - Parts 2 and 3 of Article 7.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 82 C.J.S. Statutes §§ 366, 385.

PART 2
WAREHOUSE RECEIPTS; SPECIAL PROVISIONS

55-7-201. Who may issue a warehouse receipt; storage under government bond.

(1) A warehouse receipt may be issued by any warehouseman.

(2) Where goods including distilled spirits and agricultural commodities are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods has like effect as a warehouse receipt even though issued by a person who is the owner of the goods and is not a warehouseman.

History: 1953 Comp., § 50A-7-201, enacted by Laws 1961, ch. 96, § 7-201.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 1, Uniform Warehouse Receipts Act.

Changes. Provision added to cover storage under government bond or under licensing statute.

Purposes. - It is not intended by reenactment of Subsection (1) to repeal any provisions of special licensing or other statutes regulating who may become a warehouseman. Subsection (2) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 26. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. Section 7-103. Compare Section 7-401(d) on the liability of the issuer in such cases.

Cross references. - Sections 7-103 and 7-401.

Definitional cross references. - "Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 51; 68A Am. Jur. 2d Secured Transactions § 109; 78 Am. Jur. 2d Warehouses §§ 42, 44.

Uniform Warehouse Receipts Act as affecting liens on the property represented by the receipts, 61 A.L.R. 949.

Relationship of bailor and bailee as between owner of goods in bonded warehouse and proprietor of warehouse, 77 A.L.R. 1502.

Legal effect of transaction by which grain or other commodity is received for storage by one who has not complied with statutory conditions necessary to become public warehouseman, 108 A.L.R. 928.

Statutory warehousing as determined by character of property stored, 132 A.L.R. 532.

Validity of field warehousing, 133 A.L.R. 209.

Estoppel of owner who permits another to have possession of certificates or other evidences of title, of personal property endorsed in blank or otherwise showing ownership in possessor, to deny latter's authority to deal with, the property, 151 A.L.R. 690.

Warehouseman's liability for loss occasioned by failure to issue a proper receipt to depositor, 168 A.L.R. 945.

93 C.J.S. Warehousemen and Safe Depositaries § 17.

55-7-202. Form of warehouse receipt; essential terms; optional terms.

(1) A warehouse receipt need not be in any particular form.

(2) Unless a warehouse receipt embodies within its written or printed terms each of the following, the warehouseman is liable for damages caused by the omission to a person injured thereby:

(a) the location of the warehouse where the goods are stored;

(b) the date of issue of the receipt;

(c) the consecutive number of the receipt;

(d) a statement whether the goods received will be delivered to the bearer, to a specified person or to a specified person or his order;

(e) the rate of storage and handling charges, except that where goods are stored under a field warehousing arrangement a statement of that fact is sufficient on a nonnegotiable receipt;

(f) a description of the goods or of the packages containing them;

(g) the signature of the warehouseman, which may be made by his authorized agent;

(h) if the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership; and

(i) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien or security interest (Section 7-209 [55-7-209 NMSA 1978]). If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

(3) A warehouseman may insert in his receipt any other terms which are not contrary to the provisions of this act and do not impair his obligation of delivery (Section 7-403 [55-7-403 NMSA 1978]) or his duty of care (Section 7-204 [55-7-204 NMSA 1978]). Any contrary provisions shall be ineffective.

History: 1953 Comp., § 50A-7-202, enacted by Laws 1961, ch. 96, § 7-202.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 2, Uniform Warehouse Receipts Act.

Changes. Exemption for field warehouse receipts added in Subsection (2) (e).

Purposes. - To make clear that the formal requirements of the Uniform Warehouse Receipts Act are continued but not to displace particular legislation requiring other or different specifications of form, see Section 7-103. This section does not require that a receipt be issued but states formal requirements for those which are issued.

Cross references. - Section 7-103.

Definitional cross references. - "Bearer". Section 1-201.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Security interest". Section 1-201.

"Term". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

"Written". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses § 44.

Provision in bill of lading prohibiting or limiting consignee's right to inspect goods shipped, 25 A.L.R. 770.

Right of purchaser of receipt against warehouseman, 38 A.L.R. 1205.

"Warehouse purchase receipt" as bailment or contract of sale, 91 A.L.R. 907.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

Validity as against third persons of sale or pledge of goods, or receipts issued for goods, retained in warehouse on premises of seller or pledgor, 133 A.L.R. 209.

Storage contract as a bailment of chattels or lease of place where chattels are stored, 138 A.L.R. 1137.

Necessity of bringing to bailor's attention provision in warehouse receipt limiting liability of warehouseman, 160 A.L.R. 1112.

Warehouseman's liability for loss occasioned by failure to issue proper receipt to depositor, 168 A.L.R. 945.

Liability of warehouseman or other bailee for loss of goods stored at other than agreed-upon place, 76 A.L.R.4th 883.

93 C.J.S. Warehousemen and Safe Depositaries § 20.

55-7-203. Liability for nonreceipt or misdescription.

A party to or purchaser for value in good faith of a document of title other than a bill of lading relying in either case upon the description therein of the goods may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to

the extent that the document conspicuously indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity or condition, or the receipt or description is qualified by "contents, condition and quality unknown," "said to contain" or the like, if such indication be true or the party or purchaser otherwise has notice.

History: 1953 Comp., § 50A-7-203, enacted by Laws 1961, ch. 96, § 7-203.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 20, Uniform Warehouse Receipts Act.

Changes. New section confined to problem of non-receipt and misdescription.

Purposes of changes and new matter. - This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of the latter liability is permitted.

Cross references. - Sections 7-301 and 7-203.

Definitional cross references. - "Conspicuous". Section 1-201.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Notice". Section 1-201.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Receipt of goods". Section 2-103.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 50, 55; 78 Am. Jur. 2d Warehouses § 48.

Right of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

55-7-204. Duty of care; contractual limitation of warehouseman's liability.

(1) A warehouseman is liable for damages for loss of or injury to the goods caused by his failure to exercise such care in regard to them as a reasonably careful man would exercise under like circumstances but unless otherwise agreed he is not liable for damages which could not have been avoided by the exercise of such care.

(2) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage, and setting forth a specific liability per article or item, or value per unit of weight, beyond which the warehouseman shall not be liable; provided, however, that such liability may on written request of the bailor at the time of signing such storage agreement or within a reasonable time after receipt of the warehouse receipt be increased on part or all the goods thereunder, in which event increased rates may be charged based on such increased valuation, but that no such increase shall be permitted contrary to a lawful limitation of liability contained in the warehouseman's tariff, if any. No such limitation is effective with respect to the warehouseman's liability for conversion to his own use.

(3) Reasonable provisions as to the time and manner of presenting claims and instituting actions based on the bailment may be included in the warehouse receipt or tariff.

History: 1953 Comp., § 50A-7-204, enacted by Laws 1961, ch. 96, § 7-204.

ANNOTATIONS

Compiler's notes. - New Mexico did not enact a Subsection (4) to this section which would have placed a higher standard of care upon the warehouseman or invalidated limitations upon that duty allowed under Article 7.

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 3 and 21, Uniform Warehouse Receipts Act.

Changes. Consolidated and rewritten and material on limitation of remedy is new.

Purposes of changes. - The old uniform acts provided that receipts could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. The section is intended to eliminate that controversy by setting forth the conditions under which liability is so limited. However, as Subsection (4) makes clear, the states as well as the federal government may supplement this section with more rigid standards of responsibility for some or all bailees.

Cross reference. - Section 7-103.

Definitional cross references. - "Action". Section 1-201.

"Agreed". Section 1-201.

"Goods". Section 7-102.

"Reasonable time". Section 1-204.

"Sign". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

"Written". Section 1-201.

Burden of proving ordinary care upon warehouseman. - Plain and unambiguous language of the law has changed common-law rule so as to place the burden upon the warehouseman to show that in the exercise of ordinary care, he is unable to redeliver the goods bailed to him. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Not enough to show fire of unknown origin. - Establishment of fact that broomcorn in warehouseman's custody was destroyed by fire of unknown origin does not, without more, sustain the burden of showing due care with respect to it. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Evidence allowable in damage suit. - In damage suit to recover for broomcorn in custody of warehouseman, evidence to effect that debris had been allowed to collect beneath platform or floor on which broomcorn was stored, and concerning smoking in and around the place were properly submitted to the jury and its findings were held

binding on review. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 51; 78 Am. Jur. 2d Warehouses §§ 44, 139, 140, 188, 234, 248, 251.

Liability of warehouseman for damage to or destruction of property by fire, 16 A.L.R. 280.

Liability of warehouseman for theft of property in his care, 26 A.L.R. 223, 48 A.L.R. 378.

Warehouseman's bond as covering warehouse receipts issued by warehouse to itself or for its own property, 61 A.L.R. 331.

Right of owner to sue on insurance policy taken out by warehouseman, 61 A.L.R. 720.

Interest on damages for warehouseman's refusal to deliver property, or for injury to, or loss of, property, 96 A.L.R. 18, 36 A.L.R.2d 337.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

Validity and applicability of stipulation in warehouseman's receipt fixing valuation of property as basis of responsibility, 142 A.L.R. 776.

Damages recoverable from warehousemen for negligence causing injury to, or destruction of, goods of a perishable nature, 32 A.L.R.2d 910.

Liability of warehouseman for injury to, or destruction of, stored goods from floods, heavy rains or the like, 60 A.L.R.2d 1097.

Liability of warehouseman for deterioration of goods due to improper temperature, 92 A.L.R.2d 1298.

Liability of warehouseman or other bailee for loss of goods stored at other than agreed-upon place, 76 A.L.R.4th 883.

8 C.J.S. Bailments § 40; 93 C.J.S. Warehousemen and Safe Depositaries § 27.

55-7-205. Title under warehouse receipt defeated in certain cases.

A buyer in the ordinary course of business of fungible goods sold and delivered by a warehouseman who is also in the business of buying and selling such goods takes free of any claim under a warehouse receipt even though it has been duly negotiated.

History: 1953 Comp., § 50A-7-205, enacted by Laws 1961, ch. 96, § 7-205.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The typical case covered by this section is that of the warehouseman-dealer in grain, and the substantive question at issue is whether in case the warehouseman becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouseman. Moreover, on default of the warehouseman, the receipt holders at least share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces him completely to the status of general creditor in a situation where there was very little he could do to guard against the loss. Compare 15 U.S.C. Section 714p, enacted in 1955.

Cross references. - Sections 2-403 and 9-307.

Definitional cross references. - "Buyer in ordinary course of business". Section 1-201.

"Delivery". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Value". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 67; 67 Am. Jur. 2d Sales §§ 387 et seq., 448 et seq.; 78 Am. Jur. 2d Warehouses § 76.

Replevin for an undivided share in or undivided quantity of a larger mass, 26 A.L.R. 1015.

15A C.J.S. Confusion of Goods § 1; 93 C.J.S. Warehousemen and Safe Depositaries §§ 14, 39.

55-7-206. Termination of storage at warehouseman's option.

(1) A warehouseman may on notifying the person on whose account the goods are held and any other person known to claim an interest in the goods require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document, or, if no period is fixed, within a stated period not less than thirty days after the notification. If the goods are not removed before the date specified in the notification, the warehouseman may sell them in accordance with the provisions of the section on enforcement of a warehouseman's lien (Section 7-210 [55-7-210 NMSA 1978]).

(2) If a warehouseman in good faith believes that the goods are about to deteriorate or decline in value to less than the amount of his lien within the time prescribed in Subsection (1) for notification, advertisement and sale, the warehouseman may specify in the notification any reasonable shorter time for removal of the goods and in case the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(3) If as a result of a quality or condition of the goods of which the warehouseman had no notice at the time of deposit the goods are a hazard to other property or to the warehouse or to persons, the warehouseman may sell the goods at public or private sale without advertisement on reasonable notification to all persons known to claim an interest in the goods. If the warehouseman after a reasonable effort is unable to sell the goods he may dispose of them in any lawful manner and shall incur no liability by reason of such disposition.

(4) The warehouseman must deliver the goods to any person entitled to them under this article upon due demand made at any time prior to sale or other disposition under this section.

(5) The warehouseman may satisfy his lien from the proceeds of any sale or disposition under this section but must hold the balance for delivery on the demand of any person to whom he would have been bound to deliver the goods.

History: 1953 Comp., § 50A-7-206, enacted by Laws 1961, ch. 96, § 7-206.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 34, Uniform Warehouse Receipts Act.

Changes. Rewritten and expanded to define the warehouseman's right to terminate the storage not only where the goods are perishable or hazardous as in Uniform Warehouse Receipts Act, Section 34, but also for any other reason including decline in value of the goods imperilling the warehouseman's security for charges.

Purposes of changes. - 1. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouseman's power to terminate the bailment, since it would be commercially intolerable to allow warehousemen to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under Subsection (1) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods Uniform Warehouse Receipts Act, Section 34, made no distinction between cases where the warehouseman knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (2) and (3) distinguish between the two situations.

3. Protection of his lien is the only interest which the warehouseman has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threatens the warehouseman's security.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehousemen from discriminating among customers. Nor does the section relieve the warehouseman of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such *regulatory* statutes and the regulations under them remain in force and operative. Section 7-103.

Cross references. - Sections 7-103 and 7-403.

Definitional cross references. - "Delivery". Section 1-201.

"Document". Section 7-102.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Notice". Section 1-201.

"Notification". Section 1-201.

"Person". Section 1-201.

"Reasonable time". Section 1-204.

"Value". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses §§ 213, 226, 227.

Liability of warehouseman and of surety on bond in respect of collection and remittance of proceeds of sale of merchandise, 121 A.L.R. 1155.

Liability of warehouseman for deterioration of goods due to improper temperature, 92 A.L.R.2d 1298.

93 C.J.S. Warehousemen and Safe Depositaries §§ 12, 47.

55-7-207. Goods must be kept separate; fungible goods.

(1) Unless the warehouse receipt otherwise provides, a warehouseman must keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods except that different lots of fungible goods may be commingled.

(2) Fungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share. Where because of overissue a mass of fungible goods is insufficient to meet all the receipts which the warehouseman has issued against it, the persons entitled include all holders to whom overissued receipts have been duly negotiated.

History: 1953 Comp., § 50A-7-207, enacted by Laws 1961, ch. 96, § 7-207.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 22, 23 and 24, Uniform Warehouse Receipts Act.

Changes. Consolidated and revised and holders of overissued receipts permitted to share in mass of fungible goods.

Purposes of changes. - No change of substance is made other than the explicit statement that holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

Definitional cross references. - "Delivery". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 47; 78 Am. Jur. 2d Warehouses §§ 39, 45, 179, 181, 228.

Deposit of grain without obligation to return identical grain as a bailment or a sale, 54 A.L.R. 1166.

"Warehouse purchase receipt" as bailment or contract of sale, 91 A.L.R. 906.

Statutory warehousing as determined by character of property stored, 132 A.L.R. 532.

93 C.J.S. Warehousemen and Safe Depositaries §§ 13, 14.

55-7-208. Altered warehouse receipts.

Where a blank in a negotiable warehouse receipt has been filled in without authority, a purchaser for value and without notice of the want of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any receipt enforceable against the issuer according to its original tenor.

History: 1953 Comp., § 50A-7-208, enacted by Laws 1961, ch. 96, § 7-208.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 13, Uniform Warehouse Receipts Act.

Changes. Generally revised and simplified and explicit treatment of the situation where a blank in an executed document is filled without authority.

Purposes of changes. - 1. The execution of warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former.

2. An unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of his liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouseman.

Definitional cross references. - "Issuer". Section 7-102.

"Notice". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-201.

"Warehouse receipt". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 48, 66; 78 Am. Jur. 2d Warehouses § 50.

Rights of purchaser of forged or altered receipt as against warehouseman, 38 A.L.R. 1206.

3A C.J.S. Alteration of Instruments § 1; 93 C.J.S. Warehousemen and Safe Depositaries § 27.

55-7-209. Lien of warehouseman.

(1) A warehouseman has a lien against the bailor on the goods covered by a warehouse receipt or on the proceeds thereof in his possession for charges for storage or transportation, including demurrage and terminal charges, insurance, labor or charges present or future in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for like charges or expenses in relation to other goods whenever deposited and it is stated in the receipt that a lien is claimed for charges and expenses in relation to other goods, the warehouseman also has a lien against him for such charges and expenses whether or not the other goods have been delivered by the warehouseman. But against a person to whom a negotiable warehouse receipt is duly negotiated a warehouseman's lien is limited to charges in an amount or at a rate specified on the receipt or if no charges are so specified then to a reasonable charge for storage of the goods covered by the receipt subsequent to the date of the receipt.

(2) The warehouseman may also reserve a security interest against the bailor for a maximum amount specified on the receipt for charges other than those specified in

Subsection (1), such as for money advanced and interest. Such a security interest is governed by the article on secured transactions (Article 9).

(3) (a) A warehouseman's lien for charges and expenses under Subsection (1) or a security interest under Subsection (2) is also effective against any person who so entrusted the bailor with possession of the goods that a pledge of them by him to a good faith purchaser for value would have been valid but is not effective against a person as to whom the document confers no right in the goods covered by it under Section 7-503 [55-7-503 NMSA 1978].

(b) A warehouseman's lien on household goods for charges and expenses in relation to the goods under Subsection (1) is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. "Household goods" means furniture, furnishings and personal effects used by the depositor in a dwelling.

(4) A warehouseman loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver.

History: 1953 Comp., § 50A-7-209, enacted by Laws 1961, ch. 96, § 7-209; 1969, ch. 106, § 1.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 27 to 32, Uniform Warehouse Receipts Act.

Changes. Rewritten.

Purposes of changes. - 1. Subsection (1) defines the warehouseman's statutory lien. A specific lien attaches automatically, without express notation on the receipt, to goods stored under a non-negotiable receipt. That lien is limited to the usual charges arising out of a storage transaction; by notation on the receipt it can be made a general lien extending to like charges in relation to other goods. The same rules apply where the receipt is negotiable, except that as against a holder by due negotiation the lien is limited to the amount or rate specified on the receipt, or, if none is specified, to a reasonable charge for storage of the specific goods after the date of the receipt.

2. Subsection (2) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financer or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare Sections 9-102(2) and 9-310. It is governed in all respects by Article 9, except that Subsection (2) requires that

the receipt specify a maximum amount and limits the security interest to the amount specified.

3. Subsections (1) and (2) validate the lien and security interest "against the bailor." As against third parties, Subsection (3) (a) continues the rule under the prior uniform statutory provision that to validate the lien the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of his goods by a thief. The warehouseman may be protected because of the actual, implied or apparent authority of the depositor, because of a factor's act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under Section 7-503. Where the third party is the holder of a security interest, the rights of the warehouseman depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly Section 9-312. Thus the special priority granted to statutory liens by Section 9-310 does not apply to liens under Subsection (1) of this section, since Subsection (3) "expressly provides otherwise" within the meaning of Section 9-310. As to household goods, however, Subsection (3) (b) makes the warehouseman's lien "for charges and expenses in relation to the goods" effective against all persons if the depositor was the legal possessor. The purpose of the exception is to permit the warehouseman to accept household goods for storage in sole reliance on the value of the goods themselves, especially in situations of family emergency.

4. It is unnecessary to state here, as in Uniform Warehouse Receipts Act 31, that a bailee with a valid lien need not deliver until the lien is satisfied. Section 7-403 provides that a person demanding delivery under a document must be prepared to satisfy the bailee's lien.

5. Where goods have been stored under a non-negotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in Section 2-503(4) on tender of delivery and include procurement of an acknowledgment by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of Subsection (1), continues valid unless the bailee gives it up. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of Subsection (1); unless he undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under Subsection (2).

Cross references. - Point 2: Sections 9-102(2) and 9-310.

Point 3: Sections 7-503, 9-310 and 9-312.

Point 4: Section 7-403.

Point 5: Section 2-503.

Definitional cross references. - "Deliver". Section 1-201.

"Document". Section 7-102.

"Goods". Section 7-102.

"Money". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Right". Section 1-201.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions §§ 18, 129 et seq., 869 et seq.; 78 Am. Jur. 2d Warehouses §§ 116 to 121, 188.

Waiver of warehouseman's lien by filing claim against decedent's estate as an unsecured one, 2 A.L.R. 1132.

Right of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Warehouseman's lien on property stored by officer who had seized it under attachment or execution, 95 A.L.R. 1529.

Damages recoverable from warehousemen for negligence causing injury to, or destruction of, goods of a perishable nature, 32 A.L.R.2d 910.

93 C.J.S. Warehousemen and Safe Depositaries §§ 63, 67, 69.

55-7-210. Enforcement of warehouseman's lien.

(1) Except as provided in Subsection (2), a warehouseman's lien may be enforced by public or private sale of the goods in block or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the warehouseman is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the warehouseman either sells the goods in the usual manner in any recognized market therefor, or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold, he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to insure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) A warehouseman's lien on goods other than goods stored by a merchant in the course of his business may be enforced only as follows:

(a) all persons known to claim an interest in the goods must be notified;

(b) the notification must be delivered in person or sent by registered or certified letter to the last known address of any person to be notified;

(c) the notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than ten days after receipt of the notification and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place;

(d) the sale must conform to the terms of the notification;

(e) the sale must be held at the nearest suitable place to that where the goods are held or stored;

(f) after the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account they are being held and the time and place of the sale. The sale must take place at least fifteen days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten days before the sale in not less than six conspicuous places in the neighborhood of the proposed sale.

(3) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the warehouseman subject to the terms of the receipt and this article.

(4) The warehouseman may buy at any public sale pursuant to this section.

(5) A purchaser in good faith of goods sold to enforce a warehouseman's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the warehouseman with the requirements of this section.

(6) The warehouseman may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(7) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(8) Where a lien is on goods stored by a merchant in the course of his business the lien may be enforced in accordance with either Subsection (1) or (2).

(9) The warehouseman is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion.

History: 1953 Comp., § 50A-7-210, enacted by Laws 1961, ch. 96, § 7-210; 1967, ch. 186, § 18.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 33, Uniform Warehouse Receipts Act.

Changes. Rewritten and simplified foreclosure proceeding provided for all liens other than warehousemen's lien in non-commercial storage.

Purposes of changes. - 1. Subsection (1) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except non-commercial storage with a warehouseman. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale, found in Section 33 of the Uniform Warehouse Receipts Act are retained in Subsection (2). The swifter, more flexible procedure of Subsection (1) is appropriate to commercial storage. Compare seller's power of resale on breach by buyer under the provisions of the article on sales (Section 2-706).

2. The provisions of Subsections (4) and (5) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices.

Cross reference. - Section 7-403.

Definitional cross references. - "Bill of lading". Section 1-201.

"Conspicuous". Section 1-201.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Notification". Section 1-201.

"Notifies". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 506; 78 Am. Jur. 2d Warehouse §§ 123 to 126, 211, 244.

Liability of warehouseman, and of surety on bond, in respect of collection and remittance of proceeds of sale of merchandise, 121 A.L.R. 1155.

93 C.J.S. Warehousemen and Safe Depositaries § 69.

PART 3
BILLS OF LADING; SPECIAL PROVISIONS

55-7-301. Liability for nonreceipt or misdescription; "said to contain"; "shipper's load and count"; improper handling.

(1) A consignee of a nonnegotiable bill who has given value in good faith or a holder to whom a negotiable bill has been duly negotiated relying in either case upon the description therein of the goods, or upon the date therein shown, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the document indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, as where the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown," "said to contain," "shipper's weight, load and count" or the like, if such indication be true.

(2) When goods are loaded by an issuer who is a common carrier, the issuer must count the packages of goods if package freight and ascertain the kind and quantity if bulk freight. In such cases "shipper's weight, load and count" or other words indicating that the description was made by the shipper are ineffective except as to freight concealed by packages.

(3) When bulk freight is loaded by a shipper who makes available to the issuer adequate facilities for weighing such freight, an issuer who is a common carrier must ascertain the kind and quantity within a reasonable time after receiving the written request of the shipper to do so. In such cases "shipper's weight" or other words of like purport are ineffective.

(4) The issuer may by inserting in the bill the words "shipper's weight, load and count" or other words of like purport indicate that the goods were loaded by the shipper; and if such statement be true the issuer shall not be liable for damages caused by the improper loading. But their omission does not imply liability for such damages.

(5) The shipper shall be deemed to have guaranteed to the issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition and weight, as furnished by him; and the shipper shall indemnify the issuer against damage caused by inaccuracies in such particulars. The right of the issuer to such indemnity shall in no way limit his responsibility and liability under the contract of carriage to any person other than the shipper.

History: 1953 Comp., § 50A-7-301, enacted by Laws 1961, ch. 96, § 7-301.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 23, Uniform Bills of Lading Act.

Changes. Rewritten in part.

Purposes of changes. - 1. The provision as to misdating in Subsection (1) conforms to the policy of the amendment to the Federal Bills of Lading Act by 44 Stat. 1450 (1927), as amended 49 U.S.C. Section 102, after the holding in Browne v. Union Pac. R. Co., 113 Kan. 726, 216 P. 299 (1923), affirmed on other grounds 267 U.S. 255, 45 S. Ct. 315, 69 L. Ed. 601 (1925). Subsections (2) and (3) conform to the policy of the Federal Bills of Lading Act, 49 U.S.C. Sections 100, 101, and the laws of several states. See, e.g., N.Y.Pers.Prop. Law Section 209; Report of N. Y. Law Revision Commission, N.Y.Leg.Doc. (1941) No. 65(F).

2. The language of the old uniform act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve himself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is that the carrier is not liable for losses caused by act or default of the shipper, which would include improper loading. There is some question whether under present law a carrier is liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. It is this doubtful liability which Subsection (4) permits the carrier to bar by disclosure of shipper's loading. There is no implication that decisions such as Modern Tool Corp. v. Pennsylvania R. Co., 100 F. Supp. 595 (D.N.J. 1951), are disapproved.

3. This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the carrier concerning the goods may cause damage to the carrier. Subsection (5) therefore provides appropriate indemnity.

Cross references. - Sections 7-203 and 7-309.

Definitional cross references. - "Bill of lading". Section 1-201.

"Consignee". Section 7-102.

"Document". Section 7-102.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Notice". Section 1-201.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Receipt of goods". Section 2-103.

"Value". Section 1-201.

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers §§ 291, 292; 15A Am. Jur. 2d Commercial Code §§ 50, 51.

Provision in bill of lading prohibiting or limiting consignee's right to inspect goods shipped, 25 A.L.R.2d 770.

Rail or motor carrier of freight, liability for loss through weight deficiency of goods shipped, 39 A.L.R.2d 325.

Conclusiveness of receipt clause in bill of lading, 67 A.L.R.2d 1028.

Shipper's misdescription of goods as affecting carrier's liability for loss or damage, 1 A.L.R.3d 736.

80 C.J.S. Shipping § 113.

55-7-302. Through bills of lading and similar documents.

(1) The issuer of a through bill of lading or other document embodying an undertaking to be performed in part by persons acting as its agents or by connecting carriers is liable to anyone entitled to recover on the document for any breach by such other persons or by a connecting carrier of its obligation under the document but to the extent that the bill covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation this liability may be varied by agreement of the parties.

(2) Where goods covered by a through bill of lading or other document embodying an undertaking to be performed in part by persons other than the issuer are received by any such person, he is subject with respect to his own performance while the goods are

in his possession to the obligation of the issuer. His obligation is discharged by delivery of the goods to another such person pursuant to the document, and does not include liability for breach by any other such persons or by the issuer.

(3) The issuer of such through bill of lading or other document shall be entitled to recover from the connecting carrier or such other person in possession of the goods when the breach of the obligation under the document occurred, the amount it may be required to pay to anyone entitled to recover on the document therefor, as may be evidenced by any receipt, judgment or transcript thereof, and the amount of any expense reasonably incurred by it in defending any action brought by anyone entitled to recover on the document therefor.

History: 1953 Comp., § 50A-7-302, enacted by Laws 1961, ch. 96, § 7-302.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any connecting carrier and to make it clear that any such connecting carrier holds the goods on terms which are defined by the document of title even though such connecting carrier did not issue the document. Since the connecting carrier does hold on the terms of the document, it must honor a proper demand for delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for nondelivery and limitations of liability provided for the original bailee. Unlike the original bailee-issuer, the connecting carrier's responsibility is limited to the period while the goods are in its possession. The section is patterned generally after the Interstate Commerce Act, but does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multi-purpose documents may come into use, e.g., combination warehouse receipts and bills of lading.

3. Where the obligations or standards applicable to different parties bound by a document of title are different, the initial carrier's responsibility for portions of the journey not on its own lines will be determined by the standards appropriate to the connecting carrier. Thus a land carrier issuing a through bill of lading involving water carriage at a later stage will have the benefit of the water carrier's immunity from liability for negligence of its servants in navigating the vessel, where the law provides such an immunity for water carriers and the loss occurred while the goods were in the water carrier's possession.

4. Under Subsection (1) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (3) gives it appropriate rights of recourse.

Definitional cross references. - "Agreement". Section 1-201.

"Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Overseas". Section 2-323.

"Party". Section 1-201.

"Person". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 14 Am. Jur. 2d Carriers § 710.

Strike on connecting line as defense, 28 A.L.R. 503, 45 A.L.R. 919.

Initial carrier's liability for diverting shipment by connecting carrier, 61 A.L.R. 1309.

Initial carrier's liability as that of carrier or of warehouseman in respect of goods while in its warehouse awaiting delivery to connecting carrier, 172 A.L.R. 802.

80 C.J.S. Shipping § 113.

55-7-303. Diversion; reconsignment; change of instructions.

(1) Unless the bill of lading otherwise provides, the carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods on instructions from:

(a) the holder of a negotiable bill; or

(b) the consignor on a nonnegotiable bill notwithstanding contrary instructions from the consignee; or

(c) the consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the bill; or

(d) the consignee on a nonnegotiable bill if he is entitled as against the consignor to dispose of them.

(2) Unless such instructions are noted on a negotiable bill of lading, a person to whom the bill is duly negotiated can hold the bailee according to the original terms.

History: 1953 Comp., § 50A-7-303, enacted by Laws 1961, ch. 96, § 7-303.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The old acts contained no reference to diversion, a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. The carrier was protected under the heading of "justified delivery" if the substituted consignee who received delivery was "a person lawfully entitled to possession of the goods." Cf. Subsection (1) (d). This in turn depended on whether the person ordering the diversion was the owner of the goods or empowered to dispose of them, which again might depend upon whether under sales law title had passed from the consignor-seller to the consignee-buyer. The carrier is plainly not in a position to decide such questions when directed by the person with whom it has contracted for transportation to change the destination of the goods in transit. Carriers may as a business matter be willing to accept instructions from consignees in which case, as under the old uniform acts, the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods. The section imposes no duty on carriers to undertake diversion; it is of course subject to the provisions of filed tariffs. Section 7-103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee-buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a non-negotiable bill of lading. Thus if the carrier, upon instructions from the consignor, returns the goods to him, the consignee may recover the goods from the consignor or his insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee.

Cross references. - Point 2: Sections 7-403 and 7-504(3).

Definitional cross references. - "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 394.

Right of shipper or consignee to divert shipment, 61 A.L.R. 1309.

Liability for damages from loss of shipper's opportunity to sell or divert goods at intermediate point because of carrier's deviation from route, 33 A.L.R.2d 145.

80 C.J.S. Shipping § 119.

55-7-304. Bills of lading in a set.

(1) Except where customary in overseas transportation, a bill of lading must not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(2) Where a bill of lading is lawfully drawn in a set of parts, each of which is numbered and expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitute [constitutes] one bill.

(3) Where a bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to whom the first due negotiation is made prevails as to both the document and the goods even though any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrender of his part.

(4) Any person who negotiates or transfers a single part of a bill of lading drawn in a set is liable to holders of that part as if it were the whole set.

(5) The bailee is obliged to deliver in accordance with Part 4 of this article against the first presented part of a bill of lading lawfully drawn in a set. Such delivery discharges the bailee's obligation on the whole bill.

History: 1953 Comp., § 50A-7-304, enacted by Laws 1961, ch. 96, § 7-304.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 6, Uniform Bills of Lading Act.

Changes. This section adds to existing legislation, which merely prohibits bills in a set in ordinary domestic trade, a statement of the legal effect of a lawfully issued set.

Purposes of changes. - The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other overseas bills. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this article.

Definitional cross references. - "Bailee". Section 7-102.

"Bill of lading". Section 7-102.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Overseas". Section 2-323.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers §§ 268, 272; 15A Am. Jur. 2d Commercial Code § 47.

Estoppel of owner who permits another to have possession of certificates or other evidences to title to personal property, endorsed in blank or otherwise showing ownership in possessor, to deny latter's authority to deal with property, 151 A.L.R. 690.

80 C.J.S. Shipping § 113.

55-7-305. Destination bills.

(1) Instead of issuing a bill of lading to the consignor at the place of shipment a carrier may at the request of the consignor procure the bill to be issued at destination or at any other place designated in the request.

(2) Upon request of anyone entitled as against the carrier to control the goods while in transit and on surrender of any outstanding bill of lading or other receipt covering such goods, the issuer may procure a substitute bill to be issued at any place designated in the request.

History: 1953 Comp., § 50A-7-305, enacted by Laws 1961, ch. 96, § 7-305.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e.g. a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank. Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when he honors the draft. Normally seller would act through his own bank in San Francisco, which would extend him credit in reliance on the airline's contract to deliver a bill to the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills.

Whether a connecting carrier will act as issuing agent is left to agreement between carriers.

Definitional cross references. - "Bill of lading". Section 1-201.

"Consignor". Section 7-102.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Receipt of goods". Section 2-103.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 272.

80 C.J.S. Shipping § 113.

55-7-306. Altered bills of lading.

An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor.

History: 1953 Comp., § 50A-7-306, enacted by Laws 1961, ch. 96, § 7-306.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 16, Uniform Bills of Lading Act.

Changes. Generally revised and simplified and explicit treatment of the situation where a blank in an executed document is filled without authority.

Purposes of changes. - An unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of his liability on the document as originally executed. Uniform Warehouse Receipts Act 13 excused the issuer from any liability to a fraudulent alterer, other than the liability to deliver the goods according to the terms of the original document. It is difficult to conceive what liability the draftsman intended to excuse. Uniform Bills of Lading Act 16 contains no such excuse provision, and is followed in this respect in the present section. Uniform Bills of Lading Act 16 characterizes an unauthorized alteration as "void" but apparently nothing more was intended than that the alteration did not change the obligation of the issuer. This is sufficiently covered by the terms of this section. Moreover cases are conceivable in which an alteration would not be "void"; for example, an alteration made by common consent of a transferor and transferee of a document might evidence an enforceable

contract between them. The same rule is made applicable to the filling in of blanks, a matter on which the prior acts were silent.

Definitional cross references. - "Bill of lading". Section 1-201.

"Issuer". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 270; 15A Am. Jur. 2d Commercial Code §§ 48, 66.

3A C.J.S. Alteration of Instruments § 6.

55-7-307. Lien of carrier.

(1) A carrier has a lien on the goods covered by a bill of lading for charges subsequent to the date of its receipt of the goods for storage or transportation (including demurrage and terminal charges) and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. But against a purchaser for value of a negotiable bill of lading a carrier's lien is limited to charges stated in the bill or the applicable tariffs, or if no charges are stated then to a reasonable charge.

(2) A lien for charges and expenses under Subsection (1) on goods which the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to such charges and expenses. Any other lien under Subsection (1) is effective against the consignor and any person who permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked such authority.

(3) A carrier loses his lien on any goods which he voluntarily delivers or which he unjustifiably refuses to deliver.

History: 1953 Comp., § 50A-7-307, enacted by Laws 1961, ch. 96, § 7-307.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 27 and 32, Uniform Warehouse Receipts Act.

Changes. Rewritten and lien extended to carrier. Lien of common carrier validated unless carrier had notice that consignor lacked authority to subject the goods to charges and expenses. Where the carrier is not required by law to receive the goods for

transportation, lien validated against anyone who permitted the bailor to have possession even if he had no real or apparent authority.

Purposes of changes. - The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehousemen by the first sentence of Section 7-209. But since carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7-209(1) and (2) are omitted. See comment to Section 7-105. Since the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, Subsection (2) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. Cf. Section 9-310. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority.

Cross references. - Sections 7-209, 9-102(2) and 9-310.

Definitional cross references. - "Bill of lading". Section 1-201.

"Consignor". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-201.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers §§ 497, 499, 501, 503; 68A Am. Jur. 2d Secured Transactions §§ 18, 129 et seq., 869 et seq.

Marking freight bill "paid" or "prepaid" as estopping carrier to deny that freight has been paid, 10 A.L.R. 736.

Duty to collect freight charges from party to be notified under "order" bill of lading, 26 A.L.R. 1315.

Right of carrier to lien on goods shipped without owner's authority, 39 A.L.R. 168.

Status, rights and obligations of freight forwarders, 141 A.L.R. 919.

13 C.J.S. Carriers §§ 484 to 486; 80 C.J.S. Shipping § 170.

55-7-308. Enforcement of carrier's lien.

(1) A carrier's lien may be enforced by public or private sale of the goods, in bloc [block] or in parcels, at any time or place and on any terms which are commercially reasonable, after notifying all persons known to claim an interest in the goods. Such notification must include a statement of the amount due, the nature of the proposed sale and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the carrier either sells the goods in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with commercially reasonable practices among dealers in the type of goods sold he has sold in a commercially reasonable manner. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable except in cases covered by the preceding sentence.

(2) Before any sale pursuant to this section any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred under this section. In that event the goods must not be sold, but must be retained by the carrier subject to the terms of the bill and this article.

(3) The carrier may buy at any public sale pursuant to this section.

(4) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against whom the lien was valid, despite noncompliance by the carrier with the requirements of this section.

(5) The carrier may satisfy his lien from the proceeds of any sale pursuant to this section but must hold the balance, if any, for delivery on demand to any person to whom he would have been bound to deliver the goods.

(6) The rights provided by this section shall be in addition to all other rights allowed by law to a creditor against his debtor.

(7) A carrier's lien may be enforced in accordance with either Subsection (1) or the procedure set forth in Subsection (2) of Section 7-210 [55-7-210 NMSA 1978].

(8) The carrier is liable for damages caused by failure to comply with the requirements for sale under this section and in case of willful violation is liable for conversion.

History: 1953 Comp., § 50A-7-308, enacted by Laws 1961, ch. 96, § 7-308.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 33, Uniform Warehouse Receipts Act.

Changes. Rewritten; provisions extended to carriers' liens and simplified foreclosure proceeding provided.

Purposes of changes. - This section is intended to give the carrier an enforcement procedure of his lien coextensive with that given the warehousemen in cases other than those covering noncommercial storage by him. See comment to Section 7-210.

Cross reference. - Section 7-210.

Definitional cross references. - "Bill of lading". Section 1-201.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Notification". Section 1-201.

"Notifies". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 506.

Liability for freight charge as affected by delivery without collecting charge as stipulated or directed, 24 A.L.R. 1163, 78 A.L.R. 926, 129 A.L.R. 213.

13 C.J.S. Carriers § 485; 80 C.J.S. Shipping § 170.

55-7-309. Duty of care; contractual limitation of carrier's liability.

(1) A carrier who issues a bill of lading whether negotiable or nonnegotiable must exercise the degree of care in relation to the goods which a reasonably careful man would exercise under like circumstances. This subsection does not repeal or change any law or rule of law which imposes liability upon a common carrier for damages not caused by its negligence.

(2) Damages may be limited by a provision that the carrier's liability shall not exceed a value stated in the document if the carrier's rates are dependent upon value and the consignor by the carrier's tariff is afforded an opportunity to declare a higher value or a value as lawfully provided in the tariff, or where no tariff is filed he is otherwise advised of such opportunity; but no such limitation is effective with respect to the carrier's liability for conversion to its own use.

(3) Reasonable provisions as to the time and manner of presenting claims and instituting actions based on the shipment may be included in a bill of lading or tariff.

History: 1953 Comp., § 50A-7-309, enacted by Laws 1961, ch. 96, § 7-309.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 3, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - The old uniform act provided that bills of lading could not contain terms impairing the obligation of reasonable care. Whether this is violated by a stipulation that in case of loss the bailee's liability is limited to stated amounts has been much controverted. For interstate rail transportation the matter is settled by the Carmack Amendment to the Interstate Commerce Act (see 49 U.S.C.A. § 20(11)). The present section is a generalized version of the Interstate Commerce Act provisions. The obligation of due care is radically qualified, in the case of maritime bills and international airbills, by federal legislation and treaty. All this special legislation would remain in effect even if congress enacts this code, including the present article. See Section 7-103.

Subsection (1) does not impair any rule of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (2), however, applies to such liability as well as to liability based on negligence. The entire section is subject under Section 7-103 to applicable provisions in filed tariffs, such as the common disclaimer of responsibility for undeclared articles of extraordinary value, hidden from view. Tariffs which lawfully provide a maximum unit value beyond which goods are not taken fall within the same principle, and are expressly covered by the words "value as lawfully provided in the tariff."

Cross reference. - Section 7-103.

Definitional cross references. - "Action". Section 1-201.

"Bill of lading". Section 1-201.

"Consignor". Section 7-102.

"Document". Section 7-102.

"Goods". Section 7-102.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 14 Am. Jur. 2d Carriers §§ 517, 555, 560, 566, 578; 15A Am. Jur. 2d Commercial Code § 51.

Application of state statute as to carrier's limitation of common-law liability to federal government operating railroads, 4 A.L.R. 1680, 8 A.L.R. 969, 10 A.L.R. 956, 11 A.L.R. 1450, 14 A.L.R. 234, 19 A.L.R. 678, 52 A.L.R. 296.

Stipulation limiting amount of carrier's liability as applicable where goods are stolen by its employee, 5 A.L.R. 986, 52 A.L.R. 1073.

Carrier's right to stipulate against liability for loss resulting from strike causing delay in transportation, 45 A.L.R. 921.

Refusal on grounds of public policy of forum to enforce stipulation in carrier's contract limiting its liability, valid according to the proper law of the contract, 57 A.L.R. 175.

Effect of value limitation clause in bill of lading or shipping receipt for goods misdescribed therein or not received by carrier, 74 A.L.R. 1382.

Validity as affected by rule against unjust discrimination, of agreement in bill of lading to insurance, 76 A.L.R. 1265.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 226.

Provision in carrier's contract regarding amount of recovery for damages as provision of liquidating damages or limitation of liability, 128 A.L.R. 632.

Presumption and burden of proof as to consignee's title to or interest in respect of goods comprising shipment, in consignee's action against carrier for loss, damage, delay, nondelivery or conversion, 135 A.L.R. 456.

Expiration of period prescribed by bill of lading or statute or shipper's claim or action against carrier as affecting his rights to avail himself of claim by recoupment in carrier's action against him, 140 A.L.R. 816.

Initial carrier's liability as that of carrier or of warehouseman in respect to goods while in its warehouse awaiting delivery to connecting carrier, 172 A.L.R. 802.

Presumption and burden of proof or of evidence where goods stored in situation governed by Uniform Warehouse Receipts Act are stolen, or are damaged or lost by fire or water, 13 A.L.R.2d 681.

Provision in bill of lading prohibiting or limiting consignee's right to inspect goods shipped, 25 A.L.R.2d 770.

Conclusiveness of receipt clauses in bill of lading, 67 A.L.R.2d 1028.

Railroad carrier's liability where goods were allegedly damaged by failure to properly refrigerate, 4 A.L.R.3d 994.

Liability of carrier by land for damage to goods resulting from improper packing by carrier, 7 A.L.R.3d 723.

Validity and construction of stipulation exempting carrier from liability for loss or damage to property at nonagency station, 16 A.L.R.3d 1111.

Validity of contractual provision limiting place or court in which action may be brought, 31 A.L.R.4th 404.

Liability of warehouseman or other bailee for loss of goods stored at other than agreed-upon place, 76 A.L.R.4th 883.

13 C.J.S. Carriers §§ 405, 406, 448 to 459; 80 C.J.S. Shipping § 25.

PART 4 WAREHOUSE RECEIPTS AND BILLS OF LADING; GENERAL OBLIGATIONS

55-7-401. Irregularities in issue of receipt or bill or conduct of issuer.

The obligations imposed by this article on an issuer apply to a document of title regardless of the fact that:

(a) the document may not comply with the requirements of this article or of any other law or regulation regarding its issue, form or content; or

(b) the issuer may have violated laws regulating the conduct of his business; or

(c) the goods covered by the document were owned by the bailee at the time the document was issued; or

(d) the person issuing the document does not come within the definition of warehouseman if it purports to be a warehouse receipt.

History: 1953 Comp., § 50A-7-401, enacted by Laws 1961, ch. 96, § 7-401.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 20, Uniform Warehouse Receipts Act; Section 23, Uniform Bills of Lading Act.

Changes. Most of the material is new and the uniform act sections cited deal only with non-receipt and misdescription.

Purposes of changes and new matter. - The bailee's liability on his document despite non-receipt or misdescription of the goods is affirmed in Sections 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregularities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this article. For example, a bailee will not be permitted to avoid his obligation to deliver the goods (Section 7-403) or his obligation of due care with respect to them (Sections 7-204 and 7-309) by taking the position that no valid "document" was issued because he failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the duty. As to the continuing vitality of regulations, in addition to those found in this article, of documents of title, see Section 7-103.

Cross references. - Sections 7-103, 7-203, 7-204, 7-301 and 7-309.

Definitional cross references. - "Bailee". Section 7-102.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 280; 15A Am. Jur. 2d Commercial Code § 50; 78 Am. Jur. 2d Warehouses §§ 40, 42.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

Legal effect of transaction by which commodity is received for storage by one who has not complied with statutory conditions necessary to become a public warehouseman, 108 A.L.R. 928.

13 C.J.S. Carriers § 392; 80 C.J.S. Shipping § 111; 93 C.J.S. Warehousemen and Safe Depositaries § 20.

55-7-402. Duplicate receipt or bill; overissue.

Neither a duplicate nor any other document of title purporting to cover goods already represented by an outstanding document of the same issuer confers any right in the goods, except as provided in the case of bills in a set, overissue of documents for fungible goods and substitutes for lost, stolen or destroyed documents. But the issuer is liable for damages caused by his overissue or failure to identify a duplicate document as such by conspicuous notation on its face.

History: 1953 Comp., § 50A-7-402, enacted by Laws 1961, ch. 96, § 7-402.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 6, Uniform Warehouse Receipts Act; Section 7, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - 1. This section treats a duplicate which is not properly identified as such like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages against the person who made his deception possible, except in the cases noted in the section. But parts of a bill lawfully issued in a set of parts are not "overissue" (Section 7-304). Of course, if

the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the warehouseman is not liable for preparing and delivering such a duplicate copy.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore himself have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable document acquires only the rights of his transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e. g. negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. Section 7-503 provides for cases of conflict between documents of different issuers.

Cross references. - Point 1: Sections 7-207, 7-304 and 7-601.

Point 3: Section 7-503.

Definitional cross references. - "Bill of lading". Section 1-201.

"Conspicuous". Section 1-201.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Right". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 268; 15A Am. Jur. 2d Commercial Code § 47; 78 Am. Jur. 2d Warehouse § 45.

Assignment of duplicate bill of lading as terminating vendor's right of stoppage in transitu, 7 A.L.R. 1422.

13 C.J.S. Carriers § 402; 80 C.J.S. Shipping § 111; 93 C.J.S. Warehousemen and Safe Depositaries § 23.

55-7-403. Obligation of warehouseman or carrier to deliver; excuse.

(1) The bailee must deliver the goods to a person entitled under the document who complies with Subsections (2) and (3), unless and to the extent that the bailee establishes any of the following:

(a) delivery of the goods to a person whose receipt was rightful as against the claimant;

(b) damage to or delay, loss or destruction of the goods for which the bailee is not liable;

(c) previous sale or other disposition of the goods in lawful enforcement of a lien or on warehouseman's lawful termination of storage;

(d) the exercise by a seller of his right to stop delivery pursuant to the provisions of the article on sales (Section 2-705 [55-2-705 NMSA 1978]);

(e) a diversion, reconsignment or other disposition pursuant to the provisions of this article (Section 7-303 [55-7-303 NMSA 1978]) or tariff regulating such right;

(f) release, satisfaction or any other fact affording a personal defense against the claimant;

(g) any other lawful excuse.

(2) A person claiming goods covered by a document of title must satisfy the bailee's lien where the bailee so requests or where the bailee is prohibited by law from delivering the goods until the charges are paid.

(3) Unless the person claiming is one against whom the document confers no right under Section 7-503(1) [55-7-503(1) NMSA 1978], he must surrender for cancellation or notation of partial deliveries any outstanding negotiable document covering the goods, and the bailee must cancel the document or conspicuously note the partial delivery thereon or be liable to any person to whom the document is duly negotiated.

(4) "Person entitled under the document" means holder in the case of a negotiable document, or the person to whom delivery is to be made by the terms of or pursuant to written instructions under a nonnegotiable document.

History: 1953 Comp., § 50A-7-403, enacted by Laws 1961, ch. 96, § 7-403.

ANNOTATIONS

Compiler's notes. - New Mexico did not adopt the optional language of the uniform act in Subsection (1)(b) which would have placed the burden of establishing negligence in cases relevant to that subsection on persons entitled under the document.

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 8 to 12, 16 and 19, Uniform Warehouse Receipts Act; Sections 11 to 15, 19 and 22, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - 1. The general and primary purpose of this revision is to simplify the statement of the bailee's obligation on the document. The interrelations of the separate sections of the old uniform acts dealing with "obligation to deliver," "justification in delivering" and "liability for misdelivery" are obscure. The present section is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the old uniform acts now find their place as "excuse" under Subsection (1). Unjustified deliveries, i. e., "misdeliveries" under the old acts, are simply omitted from the list of excuses, thus permitting the normal obligation on the document to be asserted.

2. The principal case covered by Subsection (1) (a) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse and takes a negotiable receipt, the warehouseman is not liable on the receipt if he has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See Section 7-503(1). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner's receipt would not be rightful as against a holder to whom the negotiable document was duly negotiated, and delivery to the owner would not give the bailee a defense against such a holder. See Sections 7-502(1)(b) and 7-503(1)(a).

3. Subsection (1) (b) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers and other bailees by the regulatory state laws preserved by Section 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by Sections 7-204 and 7-309 of this article. The optional language in Subsection (1)(b) states the rule laid down for interstate carriers in

many federal cases. State decisions are in conflict as to both carriers and warehousemen. Particular states may prefer to adopt the federal rule.

4. Subsection (2) eliminates the implication of the old uniform acts that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of his lien when asked to deliver, and only in case this request is refused is he justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases.

5. Subsection (3) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in Subsection 1(a) of this section and in Section 7-503(1). It is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

Cross references. - Point 2: Sections 7-502 and 7-503.

Point 3: Sections 7-103, 7-204 and 7-309.

Point 5: Section 7-503(1).

Definitional cross references. - "Bailee". Section 7-102.

"Conspicuous". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.

"Terms". Section 1-201.

"Warehouseman". Section 7-102.

"Written". Section 1-201.

Burden of proving ordinary care upon warehouseman. - Plain and unambiguous language of the law has changed common-law rule so as to place the burden upon the warehouseman to show that in the exercise of ordinary care, he is unable to redeliver the goods bailed to him. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Not enough to show fire of unknown origin. - Establishment of fact that broomcorn in warehouseman's custody was destroyed by fire of unknown origin does not, without more, sustain the burden of showing due care with respect to it. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Evidence allowable in damage suit. - In damage suit to recover for broomcorn in custody of warehouseman, evidence to effect that debris had been allowed to collect beneath platform or floor on which broomcorn was stored, and concerning smoking in and around the place were properly submitted to the jury and its findings were held binding on review. Denning Whse. Co. v. Widener, 172 F.2d 910, 13 A.L.R.2d 669 (10th Cir. 1949)(decided under prior law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 8 Am. Jur. 2d Bailments § 332; 13 Am. Jur. 2d Carriers §§ 417, 419, 423, 436, 439, 442; 15A Am. Jur. 2d Commercial Code §§ 39, 67; 78 Am. Jur. 2d Warehouses §§ 38, 75, 78, 201, 203, 205, 208 to 210, 212, 214, 215, 217 to 219, 255, 293.

Duty of carrier to deliver goods on siding or private track of consignee, 1 A.L.R. 1425.

Delivery of goods to one whose authority to act for consignee has ceased, 2 A.L.R. 279.

Duty to notify consignor when consignee, or person to be notified, refuses to accept goods, 4 A.L.R. 1285.

Lost or mislaid property, respective rights of carrier or one in similar relation to owner and finder, 9 A.L.R. 1388, 170 A.L.R. 706.

What constitutes delivery to carriers of goods in warehouse, 22 A.L.R. 985, 113 A.L.R. 1459.

Delivery without collecting charge as stipulated or directed as affecting liability, 24 A.L.R. 1163, 78 A.L.R. 926, 129 A.L.R. 213.

Delay, or damages incident to delay, in transportation, due to strike, liability of carrier, 28 A.L.R. 503, 45 A.L.R. 919.

Rights of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Delay in transportation or delivery as affecting carrier's liability for loss of or damages to goods by act of God, 46 A.L.R. 302.

Delivery by carrier or warehouseman of property to impostor, 54 A.L.R. 1335.

Warehouseman's bond as covering warehouse receipts issued by warehouse to itself or for its own property, 61 A.L.R. 331.

Diverting shipment, right of shipper or consignee, 61 A.L.R. 1309.

Carrier's employees as agents of shipper or consignee in unloading or caring for livestock at destination, 62 A.L.R. 525.

Interest on damages for warehouseman's refusal to deliver property, or for injury to, or loss of property, 96 A.L.R. 18, 36 A.L.R.2d 337.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

Presumption and burden of proof as to carrier's responsibility for goods received in good condition and delivered to consignee in bad condition, 106 A.L.R. 1156.

Duty of warehouseman to take up and cancel negotiable receipt upon delivering goods as delegable or nondelegable, 139 A.L.R. 1488.

Consignee's refusal to accept delivery at place specified in the contract, or carrier's inability to make delivery at that place, as terminating its liability as carrier, 149 A.L.R. 1118.

When carrier put upon notice that delay in transportation or delivery will cause special damages, 166 A.L.R. 1034.

Presumptions and burden of proof or of evidence where goods stored in situation governed by Uniform Warehouse Receipts Act are stolen, or are damaged or lost by fire or water, 13 A.L.R.2d 681.

Shipper's ratification of carrier's unauthorized delivery or misdelivery, 15 A.L.R.2d 807.

Carrier's liability for conversion by delivery in violation of provision in bill of lading prohibiting or limiting consignee's right to inspect goods shipped, 25 A.L.R.2d 770.

Liability of carrier for delivering goods sent C.O.D. without receiving cash payment, 27 A.L.R.3d 1320.

13 C.J.S. Carriers §§ 408 to 417; 80 C.J.S. Shipping §§ 113, 170; 93 C.J.S. Warehousemen and Safe Depositaries §§ 27, 64.

55-7-404. No liability for good faith delivery pursuant to receipt or bill.

A bailee who in good faith including observance of reasonable commercial standards has received goods and delivered or otherwise disposed of them according to the terms of the document of title or pursuant to this article is not liable therefor. This rule applies even though the person from whom he received the goods had no authority to procure the document or to dispose of the goods and even though the person to whom he delivered the goods had no authority to receive them.

History: 1953 Comp., § 50A-7-404, enacted by Laws 1961, ch. 96, § 7-404.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 10, Uniform Warehouse Receipts Act; Section 13, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - The generalized test of good faith and observance of reasonable commercial standards is substituted for the attempts to particularize what constitutes good faith in the cited sections of the old uniform acts. The section states explicitly what is perhaps an implication from the old acts that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen, who in good faith and with reasonable observance of commercial standards perform obligations which they have assumed and which generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document.

Definitional cross references. - "Bailee". Section 7-102.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

"Term". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 437; 78 Am. Jur. 2d Warehouses §§ 201, 204.

Lack of endorsement or irregular endorsement of warehouse receipt or bill of lading as affecting privilege of goods, 18 A.L.R. 588.

Effectiveness, as pledge, of transfer of nonnegotiable instruments which represent obligations, 53 A.L.R.2d 1396.

80 C.J.S. Shipping § 113; 93 C.J.S. Warehousemen and Safe Depositaries § 27.

PART 5
WAREHOUSE RECEIPTS AND BILLS OF LADING; NEGOTIATION AND TRANSFER

55-7-501. Form of negotiation and requirements of "due negotiation."

(1) A negotiable document of title running to the order of a named person is negotiated by his indorsement and delivery. After his indorsement in blank or to bearer any person can negotiate it by delivery alone.

(2) (a) A negotiable document of title is also negotiated by delivery alone when by its original terms it runs to bearer.

(b) When a document running to the order of a named person is delivered to him the effect is the same as if the document had been negotiated.

(3) Negotiation of a negotiable document of title after it has been indorsed to a specified person requires indorsement by the special indorsee as well as delivery.

(4) A negotiable document of title is "duly negotiated" when it is negotiated in the manner stated in this section to a holder who purchases it in good faith without notice of any defense against or claim to it on the part of any person and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a money obligation.

(5) Indorsement of a nonnegotiable document neither makes it negotiable nor adds to the transferee's rights.

(6) The naming in a negotiable bill of a person to be notified of the arrival of the goods does not limit the negotiability of the bill nor constitute notice to a purchaser thereof of any interest of such person in the goods.

History: 1953 Comp., § 50A-7-501, enacted by Laws 1961, ch. 96, § 7-501.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 28, 29, 31, 32 and 38, Uniform Sales Act; Sections 37, 38, 39, 40 and 47, Uniform Warehouse Receipts Act; Sections 9, 28, 29, 30, 31 and 38, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - 1. In general this section is intended to clarify the language of the old acts and to restate the effect of the better decisions thereunder. An important new concept is added, however, in the requirement of "regular course of business or financing" to effect the "due negotiation" which will transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not his own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not his own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of Subsection (4).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor himself may not have such rights to pass, and even though he may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting the effective wrongful disposition to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy: it is also clearly outside the range of regular course.

Any notice from the face of the document sufficient to put a merchant on inquiry as to the "regular course" quality of the transaction will frustrate a "due negotiation". Thus irregularity of the document on its face or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A preexisting claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent, the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation."

2. Negotiation under this section may be made by any holder no matter how he acquired possession of the document. The present section follows in this respect the Uniform Bills of Lading Act and amendments of the original Uniform Sales Act and Uniform Warehouse Receipts Act proposed by the commissioners on uniform state laws in 1922.

3. Subsection (2) (b) makes explicit a matter upon which the intent of the old acts was clear but the language somewhat obscure: a negotiation results from a delivery to a banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course."

4. This article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by Sections 16, 24 and 59 of the Negotiable Instruments Law. But the reason of the provisions of this act (Section 1-202) on the prima facie authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this act to authorize a purchaser to indulge the presumption of regularity if the courts were not also called upon to do so.

Cross references. - Point 1: Sections 7-502 and 7-503.

Point 2: Section 7-502.

Definitional cross references. - "Bearer". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Good faith". Section 1-201.

"Holder". Section 1-201.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 305; 15A Am. Jur. 2d Commercial Code §§ 39, 51, 57 to 65; 68A Am. Jur. 2d Secured Transactions §§ 18, 109, 476, 829, 926 et seq.; 78 Am. Jur. 2d Warehouses §§ 63 to 66, 69, 72.

Pledge by factor of receipts for principal's property, 14 A.L.R. 435.

Lack of endorsement or irregular endorsement of warehouse receipt as affecting pledge of goods, 18 A.L.R. 588.

Rights of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Acceptance of draft for purchase price with warehouse receipt attached or by transfer of draft with receipt as passing title to goods, 55 A.L.R. 116, 76 A.L.R. 885, 109 A.L.R. 1381.

Duty of warehouseman to take up and cancel negotiable receipt upon delivering goods as delegable or nondelegable, 139 A.L.R. 1488.

Effectiveness, as pledge, of transfer of non-negotiable instruments which represent obligation, 53 A.L.R.2d 1396.

13 C.J.S. Carriers § 398; 80 C.J.S. Shipping § 114; 93 C.J.S. Warehousemen and Safe Depositaries § 25.

55-7-502. Rights acquired by due negotiation.

(1) Subject to the following section [55-7-503 NMSA 1978] and to the provisions of Section 7-205 [55-7-205 NMSA 1978] on fungible goods, a holder to whom a negotiable document of title has been duly negotiated acquires thereby:

(a) title to the document;

(b) title to the goods;

(c) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and

(d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by him except those arising under the terms of the document or under this article. In the case of a delivery order the bailee's obligation accrues only upon acceptance and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(2) Subject to the following section, title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person.

History: 1953 Comp., § 50A-7-502, enacted by Laws 1961, ch. 96, § 7-502.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 20(4), 25, 33, 38 and 62, Uniform Sales Act; Sections 41, 47, 48 and 49, Uniform Warehouse Receipts Act; Sections 32, 38, 39, 40 and 42, Uniform Bills of Lading Act.

Changes. Rewritten.

Purposes of changes. - 1. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the owner of the document and the goods have been brought together in the next section.

2. Subsection (1) (c) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is estopped as against the holder of the document.

3. The explicit statement in Subsection (1) (d) of the bailee's direct obligation to the holder precludes the defense, sometimes successfully asserted under the old acts, that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as non-negligent destruction even though not apparent on the face of the document, and the bailee's obligation is of course subject to lawful provisions in filed classifications and tariffs. See Sections 7-103 and 7-403. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also Section 7-503 (2) and comment.

4. Subsection (2) condenses and continues the law of a number of sections of the prior acts which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in Subsection (1), but it has been included since such explicit references were relied upon under the prior acts to preserve the rights of a purchaser by due negotiation unimpaired. The listing is not exhaustive. Only those matters have been repeated in this subsection which were explicitly reserved in the prior acts except in the case of stoppage in transit. Here, the language has been broadened to include "any stoppage" lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

Cross references. - Sections 7-103, 7-205, 7-403 and 7-503.

Definitional cross references. - "Bailee". Section 7-102.

"Delivery". Section 1-201.

"Delivery order". Section 7-102.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

"Warehouse receipt". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers §§ 307, 313; 15A Am. Jur. 2d Commercial Code §§ 62, 65, 66; 68A Am. Jur. 2d Secured Transactions §§ 18, 109, 476; 78 Am. Jur. 2d Warehouses §§ 68 to 75, 80, 93.

Receipt of partial payment or commercial paper for purchase price for goods as terminating vendor's right of stoppage in transitu, 7 A.L.R. 1412.

Assignment of duplicate bill of lading as terminating vendor's right of stoppage in transitu, 7 A.L.R. 1422.

Failure to ship by carrier designated by buyer as affecting passing of title, 31 A.L.R. 955.

Right of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Measure of seller's damages under executory contract as affected by his resale of the property, 44 A.L.R. 296, 119 A.L.R. 1141.

Passing of title to goods by acceptance of draft for purchase price, with warehouse receipt attached or by transfer of draft with receipt, 55 A.L.R. 1116.

Issuance or nonissuance of bill of lading as affecting delivery of freight to carrier, 113 A.L.R. 1469.

Right of carrier as against transferee of bill to deny receipt of goods, 130 A.L.R. 1315.

Validity as against third persons of sale or pledge of goods retained in warehouse on premises of seller or pledgor (field warehousing), 133 A.L.R. 209.

Bailors of goods covered by policy of insurance issued to warehousemen as subject to defenses that would be available to insurer as against warehousemen, 153 A.L.R. 190.

Effectiveness, as pledge, of transfer of nonnegotiable instruments which represent obligation, 53 A.L.R.2d 1396.

13 C.J.S. Carriers § 400; 80 C.J.S. Shipping § 114; 93 C.J.S. Warehousemen and Safe Depositaries § 25.

55-7-503. Document of title to goods defeated in certain cases.

(1) A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither:

(a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this article (Section 7-403 [55-7-403 NMSA 1978]) or with power of disposition under this act (Sections 2-403 [55-2-403 NMSA 1978] and 9-307 [55-9-307 NMSA 1978]) or other statute or rule of law; nor

(b) acquiesced in the procurement by the bailor or his nominee of any document of title.

(2) Title to goods based upon an unaccepted delivery order is subject to the rights of anyone to whom a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. Such a title may be defeated under the next section [55-7-504 NMSA 1978] to the same extent as the rights of the issuer or a transferee from the issuer.

(3) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of anyone to whom a bill issued by the freight forwarder is duly negotiated; but delivery by the carrier in accordance with Part 4 of this article pursuant to its own bill of lading discharges the carrier's obligation to deliver.

History: 1953 Comp., § 50A-7-503, enacted by Laws 1961, ch. 96, § 7-503.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 33, Uniform Sales Act; Section 41, Uniform Warehouse Receipts Act; Section 32, Uniform Bills of Lading Act.

Changes. Subsection (1) narrows, as compared to the cited sections, the occasions for defeating the document holder's title.

Purposes of changes. - 1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to his own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or tenant does not require active consent under Subsection (1) (b) and knowledge of the likelihood of storage or shipment with no

objection or effort to control it is sufficient to defeat his rights as against one who takes by "due" negotiation of a negotiable document.

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in his duty to sell for cash, the goods are "entrusted" to him "with actual . . . authority . . . to sell" under Subsection (1) (a), and if he procures a negotiable document of title he can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to him simply for safekeeping or storage may be entrusted under circumstances which give him "apparent authority to ship, store or sell" under Subsection (1) (a), or power of disposition under Sections 2-403, 7-205 or 9-307, or under a statute such as the earlier factors acts, or under a rule of law giving effect to apparent ownership. See Section 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. Rounding out the case law development under the prior acts, this act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to his own order and then proceed to misappropriate it. This act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safeguard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchase be in good faith and without notice. See Section 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment, the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See Section 2-403. Both in policy and under the language of Subsection (1) (a) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

2. Under Subsection (1) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in Subsection (1) (a) or (b). Thus the rights of a transferee of a nonnegotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in his procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under Section 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under Subsection (2) in much the same way that the rights of a transferee

may be defeated under Section 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. Section 7-504(2) (b). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under Subsection (3) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's certificate, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and has in all probability issued a certificate. But the carrier is protected in following the terms of its own bill of lading.

Cross references. - Point 1: Sections 2-403, 7-205, 7-501, 9-307 and 9-309.

Point 2: Sections 7-402 and 7-504.

Point 3: Sections 7-402, 7-403 and 7-404.

Definitional cross references. - "Bill of lading". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Delivery order". Section 7-102.

"Document". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Person". Section 1-201.

"Right". Section 1-201.

"Warehouse receipt". Section 1-201.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 419; 15A Am. Jur. 2d Commercial Code §§ 47, 64, 66, 67; 68A Am. Jur. 2d Secured Transactions §§ 18, 869 et seq.; 78 Am. Jur. 2d Warehouses §§ 68, 74, 75, 77, 78, 217, 218.

Uniform Warehouse Receipts Act as affecting liens on property represented by principal, 61 A.L.R. 949.

Status, rights and obligations of freight forwarders, 141 A.L.R. 919.

Estoppel of owner of tangible personal property who knowingly or voluntarily permits another to have possession of warehouse receipts, endorsed in blank or otherwise showing ownership in possessor, to deny latter's authority to sell, mortgage, pledge or otherwise deal with, the property, 151 A.L.R. 696.

Title of goods, as between purchaser from, and one who entrusted them to, auctioneer, 36 A.L.R.2d 1362.

80 C.J.S. Shipping §§ 113, 114; 93 C.J.S. Warehousemen and Safe Depositaries § 24.

55-7-504. Rights acquired in the absence of due negotiation; effect of diversion; seller's stoppage of delivery.

(1) A transferee of a document, whether negotiable or nonnegotiable, to whom the document has been delivered but not duly negotiated, acquires the title and rights which his transferor had or had actual authority to convey.

(2) In the case of a nonnegotiable document, until but not after the bailee receives notification of the transfer, the rights of the transferee may be defeated:

(a) by those creditors of the transferor who could treat the sale as void under Section 2-402 [55-2-402 NMSA 1978]; or

(b) by a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of his rights; or

(c) as against the bailee by good faith dealings of the bailee with the transferor.

(3) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver to the consignee defeats the consignee's title to the goods if they have been delivered to a buyer in ordinary course of business and in any event defeats the consignee's rights against the bailee.

(4) Delivery pursuant to a nonnegotiable document may be stopped by a seller under Section 2-705 [55-2-705 NMSA 1978], and subject to the requirement of due notification there provided. A bailee honoring the seller's instructions is entitled to be indemnified by the seller against any resulting loss or expense.

History: 1953 Comp., § 50A-7-504, enacted by Laws 1961, ch. 96, § 7-504.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 34, Uniform Sales Act; Sections 41(b) and 42, Uniform Warehouse Receipts Act; Sections 32(b) and 33, Uniform Bills of Lading Act.

Changes. Generally rewritten and Subsection (3) is new.

Purposes of changes and new matter. - 1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than he himself has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which he himself has or has "actual authority to convey." Thus, where a negotiable document of title is being transferred the operation of the principle of estoppel is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare Section 2-403 on good faith purchase of goods.)

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if he had purchased the goods themselves. True, his rights are not subject to defeat by attachment of the goods or surrender of them to his transferor [Contrast Subsection (2)]; but on the other hand, he cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to his consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the article of this act on sales (Section 2-403), whereas the same payment made in good faith against an unindorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize his status by compelling indorsement of the document (see Section 7-506).

2. As in the case of transfer - as opposed to "due negotiation" - of negotiable documents, Subsection (1) empowers the transferor of a nonnegotiable document to transfer only such rights as he himself has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than he actually has. Subsection (2) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee.

3. Subsection (3) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under orthodox passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection.

4. Subsection (4) gives the carrier an express right to indemnity where he honors a seller's request to stop delivery.

5. Section 1-201(27) gives the bailee protection, if due diligence is exercised, similar to that found in the third paragraph of Section 33, Uniform Bills of Lading Act, where the bailee's organization has not had time to act on a notification.

Cross references. - Point 1: Sections 2-403 and 7-506.

Point 2: Section 2-403.

Point 3: Sections 7-303 and 7-403(1) (e).

Point 4: Sections 2-705 and 7-403(1) (d).

Definitional cross references. - "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Buyer in ordinary course of business". Section 1-201.

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Honor". Section 1-201.

"Notification". Section 1-201.

"Purchaser". Section 1-201.

"Rights". Section 1-201.

Applicability to vehicle title. - Mere possession by the defendant of the truck title which had been assigned to the plaintiff was not effective to invest the defendant with a security interest in the truck. The certificate of title issued by the Motor Vehicle Division was not the type of instrument contemplated by Paragraph (1). Jones v. Beavers, 116 N.M. 634, 866 P.2d 362 (Ct. App. 1993).

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Attachment and Garnishment § 90; 13 Am. Jur. 2d Carriers §§ 307, 394; 15A Am. Jur. 2d Commercial Code §§ 60, 61, 63, 68, 69; 67A Am. Jur. 2d Sales §§ 807, 1055; 78 Am. Jur. 2d Warehouses §§ 65, 69, 74, 81, 108.

Lack of endorsement or irregular endorsement of warehouse receipt or bill of lading as affecting pledge of goods, 18 A.L.R. 588.

Rights of purchaser of warehouse receipt as against warehouseman, 38 A.L.R. 1205.

Attachment or garnishment of goods covered by negotiable warehouse receipt, 40 A.L.R. 969.

Uniform Warehouse Receipts Act as affecting liens on the property represented by the receipts, 61 A.L.R. 949.

Estoppel of owner of tangible personal property who knowingly or voluntarily permits another to have possession of warehouse receipts, endorsed in blank or otherwise showing ownership in possessor, to deny latter's authority to sell, mortgage, pledge or otherwise deal with the property, 151 A.L.R. 696.

What amounts to acknowledgment by third person that he holds goods on buyer's behalf within statutory provision respecting delivery when goods are in possession of third person, 4 A.L.R.2d 213.

Effectiveness, as pledge, of transfer of nonnegotiable instruments which represent obligation, 53 A.L.R.2d 1396.

80 C.J.S. Shipping §§ 113, 114; 93 C.J.S. Warehousemen and Safe Depositaries § 24.

55-7-505. Indorser not a guarantor for other parties.

The indorsement of a document of title issued by a bailee does not make the indorser liable for any default by the bailee or by previous indorsers.

History: 1953 Comp., § 50A-7-505, enacted by Laws 1961, ch. 96, § 7-505.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 37, Uniform Sales Act; Section 45, Uniform Warehouse Receipts Act; Section 36, Uniform Bills of Lading Act.

Changes. No substantial change.

Purposes of changes. - The indorsement of a document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circumstances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See Section 7-502(1) (d) as to negotiable delivery orders. However, even in such a case, once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.

Cross reference. - Section 7-502.

Definitional cross references. - "Bailee". Section 7-102.

"Document of title". Section 1-201.

"Party". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 70; 78 Am. Jur. 2d Warehouses § 71.

Lack of endorsement or irregular endorsement of warehouse receipt or bill of lading as affecting pledge of goods, 18 A.L.R. 588.

80 C.J.S. Shipping § 113; 93 C.J.S. Warehousemen and Safe Depositaries § 26.

55-7-506. Delivery without indorsement; right to compel indorsement.

The transferee of a negotiable document of title has a specifically enforceable right to have his transferor supply any necessary indorsement but the transfer becomes a negotiation only as of the time the indorsement is supplied.

History: 1953 Comp., § 50A-7-506, enacted by Laws 1961, ch. 96, § 7-506.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 35, Uniform Sales Act; Section 43, Uniform Warehouse Receipts Act; Section 34, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten and former requirement that transfer be "for value" eliminated.

Purposes of changes. - 1. From a commercial point of view the intention to transfer a negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. This position is sustained by the absence of any reported case applying the prior provisions in almost forty years of decisions. Further, the preceding section and the comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that delivery of a document of title without the necessary indorsement is effective as a transfer, the transferee, of course, has not regularized his position until such indorsement is supplied. Until this is done he cannot claim rights under due negotiation within the requirements of this article (Subsection (4) of Section 7-501) on "due negotiation." Similarly, despite the transfer to him of his transferor's title, he cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See Section 7-403(2).

Cross references. - Point 1: Section 7-505.

Point 2: Sections 7-501(4) and 7-403(2).

Definitional cross references. - "Document of title". Section 1-201.

"Rights". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 305; 15A Am. Jur. 2d Commercial Code § 61; 78 Am. Jur. 2d Warehouses § 65.

Lack of endorsement or irregular endorsement of warehouse receipt as affecting pledge of goods, 18 A.L.R. 588.

Rights of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

6A C.J.S. Assignments § 53; 80 C.J.S. Shipping § 114; 93 C.J.S. Warehousemen and Safe Depositaries § 27.

55-7-507. Warranties on negotiation or transfer of receipt or bill.

Where a person negotiates or transfers a document of title for value otherwise than as a mere intermediary under the next following section [55-7-508 NMSA 1978], then unless otherwise agreed he warrants to his immediate purchaser only in addition to any warranty made in selling the goods:

(a) that the document is genuine; and

(b) that he has no knowledge of any fact which would impair its validity or worth; and

(c) that his negotiation or transfer is rightful and fully effective with respect to the title to the document and the goods it represents.

History: 1953 Comp., § 50A-7-507, enacted by Laws 1961, ch. 96, § 7-507.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 36, Uniform Sales Act; Section 44, Uniform Warehouse Receipts Act; Section 35, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten without change in policy.

Purposes of changes. - 1. This section omits provisions of the prior acts on warranties as to the goods as unnecessary and incomplete. It is unnecessary because such warranties derive from the contract of sale and not from the transfer of the documents. The fact that transfer of control occurs by way of a document of title does not limit or displace the ordinary obligations of a seller. The former provision, moreover, was incomplete because it did not expressly include all of the warranties which might rest upon a seller under such circumstances. This act handles the problem by means of the precautionary reference to "any warranty made in selling the goods." If the transfer of documents attends or follows the making of a contract for the sale of goods, the general obligations on warranties as to the goods (Sections 2-312 to 2-318) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary are stated in Section 7-508.

Cross references. - Point 1: Sections 2-312 to 2-318.

Point 2: Section 7-508.

Definitional cross references. - "Document". Section 7-102.

"Document of title". Section 1-201.

"Genuine". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 308; 15A Am. Jur. 2d Commercial Code §§ 71, 72; 68A Am. Jur. 2d Secured Transactions § 109; 78 Am. Jur. 2d Warehouses §§ 71, 90.

13 C.J.S. Carriers § 400; 80 C.J.S. Shipping § 114; 93 C.J.S. Warehousemen and Safe Depositaries § 27.

55-7-508. Warranties of collecting bank as to documents.

A collecting bank or other intermediary known to be entrusted with documents on behalf of another or with collection of a draft or other claim against delivery of documents warrants by such delivery of the documents only its own good faith and authority. This rule applies even though the intermediary has purchased or made advances against the claim or draft to be collected.

History: 1953 Comp., § 50A-7-508, enacted by Laws 1961, ch. 96, § 7-508.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To state the limited warranties given with respect to the documents accompanying a documentary draft.

2. In warranting its authority a bank only warrants its authority from its transferor. See Section 4-203. It does not warrant the genuineness or effectiveness of the document. Compare Section 7-507.

3. Other duties and rights of banks handling documentary drafts for collection are stated in Article 4, Part 5.

Cross references. - Sections 4-203 and 7-507 and 4-501 to 4-504.

Definitional cross references. - "Collecting bank". Section 4-105.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Draft". Section 5-103.

"Good faith". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 9 C.J.S. Banks and Banking § 414.

55-7-509. Receipt or bill; when adequate compliance with commercial contract.

The question whether a document is adequate to fulfill the obligations of a contract for sale or the conditions of a credit is governed by the articles on sales (Article 2) and on letters of credit (Article 5).

History: 1953 Comp., § 50A-7-509, enacted by Laws 1961, ch. 96, § 7-509.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - To cross-refer to the articles of this act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

Cross references. - Articles 2 and 5.

Definitional cross references. - "Contract for sale". Section 2-106.

"Document". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 9 C.J.S. Banks and Banking § 414.

PART 6
WAREHOUSE RECEIPTS AND BILLS OF LADING; MISCELLANEOUS PROVISIONS

55-7-601. Lost and missing documents.

(1) If a document has been lost, stolen or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with such order. If the document was negotiable the claimant must post security approved by the court to indemnify any person who may suffer loss as a result of nonsurrender of the document. If the document was not negotiable, such security may be required at the discretion of the court. The court may also in its discretion order payment of the bailee's reasonable costs and counsel fees.

(2) A bailee who without court order delivers goods to a person claiming under a missing negotiable document is liable to any person injured thereby, and if the delivery is not in good faith becomes liable for conversion. Delivery in good faith is not conversion if made in accordance with a filed classification or tariff or, where no classification or tariff is filed, if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery who files a notice of claim within one year after the delivery.

History: 1953 Comp., § 50A-7-601, enacted by Laws 1961, ch. 96, § 7-601.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 14, Uniform Warehouse Receipts Act; Section 17, Uniform Bills of Lading Act.

Changes. General revision. Principal innovations include: affirmation of bailee's privilege to deliver to claimant without resort to judicial proceedings if the bailee acts in good faith and is willing to take the full risk of loss in case the lost document turns up in the hands of an innocent purchaser; explicit authorization to the court to order bailee to issue a substitute document rather than make physical delivery of the goods; inclusion of "stolen" as well as lost documents and extension of section to nonnegotiable documents.

Purposes of changes. The purposes of the changes insofar as they are not self-evident are as follows:

1. As to bailee's privilege to deliver without court order, doubt had arisen as to the propriety of such action under Section 54 of the Uniform Warehouse Receipts Act, which made it a crime to deliver goods covered by negotiable receipts without taking up the receipts "except in the cases provided for in Section 14" (the lost receipts section). This has been interpreted by one court as exempting from criminal liability only if the judicial procedure of Section 14 was followed. Dahl v. Winter-Truesdell-Diercks Co., 61 N. D. 84, 237 N.W. 202 (1931). Although the criminal provisions are not being reenacted in this act (and the Uniform Bills of Lading Act never did include such a criminal provision), it seems advisable to clarify the legality of the well established commercial practice of bailees to make delivery where they are satisfied that the claimant is the person entitled under a lost document. Since the bailee remains liable on the document in such cases, he will usually insist that the claimant provide an indemnity bond.

2. The old acts provide only for compulsory delivery of goods; this section provides also for compulsory issuance of a substitute document. If continuance of the bailment is desirable there is no reason to require the goods to be withdrawn and redeposited in order to secure a negotiable document. The present acts would probably be so interpreted. Section 20 of the Federal Warehouse Act and some state laws expressly require issuance of a new receipt on proof of loss and posting of bond.

3. Claimants on nonnegotiable instruments are permitted to avail themselves of this procedure because straight bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement.

Ordinarily no security would be necessary to indemnify a bailee in delivering to the person named in a nonnegotiable document. But disputes as to negotiability may arise, in which case if there is a reasonable doubt on the point the bailee should be protected against the possibility that the missing document would, in the hands of an innocent purchaser for value, be held negotiable.

4. It seems unnecessary to state, as do the present acts, that the court shall act "on satisfactory proof of such loss or destruction." The right of action created by the section is conditioned on a document being lost, stolen or destroyed. Plaintiff must of course bring himself within the section. There is nothing in the language of the old acts to suggest that they intended to impose anything but the normal burden of proof on the plaintiff in such proceedings.

5. Subsection (2) makes it clear that after delivery without court order the bailee remains liable for actual damages. Liability for conversion is provided where the delivery is dishonest, but excluded where a filed classification or tariff is followed in good faith, or where the described bond is posted in good faith and no classification or tariff is filed. Liability for conversion in other cases is left to judicial decision.

Definitional cross references. - "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Good faith". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouseman". Section 7-102.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 13 Am. Jur. 2d Carriers § 421; 15A Am. Jur. 2d Commercial Code §§ 42, 47, 121; 78 Am. Jur. 2d Warehouses §§ 45, 220.

Right of purchaser of warehouse receipt against warehouseman, 38 A.L.R. 1205.

Provision in warehouseman's receipt limiting liability as applicable where warehouseman converts property, 99 A.L.R. 266.

Degree or quantum of evidence necessary to establish a lost instrument, 148 A.L.R. 400.

54 C.J.S. Lost Instruments § 1 et seq.

55-7-602. Attachment of goods covered by a negotiable document.

Except where the document was originally issued upon delivery of the goods by a person who had no power to dispose of them, no lien attaches by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless the document be first surrendered to the bailee or its negotiation enjoined, and the bailee shall not be compelled to deliver the goods pursuant to process until the document is surrendered to him or impounded by the court. One who purchases the document for value without notice of the process or injunction takes free of the lien imposed by judicial process.

History: 1953 Comp., § 50A-7-602, enacted by Laws 1961, ch. 96, § 7-602.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 25, Uniform Warehouse Receipts Act; Section 24, Uniform Bills of Lading Act.

Changes. Consolidated and rewritten.

Purposes of changes. - 1. The purpose of the section is to protect the bailee from conflicting claims of the document holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail unless, in effect, the judgment creditors immobilize the negotiable document. However, if the document was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.

2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

Cross reference. - Point 1: Section 7-503.

Definitional cross references. - "Bailee". Section 7-102.

"Delivery". Section 1-201.

"Document". Section 7-102.

"Goods". Section 7-102.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Value". Section 1-201.

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Attachment and Garnishment § 61; 8 Am. Jur. 2d Bailments § 99; 68A Am. Jur. 2d Secured Transactions § 572; 78 Am. Jur. 2d Warehouses §§ 107, 224.

Attachment or garnishment of goods covered by negotiable warehouse receipt, 40 A.L.R. 969.

Garnishment of carrier in respect of goods shipped, 46 A.L.R. 933.

Uniform warehouse receipts as affecting liens on the property represented by the receipts, 61 A.L.R. 949.

Allowance of attorneys' fees to party interpleading claimants to funds or property, 48 A.L.R.2d 190.

7 C.J.S. Attachment § 273; 33 C.J.S. Execution §§ 128, 129.

55-7-603. Conflicting claims; interpleader.

If more than one person claims title or possession of the goods, the bailee is excused from delivery until he has had a reasonable time to ascertain the validity of the adverse claims or to bring an action to compel all claimants to interplead and may compel such interpleader, either in defending an action for nondelivery of the goods, or by original action, whichever is appropriate.

History: 1953 Comp., § 50A-7-603, enacted by Laws 1961, ch. 96, § 7-603.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 16 and 17, Uniform Warehouse Receipts Act; Sections 20 and 21, Uniform Bills of Lading Act.

Changes. Consolidation without substantial change.

Purposes of changes. - The section enables a bailee faced with conflicting claims to the goods to compel the claimants to litigate their claims with each other rather than with him.

Definitional cross references. - "Action". Section 1-201.

"Bailee". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Reasonable time". Section 1-204.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 8 Am. Jur. 2d Bailments §§ 284, 285; 13 Am. Jur. 2d Carriers § 441; 78 Am. Jur. 2d Warehouses §§ 221, 264.

Jurisdiction of state courts of actions in relation to interstate shipments, 64 A.L.R. 333.

Interpleader where one claimant asserts adverse and paramount title, 97 A.L.R. 996.

Warehouseman's right to interplead rival claimants, 100 A.L.R. 425.

Allowance of attorneys' fees to party interpleading claimants to funds or property, 48 A.L.R.2d 190.

48 C.J.S. Interpleader § 12.

PART 7 WAREHOUSE RECEIPTS; SPECIAL PENALTY PROVISIONS

55-7-701. Issue of receipt for goods not received.

A warehouseman, or any officer, agent or servant of a warehouseman, who issues or aids in issuing a receipt knowing that the goods for which such receipt is issued have not been actually received by such warehouseman, or are not under his actual control at the time of issuing such receipt, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars [($5,000)], or by both.

History: 1953 Comp., § 50A-7-701, enacted by Laws 1961, ch. 96, § 7-701.

ANNOTATIONS

Compiler's note. - Part 7 of Article 7 of this chapter is not included in the uniform act.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses § 49.

93 C.J.S. Warehousemen and Safe Depositaries § 18.

55-7-702. Issue of receipt containing false statement.

A warehouseman, or any officer, agent or servant of a warehouseman, who fraudulently issues or aids in fraudulently issuing a receipt for goods knowing that it contains any false statement, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-702, enacted by Laws 1961, ch. 96, § 7-702.

55-7-703. Issue of duplicate receipts not so marked.

A warehouseman, or any officer, agent or servant of a warehouseman, who issues or aids in issuing a duplicate or additional negotiable receipt for goods knowing that a former negotiable receipt for the same goods or any part of them is outstanding and uncancelled, without plainly placing upon the face thereof the word "duplicate" except in the case of a lost or destroyed receipt after proceedings as provided for in Section 7-601 (1) [55-7-601 (1) NMSA 1978], shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars [($5,000)] or by both.

History: 1953 Comp., § 50A-7-703, enacted by Laws 1961, ch. 96, § 7-703.

ANNOTATIONS

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses § 308.

93 C.J.S. Warehousemen and Safe Depositaries § 23.

55-7-704. Issue for warehouseman's goods of receipts which do not state that fact.

Where there are deposited with or held by a warehouseman goods of which he is owner, either solely or jointly or in common with others, such warehouseman, or any of his officers, agents or servants who, knowing this ownership, issues or aids in issuing a negotiable receipt for such goods which does not state such ownership, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-704, enacted by Laws 1961, ch. 96, § 7-704.

55-7-705. Delivery of goods without obtaining negotiable receipt.

A warehouseman, or any officer, agent or servant of a warehouseman who delivers goods out of the possession of such warehouseman, knowing that a negotiable receipt the negotiation of which would transfer the right to the possession of such goods is outstanding and uncancelled, without obtaining the possession of such receipt at or before the time of such delivery, shall, except in the cases provided for in Section 7-601 [55-7-601 NMSA 1978], be found guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-705, enacted by Laws 1961, ch. 96, § 7-705.

ANNOTATIONS

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses §§ 216 to 220.

93 C.J.S. Warehousemen and Safe Depositaries § 49.

55-7-706. Negotiation of receipt for goods subject to a security interest.

Any person who deposits goods to which he has not title, or in which there is a security interest, and who takes for such goods a negotiable receipt which he afterwards negotiates for value with intent to deceive and without disclosing his want of title or the existence of the security interest shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-706, enacted by Laws 1961, ch. 96, § 7-706.

PART 8 BILLS OF LADING; SPECIAL PENALTY PROVISIONS

55-7-801. Issue of bill for goods not received.

Any officer, agent or servant of a carrier, who with intent to defraud issues or aids in issuing a bill knowing that all or any part of the goods for which such bill is issued have not been received by such carrier, or by an agent of such carrier, or by a connecting carrier or are not under the carrier's control at the time of issuing such bill, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars [($5,000)] or by both.

History: 1953 Comp., § 50A-7-801, enacted by Laws 1961, ch. 96, § 7-801.

ANNOTATIONS

Compiler's note. - Part 8 of Article 7 of this chapter is not included in the uniform act.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses § 49.

93 C.J.S. Warehousemen and Safe Depositaries § 18.

55-7-802. Issue of bill containing false statement.

Any officer, agent or servant of a carrier, who with intent to defraud issues or aids in issuing a bill for goods knowing that it contains any false statement, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-802, enacted by Laws 1961, ch. 96, § 7-802.

55-7-803. Issue of duplicate bills not so marked.

Any officer, agent or servant of a carrier, who with intent to defraud issues or aids in issuing a duplicate or additional negotiable bill for goods in violation of the provisions of Section 7-402 [55-7-402 NMSA 1978], knowing that a former negotiable bill for the same goods or any part of them is outstanding and uncanceled, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars [($5,000)] or by both.

History: 1953 Comp., § 50A-7-803, enacted by Laws 1961, ch. 96, § 7-803.

ANNOTATIONS

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses § 308.

93 C.J.S. Warehousemen and Safe Depositaries § 23.

55-7-804. Negotiation of bill for goods subject to a security interest.

Any person who ships goods to which he has not title, or in which there is a security interest, and who takes for such goods a negotiable bill which he afterwards negotiates for value with intent to deceive and without disclosing his want of title or the existence of the security interest, shall be guilty of a crime and upon conviction shall be punished for each offense by imprisonment not exceeding one year, or by a fine not exceeding one thousand dollars [($1,000)] or by both.

History: 1953 Comp., § 50A-7-804, enacted by Laws 1961, ch. 96, § 7-804.

55-7-805. Negotiation of bill when goods are not in carrier's possession.

Any person who with intent to deceive negotiates or transfers for value a bill knowing that any or all of the goods which by the terms of such bill appear to have been reecived [received] for transportation by the carrier which issued the bill, are not in the

possession or control of such carrier, or of a connecting carrier, without disclosing this fact, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years or by a fine not exceeding five thousand dollars [($5,000)], or by both.

History: 1953 Comp., § 50A-7-805, enacted by Laws 1961, ch. 96, § 7-805.

ANNOTATIONS

Am. Jur. 2d, A.L.R. and C.J.S. references. - 78 Am. Jur. 2d Warehouses §§ 216 to 220.

93 C.J.S. Warehousemen and Safe Depositaries § 49.

55-7-806. Inducing carrier to issue bill when goods have not been received.

Any person who with intent to defraud secures the issue by a carrier of a bill knowing that at the time of such issue, any or all of the goods described in such bill as received for transportation have not been received by such carrier, or an agent of such carrier or a connecting carrier, or are not under the carrier's control, by inducing an officer, agent or servant of such carrier falsely to believe that such goods have been received by such carrier, or are under its control, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years, or by a fine not exceeding five thousand dollars [($5,000)] or by both.

History: 1953 Comp., § 50A-7-806, enacted by Laws 1961, ch. 96, § 7-806.

55-7-807. Issue of nonnegotiable bill not so marked.

Any person who with intent to defraud issues or aids in issuing a nonnegotiable bill without the words, "not negotiable" placed plainly upon the face thereof, shall be guilty of a crime, and upon conviction shall be punished for each offense by imprisonment not exceeding five years or by a fine not exceeding five thousand dollars [($5,000)], or by both.

History: 1953 Comp., § 50A-7-807, enacted by Laws 1961, ch. 96, § 7-807.

ARTICLE 8
INVESTMENT SECURITIES

Part 1

Short Title and General Matters.

Part 2

Issue and Issuer.

Part 3

Transfer of Certificated and Uncertificated Securities.

Part 4

Registration.

Part 5

Security Entitlements.

ANNOTATIONS

Compiler's notes. - Laws 1961, ch. 96 enacted New Mexico's version of the Uniform Commercial Code. The 1972 revision of the code, which revised primarily Article 9, was adopted by Laws 1985, ch. 193, effective January 1, 1986. The 1977 revision of the code, which revised primarily Article 8, was adopted by Laws 1987, ch. 248, effective June 19, 1987. The 1994 revision of Article 8 was adopted by Laws 1996, ch. 47, effective May 15, 1996.

PART 1
SHORT TITLE AND GENERAL MATTERS

55-8-101. Short title.

Chapter 55, Article 8 NMSA 1978 may be cited as the "Uniform Commercial Code - Investment Securities".

History: 1978 Comp., § 55-8-101, enacted by Laws 1996, ch. 47, § 5.

ANNOTATIONS

Purposes.

This Article sets forth certain rights and duties of the issuers of and the parties that deal with investment securities, both certificated and uncertificated. Unlike a corporation code, it does not set forth general rules defining property rights that accrue to holders of securities. And unlike a Blue Sky statute it does not set forth specific requirements for disclosing to the public the nature of the property interest that is the security. Rather it

sets forth rules relative to the transfer of the rights that constitute securities and to the establishment of those rights against the issuer and other parties.

As is true with respect to all other Articles of the Code, parties may by agreement create rights and duties between themselves that vary from those set forth in this Article. Section 1-102(3). But prejudice to the rights of those not party to the agreement is limited by Code provisions (*e.g.,* Sections 8-313 and 8-321) as well as by general legal principles that supplement the Code. See Section 1-103 and Comment 2 to Section 1-102.

This Article does not purport to determine whether a particular issue of securities should be represented by certificates, in whole or in part. That determination is left to the parties involved, subject to federal and state law.

Repeals and reenactments. - Laws 1996, ch. 47, § 5 repeals 55-8-101 NMSA 1978, as enacted by Laws 1961, ch. 96, § 8-101, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Saving clauses. - Laws 1996, ch. 47, § 69 provides that no action or proceeding will be affected by Chapter 55, Article 8 NMSA 1978 and provides for the continued perfection of existing security interests for a period of four months.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes §§ 8, 47; 15A Am. Jur. 2d Commercial Code § 73 et seq.

Conflict of laws as to transfer of corporate stock, 131 A.L.R. 192.

Construction and effect of U.C.C., art. 8, dealing with investment securities, 21 A.L.R.3d 964, 88 A.L.R.3d 949.

Awarding damages for delay, in addition to specific performance, of contract for sale of corporate stock, 28 A.L.R.3d 1401.

18 C.J.S. Corporations §§ 217 to 292; 64 C.J.S. Municipal Corporations § 1950; 81A C.J.S. States § 186.

55-8-102. Definitions.

(a) In this article:

(1) "adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer or deal with the financial asset;

(2) "bearer form", as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement;

(3) "broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity;

(4) "certificated security" means a security that is represented by a certificate;

(5) "clearing corporation" means:

(i) a person that is registered as a "clearing agency" under the federal securities laws;

(ii) a federal reserve bank; or

(iii) any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority;

(6) "communicate" means to:

(i) send a signed writing; or

(ii) transmit information by any mechanism agreed upon by the persons transmitting and receiving the information;

(7) "entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of Section 55-8-501(b)(2) or (3) NMSA 1978, that person is the entitlement holder;

(8) "entitlement order" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement;

(9) "financial asset", except as otherwise provided in Section 55-8-103 NMSA 1978, means:

(i) a security;

(ii) an obligation of a person or a share, participation or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this article. As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate or a security entitlement;

(10) "good faith", for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this article, means honesty in fact and the observance of reasonable commercial standards of fair dealing;

(11) "indorsement" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring or redeeming the security or granting a power to assign, transfer or redeem it;

(12) "instruction" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed;

(13) "registered form", as applied to a certificated security, means a form in which:

(i) the security certificate specifies a person entitled to the security; and

(ii) a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer or the security certificate so states;

(14) "securities intermediary" means:

(i) a clearing corporation; or

(ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity;

(15) "security", except as otherwise provided in Section 55-8-103 NMSA 1978, means an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer:

(i) which is represented by a security certificate in bearer or registered form or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations; and

(iii) which:

(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this article;

(16) "security certificate" means a certificate representing a security;

(17) "security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 of this article; and

(18) "uncertificated security" means a security that is not represented by a certificate.

(b) Other definitions applying to this article and the sections in which they appear are:

appropriate person Section 55-8-107 NMSA 1978;
control Section 55-8-106 NMSA 1978;
delivery Section 55-8-301 NMSA 1978;
investment company security Section 55-8-103 NMSA 1978;
issuer Section 55-8-201 NMSA 1978;
overissue Section 55-8-210 NMSA 1978;
protected purchaser Section 55-8-303 NMSA 1978; and
securities account Section 55-8-501 NMSA 1978.

(c) In addition, Chapter 55, Article 1 NMSA 1978 contains general definitions and principles of construction and interpretation applicable throughout this article.

(d) The characterization of a person, business or transaction for purposes of this article does not determine the characterization of the person, business or transaction for purposes of any other law, regulation or rule.

History: 1978 Comp., § 55-8-102, enacted by Laws 1996, ch. 47, § 6.

ANNOTATIONS

OFFICIAL COMMENT

1. "Adverse claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the secured party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as *Fallon v. Wall Street Clearing Corp.*, 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and *Pentech Intl. v. Wall St. Clearing Co.*, 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(14) [55-8-102 NMSA 1978] probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 definition when they

perform functions that would bring them within the federal securities law definition if it did not have the clause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i) [55-8-108 NMSA 1978], and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c) [55-9-115 NMSA 1978].

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible to adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) [55-1-201 NMSA 1978] as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term communicate is used in Sections 8-102(a)(7) [55-8-102 NMSA 1978] (definition of entitlement order), 8-102(a)(11) (definition of instruction), and 8-403 [55-8-403 NMSA 1978] (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 [55-8-501 NMSA 1978] even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the

person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 [55-8-106 NMSA 1978] and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b) [55-8-107 NMSA 1978].

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "securities account" in Section 8-501 [55-8-501 NMSA 1978], sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8?" Rather, one must analyze whether the relationship between an institution and a person

on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501 [55-8-501 NMSA 1978]. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 for purposes of the application to Article 8 of Section 1-203 [55-1-203 NMSA 1978], which provides that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1-203 obligation as it applies to contracts and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 [55-8-115 NMSA 1978] provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 and 8-503(e) [55-8-404 and 55-8-503 NMSA 1978], do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established inprovisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 [55-8-105 NMSA 1978] on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8-308(1) [55-8-308 NMSA 1978] of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a) [55-3-204 NMSA 1978]. The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized.

Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107 [55-8-107 NMSA 1978].

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting function, while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting in the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its

own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security - that is, the underlying intangible interest - not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 security. This opt-in provision allows for deliberate expansion of the scope of Article 8.

Section 8-103 [55-8-103 NMSA 1978] contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8-104(c) [55-8-104 NMSA 1978] and 8-503 [55-8-503 NMSA 1978]. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Bank" Section 1-201(4)

"Person" Section 1-201(30)

"Send" Section 1-201(38)

"Signed" Section 1-201(39)

"Writing" Section 1-201(46)

Cross-references. - For fiduciary or custodian depositing securities in clearing corporation, see 46-1-12 NMSA 1978.

Repeals and reenactments. - Laws 1996, ch. 47, § 6 repeals 55-8-102 NMSA 1978, as amended by Laws 1987, ch. 248, § 3, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 4 Am. Jur. 2d Alteration of Instruments § 26; 12 Am. Jur. 2d Bonds § 55; 13 Am. Jur. 2d Carriers § 47; 15A Am. Jur. 2d Commercial Code §§ 73, 74, 77, 86, 91, 107; 18A Am. Jur. 2d Corporations §§ 509, 681; 50 Am. Jur. 2d Letters of Credit and Credit Cards § 3; 68A Am. Jur. 2d Secured Transactions §§ 19, 55, 109.

What is a "security" under UCC Article 8, 11 A.L.R.4th 1036.

82 C.J.S. Statutes § 315.

55-8-103. Rules for determining whether certain obligations and interests are securities or financial assets.

(a) A share or similar equity interest issued by a corporation, business trust, joint stock company or similar entity is a security.

(b) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this article or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this article and not by Chapter 55, Article 3 NMSA 1978, even though it also meets the requirements of that article. However, a negotiable instrument governed by Chapter 55, Article 3 NMSA 1978 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security. It is a financial asset.

(f) A commodity contract, as defined in Section 55-9-115 NMSA 1978, is not a security or a financial asset.

History: 1978 Comp., § 55-8-103, enacted by Laws 1996, ch. 47, § 7.

ANNOTATIONS

OFFICIAL COMMENT

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102 [55-8-102 NMSA 1978]. The Section 8-102 definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 definitions to investment products not covered by this section.

2. Subsection (a) establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded on securities exchanges or in securities markets. Thus, shares of closely held corporations are Article 8 securities.

3. Subsection (b) establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance or redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 [55-8-102 NMSA 1978] refer to "redemptions" as well as "transfers," to ensure that the Article 8 rules on such matters as signature guaranties, Section 8-306 [55-8-306 NMSA 1978], assurances, Sections 8-402 and 8-507 [55-8-402 and 55-8-507 NMSA 1978], and effectiveness, Section 8-107 [55-8-107 NMSA 1978], apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 mechanics.

4. Subsection (c) is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) [55-8-102 NMSA 1978] to partnership interests. Subsection (c) establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Partnership interests or shares of limited liability companies are included in the broader term "financial asset." Thus, if they are held through a securities account, the indirect holding system rules of Part 5 apply, and the interest of a person who holds them through such an account is a security entitlement.

5. Subsection (d) deals with the line between Article 3 negotiable instruments and Article 8 investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 definition is covered by Article 8 rather than Article 3, even though it also meets the definition of negotiable instrument. However, subsection (d) provides that an Article 3 negotiable instrument is a "financial asset" so that the

indirect holding system rules apply if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) excludes commodity contracts from all of Article 8. However, the Article 9 rules on security interests in investment property do apply to security interests in commodity positions. See Section 9-115 [55-9-115 NMSA 1978] and Comment 8 thereto. "Commodity contract" is defined in Section 9-115.

Definitional Cross References: - "Clearing corporation" Section 8-102(a)(5) [55-8-102 NMSA 1978]

"Commodity contract" Section 9-115 [55-9-115 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

Repeals and reenactments. - Laws 1996, ch. 47, § 7 repeals former 55-8-103 NMSA 1978, as amended by Laws 1987, ch. 248, § 4, relating to issuer's lien, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-104. Acquisition of security or financial asset or interest therein.

(a) A person acquires a security or an interest therein, under this article, if:

(1) the person is a purchaser to whom a security is delivered pursuant to Section 55-8-301 NMSA 1978; or

(2) the person acquires a security entitlement to the security pursuant to Section 55-8-501 NMSA 1978.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this article, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5 of this article, but is a purchaser of any security, security entitlement or other financial asset held by the securities intermediary only to the extent provided in Section 55-8-503 NMSA 1978.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule or agreement to transfer, deliver, present, surrender, exchange or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to Subsection (a) or (b).

History: 1978 Comp., § 55-8-104, enacted by Laws 1996, ch. 47, § 8.

ANNOTATIONS

OFFICIAL COMMENT

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8. In that sense, it describes the scope of Article 8. Subsection (a) describes the two ways that a person may acquire a security or interest therein under this Article: (1) by delivery (Section 8-301 [55-8-301 NMSA 1978]), and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301, describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 [55-8-501 NMSA 1978] on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) specifies how a person may acquire an interest under Article 8 in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3, not by Article 8. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3, not Article 8, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 rules specifying how negotiable instruments are transferred. The rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect

holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 [55-8-503 NMSA 1978] a security entitlement is treated as a *sui generis* form of property interest.

3. Subsection (d) is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d) takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References: - "Delivery" Section 8-301 [55-8-301 NMSA 1978]

"Financial asset" Section 8-102(a)(9) [55-8-102 NMSA 1978]

"Person" Section 1-201(30) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security entitlement" Section 8-102(a)(17)

Repeals and reenactments. - Laws 1996, ch. 47, § 8 repeals 55-8-104 NMSA 1978, as amended by Laws 1987, ch. 248, § 5, relating to the effect of overissuance of securities, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right to compel endorsement of unendorsed "order,", 87 A.L.R. 1178.

55-8-105. Notice of adverse claim.

(a) A person has notice of an adverse claim if:

(1) the person knows of the adverse claim;

(2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) the person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) one year after a date set for presentment or surrender for redemption or exchange; or

(2) six months after a date set for payment of money against presentation or surrender of the certificate, if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(2) is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under Article 9 is not notice of an adverse claim to a financial asset.

History: 1978 Comp., § 55-8-105, enacted by Laws 1996, ch. 47, § 9.

ANNOTATIONS

OFFICIAL COMMENT

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502, and 8-510 [55-8-303, 55-8-502, and 55-8-510 NMSA 1978], provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) [55-1-201 NMSA 1978] - which provides that a person has notice of a fact if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists" - does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

The general Article 1 definition of "notice" in Section 1-201(25) [55-1-201 NMSA 1978] - which provides that a person has notice of a fact if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists" - does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1) [55-8-102 NMSA 1978]. "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefore,

awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) is a particularization of this general principle.

3. Paragraph (a)(1) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) [55-1-201 NMSA 1978] as actual knowledge.

4. Paragraph (a)(2) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See *May v. Chapman*, 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); *Goodman v. Simonds*, 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a non-professional.

The second prong of the willful blindness test of paragraph (a)(2) turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim

exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27) [55-1-201 NMSA 1978]. An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303 [55-8-303 NMSA 1978]. The same result has been reached under the prior version of Article 8. See *First Nat'l Bank of Cicero v. Lewco Securities*, 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See *State Bank of Binghamton v. Bache*, 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefore disqualified from protected purchaser status under Section 8-303 [55-8-303 NMSA 1978]. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses of an issuer (Section 8-203 [55-8-203 NMSA 1978]) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would

not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a).

8. Subsection (d) provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d).

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Bearer form" Section 8-102(a)(2)

"Certificated security" Section 8-102(a)(4)

"Financial asset" Section 8-102(a)(9)

"Knowledge" Section 1-201(25) [55-1-201 NMSA 1978]

"Person" Section 1-201(30)

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Representative" Section 1-201(35)

"Security certificate" Section 8-102(a)(16)

Cross-references. - For Uniform Act for Simplification of Fiduciary Security Transfers, see ch. 46, art. 8 NMSA 1978.

Repeals and reenactments. - Laws 1996, ch. 47, § 9 repeals former 55-8-105 NMSA 1978, as amended by Laws 1987, ch. 248, § 6, relating to the negotiability of certificated securitites and certain presumptions, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-106. Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser and:

(1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser; or

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) the purchaser becomes the entitlement holder; or

(2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of Subsection (c)(2) or (d)(2) has control even if the registered owner in the case of Subsection (c)(2) or the entitlement holder in the case of Subsection (d)(2) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in Subsection (c)(2) or (d)(2) without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

History: 1978 Comp., § 55-8-106, enacted by Laws 1996, ch. 47, § 10.

ANNOTATIONS

OFFICIAL COMMENT

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 [55-8-303 NMSA 1978] (protected purchasers); 8-503(e) [55-8-503 NMSA 1978] (purchasers from securities intermediaries); 8-510 [55-8-510 NMSA 1978] (purchasers of security entitlements from entitlement holders); 9-115(4) [55-9-115 NMSA 1978] (perfection of security interests); 9-115(5) (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301 [55-8-301 NMSA 1978]. Subsection (b) provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301, provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1), securities can be "delivered" to a purchaser. Section 8-301(b) [55-8-301 NMSA 1978] provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See Section 8-207 [55-8-207 NMSA 1978]. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202 [55-9-202 NMSA 1978]. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party - so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) makes this point explicit. The subsection (c)(2) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) specifies the means by which a purchaser can obtain control over a security entitlement. Two mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary.

Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser, even though the transferor remains listed as the entitlement holder. This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the rules of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank also has an account with Able. Debtor instructs Able to transfer the shares to Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 2. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank does not have an account with Able. Alpha Bank uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta Bank, for the account of Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha Bank enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha Bank also has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha Bank's account at Clearing Corporation. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha Bank does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta Bank's account at Clearing Corporation. Beta Bank credits the position to Alpha Bank's account with Beta Bank. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha Bank has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

5. For a purchaser to have "control" under subsection (c)(2) or (d)(2), it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) or (d)(2) because the issuer or securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) or (d)(1) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the present ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement. Subsection (f) is included to make clear the general point stated in subsection (c) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control.

Definitional Cross References: - "Bearer form" Section 8-102(a)(2) [55-8-102 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Delivery" Section 8-301 [55-8-301 NMSA 1978]

"Effective" Section 8-107 [55-8-107 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Entitlement order" Section 8-102(a)(8)

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Purchaser" Sections 1-201(33) & 8-116 [55-1-201 and 55-8-116 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 10 repeals former 55-8-106 NMSA 1978, as amended by Laws 1987, ch. 248, § 7, relating to application of laws, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-107. Whether indorsement, instruction or entitlement order is effective.

(a) "Appropriate person" means:

(1) with respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) with respect to an instruction, the registered owner of an uncertificated security;

(3) with respect to an entitlement order, the entitlement holder;

(4) if the person designated in Paragraph (1), (2) or (3) is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) if the person designated in Paragraph (1), (2) or (3) lacks capacity, the designated person's guardian, conservator or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction or entitlement order is effective if:

(1) it is made by the appropriate person;

(2) it is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under Section 55-8-106(c)(2) or (d)(2) NMSA 1978; or

(3) the appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction or entitlement order made by a representative is effective even if:

(1) the representative has failed to comply with a controlling instrument or with the law of the state having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) the representative's action in making the indorsement, instruction or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction or entitlement order is determined as of the date the indorsement, instruction or entitlement order is made, and an indorsement, instruction or entitlement order does not become ineffective by reason of any later change of circumstances.

History: 1978 Comp., § 55-8-107, enacted by Laws 1996, ch. 47, § 11.

ANNOTATIONS

OFFICIAL COMMENT

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507 [55-8-115 and 55-8-507 NMSA 1978].

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 [55-8-303 NMSA 1978] only if the purchaser obtains "control." Section 8-106 [55-8-106 NMSA 1978] provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" indorsement.

2. Subsection (a) provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 [55-8-106 NMSA 1978] provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders of instructions. Paragraph 2 of subsection (b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d), and (e) supplement the general rule of subsection (b) on effectiveness. The term "representative," used in subsections (c) and (d), is defined in Section 1-201(35) [55-1-201 NMSA 1978].

4. Subsection (c) provides that an indorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer

should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303 [55-8-303 NMSA 1978]. Under Section 8-404 [55-8-404 NMSA 1978], the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

Example 2. Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser. Subsection (d) provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

Example 3. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d), because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306 [55-8-306 NMSA 1978].

6. Subsection (e) provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

Example 4. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4). Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404 [55-8-404 NMSA 1978].

Definitional Cross References: - "Entitlement order" Section 8-102(a)(8) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Representative" Section 1-201(35) [55-1-201 NMSA 1978]

"Securities account" Section 8-501 [55-8-501 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Security entitlement" Section 8-102(a)(17)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 11 repeals former 55-8-107 NMSA 1978, as amended by Laws 1987, ch. 248, § 8, relating to the transferability of securitites and actions for price, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-108. Warranties in direct holding.

(a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser that:

(1) the certificate is genuine and has not been materially altered;

(2) the transferor or indorser does not know of any fact that might impair the validity of the security;

(3) there is no adverse claim to the security;

(4) the transfer does not violate any restriction on transfer;

(5) if the transfer is by indorsement, the indorsement is made by an appropriate person or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(6) the transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:

(1) the instruction is made by an appropriate person, or, if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;

(2) the security is valid;

(3) there is no adverse claim to the security; and

(4) at the time the instruction is presented to the issuer:

(i) the purchaser will be entitled to the registration of transfer;

(ii) the transfer will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction;

(iii) the transfer will not violate any restriction on transfer; and

(iv) the requested transfer will otherwise be effective and rightful.

(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:

(1) the uncertificated security is valid;

(2) there is no adverse claim to the security;

(3) the transfer does not violate any restriction on transfer; and

(4) the transfer is otherwise effective and rightful.

(d) A person who indorses a security certificate warrants to the issuer that:

(1) there is no adverse claim to the security; and

(2) the indorsement is effective.

(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:

(1) the instruction is effective; and

(2) at the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under Subsection (g).

(i) Except as otherwise provided in Subsection (g), a broker acting for a customer makes to the issuer and a purchaser the warranties provided in Subsections (a) through (f). A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in Subsection (a) or (b) and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer.

History: 1978 Comp., § 55-8-108, enacted by Laws 1996, ch. 47, § 12.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsections (a), (b), and (c) deal with warranties by security transferors to purchasers. Subsections (d) and (e) deal with warranties by security transferors to issuers. Subsection (f) deals with presentment warranties.

2. Subsection (a) specifies the warranties made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4), and (5) make explicit several key points that are implicit in the general warranty of paragraph (6) that the transfer is effective and rightful. Subsection (b) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2) [55-8-301 NMSA 1978]. Subsections (d) and (e) give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) limits the warranties given by a secured party who redelivers a certificate. Subsection (i) specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) [55-1-102 NMSA 1978] the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Broker" Section 8-102(a)(3)

"Certificated security" Section 8-102(a)(4)

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Person" Section 1-201(30) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Secured party" Section 9-105(1)(m) [55-9-105 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 12 repeals 55-8-108 NMSA 1978, as amended by Laws 1987, ch. 248, § 9, relating to the registration of pledges and the release of uncertificated securities, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-109. Warranties in indirect holding.

(a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) the entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) there is no adverse claim to the security entitlement.

(b) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in Section 8-108(a) or (b) [55-8-108 (a) or (b) NMSA 1978].

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in Section 55-8-108(a) or (b) NMSA 1978.

History: 1978 Comp., § 55-8-109, enacted by Laws 1996, ch. 47, § 13.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108 [55-8-108 NMSA 1978]. If the securities intermediary in turn delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i) [55-8-108 NMSA 1978].

3. As with the Section 8-108 [55-8-108 NMSA 1978] warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3) [55-1-102 NMSA 1978].

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Entitlement order" Section 8-102(a)(8)

"Instruction" Section 8-102(a)(12)

"Person" Section 1-201(30) [55-1-201 NMSA 1978]

"Securities account" Section 8-501 [55-8-501 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-110. Applicability; choice of law.

(a) The local law of the issuer's jurisdiction, as specified in Subsection (d), governs:

(1) the validity of a security;

(2) the rights and duties of the issuer with respect to registration of transfer;

(3) the effectiveness of registration of transfer by the issuer;

(4) whether the issuer owes any duties to an adverse claimant to a security; and

(5) whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in Subsection (e), governs:

(1) acquisition of a security entitlement from the securities intermediary;

(2) the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this state may specify the law of another jurisdiction as the law governing the matters specified in Subsection (a)(2) through (5).

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) if an agreement between the securities intermediary and its entitlement holder specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction;

(2) if an agreement between the securities intermediary and its entitlement holder does not specify the governing law as provided in Paragraph (1), but expressly specifies that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction;

(3) if an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in Paragraph (1) or (2), the securities intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the entitlement holder's account; or

(4) if an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in Paragraph (1) or (2) and an account statement does not identify an office serving the entitlement holder's account as provided in Paragraph (3), the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement or by the location of facilities for data processing or other record keeping concerning the account.

History: 1978 Comp., § 55-8-110, enacted by Laws 1996, ch. 47, § 14.

ANNOTATIONS

OFFICIAL COMMENT

1. This section deals with applicability and choice of law issues concerning Article 8. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determine the

applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws § 4.

2. Subsection (a) provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 determine the issuer's rights and duties. Paragraph (1) of subsection (a) provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of Article 8, concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8, concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a), rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1). The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 [55-8-202 NMSA 1978] and Comments thereto.

Although subsection (a) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another

jurisdiction's law. Neither this section nor Section 1-105 [55-1-105 NMSA 1978] deals with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) permits specification of the governing law by agreement. Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507 [55-4A-507 NMSA 1978]; compare Section 1-105(1) [55-1-105 NMSA 1978]. That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-103(6) [55-9-103 NMSA 1978].

Subsection (f) makes explicit a point that is implicit in the Article 8 description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c), New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that it is governed by Illinois law. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in Example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed by French law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8. Article 8, however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115 [55-8-115 NMSA 1978]. Subsection (b)(3) of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8, Section 8-115 as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-103(6) [55-9-103 NMSA 1978].

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Entitlement holder" Section 8-102(a)(7)

"Financial asset" Section 8-102(a)(9)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Person" Section 1-201(30)

"Purchase" Section 1-201(32)

"Securities intermediary" Section 8-102(a)(14)

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Security entitlement" Section 8-102(a)(17)

"Uncertificated security" Section 8-102(a)(18)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Law reviews. - For article, "Attachment in New Mexico - Part II," see 2 Nat. Resources J. 75 (1962).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Conflict of laws as to title and transfer of corporate stock, 131 A.L.R. 192.

Statutory requirements respecting issuance of corporate stock as applicable to foreign corporations, 8 A.L.R.2d 1185.

Construction and effect of U.C.C. art. 8, dealing with investment securities, 21 A.L.R.3d 964, 88 A.L.R.3d 949.

55-8-111. Clearing corporation rules.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if

the rule conflicts with this act and affects another party who does not consent to the rule.

History: 1978 Comp., § 55-8-111, enacted by Laws 1996, ch. 47, § 15.

ANNOTATIONS

OFFICIAL COMMENT

1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509 [55-8-504 through 55-8-509 NMSA 1978], and Section 1-102(3) and (4) [55-1-102 NMSA 1978]. Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality or reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 [55-8-111 NMSA 1978] provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 [55-8-102 NMSA 1978] covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References: - "Clearing corporation" Section 8-102(a)(5) [55-8-102 NMSA 1978]

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-112. Creditor's legal process.

(a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in Subsection (d). However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in Subsection (d).

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in Subsection (d).

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party or in an uncertificated security registered in the name of a secured party or a security entitlement maintained in the name of a secured party may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.

History: 1978 Comp., § 55-8-112, enacted by Laws 1996, ch. 47, § 16.

ANNOTATIONS

OFFICIAL COMMENT

1. In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid levy cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome-Portland Copper Mining Co.*, 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (e) so that creditors may use this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the

issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d) [55-9-103 NMSA 1978]. See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and *Shaffer v. Heitner*, 433 U.S. 186 (1977).

3. Subsection (c) provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115 [55-8-115 NMSA 1978].

4. Subsection (d) provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Secured party" Section 9-105(1)(m) [55-9-105 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security certificate" Section 8-102(a)(16)

"Security entitlement" Section 8-102(a)(17)

"Uncertificated security" Section 8-102(a)(18)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Shares of corporate stock as subject of execution or attachment, 1 A.L.R. 653.

Withdrawal value of stock in building and loan association as basis of attachment or execution by member or as subject of garnishment by member's creditor, 94 A.L.R. 1017.

Situs of corporate stock (or stock in joint stock company) for purpose of attachment, garnishment or execution, 122 A.L.R. 338.

Effect of attachment, garnishment, execution, etc., as regards right or duty of corporation to refuse to transfer stock on books to one presenting properly endorsed certificate, because of knowledge or suspicion of conflicting rights of registered holder or of a third person, 139 A.L.R. 290, 75 A.L.R.2d 746.

55-8-113. Statute of frauds inapplicable.

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

History: 1978 Comp., § 55-8-113, enacted by Laws 1996, ch. 47, § 17.

ANNOTATIONS

OFFICIAL COMMENT

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978) [55-8-319 NMSA 1978]. With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References: - "Action" Section 1-201(1) [55-1-201 NMSA 1978]

"Contract" Section 1-201(11)

"Writing" Section 1-201(46)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-114. Evidentiary rules concerning certificated securities.

The following rules apply in an action on a certificated security against the issuer:

(1) unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted;

(2) if the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized;

(3) if signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security; or

(4) if it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted.

History: 1978 Comp., § 55-8-114, enacted by Laws 1996, ch. 47, § 18.

ANNOTATIONS

OFFICIAL COMMENT

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308 [55-3-308 NMSA 1978], to actions on certificated securities governed by this Article. An "action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References: - "Action" Section 1-201(1) [55-1-201 NMSA 1978]

"Burden of establishing" Section 1-201(8)

"Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Indorsement" Section 8-102(a)(11)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Presumed" Section 1-201(31)

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-115. Securities intermediary and others not liable to adverse claimant.

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary or broker or other agent or bailee:

(1) took the action after it had been served with an injunction, restraining order or other legal process enjoining it from doing so, issued by a court of competent jurisdiction and had a reasonable opportunity to act on the injunction, restraining order or other legal process;

(2) acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) in the case of a security certificate that has been stolen, acted with notice of the adverse claim.

History: 1978 Comp., § 55-8-115, enacted by Laws 1996, ch. 47, § 19.

ANNOTATIONS

OFFICIAL COMMENT

1. Other provisions of Article 8 protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502 [55-8-303 and 55-8-502 NMSA 1978]. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries - the "conduits" in the indirect holding system - and brokers or other agents or bailees - the "conduits" in the direct holding system. The following examples illustrate its operation:

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had

an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 [55-8-115 NMSA 1978] protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts § 235. See also UCC Section 7-404 [55-7-404 NMSA 1978].

3. Except as provided in paragraph 3, this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 [55-8-115 NMSA 1978] protects Able and Baker from liability. The protections of Section 8-115 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and

securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law § 134. Other sections of the UCC embody a similar policy. See Sections 3-602, 5-114(2)(b) [55-3-602, 55-5-114 NMSA 1978].

Paragraph (1) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3) denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105 [55-8-105 NMSA 1978]. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 indirect holding system rules - that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115 [55-8-115 NMSA 1978], Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even

though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.

Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115 [55-8-115 NMSA 1978], Clearing Corporation is not liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts § 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References: - "Broker" Section 8-102(a)(3) [55-8-102 NMSA 1978]

"Effective" Section 8-107 [55-8-107 NMSA 1978]

"Entitlement order" Section 8-102(a)(8)

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security certificate" Section 8-102(a)(16)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-116. Securities intermediary as purchaser for value.

A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder.

History: 1978 Comp., § 55-8-116, enacted by Laws 1996, ch. 47, § 20.

ANNOTATIONS

OFFICIAL COMMENT

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section 1-201(44)(d) [55-1-201 NMSA 1978] should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 [55-8-116 NMSA 1978] specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303 [55-8-303 NMSA 1978], which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501 [55-8-501 NMSA 1978]. Section 8-116 [55-8-116 NMSA 1978] specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502 [55-8-502 NMSA 1978], which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 [55-8-116 NMSA 1978] specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303 [55-8-303 NMSA 1978], which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References: - "Financial asset" Section 8-102(a)(9) [55-8-102 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

"Entitlement holder" Section 8-102(a)(7)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

PART 2
ISSUE AND ISSUER

55-8-201. Issuer.

(a) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(1) places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent or the like, to evidence a share, participation or other interest in its property or in an enterprise or to evidence its duty to perform an obligation represented by the certificate;

(2) creates a share, participation or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained.

History: 1978 Comp., § 55-8-201, enacted by Laws 1996, ch. 47, § 21.

ANNOTATIONS

OFFICIAL COMMENT

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15) [55-8-102 NMSA 1978].

2. Subsection (b) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (d) of Section 8-202 [55-8-202 NMSA 1978]. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407 [55-8-407 NMSA 1978].

Definitional Cross References: - "Person" Section 1-201(30) [55-1-201 NMSA 1978]

"Security" Section 8-102(a)(15) [55-8-102 NMSA 1978]

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 21 repeals 55-8-201 NMSA 1978, as amended by Laws 1987, ch. 248 § 10, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Statutory requirements respecting issuance of corporate stock as applicable to foreign corporation, 8 A.L.R.2d 1185.

Construction and effect to UCC § 8-207(1) allowing issuer of investment security to treat registered owner as entitled to owner's rights until presentment for registration of transfer, 21 A.L.R.4th 879.

55-8-202. Issuer's responsibility and defenses; notice of defect or defense.

(a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture or document or in a constitution, statute, ordinance, rule, regulation, order or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) a security other than one issued by a government or governmental subdivision, agency or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is

valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue; and

(2) Paragraph (1) applies to an issuer that is a government or governmental subdivision, agency or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in Section 55-8-205 NMSA 1978, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the certificated security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly.

History: 1978 Comp., § 55-8-202, enacted by Laws 1996, ch. 47, § 22.

ANNOTATIONS

OFFICIAL COMMENT

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions,

statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds*, 21 Del. Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini v. Family Theatre Corporation*, 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Airmotive*, 119 F.2d 267 (C.C.A.Alaska 1941).

2. The rule in subsection (a) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) does not apply.

3. The penultimate sentence of subsection (a) and all of subsection (b) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise

would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: first, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as *Tommie v. City of Gadsden,* 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. *Chaffee County v. Potter,* 142 U.S. 355 (1892); *Oregon v. Jennings,* 119 U.S. 74 (1886); *Gunnison County Commissioners v. Rollins,* 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. *Anthony v. County of Jasper,* 101 U.S. 693 (1879); *Town of South Ottawa v. Perkins,* 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210 [55-8-210 NMSA 1978], regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for value without notice. Section 8-202 [55-8-202 NMSA 1978] describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Notice" Section 1-201(25) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Uncertificated security" Section 8-102(a)(18)

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 22 repeals 55-8-202 NMSA 1978, as amended by Laws 1987, ch. 248 § 11, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Fraudulent representations in sale of corporate stock for which note is given as throwing upon subsequent holder of note burden of proving that he is a holder in due course, 18 A.L.R. 60, 34 A.L.R. 300, 57 A.L.R. 1083.

Issuance by corporation of new stock certificates without requiring surrender of old, 61 A.L.R. 436, 150 A.L.R. 148.

Right of pledgee of corporate stock to transfer of stock on books of company, 116 A.L.R. 571.

Rights, duties and liability of corporation in connection with transfer of stock of infant or incompetent, 3 A.L.R.2d 881.

Enforcement of stock subscription after suit on note of subscriber is barred by statute of limitations, 11 A.L.R.2d 1380.

Patent rights, copyrights, trademarks, secret processes and the like, as "property" within provisions of law or charter forbidding issuance of corporate stock except for money paid or property received, 37 A.L.R.2d 913.

Issuance of stock certificate to joint tenants as creating gift inter vivos, 5 A.L.R.4th 373.

55-8-203. Staleness as notice of defect or defense.

After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them, on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) is not covered by Paragraph (1) and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due.

History: 1978 Comp., § 55-8-203, enacted by Laws 1996, ch. 47, § 23.

ANNOTATIONS

OFFICIAL COMMENT

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such

securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 [55-8-105 NMSA 1978] and Comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Notice" Section 1-201(25) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 23 repeals 55-8-203 NMSA 1978, as amended by Laws 1987, ch. 248 § 12, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Validity, construction and effect of provisions of articles of incorporation or certificates of stock relating to redemption or retirement of preferred stock, 88 A.L.R. 1131.

Validity, construction and effect of provisions of article of incorporation of stock certificates relating to call, redemption or retirement of common stock, 48 A.L.R.2d 392.

Change in stock or corporate structure, or split or substitution of stock of corporation, as affecting bequest of stock, 46 A.L.R.3d 7.

55-8-204. Effect of issuer's restriction on transfer.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) the security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) the security is uncertificated and the registered owner has been notified of the restriction.

History: 1978 Comp., § 55-8-204, enacted by Laws 1996, ch. 47, § 24.

ANNOTATIONS

OFFICIAL COMMENT

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401 [55-8-401 NMSA 1978].

3. The policy of this section is the same as in Section 8-202 [55-8-202 NMSA 1978]. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a

written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii) [55-8-108 NMSA 1978]. B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) [55-8-202 NMSA 1978] and Comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See *Quiner v. Marblehead Social Co.,* 10 Mass. 476 (1813); *Madison Bankv. Price,* 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n,* 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Conspicuous" Section 1-201(10) [55-1-201 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Knowledge" Section 1-201(25)

"Notify" Section 1-201(25)

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 24 repeals 55-8-204 NMSA 1978, as amended by Laws 1987, ch. 248 § 13, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Provision for post-mortem payment or performance as affecting instrument's character and validity as a contract, 1 A.L.R.2d 1178.

Construction and application of provision restricting sale or transfer of corporate stock, 2 A.L.R.2d 745.

Construction and effect of § 15 of Uniform Stock Act prohibiting restriction on transfer of shares unless such restriction is stated on the certificate, 29 A.L.R.2d 901.

Validity of restrictions on alienation of corporate stock, 61 A.L.R.2d 1318.

Dominant stockholders' accountability to minority for profit, bonus or the like received on sale of stock to outsiders, 38 A.L.R.3d 738.

Validity and construction of provision restricting transfer of corporate stock, which conditions transfer upon consent of one other than shareholder, officer or director of corporation, 53 A.L.R.3d 1272.

55-8-205. Effect of unauthorized signature on security certificate.

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates or the immediate preparation for signing of any of them; or

(2) an employee of the issuer or of any of the persons listed in Paragraph (1), entrusted with responsible handling of the security certificate.

History: 1978 Comp., § 55-8-205, enacted by Laws 1996, ch. 47, § 25.

ANNOTATIONS

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures may rise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See *Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co.,* 137 N.Y.231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia,* 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as *Hudson Trust Co. v. American Linseed Co.,* 232 N.Y. 350, 134 N.E. 178 (1922), and *Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.,* 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Notice" Section 1-201(25) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security certificate" Section 8-102(a)(14)

"Unauthorized signature" Section 1-201(43)

Repeals and reenactments. - Laws 1996, ch. 47, § 25 repeals 55-8-205 NMSA 1978, as amended by Laws 1987, ch. 248 § 14, relating to the effect of an unauthorized signature on certificated security or initial transaction statement, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Issuance of stock certificate to joint tenants as creating gift inter vivos, 5 A.L.R.4th 373.

55-8-206. Completion or alteration of security certificate.

(a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) any person may complete it by filling in the blanks as authorized; and

(2) even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

History: 1978 Comp., § 55-8-206, enacted by Laws 1996, ch. 47, § 26.

ANNOTATIONS

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a) [55-8-305 NMSA 1978]).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the

completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a) [55-8-302 NMSA 1978].

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210 [55-8-210 NMSA 1978]).

Definitional Cross References: - "Notice" Section 1-201(25) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security certificate" Section 8-102(a)(16) [55-8-102 NMSA 1978]

"Unauthorized signature" Section 1-201(43)

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 26 repeals 55-8-206 NMSA 1978, as amended by Laws 1987, ch. 248 § 15, relating to completion or alteration of certificated security or initial transaction statement, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Effect of entrusting another with stock certificate endorsed or assigned in blank, to estop owner as against bona fide purchaser or pledgee for value, 73 A.L.R. 1405.

55-8-207. Rights and duties of issuer with respect to registered owners.

(a) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications and otherwise exercise all the rights and powers of an owner.

(b) Chapter 55, Article 8 NMSA 1978 does not affect the liability of the registered owner of a security for a call, assessment or the like.

History: 1978 Comp., § 55-8-207, enacted by Laws 1996, ch. 47, § 27.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401 [55-8-401 NMSA 1978]. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsection (a) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporation,* 128 N.J.L.309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See *State ex rel. Squire v. Murfey, Blosson & Co.,* 131 Ohio St. 289, 2 N.E.2d 866 (1936); *Willing v. Delaplaine,* 23 F. Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Security" Section 8-102(a)(15)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 27 repeals 55-8-207 NMSA 1978, as amended by Laws 1987, ch. 248 § 16, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Right of corporation to refuse to register transfer of stock because of stockholder's indebtedness to it, where transfer is by operation of law, 65 A.L.R. 220.

Failure to enter transfer of stock on corporate books as affecting liability of transferor for calls or assessments, 104 A.L.R. 638.

Construction and effect of UCC § 8-207(1) allowing issuer of investment security to treat registered owner as entitled to owner's rights until presentment for registration of transfer, 21 A.L.R.4th 879.

55-8-208. Effect of signature of authenticating trustee, registrar or transfer agent.

(a) A person signing a security certificate as authenticating trustee, registrar, transfer agent or the like warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) the certificate is genuine;

(2) the person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) the person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under Subsection (a) does not assume responsibility for the validity of the security in other respects.

History: 1978 Comp., § 55-8-208, enacted by Laws 1996, ch. 47, § 28.

ANNOTATIONS

OFFICIAL COMMENT

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.,* 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.,* 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co.,* 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co.,* 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York,* 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co.,* supra; *Mullen v. Eastern Trust & Banking Co.,* 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it

interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205 [55-8-205 NMSA 1978].

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Genuine" Section 1-201(18) [55-1-201 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Notice" Section 1-201(25)

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 28 repeals 55-8-208 NMSA 1978, as amended by Laws 1987, ch. 248 § 17, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-209. Issuer's lien.

A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

History: 1978 Comp., § 55-8-209, enacted by Laws 1996, ch. 47, § 29.

ANNOTATIONS

OFFICIAL COMMENT

This section is similar to Sections 8-202 and 8-204 [55-8-202 and 55-8-204 NMSA 1978] which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs

from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement in haec verba. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204, see Comment 2 to Section 8-202.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-210. Overissue.

(a) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in Subsections (c) and (d), the provisions of Chapter 55, Article 8 NMSA 1978 which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated, or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand.

History: 1978 Comp., § 55-8-210, enacted by Laws 1996, ch. 47, § 30.

ANNOTATIONS

OFFICIAL COMMENT

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, *McWilliams v. Geddes & Moss Undertaking Co.,* 169 So. 894 (1936, La.); *Crawford v. Twin City Oil Co.,* 216 Ala. 216, 113 So. 61 (1927); *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d). The last clause of subsection (a), which is added in Revised Article 8, does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co.,* 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York and New Haven R.R. Co. v. Schuyler,* 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston Railroad,* 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am. St. Rep. 185 (1889); *Commercial Bank v. Kortright,* 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References: - "Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Security" Section 8-102(a)(15) [55-8-102 NMSA 1978]

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

PART 3 TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

55-8-301. Delivery.

(a) Delivery of a certificated security to a purchaser occurs when:

(1) the purchaser acquires possession of the security certificate;

(2) another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) a securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and has been specially indorsed to the purchaser by an effective indorsement.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

History: 1978 Comp., § 55-8-301, enacted by Laws 1996, ch. 47, § 31.

ANNOTATIONS

OFFICIAL COMMENT

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transaction,

though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501 [55-8-501 NMSA 1978]. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer.

3. Subsection (b) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called 'delivery,' as in the expression "delivery versus payment." The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2).

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Effective" Section 8-107 [55-8-107 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Securities intermediary" Section 8-102(a)(14)

"Security certificate" Section 8-102(a)(16)

"Special indorsement" Section 8-304(a) [55-8-304 NMSA 1978]

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 31, repeals 55-8-301 NMSA 1978, as amended by Laws 1987, ch. 248, § 18, relating to the rights acquired by a purchaser, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-302. Rights of purchaser.

(a) Except as otherwise provided in Subsections (b) and (c), upon delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

History: 1978 Comp., § 55-8-302, enacted by Laws 1996, ch. 47, § 32.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) provides that if a certificated or uncertificated security is delivered (Section 8-301 [55-8-301 NMSA 1978]) to a purchaser in a transfer, the purchaser acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security upon "delivery," it does not state that a person can acquire an interest in a security only by delivery. Article 8 is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 [55-9-203 NMSA 1978] and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404 [55-8-207, 55-8-401, and 55-8-404 NMSA 1978].

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Delivery" Section 8-301 [55-8-301 NMSA 1978]

"Notice of adverse claim" Section 8-105 [55-8-105 NMSA 1978]

"Protected purchaser" Section 8-303 [55-8-303 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 31, repeals 55-8-302 NMSA 1978, as amended by Laws 1987, ch. 248, § 19, relating to bona fide purchasers, adverse claims, and the title acquired by a bona fide purchaser, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Collection upon stolen or lost negotiable bond or coupon. - Under former 55-8-302 NMSA 1978 a person may become the lawful holder of a negotiable bond or bond coupon where he is a "bona fide purchaser," as defined under the statute, and be entitled to collection upon a negotiable bond or coupon, even though the bond was stolen or lost. 1961-62 Op. Att'y Gen. No. 62-139 (rendered under prior law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Rights of purchaser of stolen bonds, 18 A.L.R. 717.

Rights of owner and bona fide purchaser of lost or stolen stock certificates, 52 A.L.R. 947.

Effect of entrusting another with stock certificate endorsed or assigned in blank, to estop owner as against bona fide purchaser or pledgee for value, 73 A.L.R. 1405.

Priority as between lien of corporation and bona fide purchaser of corporate stock, 81 A.L.R. 989.

55-8-303. Protected purchaser.

(a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) gives value;

(2) does not have notice of any adverse claim to the security; and

(3) obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim.

History: 1978 Comp., § 55-8-303, enacted by Laws 1996, ch. 47, § 33.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in Section 1-201 [55-1-201 NMSA 1978]. A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44) [55-1-201 NMSA 1978]. See also Section 8-116 [55-8-116 NMSA 1978] (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1) [55-8-102 NMSA 1978]. Section 8-105 [55-8-105 NMSA 1978] specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106 [55-8-106 NMSA 1978]. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d) [55-8-304 NMSA 1978].

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take

free of the issuer's defense based on that defense. See Section 8-202 [55-8-202 NMSA 1978].

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a) [55-8-106 and 55-8-301 NMSA 1978]. For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b), plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b). Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404 [55-8-404 NMSA 1978], unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406 [55-8-406 NMSA 1978].

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b) [55-8-106 and 55-8-301 NMSA 1978], or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2). The control agreement device of Section 8-106(c)(2) takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 [55-8-105 NMSA 1978] on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Control" Section 8-106 [55-8-106 NMSA 1978]

"Notice of adverse claim" Section 8-105 [55-8-105 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

"Uncertificated security" Section 8-102(a)(18)

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 33, repeals 55-8-33 NMSA 1978, as amended by Laws 1987, ch. 248, § 20, relating to brokers, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Purchaser. - Securities clearing firm which credited shares to a securities firm before it actually received the shares performed more than a purely intermediary function and was a purchaser under former 55-8-401 (1) NMSA 1978. Broadcort Capital Corp. v. Summa Medical Corp., 972 F.2d 1183 (10th Cir. 1992).

Collection upon stolen or lost negotiable bond or coupon. - Under former 55-8-301 NMSA 1978 and this section, a person may become the lawful holder of a negotiable bond or bond coupon where he is a "bona fide purchaser," as defined under the statute, and be entitled to collection upon a negotiable bond or coupon, even though the bond was stolen or lost. 1961-62 Op. Att'y Gen. No. 62-139 (rendered under prior law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - Rights of owner and bona fide purchaser of lost or stolen stock certificates, 52 A.L.R. 947.

Priority as between lien of corporation and bona fide purchaser of lost or stolen stock certificates, 81 A.L.R. 989.

Who is "bona fide purchaser" of investment security under UCC § 8-302, 88 A.L.R.3d 949.

55-8-304. Indorsement.

(a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only of part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in Section 55-8-108 NMSA 1978 and not an obligation that the security will be honored by the issuer.

History: 1978 Comp., § 55-8-304, enacted by Laws 1996, ch. 47, § 34.

ANNOTATIONS

OFFICIAL COMMENT

1. By virtue of the definition of indorsement in Section 8-102 [55-8-102 NMSA 1978] and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. *Levey v. Nason,* 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America,* 237 App. Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and this Article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection

(d) on right to compel indorsement, such as is envisaged in *Johnson v. Johnson,* 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) deals with the effect of delivery without indorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202 [55-8-202 NMSA 1978]).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See *Coats v. Guaranty Bank & Trust Co.,* 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307 [55-8-307 NMSA 1978]). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d) [55-8-105 NMSA 1978]) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108 [55-8-108 NMSA 1978]).

Definitional Cross References: - "Bearer form" Section 8-102(a)(2). [55-8-102 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Indorsement" Section 8-102(a)(11)

"Purchaser" Sections 1-201(33) & 8-116. [55-1-201 & 55-8-116 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Security certificate" Section 8-102(a)(16)

Repeals and reenactments. - Laws 1996, ch. 47, § 31, repeals 55-8-304 NMSA 1978, as amended by Laws 1987, ch. 248, § 21, relating to the notice to purchaser of an adverse claim, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-305. Instruction.

(a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by Section 55-8-108 NMSA 1978 and not an obligation that the security will be honored by the issuer.

History: 1978 Comp., § 55-8-305, enacted by Laws 1996, ch. 47, § 35.

ANNOTATIONS

OFFICIAL COMMENT

1. The term instruction is defined in Section 8-102(a)(12) [55-8-102 NMSA 1978] as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 [55-8-107 NMSA 1978] specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6) [55-8-102 NMSA 1978]. Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 [55-8-206 NMSA 1978] and its Comment, dealing with blanks left upon issue.

2. Subsection (b) makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108 [55-8-108 NMSA 1978].

Definitional Cross References: - "Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Instruction" Section 8-102(a)(12) [55-8-102 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

Repeals and reenactments. - Laws 1996, ch. 47, § 35, repeals 55-8-305 NMSA 1978, as amended by Laws 1987, ch. 248, § 22, relating to staleness as notice of adverse claims, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-306. Effect of guaranteeing signature, indorsement or instruction.

(a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to indorse or, if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) the signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to originate the instruction or, if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) the signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under Subsection (b) and also warrants that at the time the instruction is presented to the issuer:

(1) the person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) the transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction.

(d) A guarantor under Subsections (a) and (b) or a special guarantor under Subsection (c) does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under Subsection (a) and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under Subsection (c) and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor.

History: 1978 Comp., § 55-8-306, enacted by Laws 1996, ch. 47, § 36.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) [55-8-107 NMSA 1978] to include a successor or person who has power under other law to act for a person who is

deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) [55-8-107 NMSA 1978] does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of *Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.,* 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) of subsection (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under paragraph (2), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's

identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (c), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) makes clear what can be inferred from the combination of Sections 8-401 and 8-402 [55-8-401 and 55-8-402 NMSA 1978], that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References: - "Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Genuine" Section 1-201(18) [55-1-201 NMSA 1978]

"Indorsement" Section 8-102(a)(11) [55-8-102 NMSA 1978]

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 36, repeals 55-8-306 NMSA 1978, as amended by Laws 1987, ch. 248, § 23, relating to warranties on presentment and transfer of certificated securities and warranties of originators of instructions, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet.

Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-307. Purchaser's right to requisites for registration of transfer.

Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer.

History: 1978 Comp., § 55-8-307, enacted by Laws 1996, ch. 47, § 37.

ANNOTATIONS

OFFICIAL COMMENT

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare Section 8-304(d) [55-8-304 NMSA 1978]. If a transfer is not for value the transferor need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional Cross References: - "Purchaser" Sections 1-201(33) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

"Security" Section 8-102(a)(15) [55-8-102 NMSA 1978]

"Value" Sections 1-201(44) & 8-116

Repeals and reenactments. - Laws 1996, ch. 47, § 37, repeals 55-8-307 NMSA 1978, as amended by Laws 1987, ch. 248, § 24, relating to the effect of delivery without indorsement and the right to compel endorsement, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is

effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-308 to 55-8-321. Repealed.

ANNOTATIONS

Repeals. - Laws 1996, ch. 47, § 70 repeals 55-8-308 through 55-8-321, as amended by Laws 1987, ch. 248, §§ 25 through 37 and as enacted by Laws 1987, ch. 248, § 38, relating to the purchase of securities. For provisions of former sections, see 1987 Replacement Pamphlet and 1995 Cumulative Supplement.

Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

PART 4 REGISTRATION

55-8-401. Duty of issuer to register transfer.

(a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) the indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) reasonable assurance is given that the indorsement or instruction is genuine and authorized (Section 55-8-402 NMSA 1978);

(4) any applicable law relating to the collection of taxes has been complied with;

(5) the transfer does not violate any restriction on transfer imposed by the issuer in accordance with Section 55-8-204 NMSA 1978;

(6) a demand that the issuer not register transfer has not become effective under Section 55-8-403 NMSA 1978, or the issuer has complied with Section 55-8-403(b) NMSA 1978 but no legal process or indemnity bond is obtained as provided in Section 55-8-403(d) NMSA 1978; and

(7) the transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.

History: 1978 Comp., § 55-8-401, enacted by Laws 1996, ch. 47, § 38.

ANNOTATIONS

OFFICIAL COMMENT

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404 [55-8-404 NMSA 1978].

2. By subsection (b) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) [55-8-201 NMSA 1978] provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this Part similar to those of the issuer. See Section 8-407 [55-8-407 NMSA 1978].

Definitional Cross References: - "Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Genuine" Section 1-201(18) [55-1-201 NMSA 1978]

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Protected purchaser" Section 8-303 [55-8-303 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 38, repeals 55-8-401 NMSA 1978, as amended by Laws 1987, ch. 248, § 39, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Purchaser. - Securities clearing firm which credited shares to a securities firm before it actually received the shares performed more than a purely intermediary function and was a purchaser under former 55-8-401 NMSA 1978. Broadcort Capital Corp. v. Summa Medical Corp., 972 F.2d 1183 (10th Cir. 1992).

Action for conversion allowed. - An action for conversion is not foreclosed where a plaintiff also sues under former 55-8-401 NMSA 1978. Broadcort Capital Corp. v. Summa Medical Corp., 972 F.2d 1183 (10th Cir. 1992).

Standing. - Securities clearing firm had standing under former 55-8-401 (2) NMSA 1978 as a principal of the company forwarding the stock certificate for registration of transfer, because the firm remained responsible to its customers for delivering the shares of stock since its account was debited for these shares. Broadcort Capital Corp. v. Summa Medical Corp., 972 F.2d 1183 (10th Cir. 1992).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code §§ 89, 103, 116 to 118.

Transfer on corporate books as requisite of gift of stock, 38 A.L.R. 1366.

Failure to enter transfer of stock on books of corporation as affecting liability of transferor, 45 A.L.R. 137, 104 A.L.R. 638.

Corporation's refusal to issue, convert or transfer stock as conversion, 54 A.L.R. 1157.

Right of corporation to refuse to register transfer of stock because of stockholder's indebtedness to it, where transfer is by operation of law, 65 A.L.R. 220.

Necessity of delivery of stock certificate to complete valid gift of stock, 99 A.L.R. 1077, 23 A.L.R. 1171.

Assumption of payment or guarantee of corporation's indebtedness as condition of transfer of its stock, 103 A.L.R. 1417.

Right of pledgee of corporate stock to transfer of stock on books of company, 116 A.L.R. 571.

Corporation's knowledge or suspicion of conflicting rights, 139 A.L.R. 273, 75 A.L.R.2d 746.

Rights, duties and liability of corporation in connection with stock of infants or incompetents, 3 A.L.R.2d 881.

Rights, duties and liability in connection with transfer of stock of decedent, 7 A.L.R.2d 1240.

Remedy for refusal of corporation or its agent to register or effectuate transfer of stock, 22 A.L.R.2d 12.

Transfer on corporate books as sufficient for gift of stock, 6 A.L.R.4th 250.

Lis pendens in suit to compel stock transfer, 48 A.L.R.4th 731.

11 C.J.S. Bonds § 15; 18 C.J.S. Corporations § 272; 64 C.J.S. Municipal Corporations § 1949; 81A C.J.S. States § 186.

55-8-402. Assurance that indorsement or instruction is effective.

(a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) in all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) if the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) if the indorsement is made or the instruction is originated by a fiduciary pursuant to Section 55-8-107(a)(4) or (a)(5) NMSA 1978, appropriate evidence of appointment or incumbency;

(4) if there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) if the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable; and

(2) "appropriate evidence of appointment or incumbency" means:

(i) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within 60 days before the date of presentation for transfer; or

(ii) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considered appropriate.

History: 1978 Comp., § 55-8-402, enacted by Laws 1996, ch. 47, § 39.

ANNOTATIONS

OFFICIAL COMMENT

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404 [55-8-404 NMSA 1978]. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b) [55-8-401 NMSA 1978].

2. Under subsection (a)(1), the issuer may require in all cases a guaranty of signature. See Section 8-306 [55-8-306 NMSA 1978]. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) allows the issuer to require that the person making these guaranties be

one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 CFR 240.17Ad-15.

3. This section, by paragraphs (2) through (5) of subsection (a), permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306 [55-8-306 NMSA 1978]. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c) [55-8-107 NMSA 1978]. Hence court orders and other controlling instruments are omitted from subsection (a).

Subsection (a)(3) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i). Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d) [55-8-107 NMSA 1978], hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) to require assurance beyond that specified in subsection (a). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404 [55-8-404 NMSA 1978].

Definitional Cross References: - "Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Genuine" Section 1-201(18) [55-1-201 NMSA 1978]

"Indorsement" Section 8-102(a)(11) [55-8-102 NMSA 1978]

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

Repeals and reenactments. - Laws 1996, ch. 47, § 31, repeals 55-8-402 NMSA 1978, as amended by Laws 1987, ch. 248, § 40, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Liabilities and duties of corporation in respect to sale or transfer of corporate stock held by one having life estate, 126 A.L.R. 1298.

Duty of corporation to refuse to transfer stock on books to one who presents properly indorsed certificate on ground of knowledge or suspicion of conflicting rights of registered holder or third person, 139 A.L.R. 273, 75 A.L.R.2d 746.

Rights, duties and liability of corporation in connection with transfer of stock of decedent, 7 A.L.R.2d 1240.

55-8-403. Demand that issuer not register transfer.

(a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) the certificated security has been presented for registration of transfer or instruction for registration of transfer of uncertificated security has been received;

(2) a demand that the issuer not register transfer had previously been received; and

(3) the issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in Subsection (b)(3) may not exceed 30 days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) obtain an appropriate restraining order, injunction or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) file with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective.

History: 1978 Comp., § 55-8-403, enacted by Laws 1996, ch. 47, § 40.

ANNOTATIONS

OFFICIAL COMMENT

1. The general rule under this Article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404 [55-8-404 NMSA 1978]. Section 8-403 [55-8-403 NMSA 1978] is an exception to this general rule. It permits the registered owner - but not third parties - to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See Section 8-406 [55-8-406 NMSA 1978]. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405 [55-8-405 NMSA 1978]. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal

process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406 [55-8-107 and 55-8-406 NMSA 1978], might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References: - "Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Communicate" Section 8-102(a)(6)

"Effective" Section 8-107

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 40, repeals 55-8-403 NMSA 1978, as amended by Laws 1987, ch. 248, § 41, relating to the issuer's duty as to adverse claims, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Duty of corporation upon presentation for transfer of stock standing in one's name as trustee or other fiduciary, 56 A.L.R. 1199.

Liabilities and duties of corporation in respect to sale or transfer of corporate stock held by one having life estate, 126 A.L.R. 1298.

Duty of corporation to refuse to transfer stock on books to one who presents properly endorsed certificate on ground of knowledge or suspicion of conflicting rights of registered holder or third person, 139 A.L.R. 273, 75 A.L.R.2d 746.

55-8-404. Wrongful registration.

(a) Except as otherwise provided in Section 55-8-406 NMSA 1978, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it and the transfer was registered:

(1) pursuant to an ineffective indorsement or instruction;

(2) after a demand that the issuer not register transfer became effective under Section 55-8-403(a) NMSA 1978, and the issuer did not comply with Section 55-8-403(b) NMSA 1978;

(3) after the issuer had been served with an injunction, restraining order or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order or other legal process; or

(4) by an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under Subsection (a) on demand shall provide the person entitled to the security with a like certificated or uncertificated security and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by Section 55-8-210 NMSA 1978.

(c) Except as otherwise provided in Subsection (a) or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction.

History: 1978 Comp., § 55-8-404, enacted by Laws 1996, ch. 47, § 41.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a)(1) provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 [55-8-402 NMSA 1978] does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.,* 159 Wis. 517, 149 N.W. 754 (1914). Article 8 does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210 [55-8-210 NMSA 1978]. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (c) and (a) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 [55-8-115 NMSA 1978] applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry directholding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective indorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 (1978) [55-8-403 NMSA 1978].

The rule of former Section 8-403 [55-8-403 NMSA 1978] was anomalous inasmuch as Section 8-207 [55-8-207 NMSA 1978] provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See *Kerrigan v.*

American Orthodontics Corp., 960 F.2d 43 (7th Cir. 1992). The change made in the present version of Section 8-404 [55-8-404 NMSA 1978] ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Effective" Section 8-107 [55-8-107 NMSA 1978]

"Indorsement" Section 8-102(a)(11)

"Instruction" Section 8-102(a)(12)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Security" Section 8-102(a)(15)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 41, repeals 55-8-404 NMSA 1978, as amended by Laws 1987, ch. 248, § 42, relating to liability and non-liability for registration, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Rights of owner and bona fide purchaser of lost or stolen stock certificates, 52 A.L.R. 947.

Duty of corporation upon presentation for transfer of stock standing in one's name as trustee or other fiduciary, 56 A.L.R. 1199.

Issuance by corporation of new stock certificates without requiring surrender of old, 61 A.L.R. 436, 150 A.L.R. 148.

Liabilities and duties of corporation in respect to sale or transfer of corporate stock held by one having life estate, 126 A.L.R. 1298.

Duty of corporation to refuse to transfer stock on books to one who presents properly endorsed certificate on ground of knowledge or suspicion of conflicting rights of registered holder or third person, 139 A.L.R. 273, 75 A.L.R.2d 746.

Rights, duties and liability of corporation in connection with transfer of stock of infant or incompetent, 3 A.L.R.2d 881.

Rights, duties and liability of corporation in connection with transfer of stock of decedent, 7 A.L.R.2d 1240.

Remedy for refusal of corporation or its agent to register or effectuate transfer of stock, 22 A.L.R.2d 12.

55-8-405. Replacement of lost, destroyed or wrongfully taken security certificate.

(a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) so requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) files with the issuer a sufficient indemnity bond; and

(3) satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by Section 55-8-210 NMSA 1978. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser.

History: 1978 Comp., § 55-8-405, enacted by Laws 1996, ch. 47, § 42.

ANNOTATIONS

OFFICIAL COMMENT

1. This section enables the owner to obtain a replacement of a lost, destroyed or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner - who was in the best position to prevent the loss, destruction or theft of the security certificate - is now deprived of the new security certificate issued as a replacement. This changes the pre-UCC law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without

notice. *Keller v. Eureka Brick Mach. Mfg. Co.,* 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210 [55-8-210 NMSA 1978]. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References: - "Bearer form" Section 8-102(a)(2) [55-8-102 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Notice" Section 1-201(25) [55-1-201 NMSA 1978]

"Overissue" Section 8-210 [55-8-210 NMSA 1978]

"Protected purchaser" Section 8-303 [55-8-303 NMSA 1978]

"Registered form" Section 8-102(a)(13)

"Security certificate" Section 8-102(a)(16)

Repeals and reenactments. - Laws 1996, ch. 47, § 42, repeals 55-8-405 NMSA 1978, as amended by Laws 1987, ch. 248, § 43, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Rights of owner and bona fide purchaser of lost or stolen stock certificates, 52 A.L.R. 947.

Issuance by corporation of new stock certificates without requiring surrender of old, 61 A.L.R. 436, 150 A.L.R. 148.

Constitutionality, construction and application of statute relating to lost, destroyed or stolen certificate of corporate stock, 125 A.L.R. 997.

Degree or quantum of evidence necessary to establish a lost instrument and its contents, 148 A.L.R. 400.

Statutory requirements respecting issuance of corporate stock as applicable to foreign corporations, 8 A.L.R.2d 1185.

55-8-406. Obligation to notify issuer of lost, destroyed or wrongfully taken security certificate.

If a security certificate has been lost, apparently destroyed or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under Section 55-8-404 NMSA 1978 or a claim to a new security certificate under Section 55-8-405 NMSA 1978.

History: 1978 Comp., § 55-8-406, enacted by Laws 1996, ch. 47, § 43.

ANNOTATIONS

OFFICIAL COMMENT

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404 [55-8-404 NMSA 1978], unless the owner made an effective demand that the issuer not register transfer under Section 8-403 [55-8-403 NMSA 1978].

Definitional Cross References: - "Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Notify" Section 1-201(25) [55-1-201 NMSA 1978]

"Security certificate" Section 8-102(a)(16) [55-8-102 NMSA 1978]

Repeals and reenactments. - Laws 1996, ch. 47, § 43, repeals 55-8-406 NMSA 1978, as amended by Laws 1987, ch. 248, § 44, relating to the duties of an authenticating trustee, transfer agent or registrar, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-407. Authenticating trustee, transfer agent and registrar.

A person acting as authenticating trustee, transfer agent, registrar or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions.

History: 1978 Comp., § 55-8-407, enacted by Laws 1996, ch. 47, § 44.

ANNOTATIONS

OFFICIAL COMMENT

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of the irrespective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are rejected. *Hulse v. Consolidated Quicksilver Mining Corp.,* 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan,* 119 Misc. 309, 196 N.Y. Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co.,* 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405 [55-8-405 NMSA 1978], which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. *Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co.,* 152 App.Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Issuer" Section 8-201 [55-8-201 NMSA 1978]

"Security" Section 8-102(a)(15)

"Security certificate" Section 8-102(a)(16)

"Uncertificated security" Section 8-102(a)(18)

Repeals and reenactments. - Laws 1996, ch. 47, § 44, repeals 55-8-407 NMSA 1978, as amended by Laws 1987, ch. 248, § 45, relating to the exchangeability of securities, and enacts the above section. For provisions of former section, see 1987 Replacement Pamphlet. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-408. Repealed.

ANNOTATIONS

Repeals. - Laws 1996, ch. 47, § 70 repeals 55-8-408, as amended by Laws 1987, ch. 248, § 46, relating to statements of uncertificated securities. For provisions of former section, see 1987 Replacement Pamphlet.

Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

PART 5 SECURITY ENTITLEMENTS

55-8-501. Securities account; acquisition of security entitlement from securities intermediary.

(a) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in Subsections (d) and (e), a person acquires a security entitlement if a securities intermediary:

(1) indicates by book entry that a financial asset has been credited to the person's securities account;

(2) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) becomes obligated under other law, regulation or rule to credit a financial asset to the person's securities account.

(c) If a condition of Subsection (b) has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person and the financial asset is registered in the name of payable to the order of, or specially indorsed to the other person and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement.

History: 1978 Comp., § 55-8-501, enacted by Laws 1996, ch. 47, § 45.

ANNOTATIONS

OFFICIAL COMMENT

1. Part 5 rules apply to security entitlements, and Section 8-501(b) [55-8-501 NMSA 1978] provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3) [55-1-201 NMSA 1978]. There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102 [55-1-102 NMSA 1978], however, states the fundamental principle of interpretation that the Code provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5, which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) of this section specifies what circumstances give rise to security entitlements. Paragraph (1) of subsection (b) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph (1) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) of subsection (b) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) will also be

covered by paragraph (1), because the intermediary will have credited the positions to the customer's account.

Paragraph (3) of subsection (b) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) test, the paragraph (3) test would not be needed for the ordinary cases, since they are covered by paragraph (1).

3. In a sense, Section 8-501(b) [55-8-501 NMSA 1978] is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 [55-8-313 and 55-8-320 NMSA 1978] of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) is intended to make this point clear. Subsection (c) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 [55-8-504 NMSA 1978] and regulatory law. Subsection (c) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or

in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) [55-8-301 NMSA 1978] specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15) [55-8-102 NMSA 1978]. If so, then by virtue of subsection (e) of Section 8-501 [55-8-501 NMSA 1978], the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities.

The subsection (e) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of the definition of security in Section 8-102(a)(15) [55-8-102 NMSA 1978] are the "transferability" and "divisibility" tests. Securities, in the Article 8 sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her

security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References: - "Financial asset" Section 8-102(a)(9) [55-8-102 NMSA 1978]

"Indorsement" Section 8-102(a)(11)

"Securities intermediary" Section 8-102(a)(14)

"Security" Section 8-102(a)(15)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-502. Assertion of adverse claim against entitlement holder.

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien or other theory, may not be asserted against a person who acquires a security entitlement under Section 55-8-501 NMSA 1978 for value and without notice of the adverse claim.

History: 1978 Comp., § 55-8-502, enacted by Laws 1996, ch. 47, § 46.

ANNOTATIONS

OFFICIAL COMMENT

1. The section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 [55-8-501 NMSA 1978] for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (Section 8-303 [55-8-303 NMSA 1978]).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503 [55-8-503 NMSA

1978]. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 [55-8-501 NMSA 1978] for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares." Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501 [55-8-501 NMSA 1978]. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property infavor of S. See G. Palmer, The Law of Restitution § 2.14. Section 8-502 [55-8-502 NMSA 1978] ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See Section 8-507(b) [55-8-507 NMSA 1978].

3. The following examples illustrate the operation of Section 8-502 [55-8-502 NMSA 1978].

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b) [55-8-501 NMSA 1978]. Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was himself the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 [55-8-502 NMSA 1978] does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b) [55-8-501 NMSA 1978]. Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44) [55-1-201 NMSA 1978]. If Creditor did not have notice of Owner's claim, Section 8-502 [55-8-502 NMSA 1978] precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 [55-8-105 NMSA 1978] specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume - implausibly - that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 [55-8-502 NMSA 1978] precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-115 [55-9-115 NMSA 1978]. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume - implausibly - that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 [55-8-502 NMSA 1976] precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Banks account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acmes liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501 [55-8-501 NMSA 1978]. Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt. See Section 1-201(44) [55-1-201 NMSA 1978]. If Lending Bank did not have notice of Acme's claim, Section 8-502 [55-8-502 NMSA 1978] will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b) [55-8-503 NMSA 1978]. Section 8-502 [55-8-502 NMSA 1978] protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Notice of adverse claim" Section 8-105 [55-8-105 NMSA 1978]

"Security entitlement" Section 8-102(a)(17)

"Value" Sections 1-201(44) & 8-116 [55-1-201 & 55-8-116 NMSA 1978]

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-503. Property interest of entitlement holder in financial asset held by securities intermediary.

(a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in Section 55-8-511 NMSA 1978.

(b) An entitlement holder's property interest with respect to a particular financial asset under Subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under Subsection (a) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under Sections 55-8-505 through 55-8-508 NMSA 1978.

(d) An entitlement holder's property interest with respect to a particular financial asset under Subsection (a) may be enforced against a purchaser of the financial asset or interest therein only if:

(1) insolvency proceedings have been initiated by or against the securities intermediary;

(2) the securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(3) the securities intermediary violated its obligations under Section 55-8-504 NMSA 1978 by transferring the financial asset or interest therein to the purchaser; and

(4) the purchaser is not protected under Subsection (e). The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset or interest therein from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement

holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under Subsection (a), whether framed in conversion, replevin, constructive trust, equitable lien or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under Section 55-8-504 NMSA 1978.

History: 1978 Comp., § 55-8-503, enacted by Laws 1996, ch. 47, § 47.

ANNOTATIONS

OFFICIAL COMMENT

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511 [55-8-511 NMSA 1978].

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) makes clear that the property interest described in subsection (a) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts. The traditional Article 8 rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification ofthe underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim ofownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) reflect these fundamental principles.

Subsection (c) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508 [55-8-505 through 55-8-508 NMSA 1978]. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection (d) provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504 [55-8-504 NMSA 1978]. Thus, paragraphs (1), (2), and (3) of subsection (d) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e), unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 also contains general adverse claim cut-off rules for the indirect holding system. See Sections 8-502 and 8-510 [55-8-502 and 55-8-510 NMSA 1978]. The rule of subsections (d) and (e) takes precedence over the general cut-off rules of those sections, because Section 8-503 [55-8-503 NMSA 1978] itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e), rather than by the "without notice" test of Sections 8-502 and 8-510.

3. The limitations that subsections (c) through (e) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this Article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the post hoc perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities

to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) [55-8-503 NMSA 1978] furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 concerning transfers by fiduciaries provide a good example. Under *Lowry v. Commercial & Farmers' Bank,* 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the *Lowry* rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8, and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its

customers.That is exactly what securities intermediaries are in business todo. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) [55-8-503 NMSA 1978] apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511 [55-8-511 NMSA 1978]. The statement in subsection (a) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the debtor must have "rights" in the collateral, see Section 9-203 [55-9-203 NMSA 1978], the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511, which is an application to secured transactions of the general principles expressed in subsections (d) and (e) of this section.

Definitional Cross References: - "Control" Section 8-106 [55-8-106 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Insolvency proceedings" Section 1-201(22) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

"Value" Sections 1-201(44) & 8-116

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-504. Duty of securities intermediary to maintain financial asset.

(a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to Subsection (a).

(c) A securities intermediary satisfies the duty in Subsection (a) if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

History: 1978 Comp., § 55-8-504, enacted by Laws 1996, ch. 47, § 48.

ANNOTATIONS

OFFICIAL COMMENT

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. § 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents,and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) [55-8-102 NMSA 1978] provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom a securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511 [55-8-503 and 55-8-511 NMSA 1978].

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 [55-8-504 through 55-8-508 NMSA 1978] contains an "agreement/due care" provision. Second, Section 8-509 [55-8-509 NMSA 1978] sets out general qualifications on the duties stated in these sections, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 duties.

4. The "agreement/due care" provision in subsection (c) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) to the wide variety of circumstances that may be encountered in the modern securities

holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) provides that a securities intermediary satisfies the duty stated in subsection (a) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) [55-1-102 NMSA 1978] provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1), compliance with the agreement constitutes satisfaction of the subsection (a) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10) [55-1-203 and 55-8-102 NMSA 1978], would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaimal together one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) has specified the details of the intermediary's performance of the subsection (a) duty, subsection (c)(2) provides that the intermediary satisfies that duty if it exercises due care in accordance with

reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safeguarding of customersecurities. See 17 C.F.R. § 240.15c3-3. Section 8-509(a) [55-8-509 NMSA 1978] provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-504 [55-8-504 NMSA 1978]. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e) [55-8-103 NMSA 1978]. Accordingly, the general duty of an intermediary under subsection (a) does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508 [55-8-503 and 55-8-508 NMSA 1978].

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Clearing corporation" Section 8-102(a)(5) [55-8-102 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-505. Duty of securities intermediary with respect to payments and distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

History: 1978 Comp., § 55-8-505, enacted by Laws 1996, ch. 47, § 49.

ANNOTATIONS

OFFICIAL COMMENT

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504 [55-8-504 NMSA 1978]. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 [55-8-509 NMSA 1978] also apply to the Section 8-505 [55-8-505 NMSA 1978] duty, so that compliance

with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) [55-8-509 NMSA 1978] makes this point explicit.

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-506. Duty of securities intermediary to exercise rights as directed by entitlement holder.

A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

History: 1978 Comp., § 55-8-506, enacted by Laws 1996, ch. 47, § 50.

ANNOTATIONS

OFFICIAL COMMENT

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 [55-8-509 NMSA 1978] also applies to the Section 8-506 [55-8-506 NMSA 1978] duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a), compliance with such regulatory requirement constitutes compliance with the Section 8-506 duty.

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-507. Duty of securities intermediary to comply with entitlement order.

(a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages.

History: 1978 Comp., § 55-8-507, enacted by Laws 1996, ch. 47, § 51.

ANNOTATIONS

OFFICIAL COMMENT

1. Subsection (a) of this section states another aspect of duties of securities intermediaries that make up security entitlements - the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) states the correlative liability of a

securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 [55-8-509 NMSA 1978] apply to the Section 8-507 [55-8-507 NMSA 1978] duty.

3. Appropriate person is defined in Section 8-107 [55-8-107 NMSA 1978]. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3). Entitlement holder is defined in Section 8-102(a)(7) [55-8-102 NMSA 1978] as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115 [55-8-115 NMSA 1978]. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5), which provide that the term "appropriate person" includes the successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has enteredinto a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106 [55-8-106 NMSA 1978]. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b) [55-8-107 NMSA 1978]. Moreover, Section 8-507(a) [55-8-507 NMSA

1978] provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 [55-8-107 NMSA 1978] specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b), together with Section 8-107 [55-8-107 NMSA 1978], has the effect of leaving to other law most of the questions of the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 is not a codification of all of the law of customers and stockbrokers. Article 8 deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this Article.

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Appropriate person" Section 8-107 [55-8-107 NMSA 1978]

"Effective" Section 8-107

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Entitlement order" Section 8-102(a)(8)

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-508. Duty of securities intermediary to change entitlement holder's position to other form of security holding.

A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

History: 1978 Comp., § 55-8-508, enacted by Laws 1996, ch. 47, § 52.

ANNOTATIONS

OFFICIAL COMMENT

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements - the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in

blank or specially indorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 [55-8-509 NMSA 1978] apply to the Section 8-508 [55-8-508 NMSA 1978] duty.

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-509. Specification of duties of securities intermediary by other statute or regulation; manner of performance of duties of securities intermediary and exercise of rights of entitlement holder.

(a) If the substance of a duty imposed upon a securities intermediary by Sections 55-8-504 through 55-8-508 NMSA 1978 is the subject of other statute, regulation or rule, compliance with that statute, regulation or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by Sections 55-8-504 through 55-8-508 NMSA 1978 is subject to:

(1) rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) Sections 55-8-504 through 55-8-508 NMSA 1978 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule.

History: 1978 Comp., § 55-8-509, enacted by Laws 1996, ch. 47, § 53.

ANNOTATIONS

OFFICIAL COMMENT

This Article is not a comprehensive statement of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 [55-8-504 through 55-8-508 NMSA 1978] specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508 [55-8-504 through 55-8-508 NMSA 1978].

Definitional Cross References: - "Agreement" Section 1-201(3) [55-1-201 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7) [55-8-102 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security agreement" Section 9-105(1)(l) [55-9-105 NMSA 1978]

"Security interest" Section 1-201(37)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-510. Rights of purchaser of security entitlement from entitlement holder.

(a) An action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under Section 55-8-502 NMSA 1978, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Chapter 55, Article 9 NMSA 1978, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Purchasers who have control rank equally, except that a securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

History: 1978 Comp., § 55-8-510, enacted by Laws 1996, ch. 47, § 54.

ANNOTATIONS

OFFICIAL COMMENT

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) [55-8-106 NMSA 1978] by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501 [55-8-501 NMSA 1978]. Under other law, Owner may be able to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) [55-8-510 NMSA 1978] precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(33) [55-1-201 NMSA 1978], it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 [55-8-502 NMSA 1978] rule. Thus, by virtue of Section 8-510(b) [55-8-510 NMSA 1978], Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article

9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turns holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 [55-8-502 NMSA 1978] would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c) [55-8-510 NMSA 1978], RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules ifthe interests of RP1 and RP2 are characterized as "security interests," see Section 9-115(5)(a) [55-9-115 NMSA 1978]. The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default rule of pro rata treatment for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-115(5)(b) [55-9-115 NMSA 1978] and Comment 6 to Section 9-115. Because the purchaser priority rule in Section 8-510(c) [55-8-510 NMSA 1978] is intended to track the Article 9 priority rules, it too has a pro rata rule for cases where multiple non-secured party purchasers have obtained control but omitted to specify their respective rights by agreement.

Definitional Cross References: - "Adverse claim" Section 8-102(a)(1) [55-8-102 NMSA 1978]

"Control" Section 8-106 [55-8-106 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Notice of adverse claim" Section 8-105 [55-8-105 NMSA 1978]

"Purchase" Section 1-201(32) [55-1-201 NMSA 1978]

"Purchaser" Sections 1-201(33) & 8-116 [55-8-116 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Value" Sections 1-201(44) & 8-116

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-8-511. Priority among security interests and entitlement holders.

(a) Except as otherwise provided in Subsections (b) and (c), if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

History: 1978 Comp., § 55-8-511, enacted by Laws 1996, ch. 47, § 55.

ANNOTATIONS

OFFICIAL COMMENT

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) provides that entitlement holders' claims have priority except as otherwise provided in subsection (b),

and subsection (b) provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106 [55-8-106 NMSA 1978]. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c) [55-9-115 NMSA 1978], but Alpha Bank did not obtain control under Section 8-106 [55-8-106 NMSA 1978]. Thus, under Section 8-511(a) [55-8-511 NMSA 1978] the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 and 9-115 [55-8-106 and 55-9-115 NMSA 1978]. Under Section 8-511(b) [55-8-511 NMSA 1978], Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503 [55-8-503 NMSA 1978], and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e), the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on

behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 mirrors that requirement, specifying in Section 8-504 [55-8-504 NMSA 1978] that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers claims, its customers are protected against loss from a shortfall by the Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115 [55-9-115 NMSA 1978]. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsection (c) provides a priority for secured lenders to such clearing corporations. Subsection (c) does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References: - "Clearing corporation" Section 8-102(a)(5) [55-8-102 NMSA 1978]

"Control" Section 8-106 [55-8-106 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Financial asset" Section 8-102(a)(9)

"Securities intermediary" Section 8-102(a)(14)

"Security entitlement" Section 8-102(a)(17)

"Security interest" Section 1-201(37) [55-1-201 NMSA 1978]

"Value" Sections 1-201(44) & 8-116 [55-8-116 NMSA 1978]

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Saving clauses. - Laws 1996, ch. 47, § 69 provides that nothing in Chapter 55, Article 8 NMSA 1978 shall affect an action or proceeding commenced before this Article takes effect and also provides for a four month continuance of previously perfected security interests.

ARTICLE 9
SECURED TRANSACTIONS; SALES OF ACCOUNTS, CONTRACT RIGHTS AND CHATTEL PAPER

Part 1

Short Title, Applicability and Definitions.

Part 2

Validity of Security Agreement and Rights of Parties Thereto.

Part 3

Rights of Third Parties; Perfected

and Unperfected Security Interests;

Rules of Priority.

Part 4

Filing.

Part 5

Default.

ANNOTATIONS

Compiler's notes. - Laws 1961, ch. 96 enacted New Mexico's version of the Uniform Commercial Code. The 1972 revision of the code, which revised primarily Article 9, was adopted by Laws 1985, ch. 193, effective January 1, 1986. The 1977 revision of the code, which revised primarily Article 8, was adopted by Laws 1987, ch. 248, effective June 19, 1987.

PART 1
SHORT TITLE, APPLICABILITY AND DEFINITIONS

55-9-101. Short title.

This article shall be known and may be cited as Uniform Commercial Code - Secured Transactions.

History: 1953 Comp., § 50A-9-101, enacted by Laws 1961, ch. 96, § 9-101.

ANNOTATIONS

OFFICIAL COMMENT

This article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures. It supersedes prior legislation dealing with such security devices as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivable (see note to Section 9-102).

Consumer installment sales and consumer loans present special problems of a nature which makes special regulation of them inappropriate in a general commercial codification. Many states now regulate such loans and sales under small loan acts, retail installment selling acts and the like. The National Conference of Commissioners on Uniform State Laws has proposed a Uniform Consumer Credit Code dealing with this subject. While this article applies generally to security interests in consumer goods, it is not designed to supersede such regulatory legislation (see notes to Sections 9-102 and

9-203). Nor is this article designed as a substitute for small loan acts or retail installment selling acts in any state which does not presently have such legislation.

Pre-code law recognized a wide variety of security devices, which came into use at various times to make possible different types of secured financing. Differences between one device and another persisted, in formal requisites, in the secured party's rights against the debtor and third parties, in the debtor's rights against the secured party and in filing requirements, although many of those differences no longer served any useful function. Thus an unfiled chattel mortgage was by the law of many states "void" against creditors generally; a conditional sale, often available as a substitute for the chattel mortgage, was in some states valid against all creditors without filing, and in states where filing is required was, if unfiled, void only against lien creditors. The recognition of so many separate security devices had the result that half a dozen filing systems covering chattel security devices might be maintained within a state, some on a county basis, others on a statewide basis, each of which had to be separately checked to determine a debtor's status.

Nevertheless, despite the great number of security devices there remained gaps in the structure. In many states, for example, a security interest could not be taken in inventory or a stock in trade although there was a real need for such financing. It was often baffling to try to maintain a technically valid security interest when financing a manufacturing process, where the collateral starts out as raw materials, becomes work in process and ends as finished goods. Furthermore, it was by no means clear, even to specialists, how under pre-code law a security interest might be taken in many kinds of intangible property - such as television or motion picture rights - which have come to be an important source of commercial collateral.

While the chattel mortgage was adaptable for use in almost any situation where goods are collateral, there were limitations, sometimes highly technical, on the use of other devices, such as the conditional sale and particularly the trust receipt. The cases are many in which a security transaction described by the parties as a conditional sale or a trust receipt was later determined by a court to be something else, usually a chattel mortgage. The consequence of such a determination was typically to void the security interest against creditors because the security agreement was not filed *as a chattel mortgage* (even though it may have been filed as a conditional sale or a trust receipt). The already mentioned difficulty of financing on the security of inventory has been got around to some extent by the device known as "field warehousing" as well as by the use of the trust receipt. After 1940 a number of states generally authorized inventory financing by enacting statutes, similar although not uniform, known as "factor's lien" acts. Also after 1940 the increasingly important business of lending against accounts receivable inspired new statutes in that field in more than thirty states.

The growing complexity of financing transactions forced legislatures to keep piling new statutory provisions on top of our inadequate and already sufficiently complicated nineteenth-century structure of security law. The results of this continuing development

were increasing costs to both parties and increasing uncertainty as to their rights and the rights of third parties dealing with them.

The aim of this article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.

Under this article the traditional distinctions among security devices, based largely on form, are not retained; the article applies to all transactions intended to create security interests in personal property and fixtures, and the single term "security interest" substitutes for the variety of descriptive terms which had grown up at common law and under a hundred-year accretion of statutes. This does not mean that the old forms may not be used, and Section 9-102 (2) makes it clear that they may be.

This article does not determine whether "title" to collateral is in the secured party or in the debtor and adopts neither a "title theory" nor a "lien theory" of security interests. Rights, obligations and remedies under the article do not depend on the location of title (Section 9-202). The location of title may become important for other purposes - as, for example, in determining the incidence of taxation - and in such a case the parties are left free to contract as they will. In this connection the use of a form which has traditionally been regarded as determinative of title (e. g., the conditional sale) could reasonably be regarded as evidencing the parties' intention with respect to title to the collateral.

Under the article distinctions based on form (except as between pledge and non-possessory interests) are no longer controlling. For some purposes there are distinctions based on the type of property which constitutes the collateral - industrial and commercial equipment, business inventory, farm products, consumer goods, accounts receivable, documents of title and other intangibles - and, where appropriate, the article states special rules applicable to financing transactions involving a particular type of property. Despite the statutory simplification a greater degree of flexibility in the financing transaction is allowed than is possible under existing law.

The scheme of the article is to make distinctions, where distinctions are necessary, along functional rather than formal lines.

This has made possible a radical simplification in the formal requisites for creation of a security interest.

A more rational filing system replaces the present system of different files for each security device which is subject to filing requirements. Thus not only is the information contained in the files made more accessible but the cost of procuring credit information, and, incidentally, of maintaining the files, is greatly reduced.

The article's flexibility and simplified formalities should make it possible for new forms of secured financing, as they develop, to fit comfortably under its provisions, thus avoiding

the necessity, so apparent in recent years, of year by year passing new statutes and tinkering with the old ones to allow legitimate business transactions to go forward.

The rules set out in this article are principally concerned with the limits of the secured party's protection against purchasers from and creditors of the debtor. Except for procedure on default, freedom of contract prevails between the immediate parties to the security transaction.

Priority between landlord's lien and Article 9 security interest. - The priority between a landlords' lien and an Article 9 security interest is not covered by the statutory provisions of the Uniform Commercial Code - Secured Transactions. In such a case, the common law doctrine of "first in time, first in right" controls the priorities between the parties. Kuemmerle v. United N.M. Bank, 113 N.M. 677, 831 P.2d 976 (1992).

Failure to comply with code precludes mortgagee from foreclosure. - Mortgagee was precluded from foreclosing on a mortgage taken on property subject to an executory sales contract of which it had actual notice, since it failed to comply with the provisions of the uniform commercial code on secured transactions, including failing to comply with the filing provisions of the code. First Nat'l Bank v. Luce, 87 N.M. 94, 529 P.2d 760 (1974).

The security assignment of a real estate contract is not subject to the perfection requirements of this article. Reardon v. Alsup, 114 N.M. 95, 835 P.2d 811 (1992).

Law reviews. - For comment on *Strevell-Paterson Fin. Co. v. May,* 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Lender Recourse in Indian Country: A Navajo Case Study," see 21 N.M.L. Rev. 275 (1991).

For note, "Commercial Law - And Then Personal Property Became Real Property: *In re Anthony*," see 23 N.M.L. Rev. 263 (1993).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 67 Am. Jur. 2d §§ 387 et seq., 465 et seq., 681 et seq.; 68A Am. Jur. 2d Secured Transactions § 1 et seq.

Construction and effect of U.C.C., art. 9, dealing with secured transactions, sales of accounts, contract rights and chattel paper, 30 A.L.R.3d 9, 67 A.L.R.3d 308, 69 A.L.R.3d 1162, 76 A.L.R.3d 11, 99 A.L.R.3d 807, 99 A.L.R.3d 1080, 100 A.L.R.3d 10, 100 A.L.R.3d 940, 7 A.L.R.4th 308, 11 A.L.R.4th 241, 90 A.L.R.4th 859, 25 A.L.R.5th 696.

6A C.J.S. Assignments § 93; 8 C.J.S. Bailments § 103; 35 C.J.S. Factors §§ 45 to 58; 53 C.J.S. Liens § 1 et seq.; 72 C.J.S. Pledges §§ 28 et seq., 40 et seq.; 79 C.J.S. Secured Transactions § 1 et seq.

55-9-102. Policy and subject matter of article.

(1) Except as otherwise provided in Section 9-104 [55-9-104 NMSA 1978] on excluded transactions, this article applies:

(a) to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts; and also

(b) to any sale of accounts or chattel paper.

(2) This article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This article does not apply to statutory liens except as provided in Section 9-310 [55-9-310 NMSA 1978].

(3) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

History: 1953 Comp., § 50A-9-102, enacted by Laws 1961, ch. 96, § 9-102; 1985, ch. 193, § 6.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The main purpose of this section is to bring all consensual security interests in personal property and fixtures under this article, except for certain types of transactions excluded by Section 9-104. In addition certain sales of accounts and chattel paper are brought within this article to avoid difficult problems of distinguishing between transactions intended for security and those not so intended. As to security interests in fixtures created under the law applicable to real estate, see Section 9-313(1).

1. Except for sales of accounts and chattel paper, the principal test whether a transaction comes under this article is: is the transaction intended to have effect as security? For example, Section 9-104 excludes certain transactions where the security interest (such as an artisan's lien) arises under statute or common law by reason of

status and not by consent of the parties. Transactions in the form of consignments or leases are subject to this article if the understanding of the parties or the effect of the arrangement shows that a security interest was intended. (As to consignments the provisions of Sections 2-326, 9-114 and 9-408 should be consulted.) When it is found that a security interest as defined in Section 1-201 (37) was intended, this article applies regardless of the form of the transaction or the name by which the parties may have christened it. The list of traditional security devices in Subsection (2) is illustrative only; other old devices, as well as any new ones which the ingenuity of lawyers may invent, are included, so long as the requisite intent is found. The controlling definition is that contained in Subsection (1).

The article does not in terms abolish existing security devices. The conditional sale or bailment-lease, for example, is not prohibited; but even though it is used, the rules of this article govern.

2. If an obligation is to repay money lent and is not part of chattel paper, it is either an instrument or a general intangible. A sale of an instrument or general intangible is not within this article, but a transfer intended to have effect as security for an obligation of the transferor is covered by Subsection (1)(a). In either case the nature of the transaction is not affected by the fact that collateral is transferred with the instrument or general intangible. Such a transfer is treated as a transfer by operation of law, whether or not it is articulated in the agreement.

An assignment of accounts or chattel paper as security for an obligation is covered by Subsection (1) (a). Commercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such property is therefore covered by Subsection (1) (b) whether intended for security or not, unless excluded by Section 9-104. The buyer then is treated as a secured party, and his interest as a security interest. See Sections 9-105(1) (m) and 1-201(37). Certain sales which have nothing to do with commercial financing transactions are excluded by Section 9-104(f); compare Spurlin v. Sloan, 368 S.W.2d 314 (Ky. 1963). See also Section 9-302 (1) (e), exempting from filing casual or isolated assignments, and Section 9-302(2), preserving the perfected status of a security interest against the original debtor when a secured party assigns his interest.

3. In general, problems of choice of law in this article as to the validity of security agreements are governed by Section 1-105. Problems of choice of law as to perfection of security interests and the effect of perfection or nonperfection thereof, including rules requiring reperfection, are governed by Section 9-103.

4. An illustration of Subsection (3) is as follows:

The owner of Blackacre borrows $10,000 from his neighbor, and secures his note by a mortgage on Blackacre. This article is not applicable to the creation of the real estate mortgage. Nor is it applicable to a sale of the note by the mortgagee, even though the mortgage continues to secure the note. However, when the mortgagee pledges the note

to secure his own obligation to X, this article applies to the security interest thus created, which is a security interest in an instrument even though the instrument is secured by a real estate mortgage. This article leaves to other law the question of the effect on rights under the mortgage of delivery or nondelivery of the mortgage or of recording or nonrecording of an assignment of the mortgagee's interest. See Section 9-104(j). But under Section 3-304(5) recording of the assignment does not of itself prevent X from holding the note in due course.

5. While most sections of this article apply to a security interest without regard to the nature of the collateral or its use, some sections state special rules with reference to particular types of collateral. An index of sections where such special rules are stated follows:

ACCOUNTS

Section	
9-102(1)(b)	Sale of accounts subject to article
9-103(1)	When article applies; conflict of laws rules
9-104(f)	Certain sales of accounts excluded from article
9-106	Definitions
9-205	Permissible for debtor to make collections
9-206(1)	Agreement not to assert defenses against assignee
9-301(1)(d)	Unperfected security interest subordinate to certain transferees
9-302(1)(e)	What assignments need not be filed
9-306(5)	Rule when goods whose sale gave rise to an account return to seller's possession
9-318(1)	Rights of assignee subject to defenses
9-318(2)	Modification of contract after assignment of contract right
9-318(3)	When account debtor may pay assignor
9-318(4)	Term prohibiting assignment ineffective
9-401	Place of filing
9-502	Collection rights of secured party
9-504(2)	Rights on default where underlying transaction was sale of accounts or contract rights

CHATTEL PAPER

9-102(1)(b)	Sale subject to article
9-104(f)	Certain sales excluded from article
9-105(1)(b)	Definition
9-205	Permissible for debtor to make collections
9-206(1)	Agreement not to assert defenses against assignee

9-207(1)   Duty of secured party in possession to preserve rights against
prior parties

9-301(1)(c)   Unperfected security interest subordinate to certain
transferees

9-304(1)   Perfection by filing

9-305   When possession by secured party perfects security interest

9-306(5)   Rule when goods whose sale results in chattel paper return to
seller's possession

9-308   When purchasers of chattel paper have priority over security
interest

9-318(1)   Rights of assignee subject to defenses

9-318(3)   When account debtor may pay assignor

9-502   Collection rights of secured party

9-504(2)   Rights on default where underlying transaction was sale

DOCUMENTS AND INSTRUMENTS

9-105(1)(e)   Definition of document (and see 1-201)

9-105(1)(g)   Definition of instrument

9-206(1)   Rule where buyer of goods signs both negotiable instrument and
security agreement

9-207(1)   Duty of secured party in possession of instrument to preserve
rights against prior parties

9-301(1)(c)   Unperfected security interest subordinate to certain
transferees

9-302(1)(b) and (f)   What interests need not be filed

9-304(1)   How security interest can be perfected

9-304(2, 3)   Perfection of security interest in goods in possession of
issuer of negotiable document or of other bailee

9-304(4, 5)   Perfection of security interest in instruments or negotiable
documents without filing or transfer of possession

9-305   When possession by secured party perfects security interest

9-308   When purchasers of instruments have priority over

security
interest
9-309 When purchasers of negotiable instruments or negotiable
documents have priority over security interest
9-501(1) Rights on default where collateral is documents
9-502 Collection rights of secured party

GENERAL INTANGIBLES

9-103(2) When article applies; conflict of laws rules
9-105 Obligor is "account debtor"
9-106 Definition
9-301(1)(d) Unperfected security interest subordinate to certain
transferees
9-318(1) Rights of assignee subject to defenses
9-318(3) When account debtor may pay assignor
9-502 Collection rights of secured party

GOODS

(See also Consumer Goods, Equipment, Farm Products, Inventory)

9-103 When article applies with regard to goods of a type normally
used in more than one jurisdiction; goods covered by
certificate of title; conflict of laws rules
9-105(1)(h) Definition
9-109 Classification of goods as consumer goods, equipment, farm
products and inventory
9-203 Formal requisites of security agreement covering certain types
of goods (crops or timber)
9-204 Validity of after-acquired property clause covering certain
types of goods (crops, consumer goods)
9-205 Permissible for debtor to accept returned goods
9-206(2) When security agreement can limit or modify warranties on sale
9-301(1)(c) Unperfected security interest subordinate to certain
transferees
9-304(2, 3) Perfection of security interest in goods in possession of

issuer of negotiable document or of other bailee
9-304(5) Perfection of security interest without filing or transfer of
possession where goods in possession of certain bailees
9-305 When possession by secured party perfects security interest
9-306(5) Rule when goods whose sale gave rise to account or chattel
paper return to seller's possession
9-307 When buyers of goods from debtor take free of security interest
9-313 Goods which are or become fixtures
9-314 Goods affixed to other goods
9-315 Goods commingled in a product
9-401(1) Place of filing for fixtures
9-402 Form of financing statement covering fixtures
9-504(1) Sale of goods by secured party after default subject to
Article 2 (Sales)

CONSUMER GOODS

9-109(1) Definition
9-203(2) Transaction, although subject to this article, may also be
subject to certain regulatory statutes
9-204(2) Validity of after-acquired property clause
9-206(1) Buyer's agreement not to assert defenses against an assignee
subject to statute or decision which establishes rule for
buyers of consumer goods
9-302(1)(d) When filing not required
9-307(2) When buyers from debtor take free of security interest
9-401(1)(a) Place of filing
9-505(1) Secured party's duty to dispose of repossessed consumer goods
9-507(1) Secured party's liability for improper disposition of consumer
goods after default

EQUIPMENT

9-103(2) When article applies with regard to certain types of equipment

normally used in more than one jurisdiction; conflict of laws rules

9-109(2) Definition

9-302(1)(c) When filing not required to perfect security interest in certain farm equipment

9-307(2) When buyers of certain farm equipment from debtor take free of security interest

9-401(1) Place of filing for equipment used in farming operation

9-503 Secured party's right after default to remove or to render equipment unusable

FARM PRODUCTS

9-109(3) Definition

9-203(1)(b) Formal requisites of security agreement covering crops

9-307 When a buyer of farm products takes free of security interest

9-312(2) Priority of secured party who gives new value to enable debtor to produce crops

9-401(1) Place of filing

9-402(1) and (3) Form of financing statement covering crops

INVENTORY

9-103(3) When article applies with regard to certain types of inventory normally used in more than one jurisdiction; conflict of laws rules

9-109(4) Definition

9-114 Consigned goods

9-306(5) Rule where goods whose sale gave rise to account or chattel paper return to seller's possession

9-307(1) When buyers from debtor take free of security interest

9-312(3), 9-304(5) When purchase money security interest takes priority over

```
                conflicting security interest
9-408           Financing statements covering consigned or leased
goods
```

Cross references. - Sections 9-103 and 9-104.

Point 1: Section 2-326.

Point 2: Section 1-105.

Definitional cross references. - "Account". Section 9-106.

"Chattel paper". Section 9-105.

"Contract". Section 1-201.

"Document". Section 9-105.

"General intangibles". Section 9-106.

"Goods". Section 9-105.

"Instrument". Section 9-105.

"Security interest". Section 1-201.

Use of conditional sale device or method gave to seller a security interest in ski lifts in accordance with this section. Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972).

Code to determine legal effects of lease agreement. - When the terms of the lease agreement are not in dispute and the issue between parties is as to its legal effect, it is to be determined under the framework of the code. Rust Tractor Co. v. Bureau of Revenue, 82 N.M. 82, 475 P.2d 779 (Ct. App.), cert. denied, 82 N.M. 81, 475 P.2d 778 (1970).

Sales of accounts are secured transactions governed by the UCC. GMA, Inc. v. Boerner, 70 Bankr. 77 (Bankr. D.N.M. 1987).

Action by Indian for violation of tribal law in repossessing pickup truck. - See GMAC v. Chischilly, 96 N.M. 113, 628 P.2d 683 (1981).

Law reviews. - For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Attachment and Garnishment § 144; 15A Am. Jur. 2d Commercial Code § 11; 68A Am. Jur. 2d Secured Transactions § 1 et seq.

Title and rights incident to trust receipts generally, 168 A.L.R. 366.

What amounts to conditional sale, 175 A.L.R. 1367.

Constitutionality, construction and application of statute respecting sale, assignment or transfer of retail installment contracts, 10 A.L.R.2d 447.

Carrier's certificate of convenience and necessity, franchise or permit as subject to transfer or encumbrance, 15 A.L.R.2d 883.

Bill of sale, absolute on its face, as a chattel mortgage, 33 A.L.R.2d 364.

Lease of real estate for term of years as subject of chattel mortgage, 33 A.L.R.2d 1277.

Necessity that mortgage covering oil and gas lease be recorded as real estate mortgage, and/or filed or recorded as chattel mortgage, 34 A.L.R.2d 902.

Effectiveness, as pledge, of transfer of nonnegotiable instruments which represent obligation, 53 A.L.R.2d 1396.

Liability of pawnbroker or pledgee for theft by third person of pawned or pledged property, 68 A.L.R.2d 1259.

Validity of chattel mortgage on stock of goods which mortgagor has right to sell, where mortgagee takes possession of goods before third person's rights attacked, 71 A.L.R.2d 1416.

Relative rights as between assignee of conditional seller and a subsequent buyer from the conditional seller after repossession or the like, 72 A.L.R.2d 342.

Priority as between seller or conditional seller of personalty and claimant under after acquired property clause of mortgage or other instrument, 86 A.L.R.2d 1152.

Construction and effect of U.C.C. art. 9, dealing with secured transactions, sales of accounts, contract rights and chattel paper, 30 A.L.R.3d 9, 67 A.L.R.3d 308, 69 A.L.R.3d 1162, 76 A.L.R.3d 11, 99 A.L.R. 3d 807, 99 A.L.R.3d 1080, 100 A.L.R.3d 10,

100 A.L.R.3d 940, 7 A.L.R.4th 308, 11 A.L.R.4th 241, 90 A.L.R.4th 859, 25 A.L.R.5th 696.

Effectiveness of original financing statement under U.C.C. Article 9 after change in debtor's name, identity, or business structure, 99 A.L.R.3d 1194.

Applicability of Article 9 of Uniform Commercial Code to assignment of rights under real-estate sales contract, lease agreement, or mortgage as collateral for separate transaction, 76 A.L.R.4th 765.

6A C.J.S. Assignments § 93; 8 C.J.S. Bailments § 102; 35 C.J.S. Factors §§ 45 to 58; 53 C.J.S. Liens § 1 et seq.; 72 C.J.S. Pledges § 40; 79 C.J.S. Secured Transactions § 1 et seq.

55-9-103. Perfection of security interests in multiple state transactions.

(1) Documents, instruments and ordinary goods.

(a) This subsection applies to documents, instruments, rights to proceeds of written letters of credit and goods other than those covered by a certificate of title described in Subsection (2) of this section, mobile goods described in Subsection (3) of this section and minerals described in Subsection (5) of this section.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or non-perfection of the security interest from the time it attaches until thirty days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the thirty-day period.

(d) When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Sections 55-9-301 through 55-9-318 NMSA 1978 to perfect the security interest:

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of

that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) if the action is taken before the expiration of the period specified in Subparagraph (i) of this paragraph, the security interest continues perfected thereafter; or

(iii) for the purpose of priority over a buyer of consumer goods (Subsection (2) of Section 55-9-307 NMSA 1978), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in Subparagraphs (i) and (ii) of this paragraph.

(2) Certificate of title.

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of the security interest are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title within the meaning of this section.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this state and thereafter covered by a certificate of title issued by this state is subject to the rules stated in Paragraph (d) of Subsection (1) of this section.

(d) If goods are brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this state and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

(3) Accounts, general intangibles and mobile goods.

(a) This subsection applies to accounts (other than an account described in Subsection (5) of this section on minerals) and general intangibles (other than uncertificated securities) and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes,

shipping containers, road building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in Subsection (2) of this section.

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or non-perfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the accounts debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

(4) Chattel paper.

The rules stated for goods in Subsection (1) of this section apply to a possessory security interest in chattel paper. The rules stated for accounts in Subsection (3) of this section apply to a nonpossessory security interest in chattel paper, but the security interest may not be perfected by notification to the account debtor.

(5) Minerals.

Perfection and the effect of perfection or non-perfection of a security interest which is created by a debtor who has an interest in minerals or the like (including oil and gas) before extraction and which attaches thereto as extracted or which attaches to an account resulting from the sale thereof at the wellhead or minehead are governed by

the law (including the conflict of laws rules) of the jurisdiction wherein the wellhead or minehead is located.

(6) Investment property.

(a) This subsection applies to investment property.

(b) Except as otherwise provided in Paragraph (f) of this subsection, during the time that a security certificate is located in a jurisdiction, perfection of a security interest, the effect of perfection or non-perfection and the priority of a security interest in the certified security represented thereby are governed by the local law of that jurisdiction.

(c) Except as otherwise provided in Paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or non-perfection and the priority of a security interest in an uncertificated security are governed by the local law of the issuer's jurisdiction as specified in Section 55-8-110(d) NMSA 1978.

(d) Except as otherwise provided in Paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or non-perfection and the priority of a security interest in a security entitlement or securities account are governed by the local law of the securities intermediary's jurisdiction as specified in Section 55-8-110(e) NMSA 1978.

(e) Except as otherwise provided in Paragraph (f) of this subsection, perfection of a security interest, the effect of perfection or non-perfection and the priority of a security interest in a commodity contract or commodity account are governed by the local law of the commodity intermediary's jurisdiction. The following rules determine a "commodity intermediary's jurisdiction" for purposes of this paragraph:

(i) if an agreement between the commodity intermediary and commodity customer specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction;

(ii) if an agreement between the commodity intermediary and commodity customer does not specify the governing law as provided in Subparagraph (i) of this paragraph, but expressly specifies that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction;

(iii) if an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in Subparagraph (i) or (ii) of this paragraph, the commodity intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the commodity customer's account; and

(iv) if an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in Subparagraph (i) or (ii) of this paragraph

and an account statement does not identify an office serving the commodity customer's account as provided in Subparagraph (iii) of this paragraph, the commodity intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

(f) Perfection of a security interest by filing, automatic perfection of a security interest in investment property granted by a broker or securities intermediary and automatic perfection of a security interest in a commodity contract or commodity account granted by a commodity intermediary are governed by the local law of the jurisdiction in which the debtor is located. The rules in Paragraphs (c), (d) and (e) of Subsection (3) of this section apply to security interests to which this paragraph applies.

History: 1953 Comp., § 50A-9-103, enacted by Laws 1961, ch. 96, § 9-103; 1985, ch. 193, § 7; 1987, ch. 248, § 47; 1996, ch. 47, § 56; 1997, ch. 75, § 20.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. Paragraph 1(d): Section 14, Uniform Conditional Sales Act.

Purposes. - 1. The general rules on choice of law between the original parties in Section 1-105 [55-1-105 NMSA 1978] apply to this article. However, when conflicting claims to collateral arise, the question depends on *perfection* of security interests, and thus on the effect of perfection or nonperfection. These problems are dealt with in this section. The general rule (paragraph (1) (b)) is that these questions are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected. This event will frequently be the filing. If the last event is not filing and perfection is through filing, the filing required is in the jurisdiction where the collateral is when the last event occurs; prior filing in another jurisdiction is not effective and is not saved by the four-month rule discussed below, which applies only when the security interest was *perfected* in the jurisdiction from which the collateral was removed. If the security interest was perfected in one jurisdiction and then removed to another jurisdiction, maintenance of perfection in the latter jurisdiction or failure to do so is the "last event" to which the basic rule refers.

There are, however, exceptions to this basic rule:

2. If the parties to a transaction creating a purchase money security interest in goods understand when the security interest attaches that the collateral will be kept in another jurisdiction, the law of that jurisdiction governs perfection and the effect of perfection or nonperfection until 30 days after the debtor receives possession of the goods (Paragraph (1) (c)). A filing in that jurisdiction perfects the security interest even before the goods are removed. The 30-day period is not a period of grace during which filing is unnecessary or has retroactive effect, but merely states the period during which the

other jurisdiction is the place of filing. The effect of late filing is governed by other provisions, such as Sections 9-301 and 9-312 [55-9-301 and 55-9-312 NMSA 1978].

3. If the goods reach that jurisdiction within the 30 days, the effectiveness of the filing in that jurisdiction continues without interruption. If the collateral is not kept in that jurisdiction before the end of the 30-day period, Paragraph (1) (c) ceases to be applicable and thereafter the law of the jurisdiction where the collateral is controls perfection. A failure of the collateral to reach the intended destination jurisdiction before the expiration of the 30-day period because of a conflicting claim or otherwise may cause disappointment of expectations that the law of the destination jurisdiction will govern continuously, and caution may dictate filing both in that jurisdiction and in the jurisdiction where the security interest attaches.

This section uses the concepts that goods are "kept" in a state or "brought" into a state, and related terms. These concepts imply a stopping place of a permanent nature in the state, not merely transit or storage intended to be transitory.

4.(a) Where the collateral is an automobile or other goods covered by a certificate of title issued by any state and the security interest is perfected by notation on the certificate of title, perfection is controlled by the certificate of title rather than by the law of the state wherein the security interest attached (Subsection (2)).

(b) It has long been hoped that "exclusive certificate of title laws" would provide a sure means of controlling property interests in goods like automobiles, which because of their nature cannot readily be controlled by local or statewide filing alone. In theory the certificate of title should control the property interests in the vehicle wherever the vehicle may be. However, two circumstances operate to prevent the perfect operation of the certificate of title device:

First, some states have never adopted certificate of title laws. This results in a problem in the issuance of a certificate of title when the vehicle moves from a noncertificate to a certificate state, because the certificate-issuing officer is in no position to conduct a complete search to ascertain the condition of the title in a state of origin which requires no filing or in which filing could be in any one or more of several localities. Also, it seems that when a vehicle moves from a certificate to a noncertificate state, the officers issuing a new registration for the vehicle are not always meticulous to notify secured parties shown on the certificate to give them a chance to perfect their security interests in the noncertificate state when a new registration is issued. Moreover, some vehicles like mobile homes are not always registered and title certificates are not always issued even in a state which may have certificate laws applicable thereto, because the certificate laws may apply only if the mobile homes use the highways. Registration plates of a mobile home having a certificate could be removed and there would be nothing visible to show that a certificate had ever been issued for it.

Second, various fraudulent devices based on allegations of loss of the certificate of title enable a dishonest person to obtain both an original and a duplicate of title; to have a

security interest shown on only one thereof; and then to effect a transfer into a new state on the basis of the clean certificate, no matter how diligent the officers in the second state may be.

Given these practical problems, the choice of applicable rules of law after interstate removals of vehicles subject to certificate of title laws is most difficult. This article provides the rules set forth below.

(c) The security interest perfected by notation on a certificate of title will be recognized without limit as to time; but, of course, perfection by this method ceases if the certificate of title is surrendered (Paragraph (2) (b)). Since the secured party ordinarily holds the certificate, surrender thereof could not occur without his action in the matter in some respect. If the vehicle is reregistered in another jurisdiction while the secured party still holds the certificate, a danger of deception to third parties arises. The section provides that the certificate ceases to control after 4 months following removal if reregistration has occurred, but during the 4 months the secured party has the same protection for cases of interstate removal as is set forth in Paragraph (1) (d) of the section and Comment 7, subject to additional limitation if the reregistration also involves a new "clean" certificate of title in the removal jurisdiction and a nonprofessional buyer buys while that new certificate is outstanding. See Paragraph (2) (d) and Comment 4 (e).

(d) If a vehicle not described in the preceding paragraph (i. e., not covered by a certificate of title) is removed to a certificate state and a certificate is issued therefor, the holder of a security interest has the same 4-month protection, subject to the provision discussed in the next paragraph of comment.

(e) Where "this state" issues a certificate of title on collateral that has come from another state subject to a security interest perfected in any manner, problems will arise if this state, from whatever cause, fails to show on its certificate the security interest perfected in the other jurisdiction. This state will have every reason, nevertheless, to make its certificate of title reliable to the type of person who most needs to rely on it. Paragraph (2) (d) of the section therefore provides that the security interest perfected in the other jurisdiction is subordinate to the rights of a limited class of persons buying the goods while there is a clean certificate of title issued by this state, without knowledge of the security interest perfected in the other jurisdiction. The limited class are buyers who are nonprofessionals, i. e., not dealers and not secured parties, because these are ordinarily professionals. The protective rule mentioned does not apply if this state adopts a device used under some certificate of title laws, namely, stating on the certificate of title that the vehicle may be subject to security interests not shown on the certificate, where the collateral came from a noncertificate state.

In any event the security interest perfected out of state becomes unperfected unless reperfected in this state under the usual 4-month rule (Paragraph (2) (d) of the section). States which place a cautionary statement on a certificate of title coming from a noncertificate state make provision to reissue the certificate without the caution after four months.

One difficulty is that no state's certificate of title law makes any provision by which a foreign security interest may be reperfected in that state, without the cooperation of the owner or other person holding the certificate in temporarily surrendering the certificate. But that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party. The only solution for the out-of-state secured party under present certificate of title laws seems to be reperfect by possession, i. e., by repossessing the goods.

5. The general rules of the section based on location of the collateral could not be applied to certain types of intangible collateral which have no location in any realistic sense, or to certain movable chattels which have no permanent location.

(a) For accounts and general intangibles there is no indispensable or symbolic document which represents the underlying claim, whose endorsement or delivery is the one effectual means of transfer. There is a considerable body of case law dealing with the situs of choses in action such as these. This case law is in the highest degree confused, contradictory and uncertain: it affords no base on which to build a statutory rule.

An account arises typically out of a sale; the contract of sale may be executed in State A, the goods shipped from a warehouse in State B to buyer (account debtor) in State C. The account may then be assigned to an assignee in State D. The seller-assignor may keep his principal records in State E. Under the non-notification system of accounts financing, the seller-assignor, despite the assignment, bills and collects from the account debtor; under notification financing the account debtor makes payment to the assignee, but the bills may be prepared and sent out by either assignor or assignee. The contacts of the transaction are with many jurisdictions: to which one is it appropriate to look for the governing law? Even more complicated situations may be anticipated when the collateral consists of novel or uncommon types of personal property, which fall within the definition of general intangibles.

If we bear in mind that our principal question is where certain financing statements shall be filed, two things become clear. *First:* since the purpose of filing is to allow subsequent creditors of the *debtor-assignor* to determine the true status of his affairs, the place chosen must be one which such creditors would normally associate with the assignor; thus the place of business of the assignee and the places of business or residences of the various account debtors must be rejected in ordinary situations. *Second:* the place chosen must be one which can be determined with the least possible risk of error. The place chosen by Subsection (3) is the debtor's location, which is ordinarily the location of its chief executive office. This concept is discussed below.

(b) Another class of collateral for which a special rule is stated in Subsection (3) is mobile goods of types which are normally moved for use from one jurisdiction to another. Such goods are generally classified as equipment; sometimes they may be

classified as inventory, for example, goods leased by a professional lessor. Subsection (3) provides that a security interest in such equipment or inventory is subject to this article when the debtor's location, i. e., ordinarily its chief executive office, is in this state.

While automobiles are obviously mobile goods, they will in most cases be covered by Subsection (2) of this section and therefore excluded from Subsection (3) by Paragraph (a) thereof. If an automobile is not covered by a certificate of title and is classified as equipment or as inventory under lease, it will be subject to Subsection (3). Automobiles and other mobile goods which are classified as consumer goods are not subject to Subsection (3).

The rule of Subsection (3) applies to goods of a type "normally used" in more than one jurisdiction; there is no requirement that particular goods be in fact used out of state. Thus, if an enterprise whose chief executive office is in State X keeps in State Y goods of the type covered by Subsection (3), the rule of Subsection (3) requires filing in State X even though the goods never leave State Y.

(c) "Chief executive office" does not mean the place of incorporation; it means the place from which in fact the debtor manages the main part of his business operations. This is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. The term "chief executive office" is not defined in this section or elsewhere in this act. Doubt may arise as to which is the "chief executive office" of a multistate enterprise, but it would be rare that there could be more than two possibilities. A secured party in such a case may easily protect himself at no great additional burden by filing in each possible place. The subsection states a rule which will be simple to apply in most cases, and which makes it possible to dispense with much burdensome and useless filing.

(d) If the location of the debtor is moved after a security interest has been perfected in another jurisdiction, the secured party has four months within which to refile, unless the perfection in the original jurisdiction would have expired earlier (Paragraph (3) (e)).

(e) Under Subsection (3) each state other than that of the debtor's location in effect disclaims jurisdiction over certain accounts and general intangibles which, by common law rules, might be held to be within its jurisdiction; in the same way there is a disclaimer of jurisdiction over mobile chattels, even though they may be physically located within the state much of the time. If the jurisdiction whose law controls under this rule is a United States jurisdiction or has enacted legislation permitting perfection of the security interest by filing or recording in that jurisdiction, the law of that jurisdiction will be recognized in the disclaiming jurisdiction as perfecting the security interest. The jurisdiction of the debtor's location may not, however, have such legislation. For example, mobile equipment is used in New York; the debtor's chief place of business is in a Canadian jurisdiction which will not permit or recognize filing as to property not physically located therein. Paragraph (3) (c) solves this difficulty by permitting perfection through filing in the jurisdiction in the United States in which the debtor has its major

executive office in the United States. Where the debtor is not located in the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the secured party may alternatively perfect by notification to account debtors.

(f) A sentence in Paragraph (3) (d) provides a special rule for security interests in airplanes owned by a foreign air carrier. Without that sentence Subsection (3) might refer such a case to the law of a foreign nation whose law is difficult or impossible to ascertain. The sentence clears up such doubts by treating as the location of the carrier the office designated for service of process in the United States under the Federal Aviation Act of 1958. To the extent that it is applicable, the Convention on the International Recognition of Rights in Aircraft (Geneva Convention) supersedes state legislation on this subject, as set forth in Section 9-302(3) [55-9-302 NMSA 1978], but some nations are not parties to that convention.

6. Subsection (4) deals with chattel paper, a semi-intangible security interest which may be perfected either by possession or by filing (Sections 9-304(1) and 9-305) [55-9-304 and 55-9-305 NMSA 1978]. As to possessory security, Subsection (4) provides that chattel paper shall be subject to the same rule as goods in Subsection (1). As to nonpossessory security, Subsection (4) provides that it shall be subject to the same rule as the intangibles under Subsection (3), except that notification to the account debtor is ruled out as an optional means of perfection under Paragraph (3) (c). The reason for this is that a different alternative, possession, is available for chattel paper.

7. In addition to the foregoing rules defining which jurisdiction governs perfection of a security interest in the first instance, "this state" (i.e., a destination state after removal) adds its own rules requiring reperfection following removal of collateral other than that described in Subsections (2), (3), and (5). "This state" will for four months recognize perfection under the law of the jurisdiction from which the collateral came, unless the remaining period of effectiveness of the perfection in that jurisdiction was less than four months (Paragraph (1) (d)). After the four-month period or the remaining period of effectiveness, whichever is shorter, the secured party must comply with perfection requirements in this state. This rule differs from the former rule of Section 14 of the Uniform Conditional Sales Act. Under that section a conditional seller was required to file within 10 days after he "received notice" that the goods had been removed into this state. Apparently, under the Uniform Conditional Sales Act, if the seller never "received notice" his interest continued or became perfected in this state without filing. Paragraph (1)(d) proceeds on the theory that not only the secured party whose collateral has been removed but also creditors of and purchasers from the debtor "in this state" should be considered.

The four-month period is long enough for a secured party to discover in most cases that the collateral has been removed and refile in this state; thereafter, if he has not done so, his interest, although originally perfected in the jurisdiction from which the collateral was removed, is subject to defeat here by purchasers of the collateral. Compare the situation arising under Section 9-403(2) [55-9-403 NMSA 1978] when a filing lapses.

It should be noted that a "purchaser" includes a secured party. Section 1-201(32) and (33) [55-1-201 NMSA 1978]. The rights of a purchaser with a security interest against an unperfected security interest are governed by Section 9-312 [55-9-312 NMSA 1978].

In case of delay beyond the four-month period, there is no "relation back"; and this is also true where the security interest is perfected for the first time in this state.

If the removal occurs within a short period, like two weeks, before the lapse of the filing in the original state, the secured party has only that period, not the full four months, to reperfect in "this state". But ordinarily he would have filed a continuation statement in the original jurisdiction; and he may do so to avoid lapse and allow himself the full four months if he is searching for the collateral and needs more time.

Paragraph (1) (d) does not apply to the case of goods removed from one filing district to another within this state (see Subsection (3) of Section 9-401 [55-9-401 NMSA 1978]), but only to property brought into this state from another jurisdiction.

8. Subsection (5) deals with problems relating to the financing of minerals (including oil and gas) as these products come from the ground. In some cases rights in oil and gas in the ground have been split into a large variety of interests. As the oil or gas issues from the ground, it may be encumbered by the group of persons having interests therein. Or the product may be sold at minehead or wellhead and the resulting accounts assigned. The question arises as to the place of filing. The usual rule of this section in Subsection (2) would make the place to search for encumbrances on the accounts the locations of the respective assignors; but the assignors might be a number of individuals located throughout the country. To avoid the difficult problems of search thus created, Subsection (5) provides that the place for filing with respect to security interests in the minerals as they issue from the ground at minehead or wellhead or in the accounts arising out of the sale of the minerals at minehead or wellhead shall be in the state where the minehead or wellhead is located. Section 9-401 [55-9-401 NMSA 1978] similarly provides that the place to file within the state is in the real property records in the county where the minehead or wellhead is located. These rules conform to pre-code practice and to practice which seems to have continued in the early code period before express provision was made for these situations.

The term "at wellhead" is intended to encompass arrangements based on sale of the product as soon as it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" or the far side of a gathering tank or at some other point. The term "at minehead" is a comparable concept.

9. Subsection (6) of Section 9-103 [55-9-103 NMSA 1978] specifies choice of law rules for perfection of security interests in investment property. Paragraph (b) covers security interests in certificated securities. Paragraph (c) covers security interests in uncertificated securities. Paragraph (d) covers security interests in security entitlements and securities accounts. Paragraph (e) covers security interests in commodity contracts and commodity accounts. The approach of each of these paragraphs is essentially the

same. They identify the jurisdiction's law that governs questions of perfection and priority on the basis of the same principles that are used in Article 8 to determine other questions concerning that form of investment property. Thus, for certificated securities, the law of the jurisdiction where the certificate is located governs. Cf. Section 8-110(c) [55-8-110 NMSA 1978]. For uncertificated securities, the law of the issuer's jurisdiction governs. Cf. Section 8-110(a). For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. Cf. Section 8-110(b). For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Since commodity contracts and commodity accounts are not governed by Article 8, paragraph (e) contains rules that specify the commodity intermediary's jurisdiction. These are analogous to the rules in Section 8-110(e) specifying a securities intermediary's jurisdiction.

Under this subsection, if litigation about perfection or priority arises in this State, the relevant choice of law rule of paragraphs (b) through (e) may point to the law of this State or to the law of another State. If the litigation were in a tribunal of a jurisdiction that has not enacted this section, it would follow its own choice of law rules. The choice of law rules prescribed here by statute conform to generally accepted principles of choice of law. The simplicity and clarity in the choice of law rules, coupled with the explicit recognition that the parties to some securities transactions may agree on a governing law, are intended to assure that there will be one clear choice of law regardless of forum.

Paragraph (f) adapts the general choice of law principles of this subsection to cases where a secured party claims perfection on the basis of filing, or by virtue of the automatic perfection rules in Section 9-115(4)(c) and (d) [55-9-115 NMSA 1978]. In such a case, the law of the debtor's jurisdiction determines whether the requirements for that form of perfection have been satisfied. The rules in Section 9-103(3) [55-9-103 NMSA 1978] on the debtor's location. The main reason for the paragraph (f) rule is to specify the proper filing office. Under the substantive rules of this Act, a security interest in investment property perfected only by filing is enforceable against the debtor or lien creditors, but not against most other claimants. See Sections 9-115(5) and (6), 8-105(e), 8-303, and 8-502 [55-9-115, 55-8-105, 55-8-303, and 55-8-502 NMSA 1978]. Because the choice of law rules in this section may, in some circumstances, have the effect of directing a court in a jurisdiction that has adopted this Act to look to the law of another jurisdiction, it is possible that the jurisdiction so specified will be one that has not adopted rules concerning the effect of filing as a method of perfection for investment property. In such cases, or other circumstances where the governing substantive law is not this Act, the effect of filing on the rights of other parties should be interpreted in light of the role of that form of perfection under this Act; that is, the rights of a secured party in investment property as determined under this Act perfected only by filing against another secured party or any other person who purchases or otherwise deals with the investment property should be interpreted to be no greater than the rights of that secured party under this Act.

The following examples illustrate these rules:

Example 1. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a margin loan from Able. Subsection (6)(d) provides that Pennsylvania law - the law of the securities intermediary's jurisdiction - governs perfection and priority of the security interest.

Example 2. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a loan from a lender located in Illinois. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) [55-8-106 NMSA 1978] to give the lender control. Subsection (6)(d) provides that Pennsylvania law - the law of the securities intermediary's jurisdiction - governs perfection and priority of the security interest.

Example 3. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer borrows from SP1, and SP1 files a financing statement in New Jersey. Later, the customer obtains a loan from SP2. SP2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) [55-8-106 NMSA 1978] to give the SP2 control. Subsection (6)(f) provides that perfection of SP1's security interest by filing is governed by the location of the debtor, so the filing in New Jersey was appropriate - assuming New Jersey has adopted the revisions of Article 9 permitting perfection of security interests in investment property by filing. Subsection (6)(d), however, provides that Pennsylvania law - the law of the securities intermediary's jurisdiction - governs all other questions of perfection and priority. Thus, Pennsylvania law governs perfection of SP2's security interest, and Pennsylvania law also governs the priority of the security interests of SP1 and SP2.

Cross references. - Sections 1-105, 9-302 and 9-401 [55-1-105, 55-9-302 and 55-9-401 NMSA 1978].

Definitional cross references. - "Accounts". Section 9-106 [55-9-106 NMSA 1978].

"Attaches". Section 9-203 [55-9-203 NMSA 1978].

"Chattel Paper". Section 9-105 [55-9-105 NMSA 1978].

"Collateral". Section 9-105.

"Consumer Goods". Section 9-109 [55-9-109 NMSA 1978].

"Debtor". Section 9-105.

"Document". Section 9-105.

"Equipment". Section 9-109.

"General intangibles". Section 9-106.

"Goods". Section 9-105.

"Instrument". Section 9-109.

"Purchase money security interest". Section 9-107 [55-9-107 NMSA 1978].

"Purchaser". Section 1-201(33) [55-1-201 NMSA 1978].

"Security interest". Section 1-201(37).

The 1987 amendment, effective June 19, 1987, inserted "(other than uncertificated securities)" in Subsection (3)(a), added Subsection (6), and made minor stylistic changes throughout the section.

The 1996 amendment, effective May 15, 1996, in Subsection (6), substituted "Investment property" for "Uncertificated securities" in the subsection heading and substituted the text of Subsection (6) for "The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the perfection and the effect of perfection or nonperfection of a security interest in uncertificated securities".

The 1997 amendment, effective July 1, 1997, made minor stylistic changes throughout the section and, in Paragraph (1)(a), inserted "rights to proceeds of written letters of credit" after "instruments" and made related stylistic changes.

Federal Aviation Act of 1958. - The Federal Aviation Act of 1958, referred to in Subsection (3)(d), was codified primarily as 49 U.S.C. § 1301 et seq. Those provisions have subsequently been revised or repealed, and present comparable provisions appear as 49 U.S.C. § 40101 et seq.

Use of conditional sale device or method gives seller security interest in ski lifts in accordance with this section. Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972).

Capital retains are a general intangible and not an account because no "right to payment" exists; thus capital retains are property in which a debtor can grant a security interest. Valley Fed. Sav. Bank v. Stahl, 110 N.M. 169, 793 P.2d 851 (1990).

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 11; 16 Am. Jur. 2d Conflict of Laws §§ 2, 4, 50, 54; 68A Am. Jur. 2d Secured Transactions §§ 8, 9.

Construction and application of statutory provision respecting registration of mortgages or other liens on personal property in case of residents of other states, 10 A.L.R.2d 764.

Conflict of laws as to chattel mortgages and conditional sales of chattels, 13 A.L.R.2d 1312.

6A C.J.S. Assignments § 7; 73 C.J.S. Property § 12; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-104. Transactions excluded from article.

Chapter 55, Article 9 NMSA 1978 does not apply:

(a) to a security interest subject to any statute of the United States to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property; or

(b) to a landlord's lien; or

(c) to a lien given by statute or other rule of law for services or materials except as provided in Section 55-9-310 NMSA 1978 on priority of such liens; or

(d) to a transfer of a claim for wages, salary or other compensation of an employee; or

(e) to a transfer by government or a governmental subdivision or agency; or

(f) to a sale of accounts or chattel paper as part of a sale of the business out of which they arose, or an assignment of accounts or chattel paper that is for the purpose of collection only, or a transfer of a right to payment under a contract to an assignee who is also to do the performance under the contract or a transfer of a single account to an assignee in whole or partial satisfaction of a preexisting indebtedness; or

(g) to a transfer of an interest in or claim in or under any policy of insurance, except as provided with respect to proceeds (Section 55-9-306 NMSA 1978) and priorities in proceeds (Section 55-9-312 NMSA 1978); or

(h) to a right represented by a judgment (other than a judgment taken on a right to payment that was collateral); or

(i) to any right of set-off; or

(j) except to the extent that provision is made for fixtures in Section 55-9-313 NMSA 1978, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or

(k) to a transfer in whole or in part of any claim arising out of tort; or

(l) to a transfer of an interest in any deposit account (Subsection (1) of Section 55-9-105 NMSA 1978), except as provided with respect to proceeds (Section 55-9-306 NMSA 1978) and priorities in proceeds (Section 55-9-312 NMSA 1978); or

(m) to a transfer of an interest in a letter of credit other than the rights to proceeds of written letters of credit.

History: 1953 Comp., § 50A-9-104, enacted by Laws 1961, ch. 96, § 9-104; 1985, ch. 193, § 8; 1992, ch. 114, § 235; 1997, ch. 75, § 21.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. None.

Purposes. - To exclude certain security transactions from this article.

1. Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statute and excluded from this article. The Ship Mortgage Act, 1920, is an example of such a federal act. The present provisions of the Federal Aviation Act of 1958 (49 U.S.C. § 1403 et seq.) call for registration of title to and liens upon aircraft with the civil aeronautics administrator and such registration is recognized as equivalent to filing under this article (Section 9-302(3)); but to the extent that the Federal Aviation Act does not regulate the rights of parties to and third parties affected by such transactions, security interests in aircraft remain subject to this article.

Although the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright (17 U.S.C. §§ 28, 30) such a statute would not seem to contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in copyrights from the provisions of this article. Compare Republic Pictures Corp. v. Security-First National Bank of Los Angeles, 197 F.2d 767 (9th Cir. 1952). Compare also with respect to patents, 35 U.S.C. § 47. The filing provisions under these acts, like the filing provisions of the Federal Aviation Act, are recognized as the equivalent to filing under this article. Section 9-302(3) and (4).

Even such a statute as the Ship Mortgage Act is far from a comprehensive regulation of all aspects of ship mortgage financing. That act contains provisions on formal requisites, on recordation and on foreclosure but not much more. If problems arise under a ship mortgage which are not covered by the act, the federal admiralty court must decide whether to improvise an answer under "federal law" or to follow the law of some state with which the mortgage transaction has appropriate contacts. The exclusionary language in Paragraph (a) is that this article does not apply to such security interest "to the extent" that the federal statute governs the rights of the parties. Thus if the federal statute contained no relevant provision, this article could be looked to for an answer.

2. Except for fixtures (Section 9-313), the article applies only to security interests in personal property. The exclusion of landlord's liens by Paragraph (b) and of leases and other interests in or liens on real estate by Paragraph (j) merely reiterates the limitations on coverage already made explicit in Section 9-102(3). See Comment 4 to that section.

3. In all jurisdictions liens are given suppliers of many types of services and materials either by statute or by common law. It was thought to be both inappropriate and unnecessary for this article to attempt a general codification of that lien structure which is in considerable part determined by local conditions and which is far removed from ordinary commercial financing. Moreover, federal law may displace state law in situations such as admiralty liens. Paragraph (c) therefore excludes statutory liens from the article. Section 9-310 states a rule for determining priorities between such liens and the consensual security interests covered by this article.

4. In many states assignments of wage claims and the like are regulated by statute. Such assignments present important social problems whose solution should be a matter of local regulation. Paragraph (d) therefore excludes them from this article.

5. Certain governmental borrowings include collateral in the form of assignments of water, electricity or sewer charges, rents on dormitories or industrial buildings, tools, etc. Since these assignments are usually governed by special provisions of law, these governmental transfers are excluded from this article.

6. In general sales as well as security transfers of accounts and chattel paper are within the article (see Section 9-102). Paragraph (f) excludes from the article certain transfers of such intangibles which, by their nature, have nothing to do with commercial financing transactions.

Similarly, this paragraph excludes from the article such transactions as that involved in Lyon v. Ty-Wood Corporation, 212 Pa.Super. 69, 239 A.2d 819 (1968) and Spurlin v. Sloan, 368 S.W.2d 314 (Ky. 1963).

7. Rights under life insurance and other policies, and deposit accounts, are often put up as collateral. Such transactions are often quite special, do not fit easily under a general commercial statute and are adequately covered by existing law. Paragraphs (g) and (l)

make appropriate exclusions, but provision is made for coverage of deposit accounts and certain insurance money as proceeds.

8. The remaining exclusions go to other types of claims which do not customarily serve as commercial collateral: judgments under Paragraph (h), set-offs under Paragraph (i) and tort claims under Paragraph (k).

Cross references. - Point 1: Section 9-302(3).

Point 2: Sections 9-102(3) and 9-313.

Point 3: Sections 9-102(2) and 9-310.

Point 6: Section 9-102.

Definitional cross references. - "Account". Section 9-106.

"Chattel paper". Section 9-105.

"Contract". Section 1-201.

"Deposit account". Section 9-105.

"Party". Section 1-201.

"Rights". Section 1-201.

"Security interest". Section 1-201.

Cross-references. - For acknowledgements for wage and salary assignments, see 14-13-11 NMSA 1978.

The 1992 amendment, effective July 1, 1992, substituted "Chapter 55, Article 9 NMSA 1978" for "This article" in the introductory paragraph; inserted "government or" in Subsection (e); and made section reference substitutions and minor stylistic changes throughout the section.

The 1997 amendment, effective July 1, 1997, added Subsection (m) and made a related stylistic change.

The security assignment of a real estate contract is not subject to the perfection requirements of this article. Reardon v. Alsup, 114 N.M. 95, 835 P.2d 811 (1992).

Land contract and its assignment. - The legislature intended that both a land contract and the assignment thereof be similarly excluded by subsection (j). Reardon v. Alsup, 114 N.M. 95, 835 P.2d 811 (1992).

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Attachment and Garnishment § 144; 15A Am. Jur. 2d Commercial Code § 37; 68A Am. Jur. 2d Secured Transactions § 123 et seq.

Priority as between statutory landlord's lien and security interest perfected in accordance with Uniform Commercial Code, 99 A.L.R.3d 1006.

Effect of U.C.C. Article 9 upon conflict, as to funds in debtor's bank account, between secured creditor and bank claiming right of setoff, 3 A.L.R.4th 998.

Applicability of Article 9 of Uniform Commercial Code to assignment of rights under real-estate sales contract, lease agreement, or mortgage as collateral for separate transaction, 76 A.L.R.4th 765.

82 C.J.S. Statutes § 315.

55-9-105. Definitions and index of definitions.

(1) In Chapter 55, Article 9 NMSA 1978, unless the context otherwise requires:

(a) "account debtor" means the person who is obligated on an account, chattel paper or general intangible;

(b) "chattel paper" means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods, but a charter or other contract involving the use or hire of a vessel is not chattel paper. When a transaction is evidenced both by such a security agreement or a lease and by an instrument or a series of instruments, the group of writings taken together constitutes chattel paper;

(c) "collateral" means the property subject to a security interest and includes accounts and chattel paper which have been sold;

(d) "debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts or chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the article dealing with the collateral, the obligor in any provision dealing with the obligation and may include both where the context so requires;

(e) "deposit account" means a demand, time, savings, passbook or like account maintained with a bank, savings and loan association, credit union or like organization, other than an account evidenced by a certificate of deposit;

(f) "document" means document of title as defined in the general definitions of Article 1 (Section 55-1-201 NMSA 1978) and a receipt of the kind described in Subsection (2) of Section 55-7-201 NMSA 1978;

(g) "encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests;

(h) "goods" includes all things which are movable at the time the security interest attaches or which are fixtures (Section 55-9-313 NMSA 1978), but does not include money, documents, instruments, investment property, commodity contracts, accounts, chattel paper, general intangibles or minerals or the like (including oil and gas) before extraction. "Goods" also includes standing timber which is to be cut and removed under a conveyance or contract for sale, the unborn young of animals and growing crops;

(i) "instrument" means a negotiable instrument (defined in Section 55-3-104 NMSA 1978) or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment. The term does not include investment property;

(j) "mortgage" means a consensual interest created by a real estate mortgage, a trust deed on real estate or the like;

(k) an advance is made "pursuant to commitment" if the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation;

(l) "security agreement" means an agreement which creates or provides for a security interest;

(m) "secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party; and

(n) "transmitting utility" means any person primarily engaged in the railroad, street railway or trolley bus business, the electric or electronics communications transmission business, the transmission of goods by pipeline or the transmission or the production and transmission of electricity, steam, gas or water or the provision of sewer service.

(2) Other definitions applying to Chapter 55, Article 9 NMSA 1978 and the sections in which they appear are:

"account". Section 55-9-106 NMSA 1978;

"attach". Section 55-9-203 NMSA 1978;

"commodity contract". Section 55-9-115 NMSA 1978;

"commodity customer". Section 55-9-115 NMSA 1978;

"commodity intermediary". Section 55-9-115 NMSA 1978;

"construction mortgage". Subsection (1) of Section 55-9-313 NMSA 1978;

"consumer goods". Subsection (1) of Section 55-9-109 NMSA 1978;

"control". Section 55-9-115 NMSA 1978;

"equipment". Subsection (2) of Section 55-9-109 NMSA 1978;

"farm products". Subsection (3) of Section 55-9-109 NMSA 1978;

"fixture". Section 55-9-313 NMSA 1978;

"fixture filing". Section 55-9-313 NMSA 1978;

"general intangibles". Section 55-9-106 NMSA 1978;

"inventory". Subsection (4) of Section 55-9-109 NMSA 1978;

"investment property". Section 55-9-115 NMSA 1978;

"lien creditor". Subsection (3) of Section 55-9-301 NMSA 1978;

"proceeds". Subsection (1) of Section 55-9-306 NMSA 1978;

"purchase money security interest". Section 55-9-107 NMSA 1978; and

"United States". Section 55-9-103 NMSA 1978.

(3) The following definitions in other articles apply to Chapter 55, Article 9 NMSA 1978:

"broker". Section 55-8-102 NMSA 1978;

"certificated security". Section 55-8-102 NMSA 1978;

"check". Section 55-3-104 NMSA 1978;

"clearing corporation". Section 55-8-102 NMSA 1978;

"contract for sale". Section 55-2-106 NMSA 1978;

"control". Section 55-8-106 NMSA 1978;

"delivery". Section 55-8-301 NMSA 1978;

"entitlement holder". Section 55-8-102 NMSA 1978;

"financial asset". Section 55-8-102 NMSA 1978;

"holder in due course". Section 55-3-302 NMSA 1978;

"letter of credit". Section 55-5-102 NMSA 1978;

"note". Section 55-3-104 NMSA 1978;

"proceeds of a letter of credit". Section 55-5-114 NMSA 1978;

"sale". Section 55-2-106 NMSA 1978;

"securities intermediary". Section 55-8-102 NMSA 1978;

"security". Section 55-8-102 NMSA 1978;

"security certificate". Section 55-8-102 NMSA 1978; and

"security entitlement". Section 55-8-102 NMSA 1978.

(4) In addition, Chapter 55, Article 1 NMSA 1978 contains general definitions and principles of construction and interpretation applicable throughout Chapter 55, Article 9 NMSA 1978.

History: 1953 Comp., § 50A-9-105, enacted by Laws 1961, ch. 96, § 9-105; 1985, ch. 193, § 9; 1987, ch. 248, § 48; 1996, ch. 47, § 57; 1997, ch. 75, § 22.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. Various.

Purposes. -
1. General. It is necessary to have a set of terms to describe the parties to a secured transaction, the agreement itself, and the property involved therein; but the selection of the set of terms applicable to any one of the existing forms (e. g., mortgagor and mortgagee) might carry to some extent the implication that the existing law referable to that form was to be used for the construction and interpretation of this article. Since it is desired to avoid any such implication, a set of terms has been chosen which have no common law or statutory roots tying them to a particular form.

In place of such terms as "chattel mortgage," "conditional sale," "assignment of accounts receivable," "trust receipt," etc., this article substitutes the general term "security agreement" defined in Paragraph (1) (l). In place of "mortgagor," "mortgagee," "conditional vendee," "conditional vendor," etc., this article substitutes "debtor", defined in Paragraph (1) (d), and "secured party", defined in Paragraph (1) (m). The property subject to the security agreement is "collateral", defined in Paragraph (1) (c). The interest in the collateral which is conveyed by the debtor to the secured party is a "security interest", defined in Section 1-201(37) [55-1-201 NMSA 1978].

2. Parties. The parties to the security agreement are the "debtor" and the "secured party."

"Debtor": In all but a few cases the person who owes the debt and the person whose property secures the debt will be the same. Occasionally, one person furnishes security for another's debt, and sometimes property is transferred subject to a secured debt of the transferor which the transferee does not assume; in such cases, under the second sentence of the definition, the term "debtor" may, depending upon the context, include either or both such persons. Section 9-112 [55-9-112 NMSA 1978] sets out special rules which are applicable where collateral is owned by a person who does not owe a debt.

"Secured Party": The term includes any person in whose favor there is a security interest (defined in Section 1-201 [55-1-201 NMSA 1978]). The term is used equally to refer to a person who as a seller retains a lien on or title to goods sold, to a person whose interest arises initially from a loan transaction, and to an assignee of either. Note that a seller is a "secured party" in relation to his customer; the seller becomes a "debtor" if he assigns the chattel paper as collateral. This is also true of a lender who assigns the debt as collateral. With the exceptions stated in Section 9-104(f) [55-9-104 NMSA 1978] the article applies to any sale of accounts or chattel paper: the term "secured party" includes an assignee of such intangibles whether by sale or for security, to distinguish him from the payee of the account, for example, who becomes a "debtor" by pledging the account as security for a loan.

On the applicability of the terms "debtor" and "secured party" to consignments and leases see Section 9-408 [55-9-408 NMSA 1978] and comment thereto.

"Account debtor": Where the collateral is an account, chattel paper or general intangible the original obligor is called the "account debtor", defined in Paragraph (1) (a).

3. Property subject to the security agreement. "Collateral", defined in Paragraph (1) (c), is a general term for the tangible and intangible property subject to a security interest. For some purposes the code makes distinctions between different types of collateral and therefore further classification of collateral is necessary. Collateral which consists of tangible property is "goods", defined in Paragraph (1) (h); and "goods" are again subdivided in Section 9-109 [55-9-109 NMSA 1978]. For purposes of this article all intangible collateral fits one of five categories, two of which, "accounts", and "general intangibles" are defined in the following Section 9-106 [55-9-106 NMSA 1978]; the other three, "documents", "instruments" and "chattel paper", are defined in Paragraphs (1) (f), (1) (i) and (1) (b) of this section.

"Goods": The definition in Paragraph (1) (h) is similar to that contained in Section 2-105 [55-2-105 NMSA 1978] except that the sales article definition refers to "time of identification to the contract for sale", while this definition refers to "the time the security interest attaches".

For the treatment of fixtures, Section 9-313 [55-9-313 NMSA 1978] should be consulted. It will be noted that the treatment of fixtures under Section 9-313 does not at all points conform to their treatment under Section 2-107 [55-2-107 NMSA 1978] (goods to be severed from realty). Section 2-107 relates to sale of such goods; Section 9-313 to security interests in them. The discrepancies between the two sections arise from the differences in the types of interest covered. A comparable discrepancy exists as to minerals. In the case of timber, both sections treat it as goods if it is to be severed under a contract of sale, but not otherwise.

If in any state minerals before severance are deemed to be personal property, they fall outside the article's definition of "goods" and would therefore fall in the catchall definition, "general intangibles", in Section 9-106 [55-9-106 NMSA 1978]. The special provisions of Section 9-103(5) [55-9-103 NMSA 1978] would not apply and those of Section 9-103(3) would apply. The resulting problems should be considered locally.

For the purpose of this article, goods are classified as "consumer goods", "equipment", "farm products" and "inventory"; those terms are defined in Section 9-109 [55-9-109 NMSA 1978]. When the general term "goods" is used in this article, it includes, as may be appropriate in the context, the subclasses of goods defined in Section 9-109.

"Instrument": the term as defined in paragraph (1)(i) includes not only negotiable instruments and certificated securities but also any other intangibles evidenced by writings which are in ordinary course of business transferred by delivery. As in the case of chattel paper "delivery" is only the minimum stated and may be accompanied by other steps.

If a writing is itself a security agreement or lease with respect to specific goods it is not an instrument although it otherwise meets the term of the definition. See comment below on "chattel paper".

The fact that an instrument is secured by collateral, whether the collateral be other instruments, documents, goods, accounts or general intangibles, does not change the character of the principal obligation as an instrument or convert the combination of instrument and collateral into a separate code classification of personal property. The single qualification to this principle is that an instrument which is secured by chattel paper is itself part of the chattel paper, while also retaining its identity as an instrument.

"Document": See the comments under Sections 1-201(15) and 7-201 [55-1-201 and 55-7-201 NMSA 1978].

"Chattel paper": To secure his own financing a secured party may wish to borrow against or sell the security agreement itself along with his interest in the collateral which he has received from his debtor. Since the refinancing of paper secured by specific goods presents some problems of its own, the term "chattel paper" is used to describe this kind of collateral. The comments under Section 9-308 [55-9-308 NMSA 1978] further describe this concept.

Charters of vessels are excluded from the definition of chattel paper because they fit under the definition of accounts. See comment to Section 9-106 [55-9-106 NMSA 1978]. The term "charter" as used herein and in Section 9-106 includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage and all other arrangements for use of vessels.

4. The following transactions illustrate the use of the term "chattel paper" and some of the other terms defined in this section.

A dealer sells a tractor to a farmer on conditional sales contract or purchase money security interest. The conditional sales contract is a "security agreement", the farmer is the "debtor", the dealer is the "secured party" and the tractor is the type of "collateral" defined in Section 9-109 [55-9-109 NMSA 1978] as "equipment". But now the dealer transfers the contract to his bank, either by outright sale or to secure a loan. Since the conditional sales contract is a security agreement relating to specific equipment, the conditional sales contract is now the type of collateral called "chattel paper". In this transaction between the dealer and his bank, the bank is the "secured party", the dealer is the "debtor", and the farmer is the "account debtor".

Under the definition of "security interest" in Section 1-201(37) [55-1-201 NMSA 1978] a lease does not create a security interest unless intended as security. Whether or not the lease itself is a security agreement, it is chattel paper when transferred if it relates to specific goods. Thus, if the dealer enters into a straight lease of the tractor to the farmer (not intended as security), and then arranges to borrow money on the security of the lease, the lease is chattel paper.

Security agreements of the type formerly known as chattel mortgages and conditional sales contracts are frequently executed in connection with a negotiable note or a series of such notes. Under the definitions in Paragraphs (1) (b) and (1) (i) the rules applicable

to chattel paper, rather than those relating to instruments, are applicable to the group of writings (contract plus note) taken together.

5. Miscellaneous definitions.

"Deposit account" is a type of collateral excluded from this article under Section 9-104(l) [55-9-104 NMSA 1978], except when it constitutes proceeds of other collateral under Section 9-306 [55-9-306 NMSA 1978].

The terms "encumbrance" and "mortgage" are defined for use in the section on fixtures, Section 9-113 [55-9-113 NMSA 1978].

The term "transmitting utility" is defined to designate a special class of debtors for whom separate filing rules are provided in Part 4, thus obviating all local filing and particularly the several local filings that would be necessary under the usual rules of Section 9-401 [55-9-401 NMSA 1978] for the fixture collateral of a far-flung public utility debtor. See comments under Sections 9-401 and 9-403 [55-9-403 NMSA 1978].

The term "pursuant to commitment" is defined for use in the rules relating to priority of future advances in Sections 9-301(4), 9-307(3) and 9-312(7) [55-9-301, 55-9-307 and 55-9-312 NMSA 1978].

6. Comments to the definitions indexed in Subsections (2) and (3) follow the sections in which the definitions are contained.

Cross references. - Point 2: Sections 9-104(f) and 9-112 [55-9-104 and 55-9-112 NMSA 1978].

Point 3: Sections 2-105, 2-107, 9-106, 9-109, 9-303 and 9-313 [55-2-105, 55-2-107, 55-9-106, 55-9-109, 55-9-303 and 55-9-313 NMSA 1978].

Definitional cross references. - "Account". Section 9-106 [55-9-106 NMSA 1978].

"Agreement". Section 1-201 [55-1-201 NMSA 1978].

"Document of title". Sections 1-201, 7-201 [55-7-201 NMSA 1978].

"General intangibles". Section 9-106.

"Holder". Section 1-201.

"Money". Section 1-201.

"Negotiable instrument". Section 3-104 [55-3-104 NMSA 1978].

"Person". Section 1-201.

"Representative". Section 1-201.

"Rights". Section 1-201.

"Security". Section 8-102 [55-8-102 NMSA 1978].

"Security interest". Section 1-201.

"Writing". Section 1-201.

The 1987 amendment, effective June 19, 1987, substituted "certificated security" for "security" in Subsection (1)(i) and substituted NMSA citations for UCC citations throughout the section.

The 1996 amendment inserted "investment property, commodity contracts" in Subsection (1)(h); deleted "or a certificated security (defined in Section 55-8-102 NMSA 1978)" preceding "or any other" and added the second sentence in Subsection (1)(i); and added the definitions contained in Sections 55-8-102, 55-8-106, 55-8-301, and 55-9-115 NMSA 1978 in Subsection (2). Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

The 1997 amendment, effective July 1, 1997, in Subsection (3), inserted "'letter of credit'. Section 55-5-102 NMSA 1978" and "'proceeds of a letter of credit'. Section 55-5-114 NMSA 1978" in alphabetical order.

Remedies of Subsection (2) of 55-9-505 NMSA 1978 are accessible to all secured parties including pawnbrokers dealing in Indian pawn with Indian debtors, and they may avail themselves of the remedies provided by the code. Begay v. Foutz & Tanner, Inc., 95 N.M. 106, 619 P.2d 551 (Ct. App. 1979) rev'd on other grounds sub nom. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980).

"Chattel mortgage" meets the definition of "security agreement" under this section. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

Mortgage serving as security interest. - Although a mortgage, without more, is not sufficient to automatically attach to the proceeds of a separate real estate contract, when a contract vendor offered his interest in the property as security for a loan the mortgage served as a security interest and was perfected upon filing with the county clerk's office where the property was located. Finch v. Beneficial N.M., Inc., 120 N.M. 658, 905 P.2d 198 (1995).

Law reviews. - For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 31 et seq.

Effect of U.C.C. Article 9 upon conflict, as to funds in debtor's bank account, between secured creditor and bank claiming right of setoff, 3 A.L.R.4th 998.

82 C.J.S. Statutes § 315.

55-9-106. Definitions; "Account"; "general intangibles".

"Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. "General intangibles" means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

History: 1953 Comp., § 50A-9-106, enacted by Laws 1961, ch. 96, § 9-106; 1985, ch. 193, § 10; 1996, ch. 47, § 58; 1997, ch. 75, § 23.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The terms defined in this section round out the classification of intangibles: see the definitions of "document", "chattel paper" and "instrument" in Section 9-105. Those three terms cover the various categories of commercial paper which are either negotiable or to a greater or less extent dealt with as if negotiable. The term "account" covers most choses in action which may be the subject of commercial financing transactions but which are not evidenced by an indispensable writing. The term "general intangibles" brings under this article miscellaneous types of contractual rights and other

personal property which are used or may become customarily used as commercial security. Examples are goodwill, literary rights and rights to performance. Other examples are copyrights, trademarks and patents, except to the extent that they may be excluded by Section 9-104(a). This article solves the problems of filing of security interests in these types of intangibles (Sections 9-103(3) and 9-401). Note that this catchall definition does not apply to money or to types of intangibles which are specifically excluded from the coverage of the article (Section 9-104) and note also that under Section 9-302 filing under a federal statute may satisfy the filing requirements of this article.

A right to the payment of money is frequently buttressed by ancillary covenants to insure the preservation of collateral, such as covenants in a purchase agreement, note or mortgage requiring insurance on the collateral or forbidding removal of the collateral; or covenants to preserve credit-worthiness of the promisor, such as covenants restricting dividends, etc. While these miscellaneous ancillary rights might conceivably be thought to fall within the definition of "general intangibles", it is not the intention of the code to treat them separately and require the perfection of assignment thereof by filing in the manner required for perfection of an assignment of general intangibles. Whatever perfection is required for the perfection of an assignment of the right to the payment of money will also carry these ancillary rights.

Similarly, when the right to the payment of money is not yet earned by performance, there are frequently ancillary rights designed to assure that an assignee may complete the performance and crystalize the right to payment of money. Such rights are frequently present in a "maintenance" lease where the lessor has continuing duties to perform, or in a ship charter. These ancillary rights, if considered in the abstract, might be thought to be "general intangibles", since they do not themselves involve the payment of money; but it is not the intent of the code to split up the rights to the payment of money and its ancillary supports, and thereby multiply the problem of perfection of assignments. Therefore, all rights of the lessor in a lease are to be perfected as "chattel paper", and all rights of the owner in a ship charter are to be perfected as "accounts".

"Account" is defined as a right to payment for goods sold or leased or services rendered; the ordinary commercial account receivable. In some special cases a right to receive money not yet earned by performance crystalizes not into an account but into a general intangible, for it is a right to payment of money that is not "for goods sold or leased or for services rendered." Examples of such rights are the right to receive payment of a loan not evidenced by an instrument or chattel paper; a right to receive partial refund of purchase prices paid by reason of retroactive volume discounts; rights to receive payment under licenses of patents and copyrights, exhibition contracts, etc.

This article rejects any lingering common law notion that only rights already earned can be assigned. In the triangular arrangement following assignment, there is reason to allow the original parties - assignor and account debtor - more flexibility in modifying the underlying contract before performance than after performance (see Section 9-318). It

will, however, be found that in most situations the same rules apply to accounts both before and after performance.

Cross references. - Sections 9-103(2), 9-104, 9-302(3), 9-318 and 9-401.

Definitional cross references. - "Chattel paper". Section 9-105.

"Contract". Section 1-201.

"Document". Section 9-105.

"Goods". Section 9-105.

"Instrument". Section 9-105.

The 1996 amendment inserted "investment property" preceding "and money" in the second sentence. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

The 1997 amendment, effective July 1, 1997, inserted "rights to proceeds of written letters of credit" preceding "and money" in the second sentence.

"General intangibles". - Real estate contract assignments from a debtor to a bank are "general intangibles" under this section and are perfected by filing. Simpson v. First Nat'l Bank, 56 Bankr. 586 (Bankr. D.N.M. 1986).

Capital retains. - Capital retains are a general intangible and not an account because no "right to payment" exists; thus capital retains are property in which a debtor can grant a security interest. Valley Fed. Sav. Bank v. Stahl, 110 N.M. 169, 793 P.2d 851 (1990).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 37; 68A Am. Jur. 2d Secured Transactions §§ 31, 38 et seq.

What constitutes "accounts receivable" under contract selling, assigning, pledging or reserving such items, 41 A.L.R.2d 1395.

Security interests in liquor licenses, 56 A.L.R.4th 1131.

82 C.J.S. Statutes § 315.

55-9-107. Definitions: "purchase money security interest."

A security interest is a "purchase money security interest" to the extent that it is:

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

History: 1953 Comp., § 50A-9-107, enacted by Laws 1961, ch. 96, § 9-107.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Under existing rules of law and under this article purchase money obligations often have priority over other obligations. Thus a purchase money obligation has priority over an interest acquired under an after-acquired property clause (Section 9-312(3) and (4)); where filing is required a grace period of ten days is allowed against creditors and transferees in bulk (Section 9-301(2)); and in some instances filing may not be necessary (Section 9-302(1) (d)).

Under this section a seller has a purchase money security interest if he retains a security interest in the goods; a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer (e. g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose.

2. When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This section therefore provides that the purchase money party must be one who gives value "by making advances or incurring an obligation": the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a preexisting claim or antecedent debt.

Cross references. - Point 1: Sections 9-301, 9-302 and 9-312.

Point 2: Section 9-108.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Person". Section 1-201.

"Rights". Section 1-201.

"Security interest". Section 1-201.

"Value". Section 1-201.

Timing of attachment of purchase money security interest. - When defendant agreed to buy equipment from pump company, company agreed to furnish the equipment, and lessee of the equipment agreed that defendant would have an interest in the equipment, security interest attached immediately, not upon actual payment by defendant of purchase price. Therefore, whatever interest lessee acquired in the equipment came impressed with defendant's purchase money security interest therein. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

Law reviews. - For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 75 et seq.

Priority as between seller or conditional seller of personalty and claimant under after acquired property clause of mortgage or other instrument, 86 A.L.R.2d 1152.

Construction and effect of UCC article 9, dealing with secured transactions, etc., 30 A.L.R.3d 9, 67 A.L.R.3d 308, 69 A.L.R.3d 1162, 76 A.L.R.3d 11, 99 A.L.R. 3d 807, 99 A.L.R.3d 1080, 100 A.L.R.3d 10, 100 A.L.R.3d 940, 7 A.L.R.4th 308, 11 A.L.R.4th 241, 90 A.L.R.4th 859, 25 A.L.R.5th 696.

82 C.J.S. Statutes § 315.

55-9-108. When after-acquired collateral not security for antecedent debt.

Where a secured party makes an advance, incurs an obligation, releases a perfected security interest or otherwise gives new value which is to be secured in whole or in part by after-acquired property, his security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt if the debtor acquires his rights in such collateral either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given.

History: 1953 Comp., § 50A-9-108, enacted by Laws 1961, ch. 96, § 9-108.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Many financing transactions contemplate that the collateral will include both the debtor's existing assets and also assets thereafter acquired by him in the operation of his business. This article generally validates such after-acquired property interests (see Section 9-204 and comment) although they may be subordinated to later purchase money interests under Section 9-312(3) and (4).

Interests in after-acquired property have never been considered as involving transfers of property for antecedent debt merely because of the after-acquired feature, nor should they be so considered. The section makes explicit what has been true under the case law: an after-acquired property interest is not, by virtue of that fact alone, security for a preexisting claim. This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act or state statutes which make certain transfers for antecedent debt voidable as preferences. The determination of when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law.

Two tests must be met under this section for an interest in after-acquired property to be one not taken for an antecedent debt. *First:* the secured party must, at the inception of the transaction, have given new value in some form. *Second:* the after-acquired property must come in either in the ordinary course of the debtor's business or as an acquisition which is made under a contract of purchase entered into within a reasonable time after the giving of new value and pursuant to the security agreement. The reason for the first test needs no comment. The second is in line with limitations which judicial construction has placed on the operation of after-acquired property clauses. Their coverage has been in many cases restricted to subsequent ordinary course acquisitions: this article does not go so far (see Section 9-204 and comment), but it does deny present value status to out of ordinary course acquisitions not made pursuant to the original loan agreement. This solution gives the secured party full protection as to the collateral which he may be reasonably thought to have contracted for; it gives other creditors the possibility, under the law of preferences, of subjecting to their claims windfall or uncontemplated acquisitions shortly before bankruptcy.

2. The term "value" is defined in Section 1-201(44) and discussed in the accompanying comment. In this section and in other sections of this article the term "new value" is used but is left without statutory definition. The several illustrations of "new value" given in the text of this section (making an advance, incurring an obligation, releasing a perfected security interest) as well as the "purchase money security interest" definition in Section 9-107 indicate the nature of the concept. In other situations it is left to the courts to distinguish between "new" and "old" value, between present considerations and antecedent debt.

Cross references. - Point 1: Sections 9-204 and 9-312.

Point 2: Section 9-107.

Definitional cross references. - "Collateral". Section 9-105.

"Contract". Section 1-201.

"Debtor". Section 9-105.

"Purchase". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 231 et seq.

Chattel mortgage on fruit crops growing or to be grown, 54 A.L.R. 1532.

Accession to motor vehicle, 43 A.L.R.2d 813.

8A C.J.S. Bankruptcy § 246 et seq.; 72 C.J.S. Pledges § 19 et seq.; 79 C.J.S. Secured Transactions §§ 12, 70.

55-9-109. Classification of goods; "consumer goods"; "equipment"; "farm products"; "inventory".

Goods are:

(1) "consumer goods" if they are used or bought for use primarily for personal, family or household purposes;

(2) "equipment" if they are used or bought for use primarily in business (including farming or a profession) or by a debtor who is a nonprofit organization or a governmental subdivision or agency or if the goods are not included in the definitions of inventory, farm products or consumer goods;

(3) "farm products" if they are crops or livestock or supplies used or produced in farming operations or if they are products of crops or livestock in their unmanufactured states (such as ginned cotton, wool-clip, maple syrup, milk and eggs), and if they are in the

possession of a debtor engaged in raising, fattening, grazing or other farming operations. If goods are farm products they are neither equipment nor inventory;

(4) "inventory" if they are held by a person who holds them for sale or lease or to be furnished under contracts of service or if he has so furnished them, or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment.

History: 1953 Comp., § 50A-9-109, enacted by Laws 1961, ch. 96, § 9-109.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This section classifies goods as consumer goods, equipment, farm products and inventory. The classification is important in many situations: it is relevant, for example, in determining the rights of persons who buy from a debtor goods subject to a security interest (Section 9-307), in certain questions of priority (Section 9-312), in determining the place of filing (Section 9-401) and in working out rights after default (Part 5). Comment 5 to Section 9-102 contains an index of the special rules applicable to different classes of collateral.

2. The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory, for example. In borderline cases - a physician's car or a farmer's jeep which might be either consumer goods or equipment - the principal use to which the property is put should be considered as determinative. Goods can fall into different classes at different times; a radio is inventory in the hands of a dealer and consumer goods in the hands of a householder.

3. The principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business. Machinery used in manufacturing, for example, is equipment and not inventory even though it is the continuing policy of the enterprise to sell machinery when it becomes obsolete. Goods to be furnished under a contract of service are inventory even though the arrangement under which they are furnished is not technically a sale. When an enterprise is engaged in the business of leasing a stock of products to users (for example, the fleet of cars owned by a car rental agency), that stock is also included within the definition of "inventory". It should be noted that one class of goods which is not held for disposition to a purchaser or user is included in inventory: "Materials used or consumed in a business". Examples of this class of inventory are fuel to be used in operations, scrap metal produced in the course of manufacture, and containers to be used to package the goods. In general it may be said that goods used in a business are equipment when they are fixed assets or have,

as identifiable units, a relatively long period of use; but are inventory, even though not held for sale, if they are used up or consumed in a short period of time in the production of some end product.

4. Goods are "farm products" only if they are in the possession of a debtor engaged in farming operations. Animals in a herd of livestock are covered whether they are acquired by purchase or result from natural increase. Products of crops or livestock remain farm products so long as they are in the possession of a debtor engaged in farming operations and have not been subjected to a manufacturing process. The terms "crops", "livestock" and "farming operations" are not defined; however, it is obvious from the text that "farming operations" includes raising livestock as well as crops; similarly, since eggs are products of livestock, livestock includes fowl.

When crops or livestock or their products come into the possession of a person not engaged in farming operations they cease to be "farm products". If they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory.

Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not determined by this article. At one end of the scale some processes are so closely connected with farming - such as pasteurizing milk or boiling sap to produce maple syrup or maple sugar - that they would not rank as manufacturing. On the other hand an extensive canning operation would be manufacturing. The line is one for the courts to draw. After farm products have been subjected to a manufacturing operation, they become inventory if held for sale.

Note that the buyer in ordinary course who under Section 9-307 takes free of a security interest in goods held for sale does not include one who buys farm products from a person engaged in farming operations.

5. The principal definition of equipment is a negative one: goods used in a business (including farming or a profession) which are not inventory and not farm products. Trucks, rolling stock, tools, machinery are typical. It will be noted furthermore that any goods which are not covered by one of the other definitions in this section are to be treated as equipment.

Cross references. - Point 1: Sections 9-102, 9-307, 9-312, 9-401 and Part 5.

Point 3: Section 9-307.

Point 4: Section 9-307.

Definitional cross references. - "Contract". Section 1-201.

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Organization". Section 1-201.

"Person". Section 1-201.

"Sale". Sections 2-106 and 9-105.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

Assorted equipment goods. - Chapter 11 debtor's rose bushes used to produce successive crops of cut periodically harvested over a life expectancy period of over seven to eight years, not being reaped as an entire crop plant; portable, prefabricated office building the size of a double wide mobile home; and "miscellaneous" computer system used in the standard operation of the floriculturist's business, were all considered equipment goods within the meaning of subsection (2), with secured creditor's interest perfected in all but the rose bushes, since these became affixed to the realty by virtue of their root system (see 55-9-313 NMSA 1978), and accordingly required a filing (see 55-9-401 NMSA 1978) which plaintiff failed to execute. Flores De N.M., Inc. v. Banda Negra Int'l, Inc., 151 Bankr. 571 (Bankr. D.N.M. 1993).

"Inventory". - The definition of inventory anticipates that the inventory will change from day to day in the normal operation of a business such as a retail store. Kuemmerle v. United N.M. Bank, 113 N.M. 677, 831 P.2d 976 (1992).

Agricultural mortgagees retain special position. - By excluding "farm products" from the classifications of "equipment" and "inventory," in this section and by expressly providing in 55-9-307 NMSA 1978 that a buyer in the ordinary course of business of farm products from a person engaged in farming operations does not take free of a security interest created by the seller, the draftsmen of the code apparently intended to retain the agricultural mortgagee in the special position he achieved under the pre-code case law. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 37 Am. Jur. 2d Fraudulent Conveyances § 253; 68A Am. Jur. 2d Secured Transactions § 57 et seq.

Conveyance of land as including mature but unharvested crops, 51 A.L.R.4th 1263.

72 C.J.S. Pledges § 8; 79 C.J.S. Secured Transactions § 11 et seq.

55-9-110. Sufficiency of description.

For the purposes of this article any description of personal property or, except as otherwise required by Subsection (5) of Section 9-402 [55-9-402 NMSA 1978] relating to the contents of a financing statement, real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

History: 1953 Comp., § 50A-9-110, enacted by Laws 1961, ch. 96, § 9-110; 1967, ch. 186, § 24; 1985, ch. 193, § 11.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The requirement of description of collateral (see Section 9-203 and comment thereto) is evidentiary. The test of sufficiency of a description laid down by this section is that the description do the job assigned to it - that it make possible the identification of the thing described. Under this rule courts should refuse to follow the holdings, often found in the older chattel mortgage cases, that descriptions are insufficient unless they are of the most exact and detailed nature, the so-called "serial number" test. The same test of reasonable identification applies where a description of real estate is required in a financing statement. See Section 9-402.

Cross references. - Sections 9-203 and 9-402.

Filing of instrument with accurate description safeguards lien. - Since under former law the legislature provided that the filing of a chattel mortgage, assignment thereof, or affidavit in lieu of an assignment, would have the force and effect given by law to the recording of instruments affecting real estate, and since when an instrument with an accurate description of realty is filed in the county wherein the realty is situate, all persons are placed on constructive notice where the personal property subject to the

chattel mortgage was accurately and completely described in the recorded instruments, and the filing of a copy of the instrument in the county into which the property was moved safeguarded the mortgage lien. Reconstruction Fin. Corp. v. Stephens, 118 F. Supp. 565 (D.N.M. 1954).

Description in security agreement may prevail over contrary financing statement. - In a conflict between the unsigned financing statement and the language of the security agreement the latter prevails for the reason that no security interest can exist in the absence of a security agreement, and therefore a financing statement which goes beyond the scope of the agreement has no effect to that extent. Jones & Laughlin Supply v. Dugan Prod. Corp., 85 N.M. 51, 508 P.2d 1348 (Ct. App. 1973).

Security agreement on mobile home did not secure appliances installed therein. - A security agreement which listed the year, model name and number and serial number of a mobile home in the description of collateral did not create a security interest in a washer, dryer and refrigerator installed in that mobile home. State v. Woodward, 100 N.M. 708, 675 P.2d 1007 (Ct. App. 1983).

Law reviews. - For article, "New Mexico's Uniform Commercial Code: Who is the Beneficiary of Stop Payment Provisions of Article 4?" see 4 Nat. Resources J. 69 (1964).

For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 9; 68A Am. Jur. 2d Secured Transactions § 192 et seq.

Sufficiency of description of property in conditional sales contract, 65 A.L.R. 714.

Sufficiency of description of property in mortgage on animals, 124 A.L.R. 944.

Defect in written record as ground for avoiding sale of contractual rights, 10 A.L.R.2d 728.

Sufficiency of description of property, as against third persons, in chattel mortgage on farm equipment, machinery, implements and the like, 32 A.L.R.2d 929.

Sufficiency of description in chattel mortgage as covering all property of a particular kind, 2 A.L.R.3d 839, 30 A.L.R.3d 9.

Sufficiency of description of collateral in financing statement under UCC §§ 9-110 and 9-402, 100 A.L.R.3d 10.

Sufficiency of description of collateral in security agreement under UCC §§ 9-110 and 9-203, 100 A.L.R.3d 940.

72 C.J.S. Pledges § 10; 79 C.J.S. Secured Transactions § 63 et seq.

55-9-111. Repealed.

ANNOTATIONS

Repeals. - Laws 1992, ch. 114, § 237C repeals 55-9-111 NMSA 1978, as enacted by Laws 1961, ch. 96, § 9-111, relating to consignment, effective July 1, 1992. For provisions of former section, see 1987 Replacement Pamphlet.

55-9-112. Where collateral is not owned by debtor.

Unless otherwise agreed, when a secured party knows that collateral is owned by a person who is not the debtor, the owner of the collateral is entitled to receive from the secured party any surplus under Section 9-502 (2) [55-9-502 (2) NMSA 1978] or under Section 9-504 (1) [55-9-504 (1) NMSA 1978], and is not liable for the debt or for any deficiency after resale, and he has the same right as the debtor:

(a) to receive statements under Section 9-208 [55-9-208 NMSA 1978];

(b) to receive notice of and to object to a secured party's proposal to retain the collateral in satisfaction of the indebtedness under Section 9-505 [55-9-505 NMSA 1978];

(c) to redeem the collateral under Section 9-506 [55-9-506 NMSA 1978];

(d) to obtain injunctive or other relief under Section 9-507 (1) [55-9-507 (1) NMSA 1978];

(e) to recover losses caused to him under Section 9-208 (2) [55-9-208 (2) NMSA 1978].

History: 1953 Comp., § 50A-9-112, enacted by Laws 1961, ch. 96, § 9-112.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - Under the definition of Section 9-105, in any provisions of the article dealing with the collateral the term "debtor" means the owner of the collateral even though he is not the person who owes payment or performance of the obligation secured. The section covers several situations in which the implications of this definition are specifically set out.

The duties which this section imposes on a secured party toward such an owner of collateral are conditioned on the secured party's knowledge of the true state of facts.

Short of such knowledge he may continue to deal exclusively with the person who owes the obligation. Nor does the section suggest that the secured party is under any duty of inquiry. It does not purport to cut across the law of conversion or of ultra vires. Whether a person who does not own property has authority to encumber it for his own debts and whether a person is free to encumber his property as collateral for the debts of another, are matters to be decided under other rules of law and are not covered by this section.

The section does not purport to be an exhaustive treatment of the subject. It isolates certain problems which may be expected to arise and states rules as to them. Others will no doubt arise: their solution is left to the courts.

Cross references. - Sections 9-105, 9-208 and Part 5.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Notice". Section 1-201.

"Person". Section 1-201.

"Receive notice". Section 1-201.

"Right". Section 1-201.

"Secured party". Section 9-105.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 225 et seq.

Validity of chattel mortgage on stock of goods which mortgagor has right to sell, where mortgagee takes possession of goods before third person's rights attach, 71 A.L.R.2d 1416.

9 C.J.S. Banks and Banking § 466; 72 C.J.S. Pledges §§ 49, 50.

55-9-113. Security interests arising under article on sales or under article on leases.

A security interest arising solely under the article on sales (Article 2) [Chapter 55, Article 2 NMSA 1978] or the article on leases (Article 55-2A) [Chapter 55, Article 2A NMSA 1978] is subject to the provisions of this article except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods:

(a) no security agreement is necessary to make the security interest enforceable; and

(b) no filing is required to perfect the security interest; and

(c) the rights of the secured party on default by the debtor are governed (i) by the article on sales (Article 2) [Chapter 55, Article 2 NMSA 1978] in the case of a security interest arising solely under such article, or (ii) by the article on leases (Article 55-2A) [Chapter 55, Article 2A NMSA 1978] in the case of a security interest arising solely under such article.

History: 1953 Comp., § 50A-9-113, enacted by Laws 1961, ch. 96, § 9-113; 1992, ch. 114, § 236.

ANNOTATIONS

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: 1. Under the provisions of Article 2 on Sales, a seller of goods may reserve a security interest (see, e.g., Sections 2-401 and 2-505) [55-2-401 and 55-2-505 NMSA 1978, respectively]; and in certain circumstances, whether or not a security interest is reserved, the seller has rights of resale and stoppage under Sections 2-703, 2-705 and 2-706 [55-2-703, 55-2-705 and 55-2-706 NMSA 1978, respectively] which are similar to the rights of a secured party. Similarly, under such sections as Sections 2-506, 2-707 and 2-711 [55-2-506, 55-2-707 and 55-2-711 NMSA 1978, respectively], a financing agency, an agent, a buyer or another person may have a security interest or other right in goods similar to that of a seller. The use of the term "security interest" in the Sales Article is meant to bring the interests so designated within this Article. This section makes it clear, however, that such security interests are exempted from certain provisions of this Article. Compare Section 4-208(3) [55-4-208 NMSA 1978], making similar special provisions for security interests arising in the bank collection process.

2. The security interests to which this section applies commonly arises by operation of law in the course of a sale transaction. Since the circumstances under which they arise are defined in the Sales Article, there is no need for the "security agreement" defined in Section 9-105(1)(h) [55-9-105 NMSA 1978] and required by Section 9-203(1) [55-9-203 NMSA 1978] and paragraph (a) dispenses with such requirements. The requirement of filing may be inapplicable under Sections 9-302(1)(a) and (b), 9-304 and 9-305 [55-9-302, 55-9-304 and 55-9-305 NMSA 1978, respectively], where the goods are in the possession of the secured party or of a bailee other than the debtor. To avoid difficulty in the residual cases, as for example where a bailee does not receive notification of the secured party's interest until after the security interest arises, paragraph (b) dispenses with any filing requirement. Finally, paragraph (c) makes inapplicable the default provisions of Part 5 of this Article, since the Sales Article contains detailed provisions governing stoppage of delivery and resale after breach. See Sections 2-705, 2-706, 2-707(2) and 2-711(3) [55-2-705, 55-2-706, 55-2-707 and 55-2-711 NMSA 1978, respectively].

3. These limitations on the applicability of this Article to security interests arising under the Sales Article are appropriate only so long as the debtor does not have or lawfully obtain possession of the goods. Compare Section 56(b) of the Uniform Sales Act. A secured party who wishes to retain a security interest after the debtor lawfully obtains possession must comply fully with all the provisions of this Article and ordinarily must file a financing statement to perfect his interest. This is the effect of the "except" clause in the preamble to this section. Note that in the case of a buyer who has a security interest in rejected goods under Section 2-711(3) [55-2-711 NMSA 1978], the buyer is the "secured party" and the seller is the "debtor".

4. This section applies only to a "security interest". The definition of "security interest" in Section 1-201(37) [55-1-201 NMSA 1978] expressly excludes the special property interest of a buyer of goods on identification under Section 2-401(1) [55-2-401 NMSA 1978]. The seller's interest after identification and before delivery may be more than a security interest by virtue of explicit agreement under Section 2-401(1) or 2-501(1) [55-2-401 or 55-2-501 NMSA 1978, respectively], by virtue of the provisions of Section 2-401(2), (3) or (4) [55-2-401 NMSA 1978], or by virtue of substitution pursuant to Section 2-501(2) [55-2-501 NMSA 1978]. In such cases, Article 9 is inapplicable by the terms of Section 9-102(1)(a) [55-9-102 NMSA 1978].

5. Where there is a "security interest", this section applies only if the security interest arises "solely" under the Sales Article. Thus Section 1-201(37) [55-1-201 NMSA 1978] permits a buyer to acquire by agreement a security interest in goods not in his possession or control; such a security interest does not impair his rights under the Sales Article, but any rights based on the security agreement are fully subject to this Article without regard to the limitations of this section. Similarly, a seller who reserves a security interest by agreement does not lose his rights under the Sales Article, but rights other than those conferred by the Sales Article depend on full compliance with this Article.

6. This section is amended to include security interests arising under the Article on Leases (Article 2A), which is being promulgated at the same time as this amendment. Section 2A-508(5) [55-2A-508 NMSA 1978]. After the effective date of the amendment to this section all references in the Act to Section 9-113 [55-9-113 NMSA 1978] will be deemed to refer to this section, as amended. *E.g.*, Sections 9-203(1) and 9-302(1)(f) [55-9-203 and 55-9-302 NMSA 1978, respectively].

Cross References: Point 1: Sections 2-401, 2-505, 2-506, 2-705, 2-706, 2-707, 2-711(3), 4-208(3) [55-2-401, 55-2-505, 55-2-506, 55-2-705, 55-2-706, 55-2-707, 55-2-711, 55-4-208 NMSA 1978, respectively].

Point 2: Sections 2-705, 2-706, 2-707(2), 2-711(3), 9-203(1), 9-302(1)(a) and (b), 9-304, 9-305 [55-2-705, 55-2-706, 55-2-707, 55-2-711, 55-9-203, 55-9-302, 55-9-304, 55-9-305 NMSA 1978, respectively] and Part 5.

Point 3: Section 2-711(3) [55-2-711 NMSA 1978].

Point 4: Sections 2-401, 2-501 and 9-102(1)(a) [55-2-401, 55-2-501 and 55-9-102 NMSA 1978, respectively].

Point 6: Article 2A, esp. Section 2A-508(5) [55-2A-508 NMSA 1978].

Definitional Cross References: "Agreement". Section 1-201(3) [55-1-201 NMSA 1978].

"Debtor". Section 9-105 [55-9-105 NMSA 1978].

"Goods". Section 2A-103(1)(h), 9-105 [55-2A-103 NMSA 1978].

"Lease". Section 2A-103(1)(j).

"Party". Section 1-201(29).

"Rights". Section 1-201(36).

"Sale". Section 2-106(1) [55-2-106 NMSA 1978].

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201(37).

The 1992 amendment, effective July 1, 1992, added "or under article on leases" at the end of the section heading; inserted "or the article on leases (Article 55-2A)" in the introductory paragraph; and, in Subsection (c), added the item (i) designation, added all of the language of item (i) following "(Article 2)", and added item (ii).

Oral title-retention contract. - Cattle seller's alleged oral title-retention contract with a buyer did not create a security interest within the provisions of this section, since it was not evidenced by a written agreement and filed so that it could take priority over a bank's perfected security interest. O'Brien v. Chandler, 107 N.M. 797, 765 P.2d 1165 (1988).

Law reviews. - For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 12 et seq.

Bill of sale, absolute on its face, as a chattel mortgage, 33 A.L.R.2d 364.

77A C.J.S. Sales § 1 et seq.

55-9-114. Consignment.

(1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this article by Paragraph (3)(c) of Section 2-326 [55-2-326 NMSA 1978] has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee, and also has priority with respect to identifiable cash proceeds received on or before the delivery of the goods to a buyer, if

(a) the consignor complies with the filing provision of the article on sales with respect to consignments (Paragraph (3)(c) of Section 2-326 [55-2-326 NMSA 1978]) before the consignee receives possession of the goods; and

(b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and

(c) the holder of the security interest receives the notification within five years before the consignee receives possession of the goods; and

(d) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.

(2) In the case of a consignment which is not a security interest and in which the requirements of the preceding subsection have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were the property of the debtor.

History: 1978 Comp., § 55-9-114, enacted by Laws 1985, ch. 193, § 12.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. None.

Purposes. - 1. This section requires that where goods are furnished to a merchant under the arrangement known as consignment rather than in a security transaction, the consignor must, in order to protect his position as against an inventory secured party of the consignee, give to that party the same notice and at the same time that he would give to that party if that party had filed first with respect to inventory and if the consignor

were furnishing the goods under an inventory security agreement instead of under a consignment.

For the distinction between true consignment and security arrangements, see Section 1-201(37). For the assimilation of consignments under certain circumstances to goods on sale or return and the requirement of filing in the case of consignments, see Section 2-326.

The requirements of notice in this section conform closely to the concepts and the language of Section 9-312(3), which should be consulted together with the relevant Comments.

Except in the limited cases of identifiable cash proceeds received on or before delivery of the goods to a buyer, no attempt has been made to provide rules as to perfection of a claim to proceeds of consignments (compare Section 9-306) or the priority thereof (compare Section 9-312). It is believed that under many true consignments the consignor acquires a claim for an agreed amount against the consignee at the moment of sale, and does not look to the proceeds of sale. In contrast to the assumption of this article that rights to proceeds of security interests under Section 9-306 represent the presumed intent of the parties (compare Section 9-203(3)), the article goes on the assumption that if consignors intend to claim the proceeds of sale, they will do so by expressly contracting for them and will perfect their security interests therein.

Cross reference: - Sections 2-326 and 9-312(3).

Definitional cross references: - "Consignment". Section 1-201(37).

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Notification". Section 1-201(26).

"Proceeds". Section 9-306.

"Security interest". Section 1-201(37).

55-9-115. Investment property.

(1) In this article:

(a) "commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer;

(b) "commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option or other contract that, in each case, is:

(i) traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to the federal commodities laws; or

(ii) traded on a foreign commodity board of trade, exchange or market and is carried on the books of a commodity intermediary for a commodity customer;

(c) "commodity customer" means a person for whom a commodity intermediary carries a commodity contract on its books;

(d) "commodity intermediary" means:

(i) a person who is registered as a futures commission merchant under the federal commodities laws; or

(ii) a person who in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to the federal commodities laws;

(e) "control" with respect to a certificated security, uncertificated security or security entitlement has the meaning specified in Section 8-106 [55-8-106 NMSA 1978]. A secured party has control over a commodity contract if by agreement among the commodity customer, the commodity intermediary, and the secured party, the commodity intermediary, has agreed that it will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer. If a commodity customer grants a security interest in a commodity contract to its own commodity intermediary, the commodity intermediary as secured party has control. A secured party has control over a securities account or commodity account if the secured party has control over all security entitlements or commodity contracts carried in the securities account or commodity account; and

(f) "investment property" means:

(i) a security, whether certificated or uncertificated;

(ii) a security entitlement;

(iii) a securities account;

(iv) a commodity contract; or

(v) a commodity account.

(2) Attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. Attachment or perfection of a security interest in a commodity

account is also attachment or perfection of a security interest in all commodity contracts carried in the commodity account.

(3) A description of collateral in a security agreement or financing statement is sufficient to create or perfect a security interest in a certificated security, uncertificated security, security entitlement, securities account, commodity contract or commodity account whether it describes the collateral by those terms or as investment property or by description of the underlying security, financial asset or commodity contract. A description of investment property collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category, by quantity, by a computational or allocational formula or procedure or by any other method, if the identity of the collateral is objectively determinable.

(4) Perfection of a security interest in investment property is governed by the following rules:

(a) a security interest in investment property may be perfected by control;

(b) except as otherwise provided in Paragraphs (c) and (d), a security interest in investment property may be perfected by filing;

(c) if the debtor is a broker or securities intermediary a security interest in investment property is perfected when it attaches. The filing of a financing statement with respect to a security interest in investment property granted by a broker or securities intermediary has no effect for purposes of perfection or priority with respect to that security interest; and

(d) if a debtor is a commodity intermediary, a security interest in a commodity contract or a commodity account is perfected when it attaches. The filing of a financing statement with respect to a security interest in a commodity contract or a commodity account granted by a commodity intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(5) Priority between conflicting security interests in the same investment property is governed by the following rules:

(a) a security interest of a secured party who has control over investment property has priority over a security interest of a secured party who does not have control over the investment property;

(b) except as otherwise provided in Paragraphs (c) and (d), conflicting security interests of secured parties, each of whom has control, rank equally;

(c) except as otherwise agreed by the securities intermediary, a security interest in a security entitlement or a securities account granted to the debtor's own securities

intermediary has priority over any security interest granted by the debtor to another secured party;

(d) except as otherwise agreed by the commodity intermediary, a security interest in a commodity contract or a commodity account granted to the debtor's own commodity intermediary has priority over any security interest granted by the debtor to another secured party;

(e) conflicting security interests granted by a broker, a securities intermediary or a commodity intermediary which are perfected without control rank equally; and

(f) in all other cases, priority between conflicting security interests in investment property is governed by Section 9-312(5), (6) and (7) [55-9-312(5), (6) and (7) NMSA 1978]. Section 9-312(4) [55-9-312(4) NMSA 1978] does not apply to investment property.

(6) If a security certificate in registered form is delivered to a secured party pursuant to agreement, a written security agreement is not required for attachment or enforceability of the security interest, delivery suffices for perfection of the security interest and the security interest has priority over a conflicting security interest perfected by means other than control, even if a necessary indorsement is lacking.

History: 1978 Comp., § 55-9-115, enacted by Laws 1996, ch. 47, § 59.

ANNOTATIONS

OFFICIAL COMMENT

1. Overview. This section sets out the principal rules on security interests in investment property. Investment property, defined in subsection (1)(f) is a new term for a category of collateral that includes securities, whether held directly or through intermediaries, and commodity futures. The term investment property is used in Article 9 as one of the general categories of collateral, such as goods or instruments. Investment property is excluded from the definitions of goods, instruments, and general intangibles. See Sections 9-105(1)(h), 9-105(1)(i), and 9-106 [55-9-105, and 55-9-106 NMSA 1978].

This section is added as part of the revision of Article 8 on investment securities. It relies in part on terms and concepts defined in Revised Article 8. For an overview of Revised Article 8, see the Prefatory Note to that Article. Prior to the 1978 amendments to Article 8, the rules on security interests insecurities were included in Article 9. The 1978 amendments moved the key rules to Article 8. The revision of Article 8 returns these matters to Article 9. In order to avoid disruption of section numbering, the new rules on security interests in investment property are collected in this section, rather than being distributed among the various sections of Article 9 dealing with corresponding issues for other categories of collateral. On matters not covered by rules set out in this section, security interests in investment property are governed by the general rules in other sections of this Article.

The distinction between the direct and indirect holding systems plays an important role in the rules on security interests in securities. Consider two investors, X and Y, each of whom owns 1000 shares of XYZ Co. common stock. X has a certificate representing 1000 shares and is registered on the books maintained by XYZ Co.'s transfer agent as the holder of record of those 1000 shares. X has a direct relationship with the issuer, and receives dividends, distributions, and proxies directly from the issuer. In Revised Article 8 terminology, X has a direct claim to a "certificated security." If X wishes to use the investment position as collateral for a loan, X would grant the lender a security interest in the "certificated security." The Article 9 rules for such transactions are explained in Comment 2. XYZ Co. might not issue certificates, but register investors such as X directly on its stockholder books. In that case, X's interest would be an "uncertificated security." The Article 9 rules for uncertificated securities are explained in Comment 3. By contrast to these direct relationships, Y holds the securities through an account with Y's broker. Y does not have a certificate and is not registered on XYZ Co.'s stock books as a holder of record. Rather, Y holds the securities through a chain of securities intermediaries. Under Revised Article 8, Y's interest in XYZ common stock is described as a "securities entitlement." If Y wishes to use the investment position as collateral for a loan, Y would grant the lender asecurity interest in the "securities entitlement." The Article 9 rules for security entitlements are explained in Comment 4.

A commercial setting in which security interests in investment property play a most economically significant role is the "wholesale" level, that is, finance of securities firms and security interests that support the extension of credit in the settlement system. Comments 6 and 7 deal with these transactions. The rules on security interests in investment property also apply to commodity futures. Comment 8 deals with these transactions.

The rules on security interests in investment property are based on the concept of "control," defined in Sections 8-106 and 9-115(1)(e) [55-8-106 and 55-9-115 NMSA 1978]. If the secured party has control the security interest can attach even without a written security agreement. See Section 9-203 [55-9-203 NMSA 1978]. A security interest in investment property can also be created by a written security agreement pursuant to Section 9-203. Security interests in investment property can be perfected by control. See subsection (4)(a). Although other methods of perfection are also permitted, the basic priority rule, set out in subsection (5)(a), is that a secured party who obtains control has priority over a secured party who relies on some other method of perfection. The control priority rule is explained in Comment 5.

2. Security interests in certificated securities. A security interest in a certificated security can be created by conferring control on the secured party. Section 8-106 [55-8-106 NMSA 1978] provides that a secured party has control of a certificated security if the certificate has been delivered, see Section 8-301 [55-8-301 NMSA 1978], and any necessary indorsement has been supplied. Section 9-203 [55-9-203 NMSA 1978] provides that a security interest can attach, even without a written security agreement, if the secured party has control. Section 9-115(4)(a) [55-9-115 NMSA 1978] provides that control is a permissible method of perfection.

A security interest in a certificated security can also be created by a written security agreement pursuant to Section 9-203 [55-9-203 NMSA 1978], and can be perfected by filing, see subsection (4)(b). (The perfection by filing rule does not apply if the debtor is a broker or securities intermediary.) However, a security interest perfected only by filing is subordinate to a conflicting security interest perfected by control. See subsection (5)(a) and Comment 5. Also, perfection by filing would not give the secured party protection against other types of adverse claims, since the Article 8 adverse claim cut-off rules require control. See Section 8-510 [55-8-510 NMSA 1978].

Section 9-115(6) [55-9-115 NMSA 1978] deals with cases where a secured party has taken possession of an unindorsed security certificate in registered form. It provides that even though the indorsement is lacking, delivery of the certificate to the secured party suffices for attachment and perfection of the security interest in the certificated security. It also provides that such a possessory security interest has priority over a conflicting non-control security interest, such as a security interest perfected by filing. However, without the indorsement the secured party would not get the other protections against adverse claims that flow from obtaining control. See Section 8-510 [55-8-510 NMSA 1978].

3. Security interests in uncertificated securities. The rules on security interests in uncertificated securities apply only where the debtor is the direct holder of an uncertificated security. For example, mutual funds typically do not issue certificates, but the beneficial owners of mutual funds shares commonly are the direct holders of the shares, whose interests are recorded on the books of the issuer. If such an investor grants a security interest in the mutual funds shares, the rules in this section on security interests in uncertificated securities apply. These rules are not germane to situations where a debtor holds securities through a securities intermediary. Security interests in positions held through securities intermediaries are governed by the rules on security entitlements and securities accounts, not the rules on uncertificated securities.

A security interest in an uncertificated security can be perfected either by control or by filing. See subsection (4)(a) and (b). (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in an uncertificated security are governed by subsection (5). Under subsection (5)(a), a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to uncertificated securities are set out in Section 8-106(c) [55-8-106 NMSA 1978]. There are two possibilities. First, a secured party has control if the uncertificated security is transferred from debtor to secured party on the books of the issuer. See Sections 8-106(c)(1) (control by "delivery") and 8-301(b) [55-8-301 NMSA 1978] (defining "delivery" of uncertificated security). So far as the issuer is concerned, the secured party is the registered owner entitled to all rights of ownership, though as between the debtor and secured party the debtor remains the

owner and the secured party holds its interest as secured party. Second, a secured party has control over an uncertificated security if the issuer agrees that it will comply with "instructions" originated by the secured party without further consent by the registered owner. See Section 8-106(c)(2). If the debtor, secured party, and issuer agree that the secured party has the right to direct the issuer to dispose of the security without further action by the debtor, the secured party has control even though the debtor remains listed as the registered owner and continues to receive dividends and distributions. Note, though, that there is no statutory requirement that issuers of uncertificated securities offer such arrangements.

4. Security interests in security entitlements and securities accounts. This section establishes a structure for creating security interests in securities and other financial assets that a debtor holds through an account with a securities intermediary. Under Revised Article 8, the interest of a person who holds securities through a securities account with a broker or other securities intermediary is described as a security entitlement. Thus, the Article 9 rules governing the use of that person's investment position as collateral are the rules for security entitlements and securities accounts, not the rules for certificated securities or uncertificated securities.

Attachment of security interests in security entitlements and securities accounts is governed by Section 9-203 [55-9-203 NMSA 1978] and subsections (2) and (3) of this section. Unless the secured party has control, a written security agreement is necessary for attachment. For purposes of description of the collateral in a security agreement, it is not essential that the precise Article 8 terminology be used. See subsection (3). For example, if a debtor who holds 1000 shares of XYZ Co. common stock through a securities account signs a security agreement which describes the collateral as "1000 shares of XYZ Co. common stock," that description is sufficient, even though the debtor's interest would be described under Revised Article 8 as a "security entitlement" to 1000 shares of XYZ Co. common stock.

The Article 8 term security entitlement also covers the interest of a person in a "financial asset," if the person holds that financial asset through a securities account. "Financial asset" is a broader term than "security." See Section 8-102(a)(9) [55-8-102 NMSA 1978]. For example, a bankers' acceptance is an Article 3 negotiable instrument and hence an instrument under Section 9-105(1)(i) [55-9-105 NMSA 1978]. If a person who holds a bankers' acceptance directly wishes to grant a security interest in it, the Article 9 rules for instruments apply. However, if a person holds a bankers' acceptance through a securities account, the person has a security entitlement to the bankers' acceptance. If the person wishes to grant a security interest in the security entitlement to the bankers' acceptance, the Article 9 rules for investment property apply.

Subsection (1)(f)(iii) provides that the term investment property also includes "securities account." This is intended to facilitate transactions in which a debtor wishes to grant a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Just as a debtor may grant a security interest either in specifically listed items of equipment or in all of the debtor's

equipment, so too a debtor who holds securities or other financial assets through a securities account may grant a security interest either in specifically listed security entitlements or in all of the security entitlements held through that account. Referring to the collateral as the securities account is a simple way of describing all of the security entitlements carried in the account. Section 9-115(2) [55-9-115 NMSA 1978] provides that attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. A security interest in a securities account would also include all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement.

A security interest in a security entitlement or securities account can be perfected either by control or by filing. See subsections (4)(a) and (4)(b), (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in a security entitlement or securities account are governed by subsection (5). The basic rule of subsection (5)(a) is that a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to security entitlements and securities accounts are set out in Sections 8-106(d) and 9-115(1)(e) [55-8-106 and 55-9-115 NMSA 1978]. There are two possibilities. First, Section 8-106(d)(1) provides that a secured party has control over a security entitlement if the secured party becomes the entitlement holder, that is, the position is transferred from debtor to secured party on the books of a securities intermediary. See Examples 1 and 2 in Comment 4 to Section 8-106. Second, Section 8-106(d)(2) provides that a secured party has control over a security entitlement if the securities intermediary agrees that it will comply with entitlement orders originated by the secured party without further consent by the debtor. See Example 3 in Comment 4 to Section 8-106. If the debtor, secured party, and issuer agree that the secured party has the right to direct the securities intermediary to dispose of the collateral without further action by the debtor, the secured party has control even though the debtor remains listed as the entitlement holder and continues to receive dividends and distributions. The secured party can obtain control even though the debtor is also allowed to continue to trade. See Section 8-106(f) and Comment 7 thereto. The three-party control agreement device is based on arrangements that have already developed in the securities business. Even under prior law, some securities brokers developed standard forms of such agreements. Note though that, as is the case with respect to issuers of uncertificated securities, there is no statutory requirement that securities intermediaries offer such control agreement arrangements.

Subsection (1)(e) provides that a secured party has control over a securities account if it has control over all security entitlements carried in the account. Thus, the rules in

Section 8-106(d) [55-8-106 NMSA 1978] on control with respect to security entitlements determine whether a secured party has control over a securities account. Control with respect to a securities account is defined in terms of obtaining control over the security entitlements simply for drafting convenience. Of course, an agreement that provides that the securities intermediary will honor instructions from the secured party concerning a securities account described as such is sufficient since such an agreement necessarily implies that the secured party has control over all security entitlements carried in the account.

If a customer borrows from its own securities intermediary, e.g., to purchase securities "on margin" or for other purposes, and grants a security interest to its intermediary, the intermediary has control. See Section 8-106(e) [55-8-106 NMSA 1978]. A securities firm could also provide control financing arrangements to its customers through a different legal entity than the securities intermediary itself, e.g., the securities trading, custody, and credit services might be provided by different corporate entities within the financial services firm's "family." So long as the agreement with the customer provides that the entity providing the custodial function (the "securities intermediary") will act on instructions received from entity providing the credit, the credit entity has control.

5. Priority Rules. Subsection (5) specifies the priority rules for conflicting security interests in the same investment property. Subsection (5)(a) states the most important general rule - that a secured party who obtains control has priority over a secured party who does not obtain control. The other priority rules, in subsections (5)(b) through (5)(e), deal with relatively unusual circumstances not covered by the control priority rule. Subsection (5)(f) provides that the general priority rules of Section 9-312 [55-9-312 NMSA 1978] apply to cases not covered by the specific rules in subsection (5). The principal application of this residual rule is that the usual first in time of filing rule applies to conflicting security interests that are perfected only by filing. Because the control priority rule of subsection (5)(a) provides for the ordinary cases in which persons purchase securities on margin credit from their brokers, there is no need for special rules for purchase money security interests. Accordingly, subsection (5)(f) provides that the purchase money priority rule of Section 9-312(4) does not apply to investment property.

The following examples illustrate the basic priority rules of this section:

Example 1. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock for which Debtor has a certificate. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor delivers the certificate, properly indorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(b)(1) [55-8-106 NMSA 1978], and hence has priority over Alpha.

Example 2. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor instructs Able to have the 1000 shares transferred through the clearing corporation to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(1) [55-8-106 NMSA 1978], and hence has priority over Alpha.

Example 3. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, which is held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(2) [55-8-106 NMSA 1978], and hence has priority over Alpha.

Example 4. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of Section 8-106(e) [55-8-106 NMSA 1978] that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of subsection (5)(a).

Example 5. Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. stock carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of subsection (5)(a) does not apply. Compare Example 4. Subsection (5)(c) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an external lender, so Able has priority over Beta. (Subsection (5)(d) has a parallel rule for commodities intermediaries.) The agreement among Able, Beta, and Debtor could, of course,

determine the relative priority of the security interests of Able and Beta, see Section 9-316 [55-9-316 NMSA 1978], but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by filing. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of subsection (4)(c), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of subsection (5)(a) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting secured transactions only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by filing without regard to inquiry into whether the control secured party was aware of the filed security interest. Prior to enactment of this section, Article 9 did not permit perfection of security interests in securities by filing. Accordingly, parties who deal in securities have never developed a practice of searching the UCC files before conducting securities transactions. Although filing is now a permissible method of perfection, in order to avoid disruption of existing practices in this business it is necessary to give perfection by filing a different and more limited effect for securities than for some other forms of collateral. The priorit yrules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the files. Quite the contrary, the control priority rule is intended to ensure that secured parties who do obtain control are entirely unaffected by filings. To state the point another way, perfection by filing is intended to affect only general creditors or other secured creditors who rely on filing. The rule that a security interest perfected by filing can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where filing is not given the same effect as for some other forms of property. No implication is made about the effect of filing with respect to security interests in other forms of property, nor about other Article 9 rules, e.g., Section 9-308 [55-9-308 NMSA 1978], which govern the circumstances in which security interests in

other forms of property perfected by filing can be primed by subsequent perfected security interests.

6. Secured finance of securities firms. Modernization of the commercial law rules governing secured finance of securities dealers and security interest arrangements in the clearance and settlement system is essential to the safe and efficient functioning of the securities markets.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this section are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. If the lender obtains control, the security interest is perfected and has priority over a conflicting non-control security interest. For examples of control arrangements in this setting see Examples 4 through 8 in Comment 4 to Section 8-106 [55-8-106 NMSA 1978]. The secured party can obtain control even though the debtor retains the right to trade or otherwise dispose of the collateral. See Section 8-106(f) and Examples 7 and 8 in Comment 4 to Section 8-106.

Non-control secured financing arrangements for securities firms are covered by the automatic perfection rule of subsection (4)(c). Under prior law, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The perfection rule of subsection (4)(c) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control priority rule of subsection (5)(a), as supplemented by the special rules set out in subsections (b), (c), and (e). In cases not covered by the control priority rule, conflicting security interests rank equally. The following examples illustrate the priority rules as applied to this setting. (In all cases it is

assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between asecured lender and the firm's own customers are governed by Section 8-511 [55-8-511 NMSA 1978].)

Example 6. Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic perfection rule of subsection (4)(c). Neither Alpha nor Beta has control. Subsection (5)(e) provides that the security interests of Alpha and Beta rank equally, because each of them has a non-control security interest granted by a securities firm. They share pro-rata.

Example 7. Able enters into financing arrangements with Alpha Bank and Beta Bank as in Example 6. At some point, however, Beta decides that it is unwilling to continue to provide financing on a non-control basis. Able directs the clearing corporation where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic perfection rule of subsection (4)(c), and Beta under that rule and also the subsection (4)(a) control perfection rule. Beta has control but Alpha does not. Beta has priority over Alpha under subsection (5)(a).

Example 8. Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. They share pro rata under subsection (5)(b).

7. Secured financing arrangement in the settlement system. Under the rules or agreements governing the relationship between a clearing corporation and its participants, the clearing corporation may have a security interest in securities that the

participants have deposited with the clearing corporation pursuant to guaranty fund arrangements or in securities that are in the process of delivery to or from a participant's account in the settlement process. The control rules protect the clearing corporation's rights as secured party in such arrangements, since the clearing corporation would have control over the collateral under the Section 8-106 [55-8-106 NMSA 1978] rules. The control rules also protect therights of "upper-tier" intermediaries that are not themselves clearing corporations. For example, if a securities dealer carries its inventory through a clearing bank that provides both custodial and credit services, the clearing bank as secured party would have control and hence be assured of perfection and priority over any potential conflicting security interests granted by the securities dealer.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in Section 8-102(a)(14) [55-8-102 NMSA 1978] to include clearing corporations. Thus, the perfection rule of subsection (4)(c) applies to security interests in investment property granted by clearing corporations.

In secured financing arrangements for clearing corporations and other securities intermediaries, it is sometimes necessary to specify that a secured lender will have a security interest in a certain bundle of securities that, after all the calculations necessary to complete a processing cycle are completed, turn out to be appropriate and available for pledge. At the time the security interest attaches, the necessary computations may not have been completed, though the information that ultimately will determine what positions are to be pledged has been entered. Accordingly, subsection (3) provides that the description of collateral in a security agreement may identify the collateral by means of a computational or allocational formula.

8. Security interests in commodity futures. Section 9-115 [55-9-115 NMSA 1978] establishes rules on security interests in commodity contracts and commodity accounts that are, in general, parallel to the rules on security interests in security entitlements and securities accounts. Note, though, that commodity contracts are not "securities" or "financial assets" under Article 8. See Section 8-103(f) [55-8-103 NMSA 1978]. Thus,

the relationship between commodity intermediaries and commodity customers is not governed by the indirect holding system rules of Part 5 of Article 8. For securities, the UCC establishes rules in Article 9 on security interests, and rules in Article 8 on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful so that another party has an adverse claim. For commodity contracts, Article 9 establishes rules on security interests, but questions of the sort dealt with in Article 8 for securities are left to other law.

Subsection (1) contains the definitions of the terms used in substantive rules on security interests in commodity contracts and commodity accounts. The key term "commodity contract" is defined in subsection (1)(b). Section 8-103(f) [55-8-103 NMSA 1978] provides that a commodity contract, as defined in Section 9-115 [55-9-115 NMSA 1978], is not a security or a financial asset. The result is that the indirect holding system rules in Revised Article 8 Part 5 do not apply to anything that falls within the definition of commodity contract in this section. The indirect holding system rules of Article 8, however, are intended to be sufficiently flexible that they can be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the "commodity contract" definition in this section is narrowly drafted to ensure that it does not operate as an obstacle to the application of the new Article 8 indirect holding system rules to new products. The term commodity contract covers those contracts that are traded on or subject to the rules of a designated contract market, and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that are excluded from Article 8 but governed by Article 9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodities Futures Trading Commission.

Commodity contracts are rather different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the commodity exchanges require that the contracts be marked to market on a daily basis, that is the customer pays or receives any increment attributable to that day's price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire

commodity account in which the borrower carries the hedging contracts, rather than in individual contracts. Section 9-115 [55-9-115 NMSA 1978] provides a simple mechanism for implementation of such arrangements, either by granting a security interest in the commodity account, or in particular commodity contracts carried in the account. The security interest can be perfected by filing or by control. Under subsection (1)(e) the secured party can obtain control over a commodity contract or commodity account by obtaining an agreement among the commodity customer, the secured party, and the commodity intermediary in which the commodity intermediary agrees to apply any value distributed as directed by the secured party. This provides a clear and certain legal framework for practices that have already developed in the industry.

One important effect of including commodity contracts and commodity accounts in the new Article 9 rules is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer's positions in order to satisfy obligations of the customer to the futures commission merchant. Section 9-115 [55-9-115 NMSA 1978] treats these rights as security interests and applies to them the same priority rules that apply to the somewhat analogous relationships between securities clearing corporations or securities intermediaries and their participants or customers. Subsection (1)(e) provides that the commodity intermediary has control, and therefore the security interest is perfected under subsection (4)(a). Subsection (5)(d) provides that the security interest of a commodity clearing organization in its participant's commodity contracts has priority over any security interest granted by the participant to a third-party lender. Similarly, an FCM's security interest would have priority over any security interest granted by its customer to a third-party lender.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary's security interest in such securities is governed by the rules of this section on security interests in securities, not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and security markets are closely linked. The Section 9-115 [55-9-115 NMSA 1978] rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a

commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The Section 9-115 rules would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

9. Relation to other law. Section 1-103 [55-1-103 NMSA 1978] provides that "unless displaced by particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a party from asserting its Article 9 priority depends on an assessment of the party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the UCC.

Some circumstances in which other law is clearly displaced by the UCC rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a party with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, Article 8 provides protections against adverse claims to certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under Section 9-115 [55-9-115 NMSA 1978], but also qualifies for protection against adverse claims under Section 8-303, 8-502, or 8-510 [55-8-303, 55-8-502, or 55-8-510 NMSA 1978], resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the revision of Article 8 and corresponding provisions of Article 9 is to ensure that secured financing transactions can be implemented on a simple, timely, and certain basis. One of the circumstances that led to the revision was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to

establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an inquiry into the state of a party's awareness of potential conflicting claims because a rule under which a party's rights depended on that sort of after the fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rule of this section would have incorporated that test. The fact that it does not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

Definitional Cross References: - "Broker" Section 8-102(a)(3) [55-8-102 NMSA 1978]

"Certificated security" Section 8-102(a)(4)

"Collateral" Section 9-105(1)(c) [55-9-105 NMSA 1978]

"Control" Section 8-106 [55-8-106 NMSA 1978]

"Debtor" Section 9-105(1)(d)

"Delivery" Section 8-301 [55-8-301 NMSA 1978]

"Entitlement holder" Section 8-102(a)(7)

"Secured party" Section 9-105(1)(m)

"Securities account" Section 8-501 [55-8-501 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security" Section 8-102(a)(15)

"Security agreement" Section 9-105(1)(l)

"Security entitlement" Section 8-102(a)(17)

"Security interest" Section 1-201(37) [55-1-201 NMSA 1978]

"Uncertificated security" Section 8-102(a)(18)

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

55-9-116. Security interest arising in purchase or delivery of financial asset.

(1) If a person buys a financial asset through a securities intermediary in a transaction in which the buyer is obligated to pay the purchase price to the securities intermediary at the time of the purchase, and the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary, the securities intermediary has a security interest in the buyer's security entitlement securing the buyer's obligation to pay. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

(2) If a certificated security or other financial asset represented by a writing which in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment is delivered pursuant to an agreement between persons in the business of dealing with such securities or financial assets and the agreement calls for delivery versus payment, the person delivering the certificate or other financial asset has a security interest in the certificated security or other financial asset securing the seller's right to receive payment. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

History: 1978 Comp., § 55-9-116, enacted by Laws 1996, ch. 47, § 60.

ANNOTATIONS

OFFICIAL COMMENT

1. This section establishes two special rules concerning security interests in investment property in order to provide certainty in the securities settlement system.

2. Depending upon a securities intermediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to the securities in question before the entitlement holder has actually made payment for them. For example, many brokers permit retail customers to pay for securities by check. The broker may not receive final payment of the check until several days after the broker has credited the customer's securities account for the securities. Thus, the customer will have acquired a security entitlement prior to payment. Subsection (1) provides that in such circumstances the securities intermediary has a security interest in the entitlement holder's security entitlement as security for the payment obligation. This is a codification and adaptation to the indirect holding system of the so-called "broker's lien," which has long been recognized in existing law. See Restatement of Security §

12. An intermediary who has a security interest under this section will have control by virtue of Section 8-106(e) [55-8-106 NMSA 1978]. The security interest has priority over conflicting security interests granted by the entitlement holder, under Section 9-115(5)(a) and (c) [55-9-115 NMSA 1978].

3. Subsection (2) specifies the rights of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In the typical arrangement for settlement of physical securities, the seller's securities custodian will deliver the physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Subsection (2) is intended to clarify the rights of persons making deliveries in such circumstances. It specifies that the person making delivery has a security interest in the securities or other financial assets, securing the right to receive payment. No security agreement is required for attachment, and no filing or other action is required for perfection.

Definitional Cross References: - "Certificated security" Section 8-102(a)(4) [55-8-102 NMSA 1978]

"Financial asset" Section 8-102(a)(9)

"Securities account" Section 8-501 [55-8-501 NMSA 1978]

"Securities intermediary" Section 8-102(a)(14)

"Security agreement" Section 9-105(1)(l) [55-9-105 NMSA 1978]

"Security entitlement" Section 8-102(a)(17)

"Security interest" Section 1-201(37) [55-1-201 NMSA 1978]

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

PART 2
VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES THERETO

55-9-201. General validity of security agreement.

Except as otherwise provided by this act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. Nothing in this article validates any charge or practice illegal under any statute or regulation thereunder governing usury, small loans, retail installment sales or the like, or extends the application of any such statute or regulation to any transaction not otherwise subject thereto.

History: 1953 Comp., § 50A-9-201, enacted by Laws 1961, ch. 96, § 9-201.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. Section 4, Uniform Conditional Sales Act; Section 3, Uniform Trust Receipts Act.

Purposes. - This section states the general validity of a security agreement. In general the security agreement is effective between the parties; it is likewise effective against third parties. Exceptions to this general rule arise where there is a specific provision in any article of this act, for example, where article 1 invalidates a disclaimer of the obligations of good faith, etc. (Section 1-102(3)), or this article subordinates the security interest because it has not been perfected (Section 9-301) or for other reasons (see Section 9-312 on priorities) or defeats the security interest where certain types of claimants are involved (for example Section 9-307 on buyers of goods). As pointed out in the note to Section 9-102, there is no intention that the enactment of this article should repeal retail installment selling acts or small loan acts. Nor of course are the usury laws of any state repealed. These are mentioned in the text of Section 9-201 as examples of applicable laws, outside this code entirely, which might invalidate the terms of a security agreement.

Cross references. - Sections 1-102(3), 9-301, 9-307 and 9-312.

Definitional cross references. - "Collateral". Section 9-105.

"Creditor". Section 1-201.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Security agreement". Section 9-105.

Law reviews. - For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 155 et seq.

Violation of statute as to form of, or terms to be included in, conditional sales contract as invalidating entire transaction or merely its effect to reserve title in vendor, 144 A.L.R. 1103.

Validity and nature of trust receipts, 168 A.L.R. 359.

Rights of seller of motor vehicle with respect to purchase price or security on failure to comply with law governing transfer of title, 58 A.L.R.2d 1351.

Attorney's liability for negligence in preparing or recording security document, 87 A.L.R.2d 991.

"Unconscionability" as ground for refusing enforcement of contract for sale of goods or agreement collateral thereto, 18 A.L.R.3d 1305.

Leaving part of loan on deposit with lender as usury, 92 A.L.R.3d 769.

Sufficiency of description of collateral in security agreement under UCC §§ 9-110 and 9-203, 100 A.L.R.3d 940.

Modern status and application of rule that only voluntary transfer or assignment of claim against United States is within Assignment of Claims Act (31 U.S.C.S. § 203, 41 U.S.C.S. § 15), 44 A.L.R. Fed. 775.

72 C.J.S. Pledges §§ 19, 31; 79 C.J.S. Secured Transactions § 8 et seq.

55-9-202. Title to collateral immaterial.

Each provision of this article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor.

History: 1953 Comp., § 50A-9-202, enacted by Laws 1961, ch. 96, § 9-202.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The rights and duties of the parties to a security transaction and of third parties are stated in this article without reference to the location of "title" to the collateral. Thus the incidents of a security interest which secures the purchase price of goods are the same under this article whether the secured party appears to have

retained title or the debtor appears to have obtained title and then conveyed it or a lien to the secured party. This article in no way determines which line of interpretation (title theory v. lien theory or retained title v. conveyed title) should be followed in cases where the applicability of some other rule of law depends upon who has title. Thus if a revenue law imposes a tax on the "legal" owner of goods or if a corporation law makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determine the location of "title" for such purposes.

Petitions for reclamation brought by a secured party in his debtor's insolvency proceedings have often been granted or denied on a title theory: where the secured party has title, reclamation will be granted; where he has "merely a lien", reclamation may be denied. For the treatment of such petitions under this article, see Point 1 of comment to Section 9-507.

Cross references. - Sections 2-401 and 2-507.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

Law reviews. - For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 225 et seq.

72 C.J.S. Pledges § 21; 79 C.J.S. Secured Transactions § 8 et seq.

55-9-203. Attachment and enforceability of security interest; proceeds; formal requisites.

(1) Subject to the provisions of Section 55-4-210 NMSA 1978 on the security interest of a collecting bank, Sections 55-9-115 and 55-9-116 NMSA 1978 on security interests in investment property and Section 55-9-113 NMSA 1978 on a security interest arising

under the article on sales (Article 2) [Chapter 55, Article 2 NMSA 1978] or the article on leases (Article 2A) [Chapter 55, Article 2A NMSA 1978], a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement, or the debtor has signed a security agreement that contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;

(b) value has been given; and

(c) the debtor has rights in the collateral.

(2) A security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in Subsection (1) of this section have taken place unless explicit agreement postpones the time of attaching.

(3) Unless otherwise agreed, a security agreement gives the secured party the rights to proceeds provided by Section 55-9-306 NMSA 1978.

(4) A transaction, although subject to Chapter 55, Article 9 NMSA 1978, is also subject to the Oil and Gas Products Lien Act [48-9-1 to 48-9-8 NMSA 1978]; Sections 56-1-1 through 56-1-15 NMSA 1978 (pertaining to retail installment sales); Sections 56-12-1 through 56-12-16 NMSA 1978 (pertaining to credit extended by pawnbrokers); the New Mexico Bank Installment Loan Act of 1959 [58-7-1 to 58-7-3, 58-7-5 to 58-7-9 NMSA 1978]; the New Mexico Small Loan Act of 1955 [Chapter 58, Article 15 NMSA 1978]; and the Motor Vehicle Sales Finance Act. In the case of conflict between the provisions of Chapter 55, Article 9 NMSA 1978 and any such statute, the provisions of such statute control. Failure to comply with any applicable statute has only the effect which is specified therein.

History: 1953 Comp., § 50A-9-203, enacted by Laws 1961, ch. 96, § 9-203; 1985, ch. 193, § 13; 1987, ch. 248, § 49; 1993, ch. 214, § 5; 1996, ch. 47, § 61.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 2, Uniform Trust Receipts Act.

Purposes. - 1. Subsection (1) states three basic prerequisites to the existence of a security interest: agreement, value, and collateral. In addition, the agreement must be in writing unless the collateral is in the possession of the secured party (including an agent

on his behalf - see Comment 2 to Section 9-305). When all of these elements exist, the security agreement becomes enforceable between the parties and is said to "attach". Perfection of a security interest (see Section 9-303) will in many cases depend on the additional step of filing a financing statement (see Section 9-302) or possession of the collateral (Sections 9-304(1) and 9-305). Section 9-301 states who will take priority over a security interest which has attached but which has not been perfected. Subsection (2) states a rule of construction under which the security interest, unless postponed by explicit agreement, attaches automatically when the stated events have occurred.

2. As to the type of description of collateral in a written security agreement which will satisfy the requirements of this section, see Section 9-110 and Comment thereto.

In the case of crops growing or to be grown or timber to be cut the best identification is by describing the land, and Subsection (1) (a) requires such a description.

3. One purpose of the formal requisites stated in Subsection (1) (a) is evidentiary. The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is in the debtor's possession; customarily, of course, as a matter of business practice the written record will be kept, but, in this article as at common law, the writing is not a formal requisite. Subsection (1) (a), therefore, dispenses with the written agreement - and thus with signature and description - if the collateral is in the secured party's possession.

4. The definition of "security agreement" (Section 9-105) is "an agreement which creates or provides for a security interest". Under that definition the requirement of this section that the debtor sign a security agreement is not intended to reject, and does not reject, the deeply rooted doctrine that a bill of sale although absolute in form may be shown to have been in fact given as security. Under this article as under prior law a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security and may then, on payment of the debt, assert his fundamental right to return of the collateral and execution of an acknowledgment of satisfaction.

5. The formal requisite of a writing stated in this section is not only a condition to the enforceability of a security interest against third parties, it is in the nature of a statute of frauds. Unless the secured party is in possession of the collateral, his security interest, absent a writing which satisfies Paragraph (1) (a), is not enforceable even against the debtor, and cannot be made so on any theory of equitable mortgage or the like. If he has advanced money, he is of course a creditor and, like any creditor, is entitled after judgment to appropriate process to enforce his claim against his debtor's assets; he will not, however, have against his debtor the rights given a secured party by Part 5 of this article on default. The theory of equitable mortgage, insofar as it has operated to allow creditors to enforce informal security agreements against debtors, may well have developed as a necessary escape from the elaborate requirements of execution, acknowledgment and the like which the nineteenth-century chattel mortgage acts vainly

relied on as a deterrent to fraud. Since this article reduces formal requisites to a minimum, the doctrine is no longer necessary or useful. More harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing.

6. Subsection (4) states that the provisions of regulatory statutes covering the field of consumer finance prevail over the provisions of this article in case of conflict. The second sentence of the subsection is added to make clear that no doctrine of total voidness for illegality is intended: failure to comply with the applicable regulatory statute has whatever effect may be specified in that statute, but no more.

Cross references. - Sections 4-208 and 9-113.

Point 1: Section 9-110.

Point 5: Part 5.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Party". Section 1-201.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Signed". Section 1-201.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

The 1987 amendment, effective June 19, 1987, inserted "Section 55-8-321 NMSA 1978 on security interests in securities" in the introductory paragraph of Subsection (1) and made minor stylistic changes throughout the section.

The 1993 amendment, effective July 1, 1993, in Subsection (1), in the introductory language, substituted "Section 55-4-210 NMSA 1978" for "Section 55-4-208 NMSA 1978", inserted "(Article 2) or the article on leases (Article 2A)" and made a stylistic change in paragraph (a).

The 1996 amendment substituted "Sections 55-9-115 and 55-9-116 NMSA 1978 on security interests in investment property" for "Section 55-8-321 NMSA 1978 on security interests in securities" in Subsection (1), inserted "the collateral is investment property and the secured party has control pursuant to agreement" in Subsection (1)(a), and, in the first sentence of Subsection (4), substituted "Section 56-12-1 through 56-12-16" for "Sections 56-8-15 through 56-8-20" and deleted "traders and others" following "pawnbrokers". Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Motor Vehicle Sales Finance Act. - See 58-19-1 NMSA 1978 and notes thereto.

Use of traditional security agreements may continue. - The traditional forms of security agreements in use before the enactment of this section may continue to be used after its enactment. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

Security interest not enforceable until debtor signs written agreement. - Purchase money security interest of defendant was not enforceable under this section until after the written security agreements had been signed by owner of equipment paid for by defendant. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

Agreement effective only as to collateral described therein. - A security interest is not effective against third parties unless the debtor has signed a security agreement which contains a description of the collateral, and the disputed items cannot be included within the security agreement by the "outside evidence" relied on by plaintiff because the disputed items are not described in the security agreement. Jones & Laughlin Supply v. Dugan Prod. Corp., 85 N.M. 51, 508 P.2d 1348 (Ct. App. 1973).

Omission of collateral from security agreement creates no security interest. - Where the collateral is described on a financing statement but omitted from the security agreement, there is no enforceable security interest. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

Parol evidence cannot be offered to establish a valid security agreement. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

Security interest in capital retains. - Capital retains are a general intangible and not an account because no "right to payment" exists; thus capital retains are property in which a debtor can grant a security interest. Valley Fed. Sav. Bank v. Stahl, 110 N.M. 169, 793 P.2d 851 (1990).

Law reviews. - For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 51 Am. Jur. 2d Liens § 23; 68A Am. Jur. 2d Secured Transactions § 155 et seq.

Sufficiency of description of collateral in security agreement under UCC §§ 9-110 and 9-203, 100 A.L.R.3d 940.

Sufficiency of debtor's signature on security agreement or financing statement under UCC §§ 9-203 and 9-402, 3 A.L.R.4th 502.

Right of secured creditor to have set aside fraudulent transfer of other property by his debtor, 8 A.L.R.4th 1123.

Conveyance of land as including mature but unharvested crops, 51 A.L.R.4th 1263.

Avoidance under 11 USCS § 522(f)(2) of the Bankruptcy Code of 1978 of nonpossessory, nonpurchase-money security interest in debtor's exempt personal property, 55 A.L.R. Fed. 353.

72 C.J.S. Pledges § 10; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-204. After-acquired property; future advances.

(1) Except as provided in Subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.

(2) No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9-314) [55-9-314 NMSA 1978] when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value.

(3) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (Subsection (1) of Section 9-105 [55-9-105 NMSA 1978]).

History: 1953 Comp., § 50A-9-204, enacted by Laws 1961, ch. 96, § 9-204; 1985, ch. 193, § 14.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) makes clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement. That is to say: the security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party - such as the taking of a supplemental agreement covering the new collateral - is required. This does not however mean that the interest is proof against subordination or defeat: Section 9-108 should be consulted on when a security interest in after-acquired collateral is not security for antecedent debt, and Section 9-312(3) and (4) on when such a security interest may be subordinated to a conflicting purchase money security interest in the same collateral.

2. This article accepts the principle of a "continuing general lien". It rejects the doctrine - of which the judicial attitude toward after-acquired property interests was one expression - that there is reason to invalidate as a matter of law what has been variously called the floating charge, the free-handed mortgage and the lien on a shifting stock. This article validates a security interest in the debtor's existing and future assets, even though (see Section 9-205) the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. (See further, however, Section 9-306 on proceeds and comment thereto.)

The widespread nineteenth-century prejudice against the floating charge was based on a feeling, often inarticulate in the opinions, that a commercial borrower should not be allowed to encumber all his assets present and future, and that for the protection not only of the borrower but of his other creditors a cushion of free assets should be preserved. That inarticulate premise has much to recommend it. This article decisively rejects it not on the ground that it was wrong in policy but on the ground that it was not effective. In pre-code law there was a multiplication of security devices designed to avoid the policy: field warehousing, trust receipts, factor's lien acts and so on. The cushion of free assets was not preserved. In almost every state it was possible before the code for the borrower to give a lien on everything he held or would have. There have no doubt been sufficient economic reasons for the change. This article, in expressly validating the floating charge, merely recognizes an existing state of things. The substantive rules of law set forth in the balance of the article are designed to achieve the protection of the debtor and the equitable resolution of the conflicting claims of creditors which the old rules no longer give.

Notice that the question of assignment of future accounts is treated like any other case of after-acquired property: no periodic list of accounts is required by this act. Where less

than all accounts are assigned such a list may of course be necessary to permit identification of the particular accounts assigned.

3. Subsection (1) has been already referred to in connection with after-acquired property. It also serves to validate the so-called "cross-security" clause under which collateral acquired at any time may secure advances whenever made.

4. Subsection (2) limits the operation of the after-acquired property clause against consumers. No such interest can be claimed as additional security in consumer goods (defined in Section 9-109), except accessions (see Section 9-314), acquired more than ten days after the giving of value.

5. Under Subsection (3) collateral may secure future as well as present advances when the security agreement so provides. At common law and under chattel mortgage statutes there seems to have been a vaguely articulated prejudice against future advance agreements comparable to the prejudice against after-acquired property interests. Although only a very few jurisdictions went to the length of invalidating interests claimed by virtue of future advances, judicial limitations severely restricted the usefulness of such arrangements. A common limitation was that an interest claimed in collateral existing at the time the security transaction was entered into for advances made thereafter was good only to the extent that the original security agreement specified the amount of such later advances and even the times at which they should be made. In line with the policy of this article toward after-acquired property interests this subsection validates the future advance interest, provided only that the obligation be covered by the security agreement.

The effect of after-acquired property and future advance clauses in the security agreement should not be confused with the use of financing statements in notice filing. The references to after-acquired property clauses and future advance clauses in Section 9-204 are limited to security agreements. This section follows Section 9-203, the section requiring a written security agreement, and its purpose is to make clear that confirmatory agreements are not necessary where the basic agreement has the clauses mentioned. This section has no reference to the operation of financing statements. The filing of a financing statement is effective to perfect security interests as to which the other required elements for perfection exist, whether the security agreement involved is one existing at the date of filing with an after-acquired property clause or a future advance clause, or whether the applicable security agreement is executed later. Indeed, Section 9-402(1) expressly contemplates that a financing statement may be filed when there is no security agreement. There is no need to refer to after-acquired property or future advances in the financing statement.

As in the case of interests in after-acquired collateral, a security interest based on future advances may be subordinated to conflicting interests in the same collateral. See Sections 9-301(4); 9-307(3); 9-312(3), (4) and (7).

Cross references. - Point 1: Sections 9-108 and 9-312.

Point 2: Sections 9-205 and 9-306.

Point 4: Sections 9-109 and 9-314.

Point 5: Sections 9-301(4); 9-307(3); 9-312(3), (4), and (7).

Definitional cross references. - "Account". Section 9-106.

"Agreement". Section 1-201.

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Contract". Section 1-201.

"Debtor". Section 9-105.

"Purchase". Section 1-201.

"Pursuant to commitment". Section 9-105.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

I. General Consideration.
II. Agreement to Attach.
III. Value Given.
IV. Debtor Rights in Collateral.

I. GENERAL CONSIDERATION.

Steps necessary to create security interest may be taken in any order. - If a financing statement is filed, value is extended, and a security agreement is executed, then there is a security interest in the described collateral. These steps can be taken in any order and priority is given to the security interest which is filed first, even if that security interest has not attached at the time of filing. Waterfield v. Burnett, 21 Bankr. 752 (Bankr. D.N.M. 1982).

Description of collateral in financing statement. - The description of collateral in the financing statement as the "entire inventory of merchandise together with all proceeds derived therefrom" is sufficient to give another creditor notice of the security interest in after-acquired inventory. Kuemmerle v. United N.M. Bank, 113 N.M. 677, 831 P.2d 976 (1992).

Effect of security agreement is to immediately transfer property interest in collateral. Hernandez v. S.I.C. Fin. Co., 79 N.M. 673, 448 P.2d 474 (1968).

Effect of future advance clause with respect to third persons. - With respect to third persons, future advances do not come within the protection of the future advance clause of the security agreement unless the future advance is of the same general class of debt as the original debt and was within the contemplation of the parties where the security agreement was made. AG-Chem Farm Servs., Inc. v. Coberly, 105 N.M. 384, 733 P.2d 15 (Ct. App. 1987).

Debt consolidation loan did not cause lapse of prior security agreement. - A loan consolidating a debtor's preceding debts was, in effect, a renewal of his previous loans, including a 1979 loan covered by a security agreement, so that the security agreement did not lapse as a result of the consolidation, since the security agreement provided that the agreement would secure "the payment of all extensions and renewals," and it was the parties' intent that the agreement secure the amount owing under the 1979 loan as well as future advances. Bond Enters., Inc. v. Western Bank, 54 Bankr. 366 (Bankr. D.N.M. 1985).

Protection of unsold collateral. - A party having a prior security interest, who receives proceeds from a sale of part of the collateral with actual or constructive notice of subordinate security interests in the collateral, must apply all of such proceeds to the debt secured by his security interest so as to protect the remaining collateral for the benefit of parties having such subordinate security interests. AG-Chem Farm Servs., Inc. v. Coberly, 105 N.M. 384, 733 P.2d 15 (Ct. App. 1987).

Law reviews. - For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 231 et seq.

Term "increase" in description in chattel mortgage on animals, as including increase other than by generation, 1 A.L.R. 554.

Chattel mortgage on livestock as including increase, 39 A.L.R. 153.

Chattel mortgage on fruit crops growing or to be grown, 54 A.L.R. 1532.

Filing of chattel mortgage on crops as constructive notice, 77 A.L.R. 572.

Chattel mortgage on livestock as covering animals subsequently acquired by means other than increase of generation, 129 A.L.R. 899.

Chattel mortgage lien attaching to subsequently born offspring as surviving period of suitable nurture, 144 A.L.R. 330.

Priority as between seller or conditional seller of personalty and claimant under after acquired property clause of mortgage or other instrument, 86 A.L.R.2d 1152.

Sufficiency of description of collateral in security agreement under UCC §§ 9-110 and 9-203, 100 A.L.R.3d 940.

Construction and effect of "future advances" clauses under UCC Article 9, 90 A.L.R.4th 859.

Avoidance under 11 USCS § 522(f)(2) of the Bankruptcy Code of 1978 of nonpossessory, nonpurchase-money security interest in debtor's exempt personal property, 55 A.L.R. Fed. 353.

72 C.J.S. Pledges § 22; 79 C.J.S. Secured Transactions § 12 et seq.

II. AGREEMENT TO ATTACH.

Agreement not payment key to attachment. - When defendant agreed to buy equipment from pump company, company agreed to furnish the equipment, and lessee of the equipment agreed that defendant would have an interest in the equipment, security interest attached immediately, not upon actual payment by defendant of purchase price. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

Value previously given. - Having previously given value for security interest, secured party acquired this interest (the security interest attached) by the equipment lease agreement. Transamerica Leasing Corp. v. Bureau of Revenue, 80 N.M. 48, 450 P.2d 934 (Ct. App. 1969).

No security interest created if collateral omitted from security agreement. - If the collateral is described on a financing statement but omitted from the security agreement, there is no enforceable security interest. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

III. VALUE GIVEN.

Binding commitment to extend credit deemed sufficient value. - The fact that equipment leases were not signed until after the installation of the equipment, and thus not enforceable at the time of the installations, did not prevent the attachment of defendant's security interest at the time of installation where defendant gave a binding commitment to extend credit, and this commitment was acted upon. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

IV. DEBTOR RIGHTS IN COLLATERAL.

Rights acquired and security interests attach upon delivery to debtor. - Where vendor from whom business owner purchased inventory provided delivery of the items in its own trucks and at its own risk, and all sales were for cash on delivery, business owner acquired rights in the collateral when it was delivered, and the bank's security interest in his inventory "now owned or hereafter acquired" attached at that point and was perfected. National Inv. Trust v. First Nat'l Bank, 88 N.M. 514, 543 P.2d 482 (1975).

No rights acquired. - Where landlord agreed to buy restaurant and equipment and to then sell them to borrowers of a loan secured by a mortgage on real estate and by a security agreement and financing statement on the restaurant equipment which one of the borrowers intended to buy from lessee, the mortgagors never obtained rights in the collateral so as to allow the bank's security interest to attach, since the mortgagors failed to comply with the initial requirements of the contract with the landlord. First Nat'l Bank v. Quintana, 105 N.M. 410, 733 P.2d 858 (1987).

55-9-205. Use or disposition of collateral without accounting permissible.

A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods to make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee.

History: 1953 Comp., § 50A-9-205, enacted by Laws 1961, ch. 96, § 9-205; 1985, ch. 193, § 15.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. This article expressly validates the floating charge or lien on a shifting stock. (See Sections 9-201, 9-204 and comment to Section 9-204.) This section provides that a security interest is not invalid or fraudulent by reason of liberty in the debtor to dispose of the collateral without being required to account for proceeds or substitute new collateral. It repeals the rule of Benedict v. Ratner, 268 U.S. 353, 45 S. Ct. 566, 69 L. Ed. 991 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral. The principal effect of the Benedict rule has been, not to discourage or eliminate security transactions in inventory and accounts receivable - on the contrary such transactions have vastly increased in volume - but rather to force financing arrangements in this field toward a self-liquidating basis. Furthermore, several lower court cases drew implications from Justice Brandeis' opinion in Benedict v. Ratner which required lenders operating in this field to observe a number of needless and costly formalities: for example it was thought necessary for the debtor to make daily remittances to the lender of all collections received, even though the amount remitted is immediately returned to the debtor in order to keep the loan at an agreed level.

2. The Benedict rule was, in the accounts receivable field, repealed in many of the state accounts receivable statutes enacted after 1943, and, in the inventory field, by some of the factor's lien statutes. (Benedict v. Ratner purported to state the law of New York and not a rule of federal bankruptcy law. Since its acceptance is a matter of state law, it can of course be rejected by state statute.)

3. The requirement of "policing" is the substance of the Benedict rule. While this section repeals Benedict in matters of form, the filing requirements (Section 9-302) give other creditors the opportunity to ascertain from public sources whether property of their debtor or prospective debtor is subject to secured claims, and the provisions about proceeds (Section 9-306(4)) enable creditors to claim collections which were made by the debtor more than 10 days before insolvency proceedings and commingled or deposited in a bank account before institution of the insolvency proceedings. The repeal of the Benedict rule under this section must be read in the light of these provisions.

4. Other decisions reaching results like that in the Benedict case, but relating to other aspects of dominion (of which Lee v. State Bank & Trust Co., 54 F.2d 518 (2d Cir. 1931), is an example) are likewise rejected.

5. Nothing in Section 9-205 prevents such "policing" or dominion as the secured party and the debtor may agree upon; business and not legal reasons will determine the extent to which strict accountability, segregation of collections, daily reports and the like will be employed.

6. The last sentence is added to make clear that the section does not mean that the holder of an unfiled security interest, whose perfection depends on possession of the collateral by the secured party or by a bailee (such as a field warehouseman), can allow the debtor access to and control over the goods without thereby losing his perfected interest. The common law rules on the degree and extent of possession which are

necessary to perfect a pledge interest or to constitute a valid field warehouse are not relaxed by this or any other section of this article.

Cross references. - Point 1: Sections 9-201 and 9-204.

Point 3: Sections 9-302 and 9-306(4).

Point 6: Sections 9-304 and 9-305.

Definitional cross references. - "Account". Section 9-106.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

Law reviews. - For article, "Attachment in New Mexico - Part I," see 1 Nat. Resources J. 303 (1961).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 272 et seq.; 78 Am. Jur. 2d Warehouses §§ 96, 99.

Forfeiture by innocent vendor of articles sold conditionally and used by vendee in violation of law, 2 A.L.R. 1596.

Statutes relating specifically to selling personal property previously sold under conditional sale, 33 A.L.R. 853, 56 A.L.R. 1217.

Validity of chattel mortgage where mortgagor is given right to sell, 73 A.L.R. 236.

Chattel mortgagee's consent to sale of mortgaged property as waiver of lien, 97 A.L.R. 646.

Recovery by conditional seller or buyer, or person standing in his shoes, against third person for damage or destruction of property, 67 A.L.R.2d 582.

37 C.J.S. Fraudulent Conveyances § 224; 79 C.J.S. Secured Transactions § 111 et seq.

55-9-206. Agreement not to assert defenses against assignee; modification of sales warranties where security agreement exists.

(1) Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the article on negotiable instruments (Article 3) [Chapter 55, Article 3 NMSA 1978]. A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

(2) When a seller retains a purchase money security interest in goods the article on sales (Article 2) [Chapter 55, Article 2 NMSA 1978] governs the sale and any disclaimer, limitation or modification of the seller's warranties.

History: 1953 Comp., § 50A-9-206, enacted by Laws 1961, ch. 96, § 9-206; 1967, ch. 186, § 25; 1993, ch. 214, § 6.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 2, Uniform Conditional Sales Act.

Purposes. - 1. Clauses are frequently inserted in installment purchase contracts under which the conditional vendee agrees not to assert defenses against an assignee of the contract. These clauses have led to litigation and their present status under the case law is in confusion. In some jurisdictions they have been held void as attempts to create negotiable instruments outside the framework of Article 3 or on grounds of public policy; in others they have been allowed to operate to cut off at least defenses based on breach of warranty. Under Subsection (1) such clauses in a security agreement are validated outside the consumer field, but only as to defenses which could be cut off if a negotiable instrument were used. This limitation is important since if the clauses were allowed to have full effect as typically drafted, they would operate to cut off real as well as personal defenses. The execution of a negotiable note in connection with a security agreement is given like effect as the execution of an agreement containing a waiver of defense clause. The same rules are made applicable to leases as to security agreements, whether or not the lease is intended as security.

2. This article takes no position on the controversial question whether a buyer of consumer goods may effectively waive defenses by contractual clause or by execution

of a negotiable note. In some states such waivers have been invalidated by statute. In other states the course of judicial decision has rendered them ineffective or unreliable - courts have found that the assignee is not protected against the buyer's defense by a clause in the contract or that the holder of a note, by reason of his too close connection with the underlying transaction, does not have the rights of a holder in due course. This article neither adopts nor rejects the approach taken in such statutes and decisions, except that the validation of waivers in Subsection (1) is expressly made "subject to any statute or decision" which may restrict the waiver's effectiveness in the case of a buyer of consumer goods.

3. Subsection (2) makes clear, as did Section 2 of the Uniform Conditional Sales Act, that purchase money security transactions are sales, and warranty rules for sales are applicable. It also prevents a buyer from inadvertently abandoning his warranties by a "no warranties" term in the security agreement when warranties have already been created under the sales arrangement. Where the sales arrangement and the purchase money security transaction are evidenced by only one writing, that writing may disclaim, limit or modify warranties to the extent permitted by Article 2.

Cross references. - Point 1: Section 3-305.

Point 2: Section 9-203(2).

Point 3: Sections 2-102 and 2-316.

Definitional cross references. - "Agreement". Section 1-201.

"Consumer goods". Section 9-109.

"Good faith". Section 1-201.

"Goods". Section 9-105.

"Holder". Section 1-201.

"Holder in due course". Sections 3-302 and 9-105.

"Negotiable instrument". Section 3-104.

"Notice". Section 1-201.

"Purchase money security interest". Section 9-107.

"Sale". Sections 2-106 and 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

The 1993 amendment, effective July 1, 1993, substituted "negotiable instruments" for "commercial paper" in Subsection (1).

Public policy encourages freedom between competent parties of the right to contract, and requires the enforcement of contracts, unless they clearly contravene some positive law or rule of public morals. GECC v. Tidenberg, 78 N.M. 59, 428 P.2d 33, 40 A.L.R.3d 1151 (1967).

Legislature allows limitations on claims against assignees of sellers. - By adopting this section, the New Mexico legislature has established a policy favoring the validity of an agreement not to assert against an assignee any claim or defense which the buyer may have against the seller, and especially when the transaction involves both a negotiable note and a security agreement, so long as the assignee takes for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument. GECC v. Tidenberg, 78 N.M. 59, 428 P.2d 33, 40 A.L.R.3d 1151 (1967).

Law reviews. - For comment, "Assignments - Maker's Defenses Cut Off - Uniform Commercial Code § 9-206," see 5 Nat. Resources J. 408 (1965).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Assignments § 103; 68A Am. Jur. 2d Secured Transactions §§ 122, 538 et seq.

Conditional buyer's right to maintain action for conversion and damages recoverable as affected by defendant's recognition of conditional seller's title or rights, 116 A.L.R. 904.

Rights of parties to conditional sale as affected by breach of warranty, 130 A.L.R. 753.

Warranty of title by seller, 132 A.L.R. 338.

Construction and application of provision in conditional sale contract regarding implied warranties, 139 A.L.R. 1276.

Constitutionality, construction and application of statute respecting sale, assignment or transfer of retail installment contracts, 10 A.L.R.2d 447.

Estoppel of obligor to assert against transferee of conditional sales contract, installment improvement or repair contract or related commercial paper, defenses or equities available against transferor, 44 A.L.R.2d 196.

Validity, in contract for installment sale of consumer goods, or commercial paper given in connection therewith, of provision waiving, as against assignee, defenses good against seller, 39 A.L.R.3d 518.

77A C.J.S. Sales § 236 et seq.

55-9-207. Rights and duties when collateral is in secured party's possession.

(1) A secured party must use reasonable care in the custody and preservation of collateral in his possession. In the case of an instrument or chattel paper reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(2) Unless otherwise agreed, when collateral is in the secured party's possession:

(a) reasonable expenses (including the cost of any insurance and payment of taxes or other charges) incurred in the custody, preservation, use or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(b) the risk of accidental loss or damage is on the debtor to the extent of any deficiency in any effective insurance coverage;

(c) the secured party may hold as additional security any increase or profits (except money) received from the collateral, but money so received, unless remitted to the debtor, shall be applied in reduction of the secured obligation;

(d) the secured party must keep the collateral identifiable but fungible collateral may be commingled;

(e) the secured party may repledge the collateral upon terms which do not impair the debtor's right to redeem it.

(3) A secured party is liable for any loss caused by his failure to meet any obligation imposed by the preceding subsections but does not lose his security interest.

(4) A secured party may use or operate the collateral for the purpose of preserving the collateral or its value or pursuant to the order of a court of appropriate jurisdiction or, except in the case of consumer goods, in the manner and to the extent provided in the security agreement.

History: 1953 Comp., § 50A-9-207, enacted by Laws 1961, ch. 96, § 9-207.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) states the duty to preserve collateral imposed on a pledge at common law. See Restatement of Security, §§ 17, 18. In many cases a secured party having collateral in his possession may satisfy this duty by notifying the debtor of any act which must be taken and allowing the debtor to perform such act himself. If the secured party himself takes action, his reasonable expenses may be added to the secured obligation.

Under Section 1-102(3) the duty to exercise reasonable care may not be disclaimed by agreement, although under that section the parties remain free to determine by agreement, in any manner not manifestly unreasonable, what shall constitute reasonable care in a particular case.

2. Subsection (2) states rules, which follow common law precedents, and which apply, unless there is agreement otherwise, in typical situations during the period while the secured party is in possession of the collateral.

3. The right of a secured party holding instruments or documents to have them indorsed or transferred to him or his order is dealt with in the relevant sections of Articles 3 (Commercial Paper), 7 (Warehouse Receipts, Bills of Lading and Other Documents) and 8 (Investment Securities). (Sections 3-201, 7-506 and 8-307.)

4. This section applies when the secured party has possession of the collateral before default, as a pledgee, and also when he has taken possession of the collateral after default. See Section 9-501(1) and (2). Subsection (4) permits operation of the collateral in the circumstances stated, and Subsection (2) (a) authorizes payment of or provision for expenses of such operation. Agreements providing for such operation are common in trust indentures securing corporate bonds and are particularly important when the collateral is a going business. Such an agreement cannot of course disclaim the duty of care established by Subsection (1), nor can it waive or modify the rights of the debtor contrary to Section 9-501(3).

Cross references. - Point 1: Section 1-102(3).

Point 3: Sections 3-201, 7-506 and 8-307.

Point 4: Section 9-501(2) and Part 5.

Definitional cross references. - "Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Instrument". Section 9-105.

"Money". Section 1-201.

"Party". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

Proof of claim of loss. - In order to establish a right to claim any loss under this section, a debtor must show: (1) that he suffered a loss; and (2) that he was willing and able to make a tender, thereby regaining a possessory interest in the collateral. Cordova v. Lee Galles Oldsmobile, Inc., 100 N.M. 204, 668 P.2d 320 (Ct. App. 1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 11 Am. Jur. 2d Bills and Notes § 939; 68A Am. Jur. 2d Secured Transactions § 538 et seq.

Effect of repledge by one who at time holds property under tentative agreement for pledge which is subsequently consummated, 24 A.L.R. 433.

Right of pledgee to allowance for expenses in connection with pledge, 40 A.L.R. 258.

Junior chattel mortgagee's liability to senior chattel mortgagee for conversion, 43 A.L.R. 388.

Personal liability of mortgagor as affected by chattel mortgagee's failure to pursue proper course after taking possession, 47 A.L.R. 582.

Sale of mortgaged chattels for unduly low price as conversion, 73 A.L.R. 839.

Duty of stockbroker, in performance of obligation to deliver, security of stock or other security, to tender identical certificate or security, 75 A.L.R. 746.

Extinguishment of pledgor's entire indebtedness to pledgee by conversion by pledgee of subject of pledge, 87 A.L.R. 586.

Interest on damages for pledgee's refusal to return pledge property, 96 A.L.R. 18, 36 A.L.R.2d 337.

Bailee's express agreement to return property, or to return it in specified condition, as enlarging his common-law liability; where property is pledged or given as security, 150 A.L.R. 269.

Purchase by pledgee as subject of pledge, 37 A.L.R.2d 1381.

Punitive or exemplary damages for conversion of personalty by one other than chattel mortgagee or conditional seller, 54 A.L.R.2d 1361.

Liability of pawnbroker or pledgee for theft by third person of pawned or pledged property, 68 A.L.R.2d 1259.

Secured party's duty under UCC § 9-207(2)(c) to reduce secured obligation by increase or profits received from collateral, 45 A.L.R.4th 394.

72 C.J.S. Pledges § 25 et seq.; 79 C.J.S. Secured Transactions § 111 et seq.

55-9-208. Request for statement of account or list of collateral.

(1) A debtor may sign a statement indicating what he believes to be the aggregate amount of unpaid indebtedness as of a specified date and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor. When the security agreement or any other record kept by the secured party identifies the collateral a debtor may similarly request the secured party to approve or correct a list of the collateral.

(2) The secured party must comply with such a request within two weeks after receipt by sending a written correction or approval. If the secured party claims a security interest in all of a particular type of collateral owned by the debtor he may indicate that fact in his reply and need not approve or correct an itemized list of such collateral. If the secured party without reasonable excuse fails to comply he is liable for any loss caused to the debtor thereby; and if the debtor has properly included in his request a good faith statement of the obligation or a list of the collateral or both the secured party may claim a security interest only as shown in the statement against persons misled by his failure to comply. If he no longer has an interest in the obligation or collateral at the time the request is received he must disclose the name and address of any successor in interest known to him and he is liable for any loss caused to the debtor as a result of failure to disclose. A successor in interest is not subject to this section until a request is received by him.

(3) A debtor is entitled to such a statement once every six months without charge. The secured party may require payment of a charge not exceeding $10 for each additional statement furnished.

History: 1953 Comp., § 50A-9-208, enacted by Laws 1961, ch. 96, § 9-208.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To provide a procedure whereby a debtor may obtain from the secured party a statement of the amount due on the obligation and in some cases a statement of the collateral.

2. The financing statement required to be filed under this article (see Section 9-402) may disclose only that a secured party may have a security interest in specified types of collateral owned by the debtor. Unless a copy of the security agreement itself is filed as the financing statement third parties are told neither the amount of the obligation secured nor which particular assets are covered. Since subsequent creditors and purchasers may legitimately need more detailed information, it is necessary to provide a procedure under which the secured party will be required to make disclosure. On the other hand, the secured party should not be under a duty to disclose details of business operations to any casual inquirer or competitor who asks for them. This section gives the right to demand disclosure only to the debtor, who will typically request a statement in connection with negotiations with subsequent creditors and purchasers, or for the purpose of establishing his credit standing and proving which of his assets are free of the security interest. The secured party is further protected against onerous requests by the provisions that he need furnish a statement of collateral only when his own records identify the collateral and that if he claims all of a particular type of collateral owned by the debtor he is not required to approve an itemized list.

Cross reference. - Point 2: Section 9-402.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Good faith". Section 1-201.

"Know". Section 1-201.

"Person". Section 1-201.

"Receive". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Written". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 547 et seq.

72 C.J.S. Pledges §§ 20, 22, 36; 79 C.J.S. Secured Transactions § 111 et seq.

PART 3
RIGHTS OF THIRD PARTIES; PERFECTED AND UNPERFECTED SECURITY INTERESTS; RULES OF PRIORITY

55-9-301. Persons who take priority over unperfected security interests; right of "lien creditor".

(1) Except as otherwise provided in Subsection (2) of this section, an unperfected security interest is subordinate to the rights of:

(a) persons entitled to priority under Section 55-9-312 NMSA 1978;

(b) a person who becomes a lien creditor before the security interest is perfected;

(c) in the case of goods, instruments, documents and chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected; and

(d) in the case of accounts, general intangibles and investment property, a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.

(2) If the secured party files with respect to a purchase money security interest before or within twenty days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment.

(4) A person who becomes a lien creditor while a security interest is perfected takes subject to the security interest only to the extent that it secures advances made before he becomes a lien creditor or within forty-five days thereafter or made without

knowledge of the lien or pursuant to a commitment entered into without knowledge of the lien.

History: 1953 Comp., § 8-50A-301, enacted by Laws 1961, ch. 96, § 9-301; 1985, ch. 193, § 16; 1989, ch. 64, § 1; 1996, ch. 47, § 62.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 8(2) and 9(2) (b), Uniform Trust Receipts Act; Section 5, Uniform Conditional Sales Act.

Purposes. - 1. This section lists the classes of persons who take priority over an unperfected security interest. As in Section 60 of the Federal Bankruptcy Act, the term "perfected" is used to describe a security interest in personal property which cannot be defeated in insolvency proceedings or in general by creditors. A security interest is "perfected" when the secured party has taken whatever steps are necessary to give him such an interest. These steps are explained in the five following sections (9-302 through 9-306).

2. Section 9-312 states general rules for the determination of priorities among conflicting security interests and in addition refers to other sections which state special rules of priority in a variety of situations. The interests given priority under Section 9-312 and the other sections therein cited take such priority in general even over a perfected security interest. *A fortiori* they take priority over an unperfected security interest, and Paragraph (1) (a) of this section so states.

3. Paragraph (1) (b) provides that an unperfected security interest is subordinate to the rights of lien creditors. The section rejects the rule applied in many jurisdictions in pre-code law that an unperfected security interest is subordinated to all creditors, but requires the lien obtained by legal proceedings to attach to the collateral before the security interest is perfected. The section subordinates the unperfected security interest but does not subordinate the secured debt to the lien.

4. Paragraphs (1) (c) and (1) (d) deal with purchasers (other than secured parties) of collateral who would take subject to a perfected security interest but who are by these subsections given priority over an unperfected security interest. In the cases of goods and of intangibles of the type whose transfer is effected by physical delivery of the representative piece of paper (instruments, documents and chattel paper) the purchaser who takes priority must both give value and receive delivery of the collateral without knowledge of the existing security interest and before perfection (Paragraph (1) (c)). Thus even if the purchaser gave value without knowledge and before perfection, he would take subject to the security interest if perfection occurred before physical delivery of the collateral to him. The Paragraph (1) (c) rule is obviously not appropriate where the collateral consists of intangibles and there is no representative piece of paper

whose physical delivery is the only or the customary method of transfer. Therefore with respect to such intangibles (accounts and general intangibles), Paragraph (1) (d) gives priority to any transferee who has given value without knowledge and before perfection of the security interest.

The term "buyer in ordinary course of business" referred to in Paragraph (1) (c) is defined in Section 1-201(9).

Other secured parties are excluded from Paragraphs (1) (c) and (1) (d) because their priorities are covered in Section 9-312 (see point 2 of this comment).

5. Except to the extent provided in Subsection (2), this article does not permit a secured party to file or take possession after another interest has received priority under Subsection (1) and thereby protect himself against the intervening interest.

A few chattel mortgage statutes did have grace periods, i.e., a filing within x days after the mortgage was given related back to the day the mortgage was given. The Uniform Conditional Sales Act had a ten-day period which cut off all intervening interests. The Uniform Trust Receipts Act had a thirty-day period but did not cut off the interest of a purchaser who took delivery before the filing.

Subsection (2) gives a grace period for perfection by filing as to purchase money security interests only (that term is defined in Section 9-107). The grace period runs for ten [now twenty] days after the debtor receives possession of the collateral but operates to cut off only the interests of intervening lien creditors or bulk purchasers.

6. Subsection (3) defines "lien creditor", following in substance the provisions of the Uniform Trust Receipts Act.

7. Subsection (4) deals with the question whether advances under an existing security interest in collateral, made after rights of lien creditors have attached to that collateral, will take precedence over rights of lien creditors. See related problems in Sections 9-307(3) and 9-312(7). In this section, because of the impact of the rule chosen on the question whether the security interest for future advances is "protected" under Sections 6323(c) (2) and (d) of the Internal Revenue Code as amended by the Federal Tax Lien Act of 1966, the priority of the security interest for future advances over a judgment lien is made absolute for 45 days regardless of knowledge of the secured party concerning the judgment lien. If, however, the advance is made after the 45 days, the advance will not have priority unless it was made or committed without knowledge of the lien obtained by legal proceedings. The importance of the rule chosen for actual conflicts between secured parties making subsequent advances and judgment lien creditors may not be great; but the rule chosen for the first 45 days is important in effectuating the intent of the Federal Tax Lien Act of 1966.

Cross references. - Section 9-312.

Point 1: Sections 9-302 to 9-306.

Point 7: Sections 9-204, 9-307(3) and 9-312(7).

Definitional cross references. - "Account". Section 9-106.

"Buyer in ordinary course of business". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Document". Section 9-105.

"General intangibles". Section 9-106.

"Goods". Section 9-105.

"Instrument". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Purchase money security interest". Section 9-107.

"Pursuant to commitment". Section 9-105.

"Representative". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

The 1989 amendment, effective June 16, 1989, made minor stylistic changes in Subsections (1) and (4), and substituted "twenty days" for "ten days" in Subsection (2).

The 1996 amendment, in Subsection (1)(d), inserted "and investment property" following "general intangibles" and made a minor stylistic change. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

For note, "Commercial Law - And Then Personal Property Became Real Property: In re Anthony," see 23 N.M.L. Rev. 263 (1993).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 288 et seq.

Constructive notice by record, 63 A.L.R. 1456.

Conditional sale contract as affected by seller's acceptance of a chattel mortgage from the buyer covering the same property, priorities, 95 A.L.R. 350.

Chattel mortgagee's consent to sale of mortgaged property as waiver of lien, 97 A.L.R. 646.

Constitutionality, construction and application of statute respecting sale, assignment or transfer of retail installment contracts, 10 A.L.R.2d 447.

Coverage of "nonrecording" or "nonfiling" insurance against loss from failure to record chattel mortgage, conditional sale or other security instrument, 51 A.L.R.2d 325.

Priority, as between holder of unfiled or unrecorded chattel mortgage who secures possession of goods or chattels, and subsequent purchaser or encumbrancer, 53 A.L.R.2d 936.

Priority as between mechanic's lien and purchase money mortgage, 73 A.L.R.2d 1407.

Priority as between seller or conditional seller of personalty and claimant under after-acquired property clause of mortgage or other instrument, 86 A.L.R.2d 1152.

Priority between attorney's lien for fees against a judgment and lien of creditor against same judgment, 34 A.L.R.4th 665.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

Equitable estoppel of secured party's right to assert prior, perfected security interest against other secured creditor or subsequent purchaser under Article 9 of Uniform Commercial Code, 9 A.L.R.5th 708.

72 C.J.S. Pledges § 23; 79 C.J.S. Secured Transactions § 88 et seq.

55-9-302. When filing is required to perfect security interest; security interests to which filing provisions of this article do not apply.

(1) A financing statement must be filed to perfect all security interests except the following:

(a) a security interest in collateral in possession of the secured party under Section 55-9-305 NMSA 1978;

(b) a security interest temporarily perfected in instruments, certificated securities or documents without delivery under Section 55-9-304 NMSA 1978 or in proceeds for a ten-day period under Section 55-9-306 NMSA 1978;

(c) a security interest created by an assignment of a beneficial interest in a trust or a decedent's estate;

(d) a purchase money security interest in consumer goods; but filing is required for a motor vehicle required to be registered; and fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 55-9-313 NMSA 1978;

(e) an assignment of accounts that does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor;

(f) a security interest of a collecting bank (Section 55-4-210 NMSA 1978) or arising under the article on sales (Article 2) [Chapter 55, Article 2 NMSA 1978] or the article on leases (Article 2A) [Chapter 55, Article 2A NMSA 1978] (see Section 55-9-113 NMSA 1978) or covered in Subsection (3) of this section;

(g) an assignment for the benefit of all the creditors of the transferor and subsequent transfers by the assignee thereunder; or

(h) a security interest in personal property which is perfected without filing under Section 55-9-515 [55-9-115 NMSA 1978] or 55-9-116 NMSA 1978.

(2) If a secured party assigns a perfected security interest, no filing under this article is required in order to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(3) The filing of a financing statement otherwise required by Chapter 55, Article 9 NMSA 1978 is not necessary or effective to perfect a security interest in property subject to:

(a) a statute or treaty of the United States that provides for a national or international registration or a national or international certificate of title or that specifies a place of filing different from that specified in this article for filing of the security interest;

(b) the following statutes of this state: Sections 66-3-201 through 66-3-204 of the Motor Vehicle Code [Chapter 66, Articles 1 to 8 NMSA 1978] and any other certificate of title statute covering automobiles, trailers, mobile homes, boats, farm tractors or the like; but during any period in which collateral is inventory held for sale by a person who is in the business of selling goods of that kind, the filing provisions of Chapter 55, Article 9 NMSA 1978 apply to a security interest in that collateral created by him as debtor; or

(c) a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection (Subsection (2) of Section 55-9-103 NMSA 1978).

(4) Compliance with a statute or treaty described in Subsection (3) of this section is equivalent to the filing of a financing statement under Chapter 55, Article 9 NMSA 1978, and a security interest in property subject to the statute or treaty can be perfected only by compliance therewith except as provided in Section 55-9-103 NMSA 1978 on multiple state transactions. Duration and renewal of perfection of a security interest perfected by compliance with the statute or treaty are governed by the provisions of the statute or treaty; in other respects the security interest is subject to Chapter 55, Article 9 NMSA 1978.

History: 1953 Comp., § 50A-9-302, enacted by Laws 1961, ch. 96, § 9-302; 1966, ch. 31, § 1; 1967, ch. 300, § 1; 1985, ch. 193, § 17; 1987, ch. 247, § 3; 1987, ch. 248, § 50; 1993, ch. 214, § 7; 1996, ch. 47, § 63.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 5, Uniform Conditional Sales Act; Section 8, Uniform Trust Receipts Act.

Purposes. - 1. Subsection (1) states the general rule that to perfect a security interest under this article a financing statement must be filed. Paragraphs (1) (a) to (1) (g) exempt from the filing requirement the transactions described. Subsection (3) further sets out certain transactions to which the filing provisions of this article do not apply, but

it does not defer to another state statute on the filing of inventory security interests. The cases recognized are those where suitable alternative systems for giving public notice of a security interest are available. Subsection (4) states the consequences of such other form of notice.

Section 9-303 states the time when a security interest is perfected by filing or otherwise. Part 4 of the article deals with the mechanics of filing: place of filing, form of financing statement and so on.

2. As at common law, there is no requirement of filing when the secured party has possession of the collateral in a pledge transaction (Paragraph (1) (a)), Section 9-305 should be consulted on what collateral may be pledged and on the requirements of possession.

3. Under this article, as under the Uniform Trust Receipts Act, filing is not effective to perfect a security interest in instruments. See Section 9-304(1).

4. Where goods subject to a security interest are left in the debtor's possession, the only permanent exception from the general filing requirement is that stated in Paragraph (1) (d): purchase money security interests in consumer goods. For temporary exceptions, see Sections 9-304(5) (a) and 9-306.

In many jurisdictions under prior law security interests in consumer goods under conditional sale or bailment leases were not subject to filing requirements. Paragraph (1) (d) follows the policy of those jurisdictions. The paragraph changes prior law in jurisdictions where all conditional sales and bailment leases were subject to a filing requirement, except that filing is required for purchase money security interests in consumer fixtures to attain priority under Section 9-313 against real estate interests.

Although the security interests described in Paragraph (1) (d) are perfected without filing, Section 9-307(2) provides that unless a financing statement is filed certain buyers may take free of the security interest even though perfected. See that section and the comment thereto.

On filing for security interests in motor vehicles under certificate of title laws see Subsection (3) of this section.

5. A financing statement must be filed to perfect a security interest in accounts except for the transactions described in Paragraphs (1) (e) and (g). It should be noted that this article applies to sales of accounts and chattel paper as well as to transfers thereof for security (Section 9-102(1) (b)); the filing requirement of this section applies both to sales and to transfers thereof for security. In this respect this article follows many of the pre-code statutes regulating assignments of accounts receivable.

Over forty jurisdictions had enacted accounts receivable statutes. About half of these statutes required filing to protect or perfect assignments; of the remainder, one was a

so-called "book-marking" statute and the others validated assignments without filing. This article adopts the filing requirement, on the theory that there is no valid reason why public notice is less appropriate for assignments of accounts than for any other type of nonpossessory interest. Section 9-305, furthermore, excludes accounts from the types of collateral which may be the subject of a possessory security interest: filing is thus the only means of perfection contemplated by this article. See Section 9-306 on accounts as proceeds.

The purpose of the Subsection (1) (e) exemption is to save from *ex post facto* invalidation casual or isolated assignments: some accounts receivable statutes were so broadly drafted that all assignments, whatever their character or purpose, fell within their filing provisions. Under such statutes many assignments which no one would think of filing might have been subject to invalidation. The Paragraph (1) (e) exemption goes to that type of assignment. Any person who regularly takes assignments of any debtor's accounts should file. In this connection Section 9-104 (f) which excludes certain transfers of accounts from the article should be consulted.

Assignments of interests in trusts and estates are not required to be filed because they are often not thought of as collateral comparable to the types dealt with by this article. Assignments for the benefit of creditors are not required to be filed because they are not financing transactions and the debtor will not ordinarily be engaging in further credit transactions.

6. With respect to the Paragraph (1) (f) exemptions, see the sections cited therein and comments thereto.

7. The following example will explain the operation of Subsection (2): Buyer buys goods from seller who retains a security interest in them which he perfects. Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on his part, continues perfected against *Buyer's* transferees and creditors. If, however, the assignment from Seller to X was itself intended for security (or was a sale of accounts or chattel paper), X must take whatever steps may be required for perfection in order to be protected against *Seller's* transferees and creditors.

8. Subsection (3) exempts from the filing provisions of this article transactions as to which an adequate system of filing, state or federal, has been set up outside this article and Subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i.e., filing under this article is not a permissible alternative).

Examples of the type of federal statute referred to in Paragraph (3) (a) are the provisions of 17 U.S.C. §§ 28, 30 (copyrights), 49 U.S.C. § 1403 (aircraft), 49 U.S.C. § 20(c) (railroads). The Assignment of Claims Act of 1940, as amended, provides for notice to contracting and disbursing officers and to sureties on bonds but does not establish a national filing system and therefore is not within the scope of Paragraph (3) (a). An assignee of a claim against the United States, who must of course comply with

the Assignment of Claims Act, must also file under this article in order to perfect his security interest against creditors and transferees of his assignor.

Some states have enacted central filing statutes with respect to security transactions in kinds of property which are of special importance in the local economy. Subsection (3) adopts such statutes as the appropriate filing system for such property.

In addition to such central filing statutes many states have enacted certificate of title laws covering motor vehicles and the like. Subsection (3) exempts transactions covered by such laws from the filing requirements of this article.

For a discussion of the operation of state motor vehicle certificate of title laws in interstate contexts, see Comment 4 to Section 9-103.

9. Perfection of a security interest under a state or federal statute of the type referred to in Subsection (3) has all the consequences of perfection under the provisions of this article, Subsection (4).

Cross references. - Point 1: Section 9-303 and Part 4.

Point 2: Section 9-305.

Point 3: Section 9-304(1).

Point 4: Section 9-307(2).

Point 5: Sections 9-102(1) (b), 9-104(f) and 9-305.

Point 6: Sections 4-208 and 9-113.

Definitional cross references. - "Account". Section 9-106.

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Delivery". Section 1-201.

"Document". Section 9-105.

"Equipment". Section 9-109.

"Fixture". Section 9-313.

"Fixture filing". Section 9-313.

"Instrument". Section 9-105.

"Inventory". Section 9-109.

"Proceeds". Section 9-306.

"Purchase". Section 1-201.

"Purchase money security interest". Section 9-107.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

I. General Consideration.
II. Motor Vehicles.

I. GENERAL CONSIDERATION.

Bracketed material. - The bracketed reference in Subsection (1)(h) was inserted by the compiler, since there is no 55-9-515 NMSA 1978. The bracketed material was not enacted by the legislature and is not part of the law.

The 1987 amendment. - Laws 1987, ch. 247, § 3, effective July 1, 1987, inserting "or boat" in Subsection (1)(d) and making minor stylistic changes including the substitution of NMSA citations for UCC citations throughout the section, was approved on April 9, 1987. However, Laws 1987, ch. 248, § 50, effective June 19, 1987, inserting "or in securities (Section 55-8-321 NMSA 1978)" in Subsection (1)(f) and making minor stylistic changes throughout the section, was approved later on April 9, 1987. The section is set out as amended by Laws 1987, ch. 248, § 50. See 12-1-8 NMSA 1978.

The 1993 amendment, effective July 1, 1993, made a stylistic change in Paragraph (e) and in Paragraph (f), substituted "(Section 55-4-210 NMSA 1978)" for "(Section 55-4-208 NMSA 1978)" and inserted "(Article 2) or the article on leases (Article 2A)"; and made stylistic changes in Subsection (3)(a).

The 1996 amendment inserted "certificated securities" preceding "or documents" in Subsection (1)(b), deleted "or in securitites (Section 55-8-321 NMSA 1978)" preceding "or arising" in Subsection (1)(f), added Subsection (1)(h), and made a minor stylistic change in Subsection (3). Laws 1996, ch. 47 contains no effective date provision, but,

pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Compiler's note. - The uniform law, in Subsection (1)(h), contains the language "investment property" instead of "personal property", and contains a reference to Section 9-115 instead of a reference to 9-515.

Purpose to inform others of lien on property. - Generally, to have constructive notice in regard to personalty or realty, it is essential that the persons against whom such notice is operative, had they wished to have inquired, could readily have learned that another possessed a lien on the property of interest. Reconstruction Fin. Corp. v. Stephens, 118 F. Supp. 565 (D.N.M. 1954) (decided under former law).

Effect of failure to record. - Failure to acknowledge and record conditional sales contract renders it void as to subsequent mortgagees in good faith and purchasers for value without notice. Loomis Mach. Co. v. Proctor, 41 N.M. 519, 71 P.2d 1029 (1936) (decided under former law).

Assignment need not be recorded. - Chapter 74 of Laws 1917, requiring recordation of conditional sales contracts, did not provide for recordation of assignment of such contract. Beebe v. Fouse, 27 N.M. 194, 199 P. 364 (1921) (decided under former law).

Sufficiency of description. - The description "contract rights arising from the sale or other disposition of dairy products" was sufficient to put a third party on inquiry notice about a prior encumbrance on a property interest in capital retains arising from the sale of dairy products. Valley Fed. Sav. Bank v. Stahl, 110 N.M. 169, 793 P.2d 851 (1990).

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 35 Am. Jur. 2d Fixtures § 72; 68A Am. Jur. 2d Secured Transactions § 288 et seq.

Creditor levying upon subject of unfiled conditional sales contract under prior judgment, 55 A.L.R. 1137.

Right of receiver of conditional vendee to avail himself of defects in filing contract, 61 A.L.R. 975.

Refiling when goods are removed from district where contract is filed, 68 A.L.R. 554.

Trust receipts as conditional sale within filing statute, 168 A.L.R. 379.

Registration of mortgages or other liens on personal property in case of residents of other states, 10 A.L.R.2d 764.

Necessity that mortgage covering oil and gas lease be recorded as real estate mortgage, and/or filed or recorded as chattel mortgage, 34 A.L.R.2d 902.

Relative rights as between assignee of conditional seller and a subsequent buyer from the conditional seller after repossession or the like, 72 A.L.R.2d 342.

Construction and effect of UCC article 9, dealing with secured transactions, etc., 30 A.L.R.3d 9, 67 A.L.R.3d 308, 69 A.L.R.3d 1162, 76 A.L.R.3d 11, 99 A.L.R. 3d 807, 99 A.L.R.3d 1080, 100 A.L.R.3d 10, 100 A.L.R.3d 940, 7 A.L.R.4th 308, 11 A.L.R.4th 241, 90 A.L.R.4th 859, 25 A.L.R.5th 696.

6A C.J.S. Assignments § 91; 72 C.J.S. Pledges § 23; 79 C.J.S. Secured Transactions § 34 et seq.

II. MOTOR VEHICLES.

When filing not necessary to perfect security interest. - Under the wording of this section, it is not necessary to file a financing statement pursuant to the code in order to perfect a security interest in a motor vehicle required to be registered and having a certificate of title issued by this state. 1961-62 Op. Att'y Gen. No. 62-30.

55-9-303. When security interest is perfected; continuity of perfection.

(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302 [55-9-302 NMSA 1978], 9-304 [55-9-304 NMSA 1978], 9-305 [55-9-305 NMSA 1978] and 9-306 [55-9-306 NMSA 1978]. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

(2) If a security interest is originally perfected in any way permitted under this article and is subsequently perfected in some other way under this article, without an intermediate period when it was unperfected, the security interest shall be deemed to be perfected continuously for the purposes of this article.

History: 1953 Comp., § 50A-9-303, enacted by Laws 1961, ch. 96, § 9-303.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The term "attach" is used in this article to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in Section 9-203. When it attaches a security interest may be either perfected or unperfected: "Perfected" means that the secured party has taken all the steps required by this article as specified in the several sections listed in Subsection (1). A perfected security interest may still be or become subordinate to other interests (see Section 9-312) but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor. Subsection (1) states the truism that the time of perfection is when the security interest has attached and any necessary steps for perfection (such as taking possession or filing) have been taken. If the steps for perfection have been taken in advance (as when the secured party files a financing statement before giving value or before the debtor acquires rights in the collateral), then the interest is perfected automatically when it attaches.

2. The following example will illustrate the operation of Subsection (2): A bank which has issued a letter of credit honors drafts drawn under the credit and receives possession of the negotiable bill of lading covering the goods shipped. Under Sections 9-304(2) and 9-305 the bank now has a perfected security interest in the document and the goods. The bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them. Under Section 9-304(5) the bank continues to have a perfected security interest in the document and goods for 21 days. The bank files before the expiration of the 21 day period. Its security interest now continues perfected for as long as the filing is good. The goods are sold by the debtor. The bank continues to have a security interest in the proceeds of the sale to the extent stated in Section 9-306.

If the successive stages of the bank's security interest succeed each other without an intervening gap, the security interest is "continuously perfected" and the date of perfection is when the interest first became perfected (i. e., in the example given, when the bank received possession of the bill of lading against honor of the drafts). If, however, there is a gap between stages - for example, if the bank does not file until after the expiration of the 21-day period specified in Section 9-304(5), the collateral still being in the debtor's possession - then, the chain being broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of the 21-day period); the bank's interest might now become subject to attack under Section 60 of the Federal Bankruptcy Act and would be subject to any interests arising during the gap period which under Section 9-301 take priority over an unperfected security interest.

The rule of Subsection (2) would also apply to the case of collateral brought into this state subject to a security interest which became perfected in another state or jurisdiction. See Section 9-103(1) (d).

Cross references. - Sections 9-302, 9-304, 9-305 and 9-306.

Point 1: Sections 9-204 and 9-312.

Point 2: Sections 9-103(1) (d) and 9-301.

Definitional cross references. - "Attach". Section 9-203.

"Security interest". Section 1-201.

Steps required for perfection may be taken in any order. - If a financing statement is filed, value is extended, and a security agreement is executed, then there is a security interest in the described collateral. These steps can be taken in any order and priority is given to the security interest which is filed first, even if that security interest has not attached at the time of filing. Waterfield v. Burnett, 21 Bankr. 752 (Bankr. D.N.M. 1982).

Attachment and perfection upon delivery of goods to debtor. - Since vendor from whom business owner purchased inventory provided delivery of the items in its own trucks and at its own risk, and all sales were for cash on delivery, business owner acquired rights in the collateral when it was delivered, and the bank's security interest in his inventory "now owned or hereafter acquired" attached at that point and was perfected. National Inv. Trust v. First Nat'l Bank, 88 N.M. 514, 543 P.2d 482 (1975).

Law reviews. - For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 288 et seq.

6A C.J.S. Assignments § 91; 72 C.J.S. Pledges § 22; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-304. Perfection of security interest in instruments, documents, proceeds of a written letter of credit and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit may be perfected by the secured party's taking possession of the letter of credit. A security interest in money or instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in Subsections (4) and (5) of this section and Subsections (2) and (3) of Section 55-9-306 NMSA 1978 on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in the goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments, certificated securities or negotiable documents is perfected without filing or the taking of possession for a period of twenty-one days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of twenty-one days without filing where a secured party having a perfected security interest in an instrument, a certificated security, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor:

(a) makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transhipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange, but priority between conflicting security interests in the goods is subject to Subsection (3) of Section 55-9-312 NMSA 1978; or

(b) delivers the instrument or certificated security to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the twenty-one-day period in Subsections (4) and (5) of this section, perfection depends upon compliance with applicable provisions of Chapter 55, Article 9 NMSA 1978.

History: 1953 Comp., § 50A-9-304, enacted by Laws 1961, ch. 96, § 9-304; 1985, ch. 193, § 18; 1987, ch. 248, § 51; 1996, ch. 47, § 64; 1997, ch. 75, § 24.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 3 and 8(1), Uniform Trust Receipts Act.

Purposes. - 1. For most types of property, filing and taking possession are alternative methods of perfection. For some types of intangibles (i. e., accounts and general intangibles) filing is the only available method (see Section 9-305 and Point 1 of comment thereto). With respect to instruments Subsection (1) provides that, except for the cases of "temporary perfection" covered in Subsections (4) and (5), taking possession is the only available method; this provision follows the Uniform Trust Receipts Act. The rule is based on the thought that where the collateral consists of instruments, it is universal practice for the secured party to take possession of them in pledge; any surrender of possession to the debtor is for a short time; therefore it would be unwise to provide the alternative of perfection for a long period by filing which, since it in no way corresponds with commercial practice, would serve no useful purpose.

For similar reasons, filing is not permitted as to money.

Subsection (1) further provides that filing is available as a method of perfection for security interests in chattel paper and negotiable documents, which also come within Section 9-305 on perfection by possession. Chattel paper is sometimes delivered to the assignee, sometimes left in the hands of the assignor for collection; Subsection (1) allows the assignee to perfect his interest by filing in the latter case. Negotiable documents may be, and usually are, delivered to the secured party; Subsection (1) follows the Uniform Trust Receipts Act in allowing filing as an alternative method of perfection. Perfection of an interest in goods through a nonnegotiable document is covered in Subsection (3).

2. Subsection (2), following prior law and consistently with the provisions of Article 7, takes the position that, so long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document and the proper way of dealing with such goods is through the document. Perfection therefore is to be made with respect to the document and, when made, automatically carries over to the goods. Any interest perfected directly in the goods while the document is outstanding (for example, a chattel mortgage type of security interest on goods in a warehouse) is subordinated to an outstanding negotiable document.

3. Subsection (3) takes a different approach to the problem of goods covered by a nonnegotiable document or otherwise in the possession of a bailee who has not issued a negotiable document. Here title to the goods is not looked on as being locked up in the document and the secured party may perfect his interest directly in the goods by filing as to them. The subsection states two other methods of perfection: issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a nonnegotiable warehouse receipt) and

receipt of notification of the secured party's interest by the bailee which, under Section 9-305, is looked on as equivalent to taking possession by the secured party.

4. Subsections (4) and (5) follow the Uniform Trust Receipts Act in giving perfected status to security interests in instruments and documents for a short period although there has been no filing and the collateral is in the debtor's possession. The period of 21 days is chosen to conform to the provisions of Section 60 of the Federal Bankruptcy Act. There are a variety of legitimate reasons - some of them are described in Subsections (5) (a) and (5) (b) - why such collateral has to be temporarily released to a debtor and no useful purpose would be served by cluttering the files with records of such exceedingly short term transactions. Under Subsection (4) the 21 day perfection runs from the date of attachment; there is no limitation on the purpose for which the debtor is in possession but the secured party must have given new value under a written security agreement. Under Subsection (5) the 21 day perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor (an example is a bank which has acquired a bill of lading by honoring drafts drawn under a letter of credit and subsequently turns over the bill of lading to its customer); there is no new value requirement but the turnover must be for one or more of the purposes stated in Subsections (5) (a) and (5) (b). Note that while Subsection (4) is restricted to instruments and *negotiable* documents, Subsection (5) extends to goods covered by nonnegotiable documents as well. Thus the letter of credit bank referred to in the example could make a subsection (5) turnover without regard to the form of the bill of lading, provided that, in the case of a nonnegotiable document, it had previously perfected its interest under one of the methods stated in Subsection (3). But note that the discussion of Subsection (5) in this comment deals only with perfection. Priority of a security interest in inventory after surrender of the document depends on compliance with the requirements of Section 9-312(3) on notice to prior inventory financer.

Finally, it should be noted that the 21 days applies only to the documents and to the goods obtained by surrender thereof. If the goods are sold, the security interest will continue in proceeds for only 10 days under Section 9-306, unless a further perfection occurs as to the security interest in proceeds.

Cross references. - Article 7 and Sections 9-303, 9-305 and 9-312(3).

Definitional cross references. - "Chattel paper". Section 9-105.

"Debtor". Section 9-105.

"Document". Section 9-105.

"Goods". Section 9-105.

"Instrument". Section 9-105.

"Receives" notification. Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Written". Section 1-201.

The 1987 amendment, effective June 19, 1987, inserted "certificated securities or" in the second sentence of Subsection (1), inserted "(other than certificated securities)" in Subsection (4), inserted "(other than a certificated security)" in Subsection (5), and made minor stylistic changes throughout the section.

The 1996 amendment deleted "certificated securities or" preceding "instruments which" in the second sentence of Subsection (1), substituted "certificated securities" for "other than certificated securities" in Subsection (4), substituted "a certificated security" for "other than a certificated security" in Subsection (5), and inserted "or certificated security" in Subsection (5)(b). Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

The 1997 amendment, effective July 1, 1997, inserted "proceeds of a written letter of credit" preceding "and goods covered by documents" in the section heading and added the second sentence in Subsection (1).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 107; 68A Am. Jur. 2d Secured Transactions § 470 et seq.

Trust receipts, 101 A.L.R. 453, 168 A.L.R. 359.

Liability of secured creditor under Uniform Commercial Code to third party on ground of unjust enrichment, 27 A.L.R.5th 719.

6A C.J.S. Assignments § 91; 72 C.J.S. Pledges § 22; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-305. When possession by secured party perfects security interest without filing.

A security interest in goods, instruments, money, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. A security interest in the rights to proceeds of a written letter of credit may be perfected by the secured party's taking possession of the letter of credit. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in Chapter 55, Article 9 NMSA 1978. The security interest may be otherwise perfected as provided in that article before or after the period of possession by the secured party.

History: 1953 Comp., § 50A-9-305, enacted by Laws 1961, ch. 96, § 9-305; 1985, ch. 193, § 19; 1987, ch. 248, § 52; 1996, ch. 47, § 65; 1997, ch. 75, § 25.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare Section 9-302(1)(a) [55-9-302 NMSA 1978]. This section permits a security interest to be perfected by transfer of possession only when the collateral is goods, rights to proceeds of letters of credit (if written), instruments, documents or chattel paper: that is to say, accounts and general intangibles are excluded. As to perfection of security interests in certificated securities by possession, see the general rules on perfection of security interests in investment property in Section 9-115(4) [55-9-115 NMSA 1978] and the special rule in Section 9-115(6) dealing with cases where a secured party takes possession of a security certificate in registered form without obtaining an indorsement. A security interest in accounts and general intangiblesproperty not ordinarily represented by any writing whose delivery operates to transfer the claim may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a "pledge". Section 9-302(1)(e) exempts from filing certain assignments of accounts which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under Section 9-303(1) [55-9-303 NMSA 1978]; they do not fall within this section.

2. Possession may be by the secured party himself or by an agent on his behalf: it is of course clear, however, that the debtor or a person controlled by him cannot qualify as such an agent for the secured party. See also the last sentence of Section 9-205 [55-9-205 NMSA 1978]. Where the collateral (except for goods covered by a negotiable document) is held by a bailee, the time of perfection of the security interest, under the second sentence of the section, is when the bailee receives notification of the secured

party's interest: this rule rejects the common law doctrine that it is necessary for the bailee to attorn to the secured party or acknowledge that he now holds on his behalf.

3. The third sentence of the section rejects the "equitable pledge" theory of relation back, under which the taking possession was deemed to relate back to the date of the original security agreement. The relation back theory has had little vitality since the 1938 revision of the Federal Bankruptcy Act, which introduced in Section 60a provisions designed to make such interests voidable as preferences in bankruptcy proceedings. This section now brings state law into conformity with the overriding federal policy: where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected, before that under the rules stated in Section 9-204 [55-9-204 NMSA 1978]. The only exception to this rule is the short twenty-one day period of perfection provided in Section 9-304(4) [55-9-304 NMSA 1978] and (5) during which a debtor may have possession of specified collateral in which there is a perfected security interest.

Cross references. - Sections 5-116, 9-204, 9-302, 9-303 and 9-304 [55-5-116, 55-9-204, 55-9-302, 55-9-303 and 55-9-304 NMSA 1978].

Definitional cross references. - "Chattel paper". Section 9-105 [55-9-105 NMSA 1978].

"Collateral". Section 9-105.

"Documents". Section 9-105.

"Goods". Section 9-105.

"Instruments". Section 9-105.

"Receives" notification. Section 1-201 [55-1-201 NMSA 1978].

"Secured party". Section 9-105.

"Security interest". Section 1-201.

The 1987 amendment, effective June 19, 1987, inserted "(other than certificated securities)" in the first sentence and made minor stylistic changes throughout the section.

The 1996 amendment deleted "other than certificated securities" following "instruments" in the first sentence. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

The 1997 amendment, effective July 1, 1997, deleted "letters of credit and advices of credit (Paragraph (a) of Subsection (2) of Section 55-5-116 NMSA 1978)" following "A security interest in" in the first sentence and added the second sentence.

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 107; 68A Am. Jur. 2d Secured Transactions § 437 et seq.

Priority, as between holder of unfiled or unrecorded chattel mortgage who secures possession of goods or chattels, and subsequent purchaser or encumbrancer, 53 A.L.R.2d 936.

6A C.J.S. Assignments § 91; 72 C.J.S. Pledges § 22; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-306. "Proceeds"; secured party's rights on disposition of collateral.

(1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds. Money, checks, deposit accounts and the like are "cash proceeds". All other proceeds are "non-cash proceeds".

(2) Except where Chapter 55, Article 9 NMSA 1978 otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise and also continues in any identifiable proceeds, including collections, received by the debtor.

(3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected, but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor unless:

(a) a filed financing statement covers the original collateral and the proceeds are collateral in which a security interest may be perfected by filing in the office or offices where the financing statement has been filed and, if the proceeds are acquired with cash proceeds, the description of collateral in the financing statement indicates the types of property constituting the proceeds;

(b) a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds;

(c) the original collateral was investment property and the proceeds are identifiable cash proceeds; or

(d) the security interest in the proceeds is perfected before the expiration of the ten-day period.

Except as provided in this section, a security interest in proceeds can be perfected only by the methods or under the circumstances permitted in Chapter 55, Article 9 NMSA 1978 for original collateral of the same type.

(4) In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:

(a) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds;

(b) in identifiable cash proceeds in the form of money which is neither commingled with other money nor deposited in a deposit account prior to the insolvency proceedings;

(c) in identifiable cash proceeds in the form of checks and the like which are not deposited in a deposit account prior to the insolvency proceedings; and

(d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this Paragraph (d) is:

(i) subject to any right of set-off; and

(ii) limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under Paragraphs (a) through (c) of this subsection.

(5) If a sale of goods results in an account or chattel paper which is transferred by the seller to a secured party, and if the goods are returned to or are repossessed by the seller or the secured party, the following rules determine priorities:

(a) if the goods were collateral at the time of sale, for an indebtedness of the seller which is still unpaid, the original security interest attaches again to the goods and continues as a perfected security interest if it was perfected at the time when the goods

were sold. If the security interest was originally perfected by a filing which is still effective, nothing further is required to continue the perfected status; in any other case, the secured party must take possession of the returned or repossessed goods or must file;

(b) an unpaid transferee of the chattel paper has a security interest in the goods against the transferor. Such security interest is prior to a security interest asserted under Paragraph (a) of this subsection to the extent that the transferee of the chattel paper was entitled to priority under Section 55-9-308 NMSA 1978;

(c) an unpaid transferee of the account has a security interest in the goods against the transferor. Such security interest is subordinate to a security interest asserted under Paragraph (a) of this subsection; and

(d) a security interest of an unpaid transferee asserted under Paragraph (b) or (c) of this subsection must be perfected for protection against creditors of the transferor and purchasers of the returned or repossessed goods.

History: 1953 Comp., § 50A-9-306, enacted by Laws 1961, ch. 96, § 9-306; 1968, ch. 12, § 2; 1985, ch. 193, § 20; 1996, ch. 47, § 66.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 10, Uniform Trust Receipts Act.

Purposes. - 1. This section states a secured party's right to the proceeds received by a debtor on disposition of collateral and states when his interest in such proceeds is perfected.

It makes clear that insurance proceeds from casualty loss of collateral are proceeds within the meaning of this section.

As to the proceeds of consigned goods, see Section 9-114 and the comment thereto.

2. (a) Whether a debtor's sale of collateral was authorized or unauthorized, prior law generally gave the secured party a claim to the proceeds. Sometimes it was said that the security interest attached to the "property" received in substitution; sometimes it was said the debtor held the proceeds as "trustee" or "agent" for the secured party. Whatever the formulation of the rule, the secured party, if he could identify the proceeds, could reclaim them or their equivalent from the debtor or his trustee in bankruptcy. This section provides new rules for insolvency proceedings. Paragraphs 4(a) to (c) substitute specific rules of identification for general principles of tracing. Paragraph 4(d) limits the security interest in proceeds not within these rules to an amount of the debtor's cash and deposit accounts not greater than cash proceeds

received within ten days of insolvency proceedings less the cash proceeds during this period already paid over and less the amounts for which the security interest is recognized under Paragraphs 4(a) to (c).

(b) Subsections (2) and (3) make clear that the four-month period for calculating a voidable preference in bankruptcy begins with the date of the secured party's obtaining the security interest in the original collateral and not with the date of his obtaining control of the proceeds. The interest in the proceeds "continues" as a perfected interest if the original interest was perfected; but the interest ceases to be perfected after the expiration of ten days unless a filed financing statement covered the original collateral and the proceeds are collateral of a type as to which a security interest could be perfected by a filing in the same office or unless the secured party perfects his interest in the proceeds themselves - i.e., by filing a financing statement covering them or by taking possession. See Section 9-312(6) and comment thereto for priority of rights in proceeds perfected by a filing as to original collateral.

(c) Where cash proceeds are covered into the debtor's checking account and paid out in the operation of the debtor's business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. The law of fraudulent conveyances would no doubt in appropriate cases support recovery of proceeds by a secured party from a transferee out of ordinary course or otherwise in collusion with the debtor to defraud the secured party.

3. In most cases when a debtor makes an unauthorized disposition of collateral, the security interest, under prior law and under this article, continues in the original collateral in the hands of the purchaser or other transferee. That is to say, since the transferee takes subject to the security interest, the secured party may repossess the collateral from him or in an appropriate case maintain an action for conversion. Subsection (2) codifies this rule. The secured party may claim both proceeds and collateral, but may of course have only one satisfaction.

In many cases a purchaser or other transferee of collateral will take free of a security interest: in such cases the secured party's only right will be to proceeds. The transferee will take free whenever the disposition was authorized; the authorization may be contained in the security agreement or otherwise given. The right to proceeds, either under the rules of this section or under specific mention thereof in a security agreement or financing statement does not in itself constitute an authorization of sale.

Section 9-301 states when transferees take free of unperfected security interests. Sections 9-307 on goods, 9-308 on chattel paper and instruments and 9-309 on negotiable instruments, negotiable documents and securities state when purchasers of such collateral take free of a security interest even though perfected and even though the disposition was not authorized.

4. Subsection (5) states rules to determine priorities when collateral which has been sold is returned to the debtor: for example goods returned to a department store by a dissatisfied customer. The most typical problems involve sale and return of inventory, but the subsection can also apply to equipment. Under the rule of Benedict v. Ratner, failure to segregate such returned goods sometimes led to invalidation of the entire security arrangement. This article rejects the Benedict v. Ratner line of cases (see Section 9-205 and comment). Subsection (5) (a) of this section reinforces the rule of Section 9-205: as between secured party and debtor (and debtor's trustee in bankruptcy) the original security interest continues on the returned goods. Whether or not the security interest in the returned goods is perfected depends upon factors stated in the text.

Paragraphs (5) (b), (c) and (d) deal with a different aspect of the returned goods situation. Assume that a dealer has sold an automobile and transferred the chattel paper or the account arising on the sale to Bank X (which had not previously financed the car as inventory). Thereafter the buyer of the automobile rightfully rescinds the sale, say for breach of warranty, and the car is returned to the dealer. Paragraph (5) (b) gives the bank as transferee of the chattel paper or the account a security interest in the car against the dealer. For protection against dealer's creditors or purchasers from him (other than buyers in the ordinary course of business, see Section 9-307), Bank X as the transferee, under Paragraph (5) (d), must perfect its interest by taking possession of the car or by filing as to it. Perfection of his original interest in the chattel paper or the account does not automatically carry over to the returned car, as it does under Paragraph (5) (a) where the secured party originally financed the dealer's inventory.

In the situation covered by (5) (b) and (5) (c) a secured party who financed the inventory and a secured party to whom the chattel paper or the account was transferred may both claim the returned goods - the inventory financer under Paragraph (5) (a), the transferee under Paragraphs (5) (b) and (5) (c). With respect to chattel paper, Section 9-308 regulates the priorities. With respect to an account, Paragraph (5) (c) subordinates the security interest of the transferee of the account to that of the inventory financer. However, if the inventory security interest was unperfected, the transferee's interest could become entitled to priority under the rules stated in Section 9-312(5).

In cases of repossession by the dealer and also in cases where the chattel was returned to the dealer by the voluntary act of the account debtor, the dealer's position may be that of a mere custodian; he may be an agent for resale, but without any other obligation to the holder of the chattel paper; he may be obligated to repurchase the chattel, the chattel paper or the account from the secured party or to hold it as collateral for a loan secured by a transferor of the chattel paper or the account.

If the dealer thereafter sells the chattel to a buyer in ordinary course of business in any of the foregoing cases, the buyer is fully protected under Section 2-403(2) as well as under Section 9-307(1), whichever is technically applicable.

Cross references. - Sections 9-307, 9-308 and 9-309.

Point 3: Sections 1-205 and 9-301.

Point 4: Sections 2-403(2), 9-205 and 9-312.

Definitional cross references. - "Account". Section 9-106.

"Bank". Section 1-201.

"Chattel paper". Section 9-105.

"Check". Sections 3-104 and 9-105.

"Collateral". Section 9-105.

"Creditors". Section 1-201.

"Debtor". Section 9-105.

"Deposit account". Section 9-105.

"Goods". Section 9-105.

"Insolvency proceedings". Section 1-201.

"Money". Section 1-201.

"Purchaser". Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

The 1996 amendment added the third sentence of Subsection (1), added Subsection (3)(c) and made related redesignation changes, and made minor stylistic changes throughout the section. Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

I. General Consideration.
II. Continuity of Security Interest in Collateral and Proceeds.

I. GENERAL CONSIDERATION.

Federal law applicable when federal government holds security interest. - Federal law applies instead of state law to determine whether a defendant is liable for conversion of livestock in which the government holds a perfected security interest and whether the government has an interest in the proceeds. A uniform federal rule is essential to protect the security interests of the United States and to prevent such interests from being detrimentally affected through the uncertainty that would arise from the application of disparate state rules. United States v. Bunker Livestock Comm'n, Inc., 437 F. Supp. 1079 (D.N.M. 1977).

Law reviews. - For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 85 et seq., 356.

Validity as to creditors of the buyer or consignee of reservation of title to goods delivered under implied or express authority to resell, 63 A.L.R. 355.

Liability of mortgagor as affected by transaction between chattel mortgagee and purchaser of mortgaged chattel, 93 A.L.R. 1203.

Chattel mortgagee's consent to sale of mortgaged property as waiver of lien, 97 A.L.R. 646.

Personal liability of purchaser of property subject to chattel mortgage, to the mortgagee, 100 A.L.R. 1038.

Rights in proceeds of vehicle collision policy, under "loss-payable" clause, of conditional seller, chattel mortgagee, or the like, of vehicle where there has been improper repossession or foreclosure after damage, 46 A.L.R.2d 992.

Effectiveness of original financing statement under UCC Article 9 after change in debtor's name, identity, or business structure, 99 A.L.R.3d 1194.

Effect of UCC Article 9 upon conflict, as to funds in debtor's bank account, between secured creditor and bank claiming right of setoff, 3 A.L.R.4th 998.

What constitutes secured party's authorization to transfer collateral free of lien under U.C.C. § 9-306(2), 37 A.L.R.4th 787.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

Secured transactions: government agricultural program payments as "proceeds" of agricultural products under UCC § 9-306, 79 A.L.R.4th 903.

72 C.J.S. Pledges §§ 28, 36; 79 C.J.S. Secured Transactions § 117 et seq.

II. CONTINUITY OF SECURITY INTEREST IN COLLATERAL AND PROCEEDS.

Ability to transfer collateral does not destroy perfected security interest. - The fact that collateral may be transferred voluntarily or involuntarily does not destroy or adversely affect a prior perfected security interest. Brummund v. First Nat'l Bank, 99 N.M. 221, 656 P.2d 884 (1983).

When new financing statement not necessary after transfer of property. - Since creditor had no notice or knowledge of a transfer of the property covered by the security agreement by the debtor to the debtor's corporation, it was not necessary for creditor to file a new financing statement, showing the transferee as a new debtor, to preserve their lien under the security agreement. Ryan v. Rolland, 434 F.2d 353 (10th Cir. 1970).

Identifiable proceeds might be goods purchased with money received from sale of original collateral. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967).

55-9-307. Protection of buyers of goods.

(1) A buyer in ordinary course of business (Subsection (9) of Section 55-1-201 NMSA 1978) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence. A buyer of farm products may be subject to a security interest under the provisions of Sections 1 through 14 [56-13-1 to 56-13-14 NMSA 1978] of the Farm Products Secured Interest Act.

(2) In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

(3) A buyer other than a buyer in ordinary course of business (Subsection (1) of this section) takes free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the purchase, or more than forty-five days after the purchase, whichever first occurs, unless made pursuant to a

commitment entered into without knowledge of the purchase and before the expiration of the forty-five-day period.

History: 1953 Comp., § 50A-9-307, enacted by Laws 1961, ch. 96, § 9-307; 1985, ch. 193, § 21; 1987, ch. 177, § 15.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 9, Uniform Conditional Sales Act; Section 9(2), Uniform Trust Receipts Act.

Purposes. - 1. This section states when buyers of goods take free of a security interest even though perfected. A buyer who takes free of a perfected security interest of course takes free of an unperfected one. Section 9-301 should be consulted to determine what purchasers, in addition to the buyers covered in this section, take free of an unperfected security interest.

Article 2 (Sales) states general rules on purchase of goods from a seller with defective or voidable title (Section 2-403).

2. The definition of "buyer in ordinary course of business" in Section 1-201(9) restricts the application of Subsection (1) to buyers (except pawnbrokers) "from a person in the business of selling goods of that kind": thus the subsection applies, in the terminology of this article, primarily to inventory. Subsection (1) further excludes from its operation buyers of "farm products", defined in Section 9-109(3), from a person engaged in farming operations. The buyer in ordinary course of business is defined as one who buys "in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party." This section provides that such a buyer takes free of a security interest, even though perfected, and although he knows the security interest exists. Reading the two provisions together, it results that the buyer takes free if he merely knows that there is a security interest which covers the goods but takes subject if he knows, in addition, that the sale is in violation of some term in the security agreement not waived by the words or conduct of the secured party.

The limitations which this section imposes on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party has authorized the sale in the security agreement or otherwise, the buyer takes free without regard to the limitations of this section. Section 9-306 states the right of a secured party to the proceeds of a sale, authorized or unauthorized.

3. Subsection (2) deals with buyers of "consumer goods" (defined in Section 9-109). Under Section 9-301(1) (d) no filing is required to perfect a purchase money interest in consumer goods subject to this subsection except motor vehicles required to be registered; filing is required to perfect security interests in such goods other than

purchase money interests and, for motor vehicles, even in the case of purchase money interests. (The special case of fixtures has added complications that are apart from the point of this discussion.)

Under Subsection (2) a buyer of consumer goods takes free of a security interest even though perfected a) if he buys without knowledge of the security interest, b) for value, c) for his own personal, family, or household purposes and d) before a financing statement is filed.

As to purchase money security interests which are perfected without filing under Section 9-302(1) (d): A secured party may file a financing statement (although filing is not required for perfection). If he does file, all buyers take subject to the security interest. If he does not file, a buyer who meets the qualifications stated in the preceding paragraph takes free of the security interest.

As to security interests which can be perfected only by filing under Section 9-302: This category includes all nonpurchase money interests, and all interests, whether or not purchase money, in motor vehicles, as well as interests which may be and are filed, though filing was not required for perfection under Section 9-302. (Note that under Section 9-302(3) the filing provisions of this article do not apply when a state has enacted a certificate of title law. Thus where motor vehicles are concerned, in a state having such a certificate of title law, perfection will be under that law.) So long as the security interest remains unperfected, not only the buyers described in Subsection (2) but the purchasers described in Section 9-301 will take free of the interest. After a financing statement has been filed or after compliance with the certificate of title law all subsequent buyers, under the rule of Subsection (2), are subject to the security interest.

4. Although a buyer is of course subject to the Code's system of notice from filing or possession, Subsection (3) makes clear that he will not be subject to future advances under a security interest after the secured party has knowledge that the buyer has purchased the collateral and in any event after 45 days after the purchase unless the advances were made pursuant to a commitment entered into before the expiration of the 45 days and without knowledge of the purchase. Of course, a buyer in ordinary course who takes free of the security interest under Subsection (1) is not subject to any future advances. Compare Sections 9-301(4) and 9-312(7).

Cross references. - Point 1: Sections 2-403 and 9-301.

Point 2: Section 9-306.

Point 3: Sections 9-301 and 9-302.

Point 4: Sections 9-301(4) and 9-312(7).

Definitional cross references. - "Buyer in ordinary course of business". Section 1-201.

"Consumer goods". Section 9-109.

"Goods". Section 9-105.

"Knows" and "Knowledge". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Pursuant to commitment". Section 9-105.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

The 1987 amendment, effective January 1, 1988, in Subsection (1), substituted "Section 55-1-201 NMSA 1978" for "Section 1-201", added the second sentence and made minor stylistic changes in Subsection (3).

Compiler's note. - Laws 1995, ch. 190, § 19 amends Laws 1987, ch. 177, § 16, as amended by Laws 1992, ch. 8, § 1, to delete the provision providing that Laws 1987, ch. 177 is effective until July 1, 1997.

Agricultural mortgagees retain special position. - By excluding "farm products" from the classifications of "equipment" and "inventory," in 55-9-103 NMSA 1978, and by expressly providing in this section that a buyer in the ordinary course of business of farm products from a person engaged in farming operations does not take free of a security interest created by the seller, the draftsmen of the code apparently intended to retain the agricultural mortgagee in the special position he achieved under the pre-code case law. Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967).

Law reviews. - For comment on Clovis Nat'l Bank v. Thomas, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 15A Am. Jur. 2d Commercial Code § 67; 68A Am. Jur. 2d Secured Transactions § 825 et seq.

Rights of holder of "trust receipt" and purchaser of goods from one who gave it, 31 A.L.R. 937.

Validity as to creditors of reservation of title to goods delivered under implied or express authority to resell, 63 A.L.R. 355.

Right of conditional vendor against one to whom property has been transferred by an infant, 63 A.L.R. 1371.

Liability for conversion of one claiming under purchaser under conditional sale contract, 73 A.L.R. 799.

Effect of recording right of purchaser from party to conditional sale as affected by actual or apparent authority in party to sell property, 88 A.L.R. 112.

Personal liability of purchaser of property subject to chattel mortgage to the mortgagee, 100 A.L.R. 1038.

Trust receipts, rights and liabilities with respect to purchasers from receiptor or other parties, 101 A.L.R. 460, 168 A.L.R. 359.

Purchaser's right to protection under factor's act where transaction involves exchange of goods, 132 A.L.R. 525.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

Avoidance under 11 USCS § 522(f)(2) of the Bankruptcy Code of 1978 of nonpossessory, nonpurchase-money security interest in debtor's exempt personal property, 55 A.L.R. Fed. 353.

72 C.J.S. Pledges § 45; 77A C.J.S. Sales § 230 et seq.; 79 C.J.S. Secured Transactions § 93 et seq.

55-9-308. Purchase of chattel paper and instruments.

A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument:

(a) which is perfected under Section 9-304 [55-9-304 NMSA 1978] (permissive filing and temporary perfection) or under Section 9-306 [55-9-306 NMSA 1978] (perfection as to proceeds) if he acts without knowledge that the specific paper or instrument is subject to a security interest; or

(b) which is claimed merely as proceeds of inventory subject to a security interest (Section 9-306 [55-9-306 NMSA 1978]) even though he knows that the specific paper or instrument is subject to the security interest.

History: 1953 Comp., § 50A-9-308, enacted by Laws 1961, ch. 96, § 9-308; 1985, ch. 193, § 22.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 9(a) and 10 of Uniform Trust Receipts Act.

Purposes. - 1. Chattel paper is defined (Section 9-105) as "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods". Such paper has become an important class of collateral in financing arrangements, which may - as in the automobile and some other fields - follow an earlier financing arrangement covering inventory or which may begin with the chattel paper itself.

Arrangements where the chattel paper is delivered to the secured party who then makes collections, as well as arrangements where the debtor, whether or not he is left in possession of the paper, makes the collections, are both widely used, and are known respectively as notification (or "direct collection") and nonnotification (or "indirect collection") arrangements. In the automobile field, for example, when a car is sold to a consumer buyer under an installment purchase agreement and the resulting chattel paper is assigned, the assignee usually takes possession, the obligor is notified of the assignment and is directed to make payments to the assignee. In the furniture field, for an example on the other hand, the chattel paper may be left in the dealer's hands or delivered to the assignee; in either case the obligor may not be notified, and payments are made to the dealer-assignor who receives them under a duty to remit to his assignee. The widespread use of both methods of dealing with chattel paper is recognized by the provisions of this article, which permit perfection of a chattel paper security interest either by filing or by taking possession.

2. Although perfection by filing is permitted as to chattel paper, certain purchasers of chattel paper allowed to remain in the debtor's possession take free of the security interest despite the filing.

Clause (b) of the section deals with the case where the security interest in the chattel paper is claimed merely as proceeds - i.e., on behalf of an inventory financer who has not by some new transaction with the debtor acquired a specific interest in the chattel paper. In that case a purchaser, even though he knows of the inventory financer's proceeds interest, takes priority provided he gives new value and takes possession of the paper in the ordinary course of his business.

The same basic rule applies in favor of a purchaser of other instruments who claims priority against a proceeds interest therein of which he has knowledge. Thus a purchaser of a negotiable instrument might prevail under Clause (b) even though his knowledge of the conflicting proceeds claim precluded his having holder in due course status under Section 9-309.

3. Clause (a) deals with the case where the nonpossessory security interest in the chattel paper is more than a mere claim to proceeds - i.e., exists in favor of a secured party who has given value against the paper, whether or not he financed the inventory whose sale gave rise to it. In this case the purchaser, to take priority, must not only give new value and take possession in the ordinary course of his business; he must also take without knowledge of the existing security interest. Thus a secured party, who has a specific interest in the chattel paper and not merely a claim to proceeds, and who wishes to leave the paper in the debtor's possession can, because of the knowledge requirement, protect himself against purchasers by stamping or noting on the paper the fact that it has been assigned to him.

4. It should be noted that under Section 9-304(1) a security interest in an instrument, negotiable or nonnegotiable, cannot be perfected by filing (except where the instrument constitutes part of chattel paper). Thus the only types of perfected nonpossessory security interest that can arise in an instrument are the temporary 21 day perfection provided for in Section 9-304(4) and (5) or the 10 day perfection in proceeds of Section 9-306. Where such a perfected interest exists in a nonnegotiable instrument, purchasers will take free if they qualify under Clause (a) of the section.

Cross references. - Point 1: Sections 9-304(1) and 9-305.

Point 2: Section 9-306.

Point 4: Sections 9-304 and 9-306.

Definitional cross references. - "Chattel paper". Section 9-105.

"Instrument". Section 9-105.

"Inventory". Section 9-109.

"Knowledge". Section 1-201.

"Proceeds". Section 9-306.

"Purchaser". Section 1-201.

"Security interest". Section 1-201.

"Value". Section 1-201.

Notice sufficient to make account debtor liable to assignee. - Here the assignment said that all right, title and interest of contractor to funds due from account debtor were to be assigned to bank, and this assignment was accepted by agent of account debtor. This was not a case of indirect collection. The account debtor could readily determine that assignee had purchased assignor's right, title and interest in the proceeds. There was no need for the assignee to instruct the account debtor not to pay the assignor. The unconditional language of the assignment was sufficient notice that the assignee was to be paid. First Nat'l Bank v. Mountain States Tel. & Tel. Co., 91 N.M. 126, 571 P.2d 118 (1977).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 823 et seq.

Bona fides of purchaser of bill or note on an executory consideration, cases where bills or notes are executed on conditional agreements, 3 A.L.R. 987, 100 A.L.R. 1357.

Constitutionality, construction and application of statute respecting sale, assignment or transfer of retail installment contracts, 10 A.L.R.2d 447.

Transferee of commercial paper given by purchaser of chattel and secured by conditional sale, retention of title or chattel mortgage, as subject to defenses which chattel purchaser could assert against seller, 44 A.L.R.2d 8, 39 A.L.R.3d 518.

6A C.J.S. Assignments § 91; 72 C.J.S. Pledges § 41; 79 C.J.S. Secured Transactions § 34 et seq.

55-9-309. Protection of purchasers of instruments and documents and securities.

Nothing in this article limits the rights of a holder in due course of a negotiable instrument (Section 55-3-302 NMSA 1978) or a holder to whom a negotiable document of title has been duly negotiated (Section 55-7-501 NMSA 1978) or a protected purchaser of a security (Section 55-8-303 NMSA 1978) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this article does not constitute notice of the security interest to such holders or purchasers.

History: 1953 Comp., § 50A-9-309, enacted by Laws 1961, ch. 96, § 9-309; 1987, ch. 248, § 53; 1996, ch. 47, § 67.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 9(a), Uniform Trust Receipts Act.

Purposes. - 1. Under this article as at common law and under prior statutes the rights of purchasers of negotiable paper, including negotiable documents of title and investment securities, are determined by the rules of holding in due course and the like which are applicable to the type of paper concerned. (Articles 3, 7, and 8.) This section, as did Section 9(a) of the Uniform Trust Receipts Act, makes explicit the rule which was implicitly but universally recognized under the earlier statutes.

2. Under Section 9-304(1) filing is ineffective to perfect a security interest in instruments (including securities) except those instruments which are part of chattel paper, and of course is ineffective to constitute notice to subsequent purchasers. Although filing is permissible as a method of perfection for a security interest in documents, this section follows the policy of the Uniform Trust Receipts Act in providing that the filing does not constitute notice to purchasers.

Cross references. - Articles 3, 7, and 8 and Sections 9-304(1) and 9-308.

Definitional cross references. - "Bona fide purchaser". Section 8-302.

"Document of title". Section 1-201.

"Duly negotiated". Section 7-501.

"Holder". Section 1-201.

"Holder in due course". Sections 3-302 and 9-105.

"Negotiable instrument". Sections 3-104 and 9-105.

"Notice". Section 1-201.

"Purchaser". Section 1-201.

"Security". Sections 8-102 and 9-105.

"Security interest". Section 1-201.

The 1987 amendment, effective June 19, 1987, added "and securities" in the catchline, and in the first sentence substituted NMSA citations for UCC citations and "Section 55-8-302 NMSA 1978" for "Section 8-301".

The 1996 amendment, in the first sentence, substituted "protected" for "bona fide" preceding "purchaser" and substituted "Section 55-8-303" for "Section 55-8-302". Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 823 et seq.

Constructive notice by record, 63 A.L.R. 1456.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

6A C.J.S. Assignments § 118; 72 C.J.S. Pledges § 43.

55-9-310. Priority of certain liens arising by operation of law.

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.

History: 1953 Comp., § 50A-9-310, enacted by Laws 1961, ch. 96, § 9-310.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision Section 11, Uniform Trust Receipts Act.

Purposes. - 1. To provide 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.

2. Apart from the Uniform Trust Receipts Act which had a section similar to this one, there was generally no specific statutory rule as to priority between security devices and liens for services or materials. Under chattel mortgage or conditional sales law many decisions made the priority of such liens turn on whether the secured party did or did not have "title". This section changes such rules and makes the lien for services or materials prior in all cases where they are furnished in the ordinary course of the lienor's business and the goods involved are in the lienor's possession. Some of the statutes creating such liens expressly make the lien subordinate to a prior security interest. This section does not repeal such statutory provisions. If the statute creating the lien is silent, even though it has been construed by decision to make the lien subordinate to the security interest, this section provides a rule of interpretation that the lien should take priority over the security interest.

Cross references. - Sections 9-102(2), 9-104(c) and 9-312(1).

Definitional cross references. - "Goods". Section 9-105.

"Person". Section 1-201.

"Security interest". Section 1-201.

Prior recorded chattel mortgage was superior to mechanic's lien prior to the code. Owen v. Waukesha Engine & Equip. Co., 74 N.M. 59, 390 P.2d 439 (1964).

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 885 et seq.

Lien for repairs to or services in connection with automobile, 62 A.L.R. 1485.

Priority of statutory lien for storage or repairs as against rights of purchasers, attaching creditors or trustees in bankruptcy which arose while car was in possession of owner after accrual of storage or completion of repairs, 100 A.L.R. 80.

Priority as between lien for repairs and the like, and right of seller under conditional sales contract, 36 A.L.R.2d 198.

Priority as between artisan's lien and chattel mortgage, 36 A.L.R.2d 229.

Lien for storage of motor vehicle, 48 A.L.R.2d 894, 85 A.L.R.3d 199.

Priority as between mechanic's lien and purchase money mortgage, 73 A.L.R.2d 1407.

8 C.J.S. Bailments § 80 et seq.; 56 C.J.S. Mechanics' Liens § 220; 61A C.J.S. Motor Vehicles § 754; 72 C.J.S. Pledges § 23; 79 C.J.S. Secured Transactions § 100 et seq.

55-9-311. Alienability of debtor's rights; judicial process.

The debtor's rights in collateral may be voluntarily or involuntarily transferred (by way of sale, creation of a security interest, attachment, levy, garnishment or other judicial process) notwithstanding a provision in the security agreement prohibiting any transfer or making the transfer constitute a default.

History: 1953 Comp., § 50A-9-311, enacted by Laws 1961, ch. 96, § 9-311.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To make clear that in all security transactions under this article, the debtor has an interest (whether legal title or an equity) which he can dispose of and which his creditors can reach.

2. Some jurisdictions have held that when a mortgagee or conditional seller has "title" to the collateral, creditors may not proceed against the mortgagor's or vendee's interest by levy, attachment or other judicial process. This section changes those rules by providing that in all security interests the debtor's interest in the collateral remains subject to claims of creditors who take appropriate action. It is left to the law of each state to determine the form of "appropriate process".

3. Where the security interest is in inventory, difficult problems arise with reference to attachment and levy. Assume that a debt of $100,000 is secured by inventory worth twice that amount. If by attachment or levy certain units of the inventory are seized, the determination of the debtor's equity in the units seized is not a simple matter. The section leaves the solution of this problem to the courts. Procedures such as marshalling may be appropriate.

Cross references. - Sections 9-301(4), 9-307(3) and 9-312(7).

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Rights". Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

Debtor may transfer property covered by the security agreement without notifying the creditor or securing his or its consent to such a transfer. Ryan v. Rolland, 434 F.2d 353 (10th Cir. 1970).

Ability to transfer collateral does not affect security interest. - The fact that collateral may be transferred voluntarily or involuntarily does not destroy or adversely affect a prior perfected security interest. Brummond v. First Nat'l Bank, 99 N.M. 221, 656 P.2d 884 (1983).

Security agreement may make transfer an event of default. - A provision in a security agreement may forbid transfer of collateral without prior consent or make such a transfer a default. Once the parties have agreed to such a security agreement provision, and that a violation thereof constitutes a default, the security agreement

provision will be enforced to the extent that it makes a transfer an event of default. Brummond v. First Nat'l Bank, 99 N.M. 221, 656 P.2d 884 (1983).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 6 Am. Jur. 2d Attachment and Garnishment § 144; 30 Am. Jur. 2d Executions § 1 et seq.; 68A Am. Jur. 2d Secured Transactions § 510 et seq.

Interest of vendee under conditional sales contract as subject to attachment, garnishment or execution, 61 A.L.R. 781.

Interest of mortgagor or pledgor in property in possession of mortgagee or pledgee as subject of garnishment, 83 A.L.R. 1383.

Validity of anti-assignment clause in contract, 37 A.L.R.2d 1251.

Construction and effect of UCC § 9-311 giving debtor right to transfer his interest in collateral, 45 A.L.R.4th 411.

72 C.J.S. Pledges § 43; 79 C.J.S. Secured Transactions § 115 et seq.

55-9-312. Priorities among conflicting security interests in the same collateral.

(1) The rules of priority stated in other sections of this part and in the following sections shall govern when applicable: Section 55-4-210 NMSA 1978 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; Section 55-9-103 NMSA 1978 on security interests related to other jurisdictions; Section 55-9-114 NMSA 1978 on consignments; and Section 55-9-115 on security interests in investment property.

(2) A perfected security interest in crops, for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise, takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

(3) A perfected purchase money security interest in inventory has priority over a conflicting security interest in the same inventory and also has priority in identifiable cash proceeds received on or before the delivery of the inventory to a buyer if:

(a) the purchase money security interest is perfected at the time the debtor receives possession of the inventory;

(b) the purchase money secured party gives notification in writing to the holder of the conflicting security interest if the holder had filed a financing statement covering the same types of inventory (i) before the date of the filing made by the purchase money secured party, or (ii) before the beginning of the twenty-one-day period where the purchase money security interest is temporarily perfected without filing or possession (Subsection (5) of Section 55-9-304 NMSA 1978);

(c) the holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(d) the notification states that the person giving the notice has or expects to acquire a purchase money security interest in inventory of the debtor, describing such inventory by item or type.

(4) A purchase money security interest in collateral other than inventory has priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within twenty days thereafter.

(5) In all cases not governed by other rules stated in this section (including cases of purchase money security interests that do not qualify for the special priorities set forth in Subsections (3) and (4) of this section), priority between conflicting security interests in the same collateral shall be determined according to the following rules:

(a) conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection; and

(b) so long as conflicting security interests are unperfected, the first to attach has priority.

(6) For the purposes of Subsection (5) of this section, a date of filing or perfection as to collateral is also a date of filing or perfection as to proceeds.

(7) If future advances are made while a security interest is perfected by filing, by the taking of possession or under Section 55-9-115 or 55-9-116 NMSA 1978 on security interests in personal property, the security interest has the same priority for the purposes of Subsection (5) of this section with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases a perfected security interest has priority from the date the advance is made.

History: 1953 Comp., § 50A-9-312, enacted by Laws 1961, ch. 96, § 9-312; 1985, ch. 193, § 23; 1987, ch. 248, § 54; 1989, ch. 64, § 2; 1993, ch. 214, § 8; 1996, ch. 47, § 68.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. In a variety of situations two or more people may claim an interest in the same property. The several sections specified in Subsection (1) contain rules for determining priorities between security interests and such other claims in the situations covered in those sections. For cases not covered in those sections this section states general rules of priority between conflicting security interests.

2. Subsection (2) gives priority to a new value security interest in crops based on a current crop production loan over an earlier security interest in the crop which secured obligations (such as rent, interest or mortgage principal amortization) due more than six months before the crops become growing crops. This priority is not affected by the fact that the person making the crop loan knew of the earlier security interest.

3. Subsections (3) and (4) give priority to a purchase money security interest (defined in Section 9-107) under certain conditions over nonpurchase money interests, which in this context will usually be interests asserted under after-acquired property clauses. See Section 9-204 on the extent to which after-acquired property interests are validated and Section 9-108 on when a security interest in after-acquired property is deemed taken for new value.

Prior law, under one or another theory, usually contrived to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). For example, in the field of industrial equipment financing it was possible, by manipulation of title theory, for the purchase money financer of new equipment (under conditional sale or equipment trust) to protect himself against the claims of prior mortgagees or bondholders under an after-acquired clause in the mortgage or trust indenture: the result was arrived at on the theory that since "title" to the equipment was never in the vendee or lessee there was nothing for the lien of the mortgage to attach to. While this article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest. That policy is carried out in Subsections (3) and (4).

Subsection (4) states a general rule applicable to all types of collateral except inventory: the purchase money interest takes priority if it is perfected when the debtor receives possession of the collateral or within ten [now twenty] days thereafter. As to the ten [now twenty] day grace period, compare Section 9-301(2). The perfection requirement means that the purchase money secured party either has filed a financing statement before that time or has a temporarily perfected interest in goods covered by documents under Section 9-304(4) and (5) (which is continued in a perfected status by filing before the expiration of the 21 day period specified in that section). There is no requirement

that the purchase money secured party be without notice or knowledge of the other interest; he takes priority although he knows of it or it has been filed.

Under Subsection (3) the same rule of priority, but without the ten [now twenty] day grace period for filing, applies to a purchase money security interest in inventory, with the additional requirement that the purchase money secured party give notification, as stated in Subsection (3), to any other secured party who filed earlier for the same item or type of inventory. The reason for the additional requirement of notification is that typically the arrangement between an inventory secured party and his debtor will require the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though he has already given a security interest in the inventory to another secured party. The notification requirement protects the inventory financer in such a situation: if he has received notification, he will presumably not make an advance; if he has not received notification (or if the other interest does not qualify as a purchase money interest), any advance he may make will have priority. Since an arrangement for periodic advances against incoming property is unusual outside the inventory field, no notification requirement is included in Subsection (4).

Where the purchase money inventory financing began by possession of a negotiable document of title by the secured party, he must in order to retain priority give the notice required by Subsection (3) at or before the usual time, i.e., when the debtor gets possession of the inventory, even though his security interest remains perfected for 21 days under Section 9-304(5).

When under these rules the purchase money secured party has priority over another secured party, the question arises whether this priority extends to the proceeds of the original collateral. Under Subsection (4) which deals with non-inventory collateral and where there was no ordinary expectation that the goods would be sold, the section gives an affirmative answer. In the case of inventory collateral under Subsection (3), where it was expected that the goods would be sold and where financing frequently is based on the resulting accounts, chattel paper or other proceeds, the subsection gives an answer limited to the preservation of the purchase money priority only in so far as the proceeds are cash received on or before the delivery of the inventory to a buyer, that is, without the creation of an intervening account to which conflicting rights might attach. The conflicting rights to proceeds consisting of accounts are governed by Subsection (5). See Comment 8.

The foregoing rules applicable to purchase money security interests in inventory apply also to the rights in consigned merchandise. See Section 9-114.

4. Subsection (5) states a rule for determining priority between conflicting security interests in cases not covered in the sections referred to in Subsection (1) or in Subsections (2), (3) and (4) of this section. Note that Subsection (5) applies to cases of purchase money security interests which do not qualify for the special priorities set forth in Subsections (3) and (4).

There is a single priority rule based on precedence in the time as of which the competing parties either filed their security interests or perfected their security interests. The form of the claim to priority, i.e., filing or perfection, may shift from time to time, and the rank will be based on the first filing or perfection so long as there is no intervening period without filing or perfection. Filing may occur as to particular collateral before the collateral comes into existence. Under the standards of Section 9-203 perfection cannot occur as to particular collateral until the collateral itself (and not prior collateral) comes into existence and the debtor has rights therein; but under Subsection (6) of this section the secured party's priority may date from his time of perfection as to the prior collateral, if perfection or filing has been continuously maintained. Subsection (6) provides that a date of filing or perfection as to original collateral is also a date of filing or perfection as to proceeds. This rule should also be read with Section 9-306, which makes it unnecessary to claim proceeds expressly in a financing statement and provides in effect that a filing as to original collateral is also a filing as to proceeds (with exceptions therein stated). Thus, if a financing statement is filed covering inventory, then (subject to the exception involving multistate problems) this filing is also a filing as to the resulting accounts and constitutes the date of filing as to the accounts.

The party who may have had a prior security interest in inventory or may have had the only such security interest does not automatically for that reason have priority as to the accounts. His claim to accounts may or may not have priority over competing filed claims to accounts. The priority is based on precedence as to the accounts under the rules stated in the preceding paragraph.

5. The operation of this section is illustrated by the examples set forth under this and the succeeding points.

Example 1. A files against X (debtor) on February 1. B files against X on March 1. B makes a nonpurchase money advance against certain collateral on April 1. A makes an advance against the same collateral on May 1. A has priority even though B's advance was made earlier and was perfected when made. It makes no difference whether or not A knew of B's interest when he made his advance.

The problem stated in the example is peculiar to a notice filing system under which filing may be made before the security interest attaches (see Section 9-402). The Uniform Trust Receipts Act, which first introduced such a filing system, contained no hint of a solution and case law under it was unpredictable. This article follows several of the accounts receivable statutes in determining priority by order of filing. The justification for the rule lies in the necessity of protecting the filing system - that is, of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his. Note, however, that his protection is not absolute: if, in the example, B's advance creates a purchase money security interest, he has priority under Subsection (4), or, in the case of inventory, under Subsection (3) provided he has properly notified A. (See further Example 3 below.)

Example 2. A and B make nonpurchase money advances against the same collateral. The collateral is in the debtor's possession and neither interest is perfected when the second advance is made. Whichever secured party first perfects his interest (by taking possession of the collateral or by filing) takes priority and it makes no difference whether or not he knows of the other interest at the time he perfects his own.

This result may be regarded as an adoption, in this type of situation, of the idea, deeply rooted at common law, of a race of diligence among creditors. Subsection (5) (b) adds the thought that so long as neither of the interests is perfected, the one which first attached (i.e., under the advance first made) has priority. The last mentioned rule may be thought to be of merely theoretical interest, since it is hard to imagine a situation where the case would come into litigation without either A or B having perfected his interest. If neither interest had been perfected at the time of the filing of a petition in bankruptcy, of course neither would be good against the trustee in bankruptcy.

Example 3. A has a temporarily perfected (21 day) security interest, unfiled, in a negotiable document in the debtor's possession under Section 9-304(4) or (5). On the fifth day B files and thus perfects a security interest in the same document. On the tenth day A files. A has priority, whether or not he knows of B's interest when he files, because he perfected first and has maintained continuous perfection or filing.

6. The application of the priority rules to after-acquired property must be considered separately for each item of collateral. Priority does not depend only on time of perfection, but may also be based on priority in filing before perfection.

Example 4. On February 1 A makes advances to X under a security agreement which covers "all the machinery in X's plant" and contains an after-acquired property clause. A promptly files his financing statement. On March 1 X acquires a new machine, B makes an advance against it and files his financing statement. On April 1 A, under the original security agreement, makes an advance against the machine acquired March 1. If B's advance creates a purchase money security interest, he has priority under Subsection (4) (provided he filed before X received possession of the machine or within ten days thereafter). If B's advance, although he gave new value, did not create a purchase money interest, A has priority as to both of his advances by virtue of his priority in filing, although the parties perfected simultaneously on March 1 as to the new machine.

The application of the priority rules to proceeds presents special features discussed in Comment 8.

7. The application of the priority rules to future advances is complicated. In general, since any secured party must operate in reference to the code's system of notice, he takes subject to future advances under a priority security interest while it is perfected through filing or possession, whether the advances are committed or noncommitted, and to any advances subsequently made "pursuant to commitment" (Section 9-105) during that period. In the rare case when a future advance is made without commitment while the security interest is perfected temporarily without either filing or possession, the

future advance has priority from the date it is made. These rules are more liberal toward the priority of future advances than the corresponding rules applicable to an intervening buyer (Section 9-307(3)) because of the different characteristics of the intervening party. Compare the corresponding rule applicable to an intervening judgment creditor. (Section 9-301(4)).

Example 5. On February 1 A makes an advance against machinery in the debtor's possession and files his financing statement. On March 1 B makes an advance against the same machinery and files his financing statement. On April 1 A makes a further advance, under the original security agreement, against the same machinery (which is covered by the original financing statement and thus perfected when made). A has priority over B both as to the February 1 and as to the April 1 advance and it makes no difference whether or not A knows of B's intervening advance when he makes his second advance.

A wins, as to the April 1 advance, because he first filed even though B's interest attached, and indeed was perfected, before the April 1 advance. The same rule would apply if either A or B had perfected through possession. Section 9-204(3) and the comment thereto should be consulted for the validation of future advances.

The same result would be reached even though A's April 1 advance was not under the original security agreement, but was under a new security agreement under A's same financing statement or during the continuation of A's possession.

8. The application of the priority rules of Subsections (5) and (6) to proceeds is shown by the following examples:

Example 6. A files a financing statement covering a described type of inventory then owned or thereafter acquired. B subsequently takes a purchase money security interest in certain inventory described in A's financing statement and achieves priority over A under Subsection (3) as to this inventory. This inventory is then sold, producing proceeds.

If the proceeds of the inventory are instruments or chattel paper, the rights of A and B on the one hand and any adverse claimant to these proceeds on the other are governed by Sections 9-308 and 9-309. If the proceeds are cash, Subsection (3) indicates that B's priority as to the inventory carries over to the cash. Proceeds which are accounts constitute different collateral and the priorities as to the original collateral do not control the priority as to the accounts. Under Sections 9-306 and 9-312(6), A's first filing as to the inventory constitutes a first filing as to the accounts, provided that the same filing office would be appropriate for filing as to accounts under the rules of Section 9-306(3). Therefore, A has priority as to the accounts.

Many parties financing inventory are quite content to protect their first security interest in the inventory itself, realizing that when inventory is sold, someone else will be financing the accounts and the priority for inventory will not run forward to the accounts. Indeed,

the cash supplied by the accounts financer will be used to pay the inventory financing. In some situations, the party financing the inventory on a purchase money basis makes contractual arrangements that the proceeds of accounts financing by another be devoted to paying off the first inventory security interest.

Example 7. In the foregoing case, if B had filed directly as to accounts, the date of that filing as to accounts would be compared with the date of A's first filing as to the inventory, and the first-to-file rule would prevail.

Subsection (6) provides that a filing as to original collateral determines the date of a filing as to the proceeds thereof. This rule implies, of course, that the filing as to the original collateral is effective as to proceeds under the rule of Section 9-306(3).

Example 8. If C had filed as to accounts in Example 6 above before either A or B had filed as to inventory, C's first filing as to accounts would have priority over the filings of A and B, which would also constitute filings as to accounts under the rule just mentioned. A's and B's position as to the inventory gives them no automatic claim to the proceeds of the inventory consisting of accounts against someone who has filed earlier as to accounts. If, on the other hand, either A's or B's filings as to the inventory constituted good filings as to accounts and these filings preceded C's direct filings as to accounts, A or B would outrank C as to the accounts.

If the filings as to inventory were not effective under Subsection (6) for filing as to accounts because a filing for accounts would have to be in a different filing office under Section 9-103(3), these inventory filings would nevertheless be effective for 10 days as to accounts. If the perfection of the security interest in accounts was continued within the 10 days by appropriate filings, then A and B's interests in the accounts would date from the date of filing as to inventory.

Cross references. - Sections 9-204(1) and 9-303.

Point 1: Sections 4-208, 9-114, 9-301, 9-304, 9-306, 9-307, 9-308, 9-309, 9-310, 9-313, 9-314, 9-315 and 9-316.

Point 3: Sections 9-108, 9-204, 9-304(4) and (5).

Points 4 to 7: Sections 9-204, 9-301(4), 9-304(4) and (5), 9-306, 9-307(3) and 9-402(1).

Point 8: Sections 9-103(6) and 9-306(3).

Definitional cross references. - "Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Collecting bank". Section 4-105.

"Debtor". Section 9-105.

"Documents". Section 9-105.

"Give notice". Section 1-201.

"Goods". Section 9-105.

"Instruments". Section 9-105.

"Inventory". Section 9-109.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Proceeds". Section 9-306.

"Purchase money security interest". Section 9-107.

"Pursuant to commitment". Section 9-105.

"Receives notification". Section 1-201.

"Secured party". Section 9-105.

"Security". Sections 8-102 and 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

The 1987 amendment, effective June 19, 1987, inserted "or under Section 55-8-321 on securities" in the first sentence of Subsection (7) and made minor stylistic changes throughout the section.

The 1989 amendment, effective June 16, 1989, substituted "twenty days" for "ten days" in Subsection (4).

The 1993 amendment, effective July 1, 1993, in Subsection (1), substituted "Section 55-4-210 NMSA 1978" for "Section 55-4-208 NMSA 1978" and inserted "and" following "jurisdictions;"; made a stylistic change in Subsection (5); and inserted "by" in the first sentence of Subsection (7).

The 1996 amendment added "and Section 55-9-115 on security interests in investment property" at the end of Subsection (1) and substituted "Section 55-9-115 or 55-9-116 NMSA 1978 on security interests in personal property" for "Section 55-8-321 on securities" in the first sentence of Subsection (7). Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.

Continuity of financing statement. - The assignee of a security interest was entitled to the priority of the original financing statement since there was no lapse in sequence of filings of amendments, assignments, and continuations, and the assignee was lawfully entitled to all rights in the financing statement. In re Camp Town, Inc., 197 Bankr. 139 (Bankr. D. N.M. 1996).

Priority between landlord's lien and perfected security interest not covered. - Since there is no statutory provision to cover the priority between a statutory landlord's lien and a perfected security interest, the court must rely on existing New Mexico case law to determine the priority between the interests. National Inv. Trust v. First Nat'l Bank, 88 N.M. 514, 543 P.2d 482 (1975).

Security interest in capital retains. - The description "contract rights arising from the sale or other disposition of dairy products" was sufficient to put a third party on inquiry notice about a prior encumbrance on a property interest in capital retains arising from the sale of dairy products. Valley Fed. Sav. Bank v. Stahl, 110 N.M. 169, 793 P.2d 851 (1990).

Law reviews. - For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 841 et seq.

Rights and liabilities of junior chattel mortgagee with respect to mortgaged property, 43 A.L.R. 388.

Priority between attorney's lien for fees against a judgment and lien of creditor against same judgment, 34 A.L.R.4th 665.

72 C.J.S. Pledges § 23; 79 C.J.S. Secured Transactions § 102 et seq.

55-9-313. Priority of security interests in fixtures.

(1) In this section and in the provisions of Part 4 of this article referring to fixture filing, unless the context otherwise requires:

(a) goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) a "fixture filing" is the filing in the office where a mortgage on the real estate would be filed or recorded of a financing statement covering goods which are or are to become fixtures and conforming to the requirements of Subsection (5) of Section 9-402 [55-9-402 NMSA 1978];

(c) a mortgage is a "construction mortgage" to the extent that it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates.

(2) A security interest under this article may be created in goods which are fixtures or may continue in goods which become fixtures, but no security interest exists under this article in ordinary building materials incorporated into an improvement on land.

(3) This article does not prevent creation of an encumbrance upon fixtures pursuant to real estate law.

(4) A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where:

(a) the security interest is a purchase money security interest, the interest of the encumbrancer or owner arises before the goods become fixtures, the security interest is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(b) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the security interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the debtor has an interest of record in the real estate or is in possession of the real estate; or

(c) the fixtures are readily removable factory or office machines or readily removable replacements of domestic appliances which are consumer goods, and before the goods become fixtures the security interest is perfected by any method permitted by this article; or

(d) the conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this article.

(5) A security interest in fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate where:

(a) the encumbrancer or owner has consented in writing to the security interest or has disclaimed an interest in the goods as fixtures; or

(b) the debtor has a right to remove the goods as against the encumbrancer or owner. If the debtor's right terminates, the priority of the security interest continues for a reasonable time.

(6) Notwithstanding Paragraph (a) of Subsection (4) but otherwise subject to Subsections (4) and (5), a security interest in fixtures is subordinate to a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent that it is given to refinance a construction mortgage, a mortgage has this priority to the same extent as the construction mortgage.

(7) In cases not within the preceding subsections, a security interest in fixtures is subordinate to the conflicting interest of an encumbrancer or owner of the related real estate who is not the debtor.

(8) When the secured party has priority over all owners and encumbrancers of the real estate, he may, on default, subject to the provisions of Part 5, remove his collateral from the real estate but he must reimburse any encumbrancer or owner of the real estate who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

History: 1953 Comp., § 50A-9-313, enacted by Laws 1961, ch. 96, § 9-313; 1985, ch. 193, § 24.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 7, Uniform Conditional Sales Act.

Purposes. - 1. Section 9-313 deals with the problem that certain goods which are the subject of chattel financing become so affixed or otherwise so related to real estate that they become part of the real estate, and that chattel interests would be subordinate to

real estate interests except as protected by the priorities regulated by the section. These goods are called "fixtures". Some fixtures also retain their chattel nature in that a chattel financing with respect to them may exist and may continue to be recognized, if notice thereof is given to real estate interests in accordance with this section. But this concept does not apply if the goods are integrally incorporated into the real estate.

The term "fixture filing" has been introduced and defined. It emphasizes that when a filing is intended to give the priority advantages herein discussed against real estate interests, the filing must (except as stated below) be for record in the real estate records and indexed therein, so that it will be found in a real estate search.

Since the determination in advance of judicial decision of the question whether goods have become fixtures is a difficult one, no inference may be drawn from a fixture filing that the secured party concedes that the goods are or will become fixtures. The fixture filing may be merely precautionary.

2. "Fixture" is defined to include any goods which become so related to particular real estate that an interest in them arises under real estate law and therefore, goods integrally incorporated into the real estate are clearly fixtures. But under Subsection (2) no security interest exists under Article 9 in ordinary building materials incorporated into an improvement on land.

Goods may be technically "ordinary building materials," e.g., window glass, but if they are incorporated into a structure which as a whole has not become an integral part of the real estate, the rules applicable to the ordinary building materials follow the rules applicable to the structure itself. The outstanding examples presenting this kind of problem are the modern "mobile homes" and the modern prefabricated steel buildings usable as warehouses, garages, factories, etc. In the case of the mobile homes, most of them are erected on leased land and the right of the debtor under a mobile home purchase contract to remove the goods as lessee will make clear that his secured party ordinarily has a similar right. See Paragraph (5) (b).

In cases where mobile homes or prefabricated steel buildings are erected by a person having an ownership interest in the land, the question into which category the buildings fall is one determined by local law. In general, the governing local law will not be that applicable in determining whether goods have become real property between landlord and tenant, or between mortgagor and mortgagee, or between grantor and grantee, but rather that applicable in a three-party situation, determining whether chattel financing can survive as against parties who acquire rights through the affixation of the goods to the real estate.

The assertion that no security interest exists in ordinary building materials is only for the operation of the priority provisions of this section. It is without prejudice to any rights which the secured party may have against the debtor himself if he incorporated the goods into real estate or against any party guilty of wrongful incorporation thereof in violation of the secured party's rights.

3. Under these concepts the section recognizes three categories of goods: (1) those which retain their chattel character entirely and are not part of the real estate; (2) ordinary building materials which have become an integral part of the real estate and cannot retain their chattel character for purposes of finance and (3) an intermediate class which has become real estate for certain purposes, but as to which chattel financing may be preserved. This third and intermediate class is the primary subject of this section. The demarcation between these classifications is not delineated by this section.

4. In considering fixture priority problems, there will always first be a preliminary question whether real estate interests per se have an interest in the goods as part of real estate. If not, it is immaterial, so far as concerns real estate parties as such, whether a chattel security interest is perfected or unperfected. In no event does a real estate party acquire an interest in a "pure" chattel just because a security interest therein is unperfected. If on the other hand real estate law gives real estate parties an interest in the goods, a conflict arises and this section states the priorities.

(a) The principal exception to the general rule of priority stated in Comment 4(b) based on time of filing or recording is a priority given in Paragraph (4) (a) to purchase money security interests in fixtures as against *prior* recorded real estate interests, provided that the purchase money security interest is filed as a fixture filing in the real estate records before the goods become fixtures or within 10 days thereafter. This priority corresponds to one given in Section 9-312(4), and the 10 days of grace represents a reduction of the purchase money priority as against prior interests in the real estate under the present Section 9-313, where the purchase money priority exists even though the security interest is *never* filed.

It should be emphasized that this purchase money priority with the 10-day grace period for filing is limited to rights against *prior* real estate interests. There is no such priority with the 10-day grace period as against subsequent real estate interests. The fixture security interest can defeat subsequent real estate interests only if it is filed first and prevails under the usual conveyancing rule recognized in Paragraph (4) (b).

(b) The general principle of priority announced in this section is set forth in Paragraph (4) (b). It is basically that a fixture filing gives to the fixture security interest priority as against other real estate interests according to the usual priority rule of conveyancing, that is, the first to file or record prevails. An apparent limitation to this principle set forth in Paragraph (4) (b), namely that the secured party must have had priority over any interest of a predecessor in title of the conflicting encumbrancer or owner, is not really a limitation, but is an expression of the usual rule that a person must be entitled to transfer what he has. Thus, if the fixture security interest is subordinate to a mortgage, it is subordinate to an interest of an assignee of the mortgage even though the assignment is a later recorded instrument. Similarly if the fixture security interest is subordinate to the rights of an owner, it is subordinate to a subsequent grantee of the owner and likewise subordinate to a subsequent mortgagee of the owner.

(c) A qualification to the rule based on priority of filing or recording is Paragraph (4) (d), where priority based on precedence in filing or recording is preserved, but there is no requirement that as against a judgment lienor of the real estate, the prior filing of the fixture security interest must be in the real estate records. The fixture security interest if perfected first should prevail even though not filed or recorded in real estate records, because generally a judgment creditor is not a reliance creditor who would have searched records. Thus, even a prior filing in the chattel records protects the priority of a fixture security interest against a subsequent judgment lien.

It is hoped that this rule will have the effect of preserving a fixture security interest so filed against invalidation by a trustee in bankruptcy. That would, of course, be the result under Section 60a of the Bankruptcy Act if the time of perfection of the fixture security interest were measured by the judgment creditor test applicable to personal property. It would not be the result if the time of perfection were measured by the purchaser test applicable to real estate. Since the fixture security interest arises against the goods in their capacity as chattels, the bankruptcy courts should apply the judgment creditor test. The effectiveness of the drafting to achieve its purpose cannot be known certainly until the courts adjudicate the question or until it is settled by amendment to Section 60a of the Bankruptcy Act.

The phrase "lien by legal or equitable proceedings" is suggested by Section 70c of the Bankruptcy Act, and is intended to encompass all liens on real estate obtained by any of the creditor action therein described.

(d) A special exception to the usual rule of priority based on precedence in time is the one of Paragraph (4) (c) in favor of holders of security interests in factory and office machines, and in certain replacement domestic appliances, as discussed below. This is not as broad an exception as it might seem. To repeat, a fixture conflict is not reached if the goods are held as a matter of local law not to have become part of the real estate, which will frequently be the holding for goods of these types. If the opposite is held, the rule of Paragraph (4) (c) operates only if the fixture security interest is perfected before the goods become fixtures. Having been perfected, it would of course have priority over subsequent real estate interests under the rule of Paragraph (4) (b). Since it would in almost all cases be a purchase money security interest, it would also have priority over other real estate interests under the purchase-money priority of Paragraph (4) (a), discussed in Paragraph (a) above. The rule is stated separately because the permitted perfection is by any method permitted by the article, and not exclusively by fixture filing in the real estate records. This rule is made necessary by the confusions of the law as to whether certain machinery and appliances become fixtures.

As an additional point, in the case of machinery, the separate statement of this rule makes clear that it is not overridden by the construction mortgage priority of Subsection (6) discussed in Comment 4(e) below, as would have been true if reliance had been solely on the purchase money priority. Factory and office machines are not always financed as part of a construction mortgage, and the mortgagee should be alert to conflicting chattel financing of these machines.

As to appliances, the rule stated is limited to readily removable replacements, not original installations, of appliances which are consumer goods in the hands of the debtor (Section 9-109). To facilitate financing of original appliances in new dwellings as part of the real estate financing of the dwellings, no special priority is given to chattel financing of original appliances. The section leaves to other law of the state the question whether original installations are fixtures to which the protection accorded by this section to construction mortgages would be applicable. Likewise, it is recognized that (when not supplied by tenants) appliances in commercial apartment buildings are intended as permanent improvements, and no special rule is stated for appliances in that case. The special priority rule here stated in favor of chattel financing is limited to situations where the installation of appliances may not be intended to be permanent, i.e., replacement appliances used by the debtor or his family (consumer goods). The principal effect of the rule is to make clear that a secured party financing occasional replacements of domestic appliances in noncommercial owner-occupied contexts need not concern himself with real estate descriptions or records; indeed, for a purchase money replacement of consumer goods, perfection without any filing will be possible. (The priority of the construction mortgage has no application to replacement appliances.)

(e) The purchase money priority presents a difficult problem in relation to construction mortgages. The latter will ordinarily have been recorded even before the commencement of delivery of materials to the job, and therefore would be prior in rank to the fixture security interests were it not for the problem of the purchase money priority. Subsection (6) expressly gives priority to the construction mortgage recorded before the filing of the fixture security interest, but this priority of a construction mortgage applies only during the construction period leading to the completion of the improvement. As to additions to the building made long after completion of the improvement, the construction priority will not apply simply because the additions are financed by the real estate mortgagee under an open end clause of his construction mortgage. In such case, the applicable principles will be those of Paragraphs (4) (a) and (4) (b). A refinancing of a construction mortgage has the same priority as the mortgage itself.

The phrase "an obligation incurred for the construction of an improvement" covers both optional advances and advances pursuant to commitment, and both types of advances have the same priority under the section.

5. The section makes it impossible for a fixture supplier to retain a security interest against a contractor, to the possible surprise and deception of real estate interests, unless the debtor has an interest of record in the real estate. See Paragraphs (4) (a) and (b).

On the other hand, these paragraphs do recognize that fixture filing may be necessary when the debtor is in possession of the real estate (e.g., a lessee) even without an interest of record. This possibility of a filing against a debtor who is not in the real estate

chain of title makes it necessary to require the furnishing of the name of a record owner in such cases. See Sections 9-402(3), item 3; 9-402(5) and 9-403(7).

6. The status of fixtures installed by tenants (as well as such persons as licensees and holders of easements) is defined by Paragraph (5) (b) to the effect that if the debtor (tenant or other interest mentioned) has the right to remove the fixture as against a real estate interest, the secured party has priority over that real estate interest.

7. Real estate lenders and title companies will have little difficulty in locating relevant fixture security interests applicable to particular parcels of real estate because of the provisions as to real estate description in fixture filings, the indexing thereof, and other related provisions in Part 4 of Article 9.

8. Real estate lending is typically long-term, and is usually done by institutional investors who can afford to take a long view of the matter rather than concentrating on the results of any particular case. It is apparent that the rule which permits and encourages purchase money fixture financing, which in contrast is typically short-term, will result in the modernization and improvement of real estate rather than in its deterioration and will on balance benefit long-term real estate lenders. Because of the short-term character of the chattel financing, it will rarely produce any conflict in fact with the real estate lender. The contrary rule would chill the availability of short-term credit for modernization of real estate by installation of new fixtures and in the long run could not help real estate lenders.

9. Subsection (8) is an important departure from Section 7 of the Uniform Conditional Sales Act and from much other conditional sales legislation. Under the Uniform Conditional Sales Act a conditional vendor could not sever and remove the affixed chattel if a "material injury to the freehold" would result. The courts of various jurisdictions were in sharp disagreement on the meaning of "material injury"; some held that only physical injury was meant; others adopted the so-called "institutional theory" and denied removal whenever the "going value" of the structure would be materially diminished by the removal. Under these rules the conditional vendor either could not remove at all, or, if he could, could damage the structure on removal without becoming accountable to the real estate claimant. The situation was complicated by the fact that it became increasingly difficult to predict what types of goods the courts in a given jurisdiction would hold not subject to removal.

Subsection (8) abandons the "material injury to the freehold" rule. Instead a secured party entitled to priority may in all cases sever and remove his collateral, subject, however, to a duty to reimburse any real estate claimant (other than the debtor himself) for any physical injury caused by the removal. The right to reimbursement is implemented by the last sentence of Subsection (8) which gives the real estate claimant a statutory right to security or indemnity failing which he may refuse permission to remove. The Subsection (8) rule thus accomplishes two things: it puts an end to the uncertainty which has grown up under the "material injury" rule, while at the same time it protects the real estate claimant under the reimbursement provisions.

Cross references. - Sections 2-107, 9-102(1), 9-104(j) and 9-312(1), and Parts 4 and 5.

Definitional cross references. - "Collateral". Section 9-105.

"Contract". Section 1-201.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Encumbrance". Section 9-105.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Mortgage". Section 9-105.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Purchaser". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Writing". Section 1-201.

Policy of this section is consistent with the majority rule under precode law, in that it gives priority to the fixture security interest over an antecedent interest in the real estate. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

Rose bushes as "fixtures". - Where the evidence showed that Chapter 11 debtor's rose bushes were planted directly into the earth, secured by root systems extending three or four feet and that the bushes were intended to produce successive crops for over a period of seven to eight years, the rose bushes had become so attached to the real estate interest that they became fixtures within the meaning of this section, and creditor's failure to file according to 55-9-401 NMSA 1978 rendered his interest unperfected. Flores De N.M., Inc. v. Banda Negra Int'l, Inc., 151 Bankr. 571 (Bankr. D.N.M. 1993).

When secured party may remove fixtures. - Where defendant's purchase money security interests in pumping equipment installed by tenant on property leased by plaintiff attached before the equipment became fixtures on the property, such interest was given priority over plaintiff's antecedent interest in the property, and defendant was therefore justified in removing equipment from land when tenant was evicted from property by plaintiff for failure to pay rent. Honea v. Laco Auto Leasing, Inc., 80 N.M. 300, 454 P.2d 782 (Ct. App. 1969).

Perfection of lien on mobile home. A bankruptcy trustee, in the position of a subsequent judgment lien creditor or good faith purchaser, could not avoid a creditor's lien on a mobile home that was perfected by notation on the certificate of title, even though the home had become a fixture and the creditor had not made a fixture filing. Lucero v. Green Tree Fin. Servicing Corp., 203 Bankr. 322 (B.A.P. 10th Cir. 1996).

Law reviews. - For article, "Fixtures and the Uniform Commercial Code in New Mexico," see 4 Nat. Resources J. 109 (1964).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 35 Am. Jur. 2d Fixtures § 61; 54A Am. Jur. 2d Mortgages §§ 5, 8; 68A Am. Jur. 2d Secured Transactions § 942 et seq.

Right of conditional seller of chattels attached to realty to claim lien on the realty, 58 A.L.R. 1121.

Heating plant as a fixture, or as a part of or attached to realty as between mortgagor and mortgagee and their privies; as between conditional vendor and owner of realty, or purchasers or encumbrancers thereof, 126 A.L.R. 600.

Rights of seller of fixtures retaining title thereto, or a lien thereon, as against purchasers or encumbrancers of the realty, 141 A.L.R. 1283.

Refrigerator or refrigerating plant as fixture, 169 A.L.R. 478.

Sprinkler system as fixture, 19 A.L.R.2d 1300.

Amusement apparatus or device as fixture, 41 A.L.R.2d 664.

Appliances, accessories, pipes or other articles connected with plumbing as fixtures, 52 A.L.R.2d 222.

Electric range as fixture as between mortgagor and mortgagee or successor in interest, 57 A.L.R.2d 1103.

Air conditioning appliance, equipment, apparatus or as fixture, 69 A.L.R.4th 359.

36A C.J.S. Fixtures § 1.

55-9-314. Accessions.

(1) A security interest in goods which attaches before they are installed in or affixed to other goods takes priority as to the goods installed or affixed (called in this section "accession") over the claims of all persons to the whole except as stated in Subsection (3) and subject to Section 9-315 (1) [55-9-315 (1) NMSA 1978].

(2) A security interest which attaches to goods after they become part of a whole is valid against all persons subsequently acquiring interests in the whole except as stated in Subsection (3) but is invalid against any person with an interest in the whole at the time the security interest attaches to the goods who has not in writing consented to the security interest or disclaimed an interest in the goods as part of the whole.

(3) The security interests described in Subsections (1) and (2) do not take priority over:

(a) a subsequent purchaser for value of any interest in the whole; or

(b) a creditor with a lien on the whole subsequently obtained by judicial proceedings; or

(c) a creditor with a prior perfected security interest in the whole to the extent that he makes subsequent advances

if the subsequent purchase is made, the lien by judicial proceedings obtained or the subsequent advance under the prior perfected security interest is made or contracted for without knowledge of the security interest and before it is perfected. A purchaser of the whole at a foreclosure sale other than the holder of a perfected security interest purchasing at his own foreclosure sale is a subsequent purchaser within this section.

(4) When under Subsections (1) or (2) and (3) a secured party has an interest in accessions which has priority over the claims of all persons who have interests in the whole, he may on default subject to the provisions of Part 5 remove his collateral from the whole but he must reimburse any encumbrancer or owner of the whole who is not the debtor and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement

may refuse permission to remove until the secured party gives adequate security for the performance of this obligation.

History: 1953 Comp., § 50A-9-314, enacted by Laws 1961, ch. 96, § 9-314.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To state when a secured party claiming an interest in goods installed in or affixed to other goods is entitled to priority over a party with a security interest in the whole.

2. This section changes prior law in that the secured party claiming an interest in a part (e.g., a new motor in an old car) is entitled to priority and has a right to remove even though under other rules of law the part now belongs to the whole.

3. This section does not apply to goods which, for example, are so commingled in a manufacturing process that their original identity is lost. That type of situation is covered in Section 9-315. Section 9-315 should also be consulted for the effect of a financing statement which claims both component parts and the resulting product.

Cross references. - Sections 9-203(1), 9-303 and 9-312(1) and Part 5.

Point 3: Section 9-315.

Definitional cross references. - "Collateral". Section 9-105.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Value". Section 1-201.

"Writing". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions §§ 101, 102.

Accession to property which is the subject of a conditional sale or chattel mortgage, 68 A.L.R. 1242.

Reservation of title by conditional sale of material to manufacturer as affecting articles fabricated or in process of fabrication from the material, 111 A.L.R. 682.

Accession to motor vehicle, 43 A.L.R.2d 813.

1 C.J.S. Accession § 6.

55-9-315. Priority when goods are commingled or processed.

(1) If a security interest in goods was perfected and subsequently the goods or a part thereof have become part of a product or mass, the security interest continues in the product or mass if:

(a) the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product or mass; or

(b) a financing statement covering the original goods also covers the product into which the goods have been manufactured, processed or assembled.

In a case to which Paragraph (b) applies, no separate security interest in that part of the original goods which has been manufactured, processed or assembled into the product may be claimed under Section 9-314 [55-9-314 NMSA 1978].

(2) When under Subsection (1) more than one security interest attaches to the product or mass, they rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass.

History: 1953 Comp., § 50A-9-315, enacted by Laws 1961, ch. 96, § 9-315.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. To state when a secured party whose collateral contributes to a product has priority over others who have conflicting claims in the same product.

2. This section changes the law in some jurisdictions where a security interest in goods (e.g., raw materials) was lost when the goods lost their identity by being commingled or processed. Under this section the security interest continues in the resulting mass or product in the cases stated in Subsection (1).

3. This section applies not only to cases where flour, sugar and eggs are commingled into cake mix or cake, but also to cases where components are assembled into a machine. In the latter case a secured party is put to an election at the time of filing, by the last sentence of Subsection (1), whether to claim under this section or to claim a security interest in one component under Section 9-314.

4. Subsection (2) is new and is needed because under Subsection (1) it is possible to have more than one secured party claiming an interest in a product. The rule stated treats all such interests as being of equal priority entitled to share ratably in the product.

Cross references. - Sections 9-203(1), 9-303, 9-312(1) and 9-314.

Definitional cross references. - "Goods". Section 9-105.

"Security interest". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 1 Am. Jur. 2d Accession and Confusion § 23; 68A Am. Jur. 2d Secured Transactions § 780 et seq.

Replevin for an undivided share of the mixed mass in case of confusion of goods, 26 A.L.R. 1015.

Commingling of goods subject to trust receipt, 101 A.L.R. 465, 168 A.L.R. 359.

Confusion of goods by accident, mistake or act of a third person, 39 A.L.R.2d 555.

15A C.J.S. Confusion of Goods §§ 3 to 9.

55-9-316. Priority subject to subordination.

Nothing in this article prevents subordination by agreement by any person entitled to priority.

History: 1953 Comp., § 50A-9-316, enacted by Laws 1961, ch. 96, § 9-316.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - The several preceding sections deal elaborately with questions of priority. This section is inserted to make it entirely clear that a person entitled to priority may effectively agree to subordinate his claim. Only the person entitled to priority may make such an agreement: his rights cannot be adversely affected by an agreement to which he is not a party.

Cross references. - Sections 1-102 and 9-312 (1).

Definitional cross references. - "Agreement". Section 1-201.

"Person". Section 1-201.

A subordination agreement by implication is not recognized; it must be expressed. Western Bank v. Matherly, 106 N.M. 31, 738 P.2d 903 (1987).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 780 et seq.

72 C.J.S. Pledges § 23; 79 C.J.S. Secured Transactions § 100 et seq.

55-9-317. Secured party not obligated on contract of debtor.

The mere existence of a security interest or authority given to the debtor to dispose of or use collateral does not impose contract or tort liability upon the secured party for the debtor's acts or omissions.

History: 1953 Comp., § 50A-9-317, enacted by Laws 1961, ch. 96, § 9-317.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 12, Uniform Trust Receipts Act.

Purposes. - There were a few common law decisions, mostly in cases involving trust receipts, which suggested, if they did not hold, that a secured party who gave his debtor liberty of sale might be liable (for example, for breach of warranty) on the debtor's contracts of sale. The theory was grounded on the law of agency; the debtor being regarded as selling agent for the secured party as principal. This section rejects that theory. Section 12 of the Uniform Trust Receipts Act provided that the entruster was not subject to liability, merely because of his status as entruster, on sale of the goods subject to trust receipt. This section adopts the policy of the prior act and states it in general terms.

Cross reference. - Section 2-210(4).

Definitional cross references. - "Collateral". Section 9-105.

"Contract". Section 1-201.

"Debtor". Section 9-105.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

Am. Jur. 2d, A.L.R. and C.J.S. references. - Liability of one financing importation of goods for reimbursement of third person who pays charges or duties, 27 A.L.R. 1526.

77A C.J.S. Sales § 284 et seq.

55-9-318. Defenses against assignee; modification of contract after notification of assignment; term prohibiting assignment ineffective; identification and proof of assignment.

(1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims arising out of a sale as provided in Section 9-206 [55-9-206 NMSA 1978] the rights of an assignee are subject to:

(a) all the terms of the contract between the account debtor and assignor and any defense arising therefrom; and

(b) any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment.

(2) So far as the right to payment or a part thereof under an assigned contract has not been fully earned by performance, and notwithstanding notification of the assignment, any modification of or substitution for the contract made in good faith and in accordance with reasonable commercial standards is effective against an assignee unless the account debtor has otherwise agreed but the assignee acquires corresponding right under the modified or substituted contract. The assignment may provide that such modification or substitution is a breach by the assignor.

(3) The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned is ineffective. If requested by the account debtor, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless he does so the account debtor may pay the assignor.

(4) A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to such assignment or security interest.

History: 1953 Comp., § 50A-9-318, enacted by Laws 1961, ch. 96, § 9-318; 1985, ch. 193, § 25.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 9(3), Uniform Trust Receipts Act.

Purposes. - 1. Subsection (1) makes no substantial change in prior law. An assignee has traditionally been subject to defenses or setoffs existing before an account debtor is notified of the assignment. When the account debtor's defenses on an assigned claim arise from the contract between him and the assignor, it makes no difference whether the breach giving rise to the defense occurs before or after the account debtor is notified of the assignment (Paragraph (1) (a)). The account debtor may also have claims against the assignor which arise independently of that contract: an assignee is subject to all such claims which accrue before, and free of all those which accrue after, the account debtor is notified (Paragraph (1) (b)). The account debtor may waive his right to assert claims or defenses against an assignee to the extent provided in Section 9-206.

2. Prior law was in confusion as to whether modification of an executory contract by account debtor and assignor without the assignee's consent was possible after notification of an assignment. Subsection (2) makes good faith modifications by assignor and account debtor without the assignee's consent effective against the assignee even after notification. This rule may do some violence to accepted doctrines of contract law. Nevertheless it is a sound and indeed a necessary rule in view of the realities of large scale procurement. When for example it becomes necessary for a government agency to cut back or modify existing contracts, comparable arrangements must be made promptly in hundreds and even thousands of subcontracts lying in many tiers below the prime contract. Typically the right to payments under these subcontracts will have been assigned. The government, as sovereign, might have the right to amend or terminate existing contracts apart from statute. This subsection gives the prime contractor (the account debtor) the right to make the required arrangements directly with his subcontractors without undertaking the task of procuring assents from the many banks to whom rights under the contracts may have been assigned. Assignees are protected by the provision which gives them automatically corresponding rights under the modified or substituted contract. Notice that Subsection (2) applies only so far as the right to payment has not been earned by performance, and therefore its application ends entirely when the work is done or the goods furnished.

3. Subsection (3) clarifies the right of an account debtor to make payment to his seller-assignor in an "indirect collection" situation (see comment to Section 9-308). So long as the assignee permits the assignor to collect claims or leaves him in possession of chattel paper which does not indicate that payment is to be made at some place other than the assignor's place of business, the account debtor may pay the assignor even though he may know of the assignment. In such a situation an assignee who wants to take over collections must notify the account debtor to make further payments to him.

4. Subsection (4) breaks sharply with the older contract doctrines by denying effectiveness to contractual terms prohibiting assignment of sums due and to become due under contracts of sale, construction contracts and the like. Under the rule as stated, an assignment would be effective even if made to an assignee who took with full knowledge that the account debtor had sought to prohibit or restrict assignment of the claims.

It is only for the past hundred years that our law has recognized the possibility of assigning choses in action. The history of this development, at law and equity, is in broad outline well known. Lingering traces of the absolute common law prohibition have survived almost to our own day.

There can be no doubt that a term prohibiting assignment of proceeds was effective against an assignee with notice through the nineteenth century and well into the twentieth. Section 151 of the Restatement of Contracts (1932) so states the law without qualification, but the changing character of the law is shown in the proposed Section 154 of the Restatement, Second, Contracts.

The original rule of law has been progressively undermined by a process of erosion which began much earlier than the cited section of the Restatement of Contracts would suggest. The cases are legion in which courts have construed the heart out of prohibitory or restrictive terms and held the assignment good. The cases are not lacking where courts have flatly held assignments valid without bothering to construe away the prohibition. See 4 Corbin on Contracts (1951) §§ 872, 873. Such cases as Allhusen v. Caristo Const. Corp., 303 N.Y. 446, 103 N.E.2d 891 (1952), are rejected by this subsection.

This gradual and largely unacknowledged shift in legal doctrine has taken place in response to economic need: as accounts and other rights under contracts have become the collateral which secures an ever increasing number of financing transactions, it has been necessary to reshape the law so that these intangibles, like negotiable instruments and negotiable documents of title, can be freely assigned.

Subsection (4) thus states a rule of law which is widely recognized in the cases and which corresponds to current business practices. It can be regarded as a revolutionary departure only by those who still cherish the hope that we may yet return to the views entertained some two hundred years ago by the Court of King's Bench.

5. The Federal Assignment of Claims Act of 1940 - to which of course this section is subject - requires that assignments of claims against the United States be filed as provided in that act. Many large business enterprises, situated like the United States in that claims against them are held by hundreds or thousands of subcontractors or suppliers, often require in their contract or purchase order forms that assignments against them be filed in a prescribed way. Subsection (3) requires reasonable identification of the account assigned and recognizes the right of an account debtor to require reasonable proof of the making of the assignment and to that extent validates such requirements in contracts or purchase order forms. If the notification does not contain such reasonable identification or if such reasonable proof is not furnished on request, the account debtor may disregard the assignment and make payment to the assignor. What is "reasonable" is not left to the arbitrary decision of the account debtor; if there is doubt as to the adequacy either of a notification or of proof submitted after request, the account debtor may not be safe in disregarding it unless he has notified the assignee with commercial promptness as to the respects in which identification or proof is considered defective.

6. If the thing to be assigned is the beneficiary's right under a letter of credit, Section 5-116 should be consulted.

Cross references. - Point 1: Section 9-206.

Point 3: Sections 9-205 and 9-308.

Point 4: Section 2-210(2) and (3).

Point 6: Section 5-116.

Definitional cross references. - "Account". Section 9-106.

"Account debtor". Section 9-105.

"Agreement". Section 1-201.

"Contract". Section 1-201.

"Good faith". Section 1-201.

"Party". Section 1-201.

"Receives" notification. Section 1-201.

"Rights". Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Seasonably". Section 1-204.

"Term". Section 1-201.

Debtor may raise defenses against assignee of chose in action. - An assignee of a chose in action acquires by virtue of his assignment nothing more than the assignor had, and all equities and defense which could have been raised by the debtor against the assignor are available to the debtor against the assignee. Associates Loan Co. v. Walker, 76 N.M. 520, 416 P.2d 529 (1966).

Debtor not liable until notified of assignment. - In the absence of notice of assignment the debtor may, without incurring liability to the assignee, make payment as directed by the assignor. S & W Trucks, Inc. v. Nelson Auction Serv., Inc., 80 N.M. 423, 457 P.2d 220 (Ct. App. 1969).

Authorizing payment to another deemed insufficient notification. - Merely authorizing payment of a stated sum to a particular person cannot be considered as a notification that such sum had been assigned to the individual to whom payment is authorized. S & W Trucks, Inc. v. Nelson Auction Serv., Inc., 80 N.M. 423, 457 P.2d 220 (Ct. App. 1969).

Sufficient notification. - Here the assignment said that all right, title and interest of contractor to funds due from account debtor were to be assigned to bank, and this assignment was accepted by agent of account debtor. This was not a case of indirect collection. The account debtor could readily determine that assignee had purchased assignor's right, title and interest in the proceeds. There was no need for the assignee to instruct the account debtor not to pay the assignor. The unconditional language of the assignment was sufficient notice that the assignee was to be paid. First Nat'l Bank v. Mountain States Tel. & Tel. Co., 91 N.M. 126, 571 P.2d 118 (1977).

Receipt and deposit of payments by an account seller were proper, since account debtors may continue making payments to the debtor unless notified of the assignment and of the fact that payments are to be sent to the assignee (creditor) under the UCC. GMA, Inc. v. Boerner, 70 Bankr. 77 (Bankr. D.N.M. 1987).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 554.

Rights and duties in respect of property subject of conditional sale as between seller and seller's assignee, 65 A.L.R. 783.

Right as between surety on contractor's bond and assignee of money to become due on contract, 76 A.L.R. 917.

Priority as between assignee of rights of, and subsequent buyer from, conditional seller, 88 A.L.R. 109.

Notice to debtor as affecting priority as between different assignees of same chose in action, 110 A.L.R. 774.

Priority between assignee and surety of contractor who completes contract as to money earned by contractor but unpaid before default, 164 A.L.R. 613.

Constitutionality, construction and application of statute respecting sale, assignment or transfer of retail installment contracts, 10 A.L.R.2d 447.

Validity of anti-assignment clause in contract, 37 A.L.R.2d 1251.

Transferee of commercial paper given by purchaser of chattel and secured by conditional sale, retention of title, or chattel mortgage as subject to defenses which chattel purchaser could assert against seller, 44 A.L.R.2d 8, 39 A.L.R.3d 518.

Construction and operation of UCC § 9-318(3) providing that account debtor is authorized to pay assignor until he receives notification to pay assignee, 100 A.L.R.3d 1218.

6A C.J.S. Assignments §§ 75, 114; 72 C.J.S. Pledges § 41; 79 C.J.S. Secured Transactions § 141.

PART 4
FILING

55-9-401. Place of filing; removal of collateral.

(1) The proper place to file in order to perfect a security interest is as follows:

(a) when collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county clerk in the county of the debtor's residence or, if the debtor is not a resident of this state then in the office of the county clerk in the county where the goods are kept, and in addition when the collateral is crops growing or to be grown, in the office of the county clerk in the county where the land is located;

(b) when the collateral is timber to be cut or is minerals or the like (including oil and gas) or accounts subject to Subsection (5) of Section 9-103 [55-9-103 NMSA 1978], or when the financing statement is filed as a fixture filing (Section 9-313 [55-9-313 NMSA 1978]) and the collateral is goods which are or are to become fixtures, then in the real estate records in the office where a mortgage on the real estate would be filed or recorded;

(c) in all other cases, in the office of the secretary of state;

(2) A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing complied with the requirements of this article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

(3) A filing which is made in the proper place in this state continues effective even though the debtor's residence or place of business or the location of the collateral or its use, whichever controlled the original filing, is thereafter changed.

(4) The rules stated in Section 9-103 [55-9-103 NMSA 1978] determine whether filing is necessary in this state.

(5) Notwithstanding the preceding subsections, and subject to Subsection (3) of Section 9-302 [55-9-302 NMSA 1978] and to Sections 62-13-8 through 62-13-12.1 NMSA 1978, the proper place to file in order to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the secretary of state. This filing constitutes a fixture filing (Section 9-313 [55-9-313 NMSA 1978]) as to the collateral described therein which is or is to become fixtures.

(6) For the purposes of this section, the residents [residence] of an organization is its place of business if it has one or its chief executive office if it has more than one place of business.

History: 1953 Comp., § 50A-9-401, enacted by Laws 1961, ch. 96, § 9-401; 1967, ch. 186, § 26; 1985, ch. 193, § 26.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 4, Uniform Trust Receipts Act; Sections 6 and 7, Uniform Conditional Sales Act.

Purposes. - 1. Under chattel mortgage acts, the Uniform Conditional Sales Act and other conditional sales legislation the geographical unit for filing or recording was local: the county or township in which the mortgagor or vendee resided or in which the goods sold or mortgaged were kept. The Uniform Trust Receipts Act used the state as the geographical filing unit: under that act statements of trust receipt financing were filed with an official in the state capital and were not filed locally. The statewide filing system of the Trust Receipts Act has been followed in many accounts receivable and factor's lien acts.

Both systems have their advocates and both their own advantages and drawbacks. The principal advantage of statewide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to

have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a statewide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the more burdensome and costly. On the other hand, it can be said that most credit inquiries about local businesses, farmers and consumers come from local sources; convenience is served by having the files locally available and there is no great advantage in centralized filing.

This section does not attempt to resolve the controversy between the advocates of a completely centralized statewide filing system and those of a large degree of local autonomy. Instead the section is drafted in a series of alternatives; local considerations of policy will determine the choice to be made.

2. Fortunately there is general agreement that the proper filing place for security interests in fixtures is in the office where a mortgage on the real estate concerned would be filed or recorded, and Paragraph (1) (a) in the first alternative and Paragraph (1) (b) in the second and third alternatives so provide. This provision follows the Uniform Conditional Sales Act. Note that there is no requirement for an additional filing with the chattel records.

3. In states where it is felt wise to preserve local filing for transactions of essentially local interest, either the second or third alternative of subsection (1) should be adopted. Paragraph (1) (a) in both alternatives provides county (township, etc.) filing for consumer goods transactions and for agricultural transactions (farm equipment, farm products, farm accounts and crops). Note that the subsection departs from Section 6 of the Uniform Conditional Sales Act and adopts instead the policy of many chattel mortgage acts in selecting the county of the debtor's residence, rather than the county where the goods are located, as the normal filing place. Where, however, the debtor is an out-of-state resident, the filing must of necessity be in the county where the goods are, and the subsection so provides. Though not expressly stated, it is evident that filing for an assignment of accounts arising from the sale of farm products by a farmer who is not a resident must be in the county where the debtor keeps his farm products. In the case of crops growing or to be grown, where the land is in one county and the debtor's residence in another, filing must be made in both counties. Neither this filing for crops in the county where the land is nor the requirements that the security agreement (Section 9-203(1) (a)) and the financing statement (Section 9-402(1) and (3)) contain a description of the real estate point to the conclusion that a financing statement for a security interest in crops must be filed in the real estate records. This article follows pre-code law which recognized such a financing as a chattel mortgage. The policy of the subsection is to require filing in the place or places where a creditor would normally look for information concerning interests created by the debtor.

For some incorporated farmers, reference to residence is an anomaly. Therefore Subsection (6) provides that the residence of an organization is its place of business, or its chief executive office if it has more than one place of business. Compare Section 9-

103(3), which reaches essentially the same concept as a definition of the "location" of a debtor.

4. It is thought that sound policy requires a statewide filing system for all transactions except the essentially local ones covered in Paragraph (1) (a) of the second and third alternatives and land related transactions covered in Paragraph (1) (b) of the second and third alternatives. Paragraph (1) (c) so provides in both alternatives, as does Paragraph (1) (b) in the first alternative. In a state which has adopted either the second or third alternative, central filing would be required when the collateral was goods except consumer goods, farm equipment or farm products (including crops), or was documents or chattel paper or was accounts or general intangibles, unless related to a farm. Note that the filing provisions of this article do not apply to instruments (see Section 9-304).

If the third alternative Subsection (1) is adopted, then local filing, in addition to the central filing, is required in all the cases stated in the preceding paragraph, with respect to any debtor whose places of business within the state are all within a single county (township, etc.) or a debtor who is not engaged in business. The last event test stated in Section 9-103(1) (b) and comment thereto applies to determine whether local filing is required under the present section, as well as to determine in which state filing is required.

In states where the arguments for a completely centralized set of files (except for fixtures) prevail, the first alternative Subsection (1) should be adopted. That alternative provides for exclusive central filing of all security interests except those in fixtures.

5. When a secured party has in good faith attempted to comply with the filing requirements but has not done so correctly, Subsection (2) makes his filing effective in so far as it was proper, and also makes it good for all collateral covered by the financing statement against any person who actually knows the contents of the improperly filed statement. The subsection rejects the occasional decisions that an improperly filed record is ineffective to give notice even to a person who knows of it. But if the third alternative Subsection (1) is adopted, the requirements of Paragraph (1) (c) are not complied with unless there is filing in both offices specified; filing in only one of two required places is not effective except as against one with actual knowledge of the contents of the defective financing statement.

6. Subsection (3) deals with change of residence or place of business or the location or use of the goods *after* a proper filing has been made. The subsection is important only when local filing is required, and covers only changes between local filing units in the state. For changes of location between states see Section 9-103(1) (d).

Subsection (3) is presented in alternative forms. Under the first no new filing is required in the county to which the collateral has been removed. Under alternative Subsection (3) the original filing lapses four months after the change in location; this is basically the

same rule that is applied by Section 9-103(1) (d) to the case of collateral brought into the state subject to a security interest which attached elsewhere.

7. The usual filing rules do not apply well for a transmitting utility (defined in Section 9-105). Many pre-code statutes provided special filing rules for railroads and in some cases for other public utilities to avoid the requirements for filing with legal descriptions in every county in which such debtors had property. The code recreates and broadens these provisions by Subsection (5) of this section, which provides that for transmitting utilities the filing need only be in the office of the secretary of state. The nature of the debtor will inform persons searching the record as to where to make a search.

Cross references. - Sections 9-302, 9-304 and 9-307(2).

Point 2: Section 9-313.

Point 6: Section 9-103(3).

Point 7: Sections 9-402(5) and 9-403(6).

Definitional cross references. - "Account". Section 9-106.

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Debtor". Section 9-105.

"Equipment". Section 9-109.

"Farm products". Section 9-109.

"Financing statement". Section 9-402.

"Fixture filing". Section 9-313.

"Good faith". Section 1-201.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Signed". Section 1-201.

"Transmitting utility". Section 9-105.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

Limited duties of filing officers. - When an instrument appears correct, it is not the duty of the filing officer to determine the validity of such document, to ascertain whether it is genuine or forged or to rule upon its legal efficacy. Similarly, whether an instrument presented for filing is in fact an original, duplicate original or a copy of an original, or whether the signature appearing upon an instrument filed under the code is intended to be operative are questions which the filing officer is not normally able to judge. Consequently, the filing officer should accept instruments for filing under the code which appear valid on their face, leaving the determination of authenticity, legal effect and evidentiary value to the courts in cases where such issues are raised. 1961-62 Op. Att'y Gen. No. 62-126.

Law reviews. - For article, "Fixtures and the Uniform Commercial Code in New Mexico," see 4 Nat. Resources J. 109 (1964).

For article, "The Warehouseman vs. the Secured Party: Who Prevails When the Warehouseman's Lien Covers Goods Subject to a Security Interest?" see 8 Nat. Resources J. 331 (1968).

For comment on *Clovis Nat'l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967), see 8 Nat. Resources J. 183 (1968).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 35 Am. Jur. 2d Fixtures § 72; 68A Am. Jur. 2d Secured Transactions § 372 et seq.

Effect of recording chattel mortgage in town or county to which the mortgagor subsequently removed, 1 A.L.R. 1662.

Omission of amount of debt in mortgage or in record thereof as affecting validity of mortgage, its operation as notice, or its coverage with respect to debts secured, 145 A.L.R. 369.

Construction and application of statutory provision respecting registration of mortgages or other liens on personal property in case of residents of other states, 10 A.L.R.2d 764.

Conflict of laws as to chattel mortgages and conditional sales of chattels, 13 A.L.R.2d 1312.

Attorney's liability for negligence in preparing or recording security document, 87 A.L.R.2d 991.

6A C.J.S. Assignments § 57; 72 C.J.S. Pledges § 14; 79 C.J.S. Secured Transactions § 25 et seq.

55-9-402. Formal requisites of financing statement; amendments; mortgage as financing statement.

(1) A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers crops growing or to be grown, the statement must also contain a description of the real estate concerned. When the financing statement covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to Subsection (5) of Section 9-103 [55-9-103 NMSA 1978], or when the financing statement is filed as a fixture filing (Section 9-313 [55-9-313 NMSA 1978]) and the collateral is goods which are or are to become fixtures, the statement must also comply with Subsection (5). A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by the debtor. A carbon, photographic or other reproduction of a security agreement or a financing statement is sufficient as a financing statement if the security agreement so provides or if the original has been filed in this state.

(2) A financing statement which otherwise complies with Subsection (1) is sufficient when it is signed by the secured party instead of the debtor if it is filed to perfect a security interest in

(a) collateral already subject to a security interest in another jurisdiction when it is brought into this state, or when the debtor's location is changed to this state. Such a financing statement must state that the collateral was brought into this state or that the debtor's location was changed to this state under such circumstances; or

(b) proceeds under Section 9-306 [55-9-306 NMA 1978] if the security interest in the original collateral was perfected. Such a financing statement must describe the original collateral; or

(c) collateral as to which the filing has lapsed; or

(d) collateral acquired after a change of name, identity or corporate structure of the debtor (Subsection (7)).

(3) A form substantially as follows is sufficient to comply with Subsection (1):

Name of debtor (or assignor)
....

Address
....
..

Name of secured party (or assignee)
....

Address
....
..

1. This financing statement covers the following types (or items) of property:

(Describe)
....

2. (If collateral is crops) The above described crops are growing or are to be grown on:

(Describe Real Estate)
....

3. (If applicable) The above goods are to become fixtures on*

* Where appropriate substitute either "The above timber is standing on ." or "The above minerals or the like (including oil and gas) or accounts will be financed at the wellhead or minehead of the well or mine located on .."

(Describe Real Estate) .... and this financing statement is to be filed for record in the real estate records. (If the debtor does not have

an interest of record) The name of a record owner is
....

4. (If products of collateral are claimed)

Products of the collateral are also covered.

....
Signature of Debtor (or Assignor)
(use whichever is applicable) ....
Signature of Secured Party (or Assignee)

(4) A financing statement may be amended by filing a writing signed by both the debtor and the secured party. An amendment does not extend the period of effectiveness of a financing statement. If any amendment adds collateral, it is effective as to the added collateral only from the filing date of the amendment. In this article, unless the context otherwise requires, the term "financing statement" means the original financing financing statement and any amendments.

(5) A financing statement covering timber to be cut or covering minerals or the like (including oil and gas) or accounts subject to Subsection (5) of Section 9-103 [55-9-103(5) NMSA 1978], or a financing statement filed as a fixture filing (Section 9-313 [55-9-313 NMSA 1978]) where the debtor is not a transmitting utility, must show that it covers this type of collateral, must recite that it is to be filed for record in the real estate records, and the financing statement must contain a description of the real estate sufficient if it were contained in a mortgage of the real estate to give constructive notice of the mortgage under the law of this state. If the debtor does not have an interest of record in the real estate, the financing statement must show the name of a record owner.

(6) A mortgage is effective as a financing statement filed as a fixture filing from the date of its recording if (a) the goods are described in the mortgage by item or type, (b) the goods are or are to become fixtures related to the real estate described in the mortgage, (c) the mortgage complies with the requirements for a financing statement in this section other than a recital that it is to be filed in the real estate records, and (d) the mortgage is duly recorded. No fee with reference to the financing statement is required other than the regular recording and satisfaction fees with respect to the mortgage.

(7) A financing statement sufficiently shows the name of the debtor if it gives the individual, partnership or corporate name of the debtor, whether or not it adds other trade names or the names of partners. Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. A filed financing statement remains effective with respect to collateral transferred by the debtor even though the secured party knows of or consents to the transfer.

(8) A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading.

History: 1953 Comp., § 50A-9-402, enacted by Laws 1961, ch. 96, § 9-402; 1967, ch. 186, § 27; 1985, ch. 193, § 27.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 13(3), 13(4), Uniform Trust Receipts Act.

Purposes. - 1. Subsection (1) sets out the simple formal requisites of a financing statement under this article. These requirements are: (1) signature of the debtor; (2) addresses of both parties; (3) a description of the collateral by type or item.

Where the collateral is crops growing or to be grown or when the financing statement is filed as a fixture filing (Section 9-313) or when the collateral is timber to be cut or minerals or the like (including oil and gas) financed at wellhead or minehead or accounts resulting from the sale thereof, the financing statement must also contain a description of the lands concerned. On description generally, see Section 9-110 and Comment 5 to the present section. An important distinction must be drawn, however, between the function of the description of land in reference to crops and its function in the other cases mentioned. For crops it is merely part of the description of the crops concerned, and the security interest in crops is a code security interest, like the pre-code "crop mortgage" which was a *chattel* mortgage. In contrast, in the other cases mentioned the function of the description of land is to have the financing statement filed in the county where the land is situated and in the realty records, as distinguished from the chattel records. Subsection (3) suggests a form which complies with the statutory requirements and makes clear that for the types of collateral mentioned other than crops, the financing statement containing a description of the land concerned is to go in the realty records. Note also Subsection (5) on the adequacy of the description of land where the filing is to be in the real estate records. See also Section 9-403(7) on the indexing of these filings in the real estate records.

A copy of the security agreement may be filed in place of a separate financing statement, if it contains the required information and signature.

2. This section adopts the system of "notice filing" which proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales act, the security agreement itself, but only a simple notice which may be filed before the security interest attaches or thereafter. The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs. Section 9-208 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure. Notice filing has proved to be of great use in financing transactions involving inventory, accounts and chattel paper, since it obviates the necessity of refiling on each of a series of transactions in a continuing arrangement where the collateral changes from day to day. Where other types of collateral are involved, the alternative procedure of filing a signed copy of the security agreement may prove to be the simplest solution. Sometimes more than one copy of a financing statement or of a security agreement used as a financing statement is needed for filing. In such a case the section permits use of a carbon copy or photographic copy of the paper, including signatures.

However, even in the case of filings that do not necessarily involve a series of transactions the financing statement is effective to encompass transactions under a security agreement not in existence and not contemplated at the time the notice was filed, if the description of collateral in the financing statement is broad enough to encompass them. Similarly, the financing statement is valid to cover after-acquired property and future advances under security agreements whether or not mentioned in the financing statement.

3. This section departs from the requirements of many pre-code chattel mortgage statutes that the instrument filed be acknowledged or witnessed or accompanied by affidavits of good faith. Those requirements did not seem to have been successful as a deterrent to fraud; their principal effect was to penalize good faith mortgagees who had inadvertently failed to comply with the statutory niceties. They are here abandoned in the interest of a simplified and workable filing system.

4. Subsection (2) allows the secured party to file a financing statement signed only by himself where the filing is required by any of the events listed, each of which occurs after the commencement of the financing, and therefore under circumstances where the cooperation of the debtor is not certain. Section 9-401(3), alternative provision, contains similar permission on removal between counties in this state. The secured party should not be penalized for failure to make a timely filing by reason of difficulty in procuring the signature of a possibly reluctant or hostile debtor. Financing statements filed under this subsection must explain the circumstances under which they are filed with the signature of the secured party rather than that of the debtor.

In contrast to the signatures on original financing statements, an amendment to a financing statement must be signed by both parties, to preclude either from adversely affecting the interests of the other.

The reference in Subsection (4) to an amendment which "adds collateral" refers to additional types of collateral. A security interest on additional units of a type of collateral already described can be created under an after-acquired property clause or a new security agreement. See Comment 5 to Section 9-204. On priorities in such cases see Section 9-312 and comments thereto.

5. A description of real estate must be sufficient to identify it. See Section 9-110. This formulation rejects the view that the real estate description must be by metes and bounds, or otherwise conforming to traditional real estate practice in conveyancing, but of course the incorporation of such a description by reference to the recording data of a deed, mortgage or other instrument containing the description should suffice under the most stringent standards. The proper test is that a description of real estate must be sufficient so that the fixture financing statement will fit into the real estate search system and the financing statement be found by a real estate searcher. Optional language has been added by which the test of adequacy of the description is whether it would be adequate in a mortgage of the real estate. As suggested in the Note, more detail may be required if there is a tract indexing system or a land registration system.

Where the debtor does not have an interest of record in the real estate, a fixture financing statement must show the name of a record owner, and Section 9-403(7) requires the financing statement to be indexed in the name of that owner. Thus the fixture financing statement will fit into the real estate search system.

6. A real estate mortgage may provide that it constitutes a security agreement with respect to fixtures (or other goods) in conformity with this article. Combined mortgages on real estate and chattels are common and useful for certain purposes. This section goes further and makes provision that the recording of the real estate mortgage (if it complies with the requirements of a financing statement) shall constitute the filing of a financing statement as to the fixtures (but not, of course, as to the other goods). Section 9-403(6) makes the usual five-year maximum life for financing statements inapplicable to real estate mortgages which operate as financing statements under Section 9-402(6), and they are effective for the duration of the real estate recording.

Of course, if a combined mortgage covers chattels which are not fixtures, a regular chattel filing is necessary, and Subsection (6) is inapplicable to such chattels. Likewise, filing as a "fixture filing" provided in Section 9-401 does not apply to true chattels.

7. Subsection (7) undertakes to deal with some of the problems as to who is the debtor. In the case of individuals, it contemplates filing only in the individual name, not in a trade name. In the case of partnerships it contemplates filing in the partnership name, not in the names of any of the partners, and not in any other trade names. Trade names are deemed to be too uncertain and too likely not to be known to the secured party or

person searching the record, to form the basis for a filing system. However, provision is made in Section 9-403(5) for indexing in a trade name if the secured party so desires.

Subsection (7) also deals with the case of a change of name of a debtor and provides some guidelines when mergers or other changes of corporate structure of the debtor occur with the result that a filed financing statement might become seriously misleading. Not all cases can be imagined and covered by statutes in advance; however, the principle sought to be achieved by the subsection is that after a change which would be seriously misleading, the old financing statement is not effective as to new collateral acquired more than four months after the change, unless a new appropriate financing statement is filed before the expiration of the four months. The old financing statement, if legally still valid under the circumstances, would continue to protect collateral acquired before the change and, if still operative under the particular circumstances, would also protect collateral acquired within the four months. Obviously, the subsection does not undertake to state whether the old security agreement continues to operate between the secured party and the party surviving the corporate change of the debtor.

8. Subsection (7) also deals with a different problem, namely whether a new filing is necessary where the collateral has been transferred from one debtor to another. This question has been much debated both in pre-code law and under the code. This article now answers the question in the negative. Thus, any person searching the condition of the ownership of a debtor must make inquiry as to the debtor's source of title, and must search in the name of a former owner if circumstances seem to require it.

9. Subsection (8) is in line with the policy of this article to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of such statutory requirements in which courts have occasionally indulged themselves. As an example of the sort of reasoning which this subsection rejects, see General Motors Acceptance Corporation v. Haley, 329 Mass. 559, 109 N.E.2d 143 (1952).

Cross references. - Point 1: Section 9-110.

Point 2: Section 9-208.

Point 4: Sections 9-103, 9-306 and 9-401(3).

Point 5: Section 9-110.

Point 6: Section 9-403(6).

Point 7: Section 9-403(8).

Point 8: Section 9-311.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Fixture". Section 9-313.

"Fixture filing". Section 9-313.

"Goods". Section 9-105.

"Party". Section 1-201.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Signed". Section 1-201.

"Transmitting utility". Section 9-105.

Cross-references. - For Farm Products Secured Interest Act, see Chapter 56, Article 13 NMSA 1978.

I. General Consideration.
II. Requisites of Financing Statement.
III. Sample Form.
IV. Substantial Compliance.
V. Transfer of Collateral.

I. GENERAL CONSIDERATION.

Old security devices replaced by simplified procedures. - Under the terms of the code, the traditional distinctions among security devices such as conditional sales contracts and chattel mortgages are not retained. The code substitutes for such a simplified statutory procedure which applies to all transactions intended to create security interests in personal property and fixtures. 1961-62 Op. Att'y Gen. No. 62-1.

Traditional forms may continue. - The traditional forms of security agreements in use before the enactment of this section may continue to be used after its enactment. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

Acknowledgement not required for filing. - In keeping with the declared purpose of the code to simplify, clarify and modernize the law governing commercial transactions, and the rule of construction that the code shall be liberally construed and applied so as

to promote its underlying purposes and policies, such instruments as are filed pursuant to the provisions of the code are not required to be acknowledged as a prerequisite to being filed with the county clerks. 1961-62 Op. Att'y Gen. No. 62-1.

Security agreement must cover disputed items. - Although the filing of the financing statement was sufficient to put defendants on inquiry as to plaintiff's security interest, this avails plaintiff nothing when the security agreement did not cover the disputed items. Jones & Laughlin Supply v. Dugan Prod. Corp., 85 N.M. 51, 508 P.2d 1348 (Ct. App. 1973).

Language of security agreement prevails over financing statement. - In a conflict between the unsigned financing statement and the language of the security agreement the latter prevails for the reason that no security interest can exist in the absence of a security agreement, and therefore a financing statement which goes beyond the scope of the agreement has no effect to that extent. Jones & Laughlin Supply v. Dugan Prod. Corp., 85 N.M. 51, 508 P.2d 1348 (Ct. App. 1973).

Law reviews. - For article, "Fixtures and the Uniform Commercial Code in New Mexico," see 4 Nat. Resources J. 109 (1964).

For note, "Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico," see 8 Nat. Resources J. 513 (1968).

For comment on *Strevell-Paterson Fin. Co. v. May*, 77 N.M. 331, 422 P.2d 366 (1967), see 8 Nat. Resources J. 713 (1968).

For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 35 Am. Jur. 2d Fixtures § 72; 68A Am. Jur. 2d Secured Transactions § 372 et seq.

Construction and application of statutory provisions respecting registration of mortgages on personal property in case of residents of other states, 10 A.L.R.2d 764.

Necessity and sufficiency of notice or statement prescribed by factor's lien law, 96 A.L.R.2d 727.

Sufficiency of description in chattel mortgage as covering all property of a particular kind, 2 A.L.R.3d 839, 30 A.L.R.3d 9.

Construction and effect of UCC article 9, dealing with secured transactions, etc., 30 A.L.R.3d 9, 67 A.L.R.3d 308, 69 A.L.R.3d 1162, 76 A.L.R.3d 11, 99 A.L.R. 3d 807, 99

A.L.R.3d 1080, 100 A.L.R.3d 10, 100 A.L.R.3d 940, 7 A.L.R.4th 308, 11 A.L.R.4th 241, 90 A.L.R.4th 859, 25 A.L.R.5th 696.

Sufficiency of designation of debtor or secured party in security agreement of financing statement under UCC § 9-402, 99 A.L.R.3d 478.

Sufficiency of address of debtor in financing statement required by UCC § 9-402(1), 99 A.L.R.3d 807.

Sufficiency of address of secured party in financing statement required under UCC § 9-402(1), 99 A.L.R.3d 1080.

Sufficiency of description of collateral in financing statement under UCC §§ 9-110 and 9-402, 100 A.L.R.3d 10.

Sufficiency of secured party's signature on financing § 9-402, or security agreement under UCC § 9-402, 100 A.L.R.3d 390.

Sufficiency of debtor's signature on security agreement or financing statement under UCC §§ 9-203 and 9-402, 3 A.L.R.4th 502.

76 C.J.S. Records § 4 et seq.; 79 C.J.S. Secured Transactions § 63 et seq.

II. REQUISITES OF FINANCING STATEMENT.

This section adopts system of notice filing designed to replace rigid description requirements. But, while the description requirements have been liberalized, the language of Subsection (1) clearly requires some specificity of description. Mogul Enters., Inc. v. Commercial Credit Bus. Loans, Inc., 92 N.M. 215, 585 P.2d 1096 (1978).

Need for description of property and names of parties to instrument. - With chattel mortgages, constructive notice generally is given by recording the instrument in the proper county along with designating the mortgagee and mortgagor (or assignee of mortgagor), inasmuch as ofttimes it is impractical to discover whether personal property is subject to a lien from solely the description of the personal property itself, without the name of the mortgagor. Reconstruction Fin. Corp. v. Stephens, 118 F. Supp. 565 (D.N.M. 1954)(decided under former law).

"Inventory," "equipment" and "supplies" sufficient to describe collateral. - The terms "inventory," "equipment" and "supplies" are sufficient to meet the requirement that collateral must be described in general language reasonably describing the items. Waterfield v. Burnett, 21 Bankr. 752 (Bankr. D.N.M. 1982).

Language in financing statement fails to satisfy section. - The words "all assets . . . regardless of type or description now owned . . . or to be bought in the future . . ." in a financing statement fail to satisfy the requirements of this section. The language is too

general and vague to fulfill the demand that the financing statement at least reveal "the type" of collateral. The language is misleading and does not give subsequent secured parties adequate notice of a security interest in inventory and accounts receivable. Mogul Enters., Inc. v. Commercial Credit Bus. Loans, Inc., 92 N.M. 215, 585 P.2d 1096 (1978).

Minor errors in information does not invalidate financing statement. - A security agreement is sufficient as a financing statement if it contains all the information required of a valid financing statement, even though there are minor errors in the information. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

Omitting debtor's address is major error. - Leaving the address of the debtor out of a financing statement is a major error. First Nat'l Bank v. Niccum (In re Permian Anchor Servs.), 649 F.2d 763 (10th Cir. 1981).

Lack of the secured party's signature does not make the instrument defective within the meaning of this section. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

Copies of signatures may be accepted. - The secretary of state may accept for filing under the uniform commercial code an instrument that contains a photo-copy or carbon-copy of the signature of the debtor and/or the secured party. 1961-62 Op. Att'y Gen. No. 62-126.

May file security agreement. - In lieu of a financing statement designated under this section, a security agreement may be filed which substantially complies with the requisites prescribed in this section. 1961-62 Op. Att'y Gen. No. 62-12.

May file chattel mortgage. - An instrument denominated as a "chattel mortgage" may be filed as a financing statement so long as it contains the necessary information. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

May not file abbreviated lease with no reservation of lien. - Recording of abbreviated lease which contained no express reservation of a lien reserved by landlord was not sufficient compliance with the Chattel Mortgage Act to be prior statutory lien against a subsequent mortgagee who did comply, or as against the trustee in bankruptcy. Savage v. McNeany, 372 F.2d 199 (10th Cir. 1967).

III. SAMPLE FORM.

No specific form is required for a financing statement filed under the code. 1961-62 Op. Att'y Gen. No. 62-2.

IV. SUBSTANTIAL COMPLIANCE.

Name only on cover of instrument not substantial compliance. - Where secured party's name appears only on cover of instrument, the secured party does not substantially comply with the necessary requirements, and such instrument is defective as a financing statement and does not give notice to the defendant of the secured party's security interest. Strevell-Paterson Fin. Co. v. May, 77 N.M. 331, 422 P.2d 366 (1967).

Security interest not unperfected when change in debtor's name not recorded. - Filed security agreement listing debtor under former corporate name did not become "seriously misleading", as referred to in Subsection (5) (now see Subsection (8)), once debtor changed its name so as not to serve sufficient notice of security interest, since financing statement is sufficient even if it fails to give any name for a debtor where debtor's address and mailing address are given, and since later creditor knew of debtor's first corporate name and of first creditor's intention to advance money so that later creditor could not have been misled; consequently, first creditor's priority did not become "unperfected" for failure to file new security agreement and financing statement. In re Bud Long Chevrolet, Inc., 39 Bankr. 499 (Bankr. D.N.M. 1984).

Minor errors which are not seriously misleading will not invalidate a financing statement or continuation statement which otherwise is in substantial compliance with statutory requirements. In re Camp Town, Inc., 197 Bankr. 139 (Bankr. D. N.M. 1996).

V. TRANSFER OF COLLATERAL.

Failure to identify new debtor. - Where the secured party had knowledge of the debtor's transfer of the collateral and accepted payments from the transferee on the debtor's note but never amended its financing statement to identify the transferee as the new debtor, the secured party's filing of a "continuation statement" naming the original debtor whom it knew was no longer in possession of the collateral was insufficient to preserve the security interest. Production Credit Ass'n v. Lane (In re Cattle Complex Corp.), 61 Bankr. 526 (Bankr. D.N.M. 1986).

55-9-403. What constitutes filing; duration of filing; effect of lapsed filing; duties of filing officer.

(1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under Chapter 55, Article 9 NMSA 1978.

(2) Except as provided in Subsection (6) of this section, a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five-year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five-year period, whichever

occurs later. Upon lapse, the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse.

(3) A continuation statement may be filed by the secured party within six months prior to the expiration of the five-year period specified in Subsection (2) of this section. Any such continuation statement must be signed by the secured party, identify the original statement by file number and state that the original statement is still effective. A continuation statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with Subsection (2) of Section 55-9-405 NMSA 1978, including payment of the required fee. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as provided in Subsection (2) of this section, unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. Unless a statute on disposition of public records provides otherwise, the filing officer may remove a lapsed statement from the files and destroy it immediately if he has retained a microfilm or other photographic record, or in other cases after one year after the lapse. The filing officer shall so arrange matters by physical annexation of financing statements to continuation statements or other related filings, or by other means, that if he physically destroys the financing statements of a period more than five years past, those which have been continued by a continuation statement or which are still effective under Subsection (6) of this section shall be retained.

(4) Except as provided in Subsection (7) of this section a filing officer shall mark each statement with a file number and with the date and hour of filing and shall hold the statement or a microfilm or other photographic copy thereof for public inspection. In addition the filing officer shall index the statements according to the name of the debtor and shall note in the index the file number and the address of the debtor given in the statement.

(5) The uniform fee for filing and indexing and for stamping a copy furnished by the secured party to show the date and place of filing for an original financing statement or for a continuation statement shall be eleven dollars fifty cents ($11.50) if the statement consists of one page otherwise fifteen dollars ($15.00); provided, however, if the number of pages filed exceeds twenty-five, such fee shall be fifty-four dollars ($54.00).

(6) If the debtor is a transmitting utility (Subsection (5) of Section 55-9-401 NMSA 1978) and a filed financing statement so states, it is effective until a termination statement is filed. A real estate mortgage which is effective as a fixture filing under Subsection (6) of Section 55-9-402 NMSA 1978 remains effective as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real estate.

(7) When a financing statement, continuation statement, termination statement, statement of assignment or statement of release covers timber to be cut or covers minerals or the like (including oil and gas) or accounts subject to Subsection (5) of Section 55-9-103 NMSA 1978, or is filed as a fixture filing, it shall be filed for record in the real estate records, notwithstanding the provisions of Sections 55-9-403, 55-9-404, 55-9-405 and 55-9-406 NMSA 1978 pertaining to the filing of such statements, and the filing officer shall index it under the names of the debtor and any owner of record shown on the financing statement in the same fashion as if they were the mortgagors in a mortgage of the real estate described, and, to the extent that the law of this state provides for indexing of mortgages under the name of the mortgagee, under the name of the secured party as if he were the mortgagee thereunder or where indexing is by description in the same fashion as if the financing statement were a mortgage of the real estate described. The fee for filing such documents for record in the real estate records shall be the fee prescribed by Subsection C of Section 14-8-12 NMSA 1978 for recording real estate records. None of these documents need be acknowledged in order to be so recorded.

History: 1953 Comp., § 50A-9-403, enacted by Laws 1961, ch. 96, § 9-403; 1967, ch. 186, § 28; 1977, ch. 179, § 1; 1985, ch. 113, § 1; 1985, ch. 193, § 28; 1986, ch. 36, § 1.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Sections 13(3), 13(4), Uniform Trust Receipts Act; Section 10, Uniform Conditional Sales Act.

Purposes. - 1. Prior law was not always clear whether a mortgage filed for record gave constructive notice from the time of presentation to the filing officer or only from the time of indexing. Subsection (1) adopts the former position.

2. Prior statutes have usually limited the effectiveness of a filing to a specified period of time after which refiling is necessary. Subsection (2) follows the same policy, establishing five years as the filing period, with an exception for the cases mentioned in Subsection (6). Subsection (3) provides for the filing of one or more continuation statements (which need be signed only by the secured party) if it is desired to continue the effectiveness of the original filing.

The theory of this article is that the public files of financing statements are self-clearing, because the filing officer may automatically discard each financing statement after a period of five years plus the year after lapse required by Subsection (3), unless a continuation statement is filed, or the financing statement is still effective under Subsection (6). This theory materially lessens the tension that would otherwise exist to have the files cleared by termination statements under Section 9-404. Similarly, a person searching the files need not go back past this five years plus one year; and if the indices are arranged by years, he has a limited and defined search problem. The

section asks the filing officer to attach financing statements whose life has been continued by continuation statements to the latter statements, so that anything contained in the files of old years can be discarded.

Subsection (6) provides certain special filing rules, namely, filings against transmitting utilities (Section 9-105), for which financing statements are filed in the office of the [secretary of state]; and real estate mortgages which serve as fixture financing statements and which are filed in the real estate records. In both of these cases the financing statement is valid for the life of the obligations secured. No confusion as to the required scope of search should result, because of the special nature of the filings involved.

3. Under Subsection (2) the security interest becomes unperfected when filing lapses. Thereafter, the interest of the secured party is subject to defeat by purchasers and lienors even though before lapse the conflicting interest may have been junior. Compare the situation arising under Section 9-103(1) (d) when a perfected security interest under the law of another jurisdiction is not perfected in this state within four months after the property is brought into this state.

Thus if A and B both make nonpurchase money advances against the same collateral, and both perfect security interests by filing, A who files first is entitled to priority under Section 9-312(5). But if no continuation statement is filed, A's filing may lapse first. So long as B's interest remains perfected thereafter, he is entitled to priority over A's unperfected interest. This rule avoids the circular priority which arose under some prior statutes, under which A was subordinate to the debtor's trustee in bankruptcy, A retained priority over B, and B's interest was valid against the trustee in bankruptcy. In re Andrews, 172 F.2d 996 (7th Cir. 1949).

4. Subsection (7) makes clear that the filings in real estate records (Sections 9-401 and 9-402(3) and (5)) shall be indexed in the real estate records, where they will be found by a real estate searcher. Where the debtor is not an owner of record, the financing statement must show the name of an owner of record, and the statement is to be indexed in his name. See Sections 9-313(4) (b) and (c); 9-402(3) and 9-402(5).

Cross references. - Point 3: Sections 9-103(3), 9-301 and 9-312(5).

Point 4: Sections 9-313(4) (b) and (c), 9-401(1), 9-402(3) and (5) and 9-405(2).

Definitional cross references. - "Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Fixture". Section 9-313.

"Fixture filing". Section 9-313.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Transmitting utility". Section 9-105.

The 1986 amendment, effective February 28, 1986, throughout the section, inserted "of this section" after references to subsections; in Subsection (1), substituted "Chapter 55, Article 9 NMSA 1978" for "this article"; in the third sentence in Subsection (3), substituted "Section 55-9-405 NMSA 1978" for "Section 9-405"; in Subsection (5), substituted "eleven dollars fifty cents ($11.50) if the statement consists of one page otherwise fifteen dollars ($15.00); provided, however, if the number of pages filed exceeds twenty-five, such fee shall be fifty-four dollars ($54.00)" for "three dollars ($3.00)"; in Subsection (6), substituted "Section 55-9-401 NMSA 1978" for "Section 9-401" and "Section 55-9-402 NMSA 1978" for "Section 9-402"; in the first sentence in Subsection (7), substituted "Section 55-9-103 NMSA 1978" for "Section 9-103," "Sections 55-9-403, 55-9-404, 55-9-405 and 55-9-406 NMSA 1978" for "Sections 9-403, 9-404, 9-405 and 9-406," and in the next-to-last sentence in Subsection (7) substituted "Subsection C" for "Subsection (c)".

Compiler's note. - Subsection C of § 14-8-12 NMSA 1978, referred to in the next-to-last sentence in Subsection (7), was repealed by Laws 1985, ch. 122, § 1. For present comparable provisions, see Subsection B of § 14-8-12 NMSA 1978.

Lapse prior to end of five-year period. - A security interest may lapse before the end of the five-year period in this section only if (1) a termination statement is filed pursuant to 55-9-404 NMSA 1978, or (2) the debtor makes full payment on the underlying note. Bond Enters., Inc. v. Western Bank, 54 Bankr. 366 (Bankr. D.N.M. 1985).

Lapse during bankruptcy proceedings. - A creditor's security interest, perfected and valid at the initiation of bankruptcy proceedings but due to expire during the pendency of those proceedings does not lapse where the creditor fails to file a continuation statement. Rather, the creditor's rights in the security interest are preserved until the later of either (1) the end of the time period fixed by this section for the lapsing of a financing statement, or (2) thirty days after notice of the expiration or termination of the stay under 11 U.S.C. 362. Bond Enters., Inc. v. Western Bank, 54 Bankr. 366 (Bankr. D.N.M. 1985).

Fee for mortgage executed before but filed after effective date of code. - When a chattel mortgage was entered into by the parties and executed prior to the date of January 1, 1962, but was offered for filing with the county clerk of secretary of state after the effective date of the uniform commercial code the proper filing fee for such instruments was the fee specified under the provisions of former 61-8-6, 1953 Comp. 1961-62 Op. Att'y Gen. No. 62-12.

Law reviews. - For comment, "New Mexico's Uniform Commercial Code in Oil and Gas Transactions," see 10 Nat. Resources J. 361 (1970).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 405 et seq.

Premature refiling, 63 A.L.R. 591.

Sufficiency of description of property in recorded conditional sales contract to give notice of third persons, 65 A.L.R. 717.

Effect of officer's failure properly to file contract, 70 A.L.R. 595.

Assignees for creditors as within protection of statute requiring filing of conditional sales contract, 71 A.L.R. 981.

Failure of conditional seller of property to tenant to file contract as defeating his rights against landlords, 98 A.L.R. 634.

Federal government or agencies of federal government as subject to payment of tax or fee imposed upon or for recording or filing instrument, 124 A.L.R. 1267.

Construction and application of statute requiring conditional sale contract or record thereof to describe all conditions or terms of the sale, 130 A.L.R. 725.

What amounts to notice which will subject one's rights to unrecorded conditional sale contract, 159 A.L.R. 669.

Registration of mortgages or other liens on personal property in case of residents of other states, 10 A.L.R.2d 764.

Sufficiency of designation of debtor or secured party in security agreement of financing statement under UCC § 9-402, 99 A.L.R.3d 478.

76 C.J.S. Records § 4 et seq.; 79 C.J.S. Secured Transactions § 63 et seq.

55-9-404. Termination statement.

(1) If a financing statement covering consumer goods is filed on or after January 1, 1986, then within one month or within ten days following written demand by the debtor after there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give value, the secured party must file with each filing officer with whom the financing statement was filed a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number. In other cases whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations or otherwise give

value, the secured party must on written demand by the debtor send the debtor, for each filing officer with whom the financing statement was filed, a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number. A termination statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record complying with Subsection (2) of Section 55-9-405 NMSA 1978, including payment of the required fee. If the affected secured party fails to file such a termination statement as required by this subsection, or to send such a termination statement within ten days after proper demand therefor he shall be liable to the debtor for one hundred dollars ($100), and in addition for any loss caused to the debtor by such failure.

(2) On presentation to the filing officer of such a termination statement he must note it in the index. If he has received the termination statement in duplicate, he shall return one copy of the termination statement to the secured party stamped to show the time of receipt thereof. If the filing officer has a microfilm or other photographic record of the financing statement, and of any related continuation statement, statement of assignment and statement of release, he may remove the originals from the files at any time after receipt of the termination statement, or if he has no such record, he may remove them from the files at any time after one year after receipt of the termination statement.

(3) The uniform fee for filing and indexing the termination statement shall be eleven dollars fifty cents ($11.50) if the statement consists of one page otherwise fifteen dollars ($15.00).

History: 1953 Comp., § 50A-9-404, enacted by Laws 1961, ch. 96, § 9-404; 1977, ch. 179, § 2; 1985, ch. 113, § 2; 1985, ch. 193, § 29; 1986, ch. 36, § 2.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 12, Uniform Conditional Sales Act.

Purposes. - 1. To provide a procedure for noting discharge of the secured obligation on the records and for noting that a financing arrangement has been terminated.

Since most financing statements expire in five years unless a continuation statement is filed (Section 9-403), no compulsion is placed on the secured party to file a termination statement unless demanded by the debtor, except in the case of consumer goods. Because many consumers will not realize the importance of clearing the situation as it appears on file, an affirmative duty is put on the secured party in that case. But many purchase money security interests in consumer goods will not be filed, except for motor vehicles (Section 9-302(1) (d)); and in the case of motor vehicles a certificate of title law may control instead of the provisions of Article 9.

2. This section adds to the usual provisions one covering the problem which arises because a secured party under a notice filing system may file notice of an intention to make advances which may never be made. Under this section a debtor may require a secured party to send a termination statement when there is no outstanding obligation and no commitment to make future advances.

Cross references. - Point 2: Section 9-402(1).

Definitional cross references. - "Consumer goods". Section 9-109.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Person". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Value". Section 1-201.

"Written". Section 1-201.

I. General Consideration.
II. Duties of Secured Party or Assignee.
III. Duties of Filing Officers.
IV. Fees.

I. GENERAL CONSIDERATION.

The 1986 amendment, effective February 28, 1986, in the next-to-last sentence in Subsection (1), substituted "Section 55-9-405 NMSA 1978" for "Section 9-405" and, in Subsection (3), substituted "eleven dollars fifty cents ($11.50) if the statement consists of one page otherwise fifteen dollars ($15.00)" for "three dollars ($3.00)".

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 426 et seq.

72 C.J.S. Pledges § 46; 76 C.J.S. Records § 4 et seq.; 79 C.J.S. Secured Transactions § 127 et seq.

II. DUTIES OF SECURED PARTY OR ASSIGNEE.

Termination statement not necessary for refinancing. - Small loan companies are no longer required to file termination statements and new financing statements merely because a loan has been refinanced. 1970 Op. Att'y Gen. No. 70-78.

III. DUTIES OF FILING OFFICERS.

Return of instruments to secured party deemed mandatory. - Subsection (2) directs the county clerks to return certain instruments upon presentation to them of a termination statement accompanied by an assignment, if necessary, or upon presentation of the termination statement if signed by the secured party of record. Such language is mandatory and not permissive in effect. 1961-62 Op. Att'y Gen. No. 62-1 (opinion rendered under prior law).

Termination statement not returned. - The termination statement should be retained by the filing officer and not returned with the other instruments since such documents evidence the fact of termination under such statute. 1964 Op. Att'y Gen. No. 64-42 (opinion rendered under prior law).

Clerks liable for failure to perform prescribed duties. - A county clerk may be personally responsible for damages to individuals incurring personal damage by reason of the neglect of the clerk or his failure to perform his required duties as set forth and prescribed under the provisions of the code. 1961-62 Op. Att'y Gen. No. 62-1 (opinion rendered under prior law).

IV. FEES.

Fees for filing statement of assignment may vary. - Under this section, the fee for filing an assignment or statement by the secured party of record, when accompanying a termination statement is $0.75. Where, however, the statement of assignment is filed separately under provisions of 55-9-405 NMSA 1978, and does not accompany a termination statement, then the proper fee for filing such instrument is $1.00. As provided in Subsection (2) of 55-9-405 NMSA 1978, the proper fee for a separate assignment not accompanying a termination statement is slightly higher. 1961-62 Op. Att'y Gen. No. 62-1 (opinion rendered under prior law).

Termination and assignment require separate fees. - Each instrument required under this section, if separately filed, is subject to the separate filing fee specified. And if both an assignment and a termination statement are contained in a combined instrument, the filing fee chargeable would be $1.75, being the combined filing fee for both instruments. 1961-62 Op. Att'y Gen. No. 62-1 (opinion rendered under prior law).

Fee on mortgage recorded before but released after effective date of Code. - The correct fee to be charged by a clerk for satisfying a chattel mortgage recorded prior to the effective date of the uniform commercial code and which is sought to be released after the effective date of the code is $.25. 1961-62 Op. Att'y Gen. No. 62-12 (opinion rendered under prior law).

55-9-405. Assignment of security interest; duties of filing officer; fees.

(1) A financing statement may disclose an assignment of a security interest in the collateral described in the financing statement by indication in the financing statement of the name and address of the assignee or by an assignment itself or a copy thereof on the face or back of the statement. On presentation to the filing officer of such a financing statement the filing officer shall mark the same as provided in Subsection (4) of Section 55-9-403 NMSA 1978. The uniform fee for filing, indexing and furnishing filing data for a financing statement so indicating an assignment shall be twelve dollars fifty cents ($12.50).

(2) A secured party may assign of record all or a part of his rights under a financing statement by the filing in the place where the original financing statement was filed of a separate written statement of assignment signed by the secured party of record and setting forth the name of the secured party of record and the debtor, the file number and the date of filing of the financing statement and the name and address of the assignee and containing a description of the collateral assigned. A copy of the assignment is sufficient as a separate statement if it complies with the preceding sentence. On presentation to the filing officer of such a separate statement, the filing officer shall mark such separate statement with the date and hour of the filing. He shall note the assignment on the index of the financing statement, or in the case of a fixture filing, or a filing covering timber to be cut, or covering minerals or the like (including oil and gas) or accounts subject to Subsection (5) of Section 55-9-103 NMSA 1978, he shall index the assignment under the name of the assignor as grantor and, to the extent that the law of this state provides for indexing the assignment of a mortgage under the name of the assignee, he shall index the assignment of the financing statement under the name of the assignee. The uniform fee for filing, indexing and furnishing filing data about such a separate statement of assignment shall be four dollars ($4.00). Notwithstanding the provisions of this subsection, an assignment of record of a security interest in a fixture contained in a mortgage effective as a fixture filing (Subsection (6) of Section 55-9-402 NMSA 1978) may be made only by an assignment of the mortgage in the manner provided by the law of this state other than the Uniform Commercial Code [Chapter 55 NMSA 1978].

(3) After the disclosure or filing of an assignment under this section, the assignee is the secured party of record.

History: 1953 Comp., § 50A-9-405, enacted by Laws 1961, ch. 96, § 9-405; 1977, ch. 179, § 3; 1985, ch. 113, § 3; 1985, ch. 193, § 30; 1986, ch. 36, § 3.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - This section provides a permissive device whereby a secured party who has assigned all or part of his interest may have the assignment noted of record. Note that under Section 9-302(2) no filing of such an assignment is required as a condition of continuing the perfected status of the security interest against creditors and transferees of the original debtor. A secured party who has assigned his interest might wish to have the fact noted of record, so that inquiries concerning the transaction would be addressed not to him but to the assignee (see Point 2 of comment to Section 9-402). After a secured party has assigned his rights of record, the assignee becomes the "secured party of record" and may file a continuation statement under Section 9-403, a termination statement under Section 9-404 or a statement of release under Section 9-406.

Where a mortgage of real estate is effective as a financing statement filed as a fixture filing (Section 9-402(6)), then an assignment of record of the security interest may be made only in the manner in which an assignment of the mortgage may be made under the local state law.

Cross references. - Sections 9-302(2) and 9-402 to 9-406.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Signed". Section 1-201.

"Written". Section 1-201.

The 1986 amendment, effective February 28, 1986, in Subsection (1), in the second sentence, substituted "Subsection (4) of Section 55-9-403 NMSA 1978" for "Section 9-403(4)" and, in the last sentence, "twelve dollars fifty cents ($12.50)" for "five dollars ($5.00)"; in Subsection (2), substituted "Section 55-9-103 NMSA 1978" for "Section 9-103" in the fourth sentence, substituted "four dollars ($4.00)" for "two dollars ($2.00)" in the fifth sentence, "Section 55-9-402 NMSA 1978" for "Section 9-402," and "the Uniform Commercial Code" for "this act" in the last sentence.

Continuity of financing statement. - The assignee of a security interest was entitled to the priority of the original financing statement since there was no lapse in sequence of filings of amendments, assignments, and continuations, and the assignee was lawfully entitled to all rights in the financing statement. In re Camp Town, Inc., 197 Bankr. 139 (Bankr. D. N.M. 1996).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 282 et seq.

72 C.J.S. Pledges §§ 41 to 43; 79 C.J.S. Secured Transactions §§ 25, 134 et seq.

55-9-406. Release of collateral; duties of filing officer; fees.

A secured party of record may by his signed statement release all or part of any collateral described in a filed financing statement. The statement of release is sufficient if it contains a description of the collateral being released, the name and address of the debtor, the name and address of the secured party, and the file number of the financing statement. A statement of release signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record and complying with Subsection (2) of Section 55-9-405 NMSA 1978, including payment of the required fee. Upon presentation of such a statement of release to the filing officer he shall mark the statement with the hour and date of filing and shall note the same upon the margin of the index of the filing of the financing statement. The uniform fee for filing and noting such a statement of release shall be seven dollars fifty cents ($7.50) if the statement consists of one page otherwise fifteen dollars ($15.00).

History: 1953 Comp., § 50A-9-406, enacted by Laws 1961, ch. 96, § 9-406; 1977, ch. 179, § 4; 1985, ch. 113, § 4; 1985, ch. 193, § 31; 1986, ch. 36, § 4.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - Like the preceding section, this section provides a permissive device for noting of record any release of collateral. There is no requirement that such a statement be filed when collateral is released (cf. Section 9-404 on Termination Statements). It is merely a method of making the record reflect the true state of affairs so that fewer inquiries will have to be made by persons who consult the files.

If the statement of release is not signed by the secured party of record, the assignment procedure of Section 9-405(2) must be followed.

Cross reference. - Section 9-404.

Definitional cross references. - "Collateral". Section 9-105.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Secured party". Section 9-105.

"Signed". Section 1-201.

The 1986 amendment, effective February 28, 1986, substituted "Section 55-9-405 NMSA 1978" for "Section 9-405" in the third sentence and "seven dollars fifty cents ($7.50) if the statement consists of one page otherwise fifteen dollars ($15.00)" for "three dollars ($3.00)" in the last sentence.

Fee on mortgage recorded before but released after effective date of code. - The correct fee to be charged by a clerk for satisfying a chattel mortgage recorded prior to the effective date of the uniform commercial code and which is sought to be released after the effective date of the code is $.25. 1961-62 Op. Att'y Gen. No. 62-12 (opinion rendered under prior law).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 434 et seq.

72 C.J.S. Pledges § 44; 76 C.J.S. Records § 4 et seq.; 79 C.J.S. Secured Transactions § 127 et seq.

55-9-407. Information from filing officer.

(1) If the person filing any financing statement, termination statement, statement of assignment or statement of release furnishes the filing officer a copy thereof, the filing officer shall upon request note upon the copy the file number and date and hour of the filing of the original and deliver or send the copy to such person.

(2) Upon request, the secretary of state shall furnish a copy of any filed financing statement or of assignment for a uniform fee of one dollar ($1.00) per page.

(3) Upon request of any person, the county clerk shall furnish a photocopy of any instrument filed with said filing officer and shall, upon request, certify said photocopy as being a true copy of the record. The uniform fee for each such photocopy shall be one dollar ($1.00) per page, and the fee for each such certificate shall be one dollar ($1.00). The county clerk shall further certify as a true and correct copy of the record any typed or photocopied instrument furnished to the county clerk by any person, if the county clerk finds such a copy to be a true and correct copy. The fee for such certificate shall be one dollar ($1.00), with an additional fee of seventy-five cents ($.75) for comparing each page so certified with the filed instrument.

History: 1953 Comp., § 50A-9-407, enacted by Laws 1961, ch. 96, § 9-407; 1985, ch. 193, § 32; 1986, ch. 36, § 5.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. Subsection (1) requires the filing officer upon request to return to the secured party a copy of the financing statement on which the material data concerning the filing are noted. Receipt of such a copy will assure the secured party that the mechanics of filing have been complied with. Note, however, that under Section 9-403(1) the secured party does not bear the risk that the filing officer will not properly perform his duties: under that section the secured party has complied with the filing requirements when he presents his financing statement for filing and the filing fee has been tendered or the statement accepted by the filing officer.

2. Subsection (2) requires the filing officer on request to issue to any person who has tendered the proper fee his certificate as to what filings have been made against any particular debtor and to furnish copies of such filed financing statements. In view of the centralized filing system adopted by this article (see Section 9-401 and comment thereto), this provision is of obvious convenience to a person who wishes to know what the files contain but who cannot conveniently consult files located in the state capital.

Cross references. - Point 1: Section 9-403(1).

Point 2: Section 9-401.

Definitional cross references. - "Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Person". Section 1-201.

"Secured party". Section 9-105.

"Send". Section 1-201.

The 1986 amendment, effective February 28, 1986, deleted the former first and second sentences of Subsection (2) which read, "Upon request of any person, the secretary of state shall issue his or her certificate showing whether there is on file on the date and hour stated therein, any presently effective financing statement naming a particular debtor and any statement of assignment thereof and if there is, giving the date and hour of filing of each such statement and the names and addresses of each secured party therein. The uniform fee for such a certificate shall be three dollars ($3.00)." and substituted "one dollar ($1.00)" for "seventy-five cents ($.75)" at the end of the subsection; in Subsection (3), substituted "one dollar ($1.00)" for "seventy-five cents ($.75)" and "one dollar ($1.00)" for "fifty cents ($.50)" in the second sentence, and substituted "one dollar ($1.00)" for "fifty cents ($.50)" in the last sentence.

Copy of filed information. - A secured party does not have a duty to retain a copy of what was filed: This section requires the noting of filing information on a copy only upon the request of the person filing and is inconsistent with any such duty. Greenman Motor, Inc. v. United N.M. Bank, 48 Bankr. 611 (Bankr. D.N.M. 1985).

The secretary of state is not required to perform searches of file documents related to the Uniform Commercial Code upon request. 1987 Op. Att'y Gen. No. 87-17.

Clerk not under duty to search records. - A county clerk is not under any legal duty to conduct searches at the request of private persons of records filed in such office pursuant to the code, and no statutory fee is provided for such service. 1961-62 Op. Att'y Gen. No. 62-20.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 412 et seq.

76 C.J.S. Registers of Deeds § 10 et seq.

55-9-408. Financing statements covering consigned or leased goods.

A consignor or lessor of goods may file a financing statement using the term "consignor", "consignee", "lessor", "lessee" or the like instead of the terms specified in Section 9-402 [55-9-402 NMSA 1978]. The provisions of this part shall apply as appropriate to such a financing statement but its filing shall not of itself be a factor in determining whether or not the consignment or lease is intended as security (Section 1-201(37) [55-1-201(37) NMSA 1978]). However, if it is determined for other reasons that the consignment or lease is so intended, a security interest of the consignor or lessor which attaches to the consigned or leased goods is perfected by such filing.

History: 1978 Comp., § 55-9-408, enacted by Laws 1985, ch. 193, § 33.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. None.

Purposes. - 1. Where filing is required under Sections 2-326(3) and 9-114 for a consignment which is not a security interest (Section 1-201(37)), this section authorizes the appropriate adaptations of terminology.

Apart from the rules in Part 4, the rules of this article using the terms "debtor" and "secured party" will not apply to consignments if they are not security interests. Section 9-114 on consignments essentially parallels Section 9-312(3) on inventory priorities, and the latter rule therefore does not apply to consignments. Section 2-326 states the

rights of creditors of a consignee who has not filed or otherwise complied with subsection (3), and Section 9-301 on unperfected security interests is therefore not applicable. Section 2-326 and the law of consignments supply rules which are provided by Section 9-311 for security interests and that section is therefore not applicable to consignments. For reasons indicated in the Comment to Section 9-114 Section 9-306 on proceeds is inapplicable to consignments. An equivalent to the protection of a buyer in ordinary course of business against a security interest under Section 9-307(1) is provided against consignments by Section 2-403(2) and (3).

2. If a lease is actually intended as security (Section 1-201(37)), this Article applies in full. But this question of intention is a doubtful one, and the lessor may choose to file for safety even while contending that the lease is a true lease for which no filing is required. This section authorizes filing with appropriate changes of terminology, and without affecting the substantive question of classification of the lease. If the lease is a true lease, none of the provisions of the article is applicable to the lease as an interest in the chattel. Note, however, that the article may be applicable to the lease in its aspect as chattel paper. See Section 9-105(b).

PART 5
DEFAULT

55-9-501. Default; procedure when security agreement covers both real and personal property.

(1) When a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this part and except as limited by Subsection (3) those provided in the security agreement. He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure. If the collateral is documents the secured party may proceed either as to the documents or as to the goods covered thereby. A secured party in possession has the rights, remedies and duties provided in Section 9-207 [55-9-207 NMSA 1978]. The rights and remedies referred to in this subsection are cumulative.

(2) After default, the debtor has the rights and remedies provided in this part, those provided in the security agreement and those provided in Section 9-207 [55-9-207 NMSA 1978].

(3) To the extent that they give rights to the debtor and impose duties on the secured party, the rules stated in the subsections referred to below may not be waived or varied except as provided with respect to compulsory disposition of collateral (Subsection (3) of Section 9-504 [55-9-504 NMSA 1978] and Section 9-505 [55-9-505 NMSA 1978]) and with respect to redemption of collateral (Section 9-506 [55-9-506 NMSA 1978]) but the parties may by agreement determine the standards by which the fulfillment of these rights and duties is to be measured if such standards are not manifestly unreasonable:

(a) Subsection (2) of Section 9-502 [55-9-502 NMSA 1978] and Subsection (2) of Section 9-504 [55-9-504 NMSA 1978] insofar as they require accounting for surplus proceeds of collateral;

(b) Subsection (3) of Section 9-504 [55-9-504 NMSA 1978] and Subsection (1) of Section 9-505 [55-9-501 NMSA 1978] which deal with disposition of collateral;

(c) Subsection (2) of Section 9-505 [55-9-505 NMSA 1978] which deals with acceptance of collateral as discharge of obligation;

(d) Section 9-506 [55-9-506 NMSA 1978] which deals with redemption of collateral; and

(e) Subsection (1) of Section 9-507 [55-9-507 NMSA 1978] which deals with the secured party's liability for failure to comply with this part.

(4) If the security agreement covers both real and personal property, the secured party may proceed under this part as to the personal property or he may proceed as to both the real and the personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this part do not apply.

(5) When a secured party has reduced his claim to judgment the lien of any levy which may be made upon his collateral by virtue of any execution based upon the judgment shall relate back to the date of the perfection of the security interest in such collateral. A judicial sale, pursuant to such execution, is a foreclosure of the security interest by judicial procedure within the meaning of this section, and the secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

History: 1953 Comp., § 50A-9-501, enacted by Laws 1961, ch. 96, § 9-501; 1971, ch. 246, § 1; 1985, ch. 193, § 34.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 6, Uniform Trust Receipts Act; Sections 16 through 26, Uniform Conditional Sales Act.

Purposes. - 1. The rights of the secured party in the collateral after the debtor's default are of the essence of a security transaction. These are the rights which distinguish the secured from the unsecured lender. This section and the following six sections state those rights as well as the limitations on their free exercise which legislative policy requires for the protection not only of the defaulting debtor but of other creditors. But Subsections (1) and (2) make it clear that the statement of rights and remedies in this part does not exclude other remedies provided by agreement.

2. Following default and the taking possession of the collateral by the secured party, there is no longer any distinction between the security interest which before default was nonpossessory and that which was possessory under a pledge. Therefore no general distinction is taken in this part between the rights of a nonpossessory secured party and those of a pledgee; the latter, being in possession of the collateral at default, will of course not have to avail himself of the right to take possession under Section 9-503.

3. Section 9-207 states rights, remedies and duties with respect to collateral in the secured party's possession. That section applies not only to the situation where he is in possession before default, as a pledgee, but also, by Subsections (1) and (2) of this section, to the secured party in possession after default. Nevertheless the relations of the parties have been changed by default, and Section 9-207 as it applies after default must be read together with this part. In particular, agreements permitted under Section 9-207 cannot waive or modify the rights of the debtor contrary to Subsection (3) of this section.

4. Section 1-102(3) states rules to determine which provisions of this act are mandatory and which may be varied by agreement. In general, provisions which relate to matters which come up between immediate parties may be varied by agreement. In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor's rights and free the secured party of his duties: no mortgage clause has ever been allowed to clog the equity of redemption. The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense.

Subsection (3) of this section contains a codification of this long-standing and deeply rooted attitude: the specified rights of the debtor and duties of the secured party may not be waived or varied except as stated. Provisions not specified in Subsection (3) are subject to the general rules stated in Section 1-102 (3).

5. The collateral for many corporate security issues consists of both real and personal property. In the interest of simplicity and speed Subsection (4) permits, although it does not require, the secured party to proceed as to both real and personal property in accordance with his rights and remedies in respect of the real property. Except for the permission so granted, this act leaves to other state law all questions of procedure with respect to real property. For example, this act does not determine whether the secured party can proceed against the real estate alone and later proceed in a separate action against the personal property in accordance with his rights and remedies against the real estate. By such separate actions the secured party "proceeds as to both," and this part does not apply in either action. But Subsection (4) does give him an option to proceed under this part as to the personal property.

6. Under Subsection (1) a secured party is entitled to reduce his claim to judgment or to foreclose his interest by any available procedure, outside this article, which state law may provide. The first sentence of Subsection (5) makes clear that any judgment lien which the secured party may acquire against the collateral is, so to say, a continuation

of his original interest (if perfected) and not the acquisition of a new interest or a transfer of property to satisfy an antecedent debt. The judgment lien is therefore stated to relate back to the date of perfection of the security interest. The second sentence of the subsection makes clear that a judicial sale following judgment, execution and levy is one of the methods of foreclosure contemplated by Subsection (1); such a sale is governed by other law and not by this article and the restrictions which this article imposes on the right of a secured party to buy in the collateral at a sale under Section 9-504 do not apply.

Cross references. - Point 2: Section 9-503.

Point 3: Section 9-207.

Point 4: Section 1-102(3).

Point 5: Sections 9-102(1) and 9-104(j).

Point 6: Section 9-504.

Definitional cross references. - "Agreement". Section 1-201.

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Documents". Section 9-105.

"Goods". Section 9-105.

"Remedy". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

A secured creditor is not required to elect a remedy, but can take any permitted action or combination of actions. Western Bank v. Matherly, 106 N.M. 31, 738 P.2d 903 (1987).

Secured party may satisfy debt outside of code. - A secured party may reduce his claim to judgment and execute upon the collateral, or otherwise satisfy the debt by

resorting to state law other than the commercial code. Riblet Tramway Co. v. Monte Verde Corp., 453 F.2d 313 (10th Cir. 1972).

Doctrine of election of remedies abolished. - The purpose of Subsections (1) and (5) of this section is to abolish the doctrine of election of remedies. Ruidoso State Bank v. Garcia, 92 N.M. 288, 587 P.2d 435 (1978).

Secured party's rights upon default. - Upon default, a secured party is entitled to take possession of the collateral for the purpose of preserving it and in addition may sue on the note for money judgment. Kimura v. Wauford, 104 N.M. 3, 715 P.2d 451 (1986).

Secured party suing on defaulted note may sue and reduce debt to judgment. In that case, the debt would be merged into the judgment. However, the debt would be carried forward so that the secured party's rights under the security agreement would not be destroyed. The security agreements would not be merged into the judgment. Ruidoso State Bank v. Garcia, 92 N.M. 288, 587 P.2d 435 (1978).

Rights of one claiming interest through vendee. - If there are no intervening equities whereby the vendor may be estopped to enforce a forfeiture against one claiming through a conditional vendee of personal property, a vendee can create no greater interest in personal property than is possessed by the vendee, and one claiming a UCC security interest through the vendee takes his interest in the property subject to all claims of title enforceable against the vendee, including forfeiture upon default. Western Bank v. Matherly, 106 N.M. 31, 738 P.2d 903 (1987).

Recovery of judgment for debt does not prevent later proceedings. - The recovery of a judgment for a debt, except to the extent that it has been satisfied, does not prevent later proceedings to enforce a mortgage or other lien given to secure its payment. Ruidoso State Bank v. Garcia, 92 N.M. 288, 587 P.2d 435 (1978).

Law reviews. - For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For article, "Essential Attributes of Commercial Paper - Part I," see 1 N.M. L. Rev. 479 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68 Am. Jur. 2d Secured Transactions §§ 9, 61, 62, 92, 116, 137, 158, 200; 69 Am. Jur. 2d Secured Transactions §§ 255, 306, 307, 321, 447, 548, 549, 551 to 553, 558, 559, 567, 583, 600, 601, 616, 622, 627, 630, 649.

Claim of lien by conditional vendor as waiver of title, 45 A.L.R. 185.

Note for price as waiver of reservation of title under conditional sale, 55 A.L.R. 1160.

Demand for payment or for possession as condition of seller's right to retake property or otherwise enforce forfeiture after waiver of strict performance, 59 A.L.R. 134.

Novation of contract as affecting applicability of protective provisions of Uniform Conditional Sales Act or similar statute, 83 A.L.R. 998.

Waiver by conditional purchaser of rights or provisions as to repossession, redemption or resale, 99 A.L.R. 1298.

Action for price as waiver by conditional vendor of right to reclaim property, 113 A.L.R. 653.

Purchase by pledgee of subject of pledge, 37 A.L.R.2d 1381.

72 C.J.S. Pledges §§ 49, 50; 79 C.J.S. Secured Transactions § 144 et seq.

55-9-502. Collection rights of secured party.

(1) When so agreed and in any event on default the secured party is entitled to notify an account debtor or the obligor on an instrument to make payment to him whether or not the assignor was theretofore making collections on the collateral, and also to take control of any proceeds to which he is entitled under Section 9-306 [55-9-306 NMSA 1978].

(2) A secured party who by agreement is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from the account debtors or obligors must proceed in a commercially reasonable manner and may deduct his reasonable expenses of realization from the collections. If the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency. But, if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

History: 1953 Comp., § 50A-9-502, enacted by Laws 1961, ch. 96, § 9-502; 1985, ch. 193, § 35.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provisions. None.

Purposes. - 1. The assignee of accounts, chattel paper or instruments holds as collateral property which is not only the most liquid asset of the debtor's business but also property which may be collected without any interruption of the business, assuming

it to continue after default. The situation is far different from that where the collateral is inventory or equipment, whose removal may bring the business to a halt. Furthermore the problems of valuation and identification, present where the collateral is tangible chattels, do not arise so sharply on the assignment of intangibles. Considerations, similar although not identical, apply to assignments of general intangibles, which are also covered by the rule of the section. Consequently, this section recognizes the fact that financing by assignment of intangibles lacks many of the complexities which arise after default in other types of financing, and allows the assignee to liquidate in the regular course of business by collecting whatever may become due on the collateral, whether or not the method of collection contemplated by the security arrangement before default was direct (i.e., payment by the account debtor to the assignee, "notification" financing) or indirect (i.e., payment by the account debtor to the assignor, "nonnotification" financing). By agreement, of course, the secured party may have the right to give notice and to make collections before default.

2. In one form of accounts receivable financing, which is found in the "factoring" arrangements which are common in the textile industry, the assignee assumes the credit risk - that is, he buys the account under an agreement which does not provide for recourse or charge-back against the assignor in the event the account proves uncollectible. Under such an arrangement, neither the debtor nor his creditors have any legitimate concern with the disposition which the assignee makes of the accounts. Under another form of accounts receivable financing, however, the assignee does not assume the credit risk and retains a right of full or limited recourse or charge-back for uncollectible accounts. In such a case both debtor and creditors have a right that the assignee not dump the accounts, if the result will be to increase a possible deficiency claim or to reduce a possible surplus.

3. Where an assignee has a right of charge-back or a right of recourse, Subsection (2) provides that liquidation must be made with due regard to the interest of the assignor and of his other creditor - "in a commercially reasonable manner" (compare Section 9-504 and see Section 9-507(2)) - and the proceeds allocated to the expenses of realization and to the indebtedness. If the "charge-back" provisions of the assignment arrangement provide only for "charge-back" of bad accounts against a reserve, the debtor's claim to surplus and his liability for a deficiency are limited to the amount of the reserve.

4. Financing arrangements of the type dealt with by this section are between businessmen. The last sentence of Subsection (2) therefore preserves freedom of contract, and the subsection recognizes that there may be a true sale of accounts or chattel paper although recourse exists. The determination whether a particular assignment constitutes a sale or a transfer for security is left to the courts. Note that, under Section 9-102, this article applies both to sales and to security transfers of such intangibles.

Cross references. - Sections 9-205 and 9-306.

Point 3: Sections 9-504 and 9-507(2).

Point 4: Sections 9-102(1) (b) and 9-104(f).

Definitional cross references. - "Account". Section 9-106.

"Account debtor". Section 9-105.

"Agreement". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Instrument". Section 9-105.

"Notify". Section 1-201.

"Proceeds". Section 9-306.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 584 et seq.

6A C.J.S. Assignments § 98; 72 C.J.S. Pledges §§ 49, 50; 79 C.J.S. Secured Transactions § 152.

55-9-503. Secured party's right to take possession after default.

Unless otherwise agreed a secured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the peace or may proceed by action. If the security agreement so provides the secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties. Without removal a secured party may render equipment unusable, and may dispose of collateral on the debtor's premises under Section 9-504 [55-9-504 NMSA 1978].

History: 1953 Comp., § 50A-9-503, enacted by Laws 1961, ch. 96, § 9-503.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 6, Uniform Trust Receipts Act; Sections 16 and 17, Uniform Conditional Sales Act.

Purposes. - Under this article the secured party's right to possession of the collateral (if he is not already in possession as pledgee) accrues on default unless otherwise agreed in the security agreement. This article follows the provisions of the earlier uniform legislation in allowing the secured party in most cases to take possession without the issuance of judicial process. In the case of collateral such as heavy equipment, the physical removal from the debtor's plant and the storage of the equipment pending resale may be exceedingly expensive and in some cases impractical. The section therefore provides that in lieu of removal the lender may render equipment unusable or dispose of collateral on the debtor's premises. The authorization to render equipment unusable or to dispose of collateral without removal would not justify unreasonable action by the secured party, since, under Section 9-504(3), all his actions in connection with disposition must be taken in a "commercially reasonable manner".

Cross reference. - Section 9-504.

Definitional cross references. - "Action". Section 1-201.

"Collateral". Section 9-105.

"Debtor". Section 9-105.

"Equipment". Section 9-109.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

Secured party may recover possession of chattel by replevin from judicial officer who has properly taken possession thereof under execution. State v. Weber, 76 N.M. 636, 417 P.2d 444 (1966).

Debtor has no conversion claim if did not redeem. - A debtor who could have regained his right to possession by redemption, but did not redeem, has no claim in conversion, as conversion only protects the rights of one entitled to lawful possession. Cordova v. Lee Galles Oldsmobile, Inc., 100 N.M. 204, 668 P.2d 320 (Ct. App. 1983).

Law enforcement officer accompanying repossessor. - Any time a law enforcement officer accompanies a repossessor and makes his official presence known to the defaulting party at or near the attempted self-help repossession, that officer has

transgressed the line of benign attendance. Hence, repossession of a truck on an air force base became wrongful as a matter of law, where the repossessor was accompanied by an armed military security police sergeant who informed the debtor that "we have to take the truck" or words to that effect. Waisner v. Jones, 107 N.M. 260, 755 P.2d 598 (1988).

Action by Indian for violation of tribal law in repossession of pickup truck. - See GMAC v. Chischilly, 96 N.M. 113, 628 P.2d 683 (1981).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For note, "Self-Help Repossession Under the Uniform Commercial Code: The Constitutionality of Article 9, Section 503," see 4 N.M. L. Rev. 75 (1973).

For article, "Problems in the Application of Full Faith and Credit for Indian Tribes," see 7 N.M. L. Rev. 133 (1977).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 590 et seq.

Retaking of property conditionally sold as affecting action previously commenced for purchase price, 23 A.L.R. 1462.

Breaking and entering for purpose of retaking possession upon default of purchaser, 36 A.L.R. 853.

Validity of provision for collection of unpaid purchase money after retaking the property in the contract, 43 A.L.R. 1243.

Demand for payment or for possession as condition of seller's right to retake possession or otherwise enforce forfeiture under conditional sale, 59 A.L.R. 134.

What constitutes retaking property, 99 A.L.R. 1297.

Action for price as waiver by conditional vendor of right to reclaim property, 113 A.L.R. 653.

Repossession of property as within statute imposing tax on retail sales, 139 A.L.R. 410.

Right of conditional seller to retake property without legal process, 146 A.L.R. 1331.

What amounts to buyer's waiver of seller's duty to give notice before repossession, 174 A.L.R. 1363.

Rights and remedies as between parties to conditional sale after seller has repossessed himself of the property, 49 A.L.R.2d 15.

Relative rights as between assignee of conditional seller and a subsequent buyer from the conditional seller after repossession or the like, 72 A.L.R.2d 342.

Maintenance of replevin or similar possessory remedy by cotenant, or security transaction creditor thereof, against other cotenants, 93 A.L.R.2d 358.

What conduct by repossessing chattel mortgagee or conditional vendor entails tort liability, 99 A.L.R.2d 358.

Punitive damages for wrongful seizure of chattel by one claiming security interest, 35 A.L.R.3d 1016.

Repossession by secured seller as affecting his right to recover on a note or other obligation given as a down payment, 49 A.L.R.3d 364.

Secured transactions: Right of secured party to take possession of collateral on default under UCC § 9-503, 25 A.L.R.5th 696.

72 C.J.S. Pledges §§ 49, 50; 79 C.J.S. Secured Transactions § 153 et seq.

55-9-504. Secured party's right to dispose of collateral after default; effect of disposition.

(1) A secured party after default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. Any sale of goods is subject to the article on sales (Article 2). The proceeds of disposition shall be applied in the order following to:

(a) the reasonable expenses of retaking, holding, preparing for sale or lease, selling, leasing and the like and, to the extent provided for in the agreement and not prohibited by law, the reasonable attorney's fees and legal expenses incurred by the secured party;

(b) the satisfaction of indebtedness secured by the security interest under which the disposition is made;

(c) the satisfaction of indebtedness secured by any subordinate security interest in the collateral if written notification of demand therefor is received before distribution of the proceeds is completed. If requested by the secured party, the holder of a subordinate

security interest must seasonably furnish reasonable proof of his interest, and unless he does so, the secured party need not comply with his demand.

(2) If the security interest secures an indebtedness, the secured party must account to the debtor for any surplus, and, unless otherwise agreed, the debtor is liable for any deficiency. But if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides.

(3) Disposition of the collateral may be by public or private proceedings and may be made by way of one or more contracts. Sale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable. Unless collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market, reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor, if he has not signed after default a statement renouncing or modifying his right to notification of sale. In the case of consumer goods, there shall be no statement renouncing or modifying this right to notification of sale. In the case of consumer goods no other notification need be sent. In other cases notification shall be sent to any other secured party from whom the secured party has received (before sending his notification to the debtor or before the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. The secured party may buy at any public sale and if the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations he may buy at private sale. If a surplus remains after sale of consumer goods used to secure a loan or indebtedness in any manner described in Sections 56-8-15 through 56-8-20 NMSA 1978, the secured party must make a record of the sale and the amount of surplus and must notify the debtor by first class mail sent to the debtor's last known address of the amount of the surplus and the debtor's right to claim it at a specified location within one year of the date of mailing of the notice. In the event that the first class mail addressed to any person is returned unclaimed to the secured party, then the secured party must post and maintain on a conspicuous public part of his premises an appropriately entitled list naming each such person. One year after the date of such mailing or posting, whichever is later, the secured party may retain any surplus remaining unclaimed by the debtor as his own property.

(4) When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein, discharges the security interest under which it is made and any security interest or lien subordinate thereto. The purchaser takes free of all such rights and interests even though the secured party fails to comply with the requirement of this part or of any judicial proceedings:

(a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale; or

(b) in any other case, if the purchaser acts in good faith.

(5) A person who is liable to a secured party under a guaranty, indorsement, repurchase agreement or the like and who receives a transfer of collateral from the secured party or is subrogated to his rights has thereafter the rights and duties of the secured party. Such a transfer of collateral is not a sale or disposition of the collateral under this article.

History: 1953 Comp., § 50A-9-504, enacted by Laws 1961, ch. 96, § 9-504; 1971, ch. 246, § 2; 1981, ch. 10, § 1; 1981, ch. 21, § 1; 1985, ch. 193, § 36.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 6, Uniform Trust Receipts Act; Sections 19, 20, 21, and 22, Uniform Conditional Sales Act.

Purposes. - 1. The Uniform Trust Receipts Act provides that an entruster in possession after default holds the collateral with the rights and duties of a pledgee, and, in particular, that he may sell such collateral at public or private sale with a right to claim deficiency and a duty to account for any surplus. The Uniform Conditional Sales Act insisted on a sale at public auction with elaborate provisions for the giving of notice of sale. This section follows the more liberal provisions of the Trust Receipts Act. Although public sale is recognized, it is hoped that private sale will be encouraged where, as is frequently the case, private sale through commercial channels will result in higher realization on collateral for the benefit of all parties. The only restriction placed on the secured party's method of disposition is that it must be commercially reasonable. In this respect this section follows the provisions of the section on resale by a seller following a buyer's rejection of goods (Section 2-706). Subsection (1) does not restrict disposition to sale: the collateral may be sold, leased, or otherwise disposed of - subject of course to the general requirement of Subsection (2) that all aspects of the disposition be "commercially reasonable". Section 9-507(2) states some tests as to what is "commercially reasonable".

2. Subsection (1) in general follows prior law in its provisions for the application of proceeds and for the debtor's right to surplus and liability for deficiency. Under Paragraph (1) (c) the secured party, after paying expenses of retaking and disposition and his own debt, is required to pay over remaining proceeds to the extent necessary to satisfy the holder of any junior security interest in the same collateral if the holder of the junior interest has made a written demand and furnished on request reasonable proof of his interest: this provision is necessary in view of the fact that under Subsection (4) the junior interest is discharged by the disposition. Since the requirement is conditioned on

written demand, it should not result in undue burden on the secured party making the disposition. It should be noted also that under Section 9-112 where the secured party knows that the collateral is owned by a person who is not the debtor, the owner of the collateral and not the debtor is entitled to any surplus.

3. In any security transaction the debtor (or the owner of the collateral if other than the debtor: see Section 9-112) is entitled to any surplus which results from realization on the collateral; the debtor will also, unless otherwise agreed, be liable for any deficiency. Subsection (2) so provides. Since this article covers sales of certain intangibles as well as transfers for security, the subsection also provides that apart from agreement the right to surplus or liability for deficiency does not accrue where the transaction between debtor and secured party was a sale and not a security transaction.

4. Subsection (4) provides that a purchaser for value from a secured party after default takes free of any rights of the debtor and of the holders of junior security interests and liens, even though the secured party has not complied with the requirements of this part or of any judicial proceedings. This subsection follows a similar provision in the Uniform Trust Receipts Act and in the section of this act on resale by a seller (Section 2-706). Where the purchaser for value has bought at a public sale he is protected under Paragraph (a) if he has no knowledge of any defects in the sale and was not guilty of collusive practices. Where the purchaser for value has bought at a private sale he must, to receive the protection of Paragraph (b), qualify in all respects as a purchaser in good faith. Thus while the purchaser at a private sale is required to proceed in the exercise of good faith, the purchaser at public sale is protected so long as he is not actively in bad faith, and is put under no duty to inquire into the circumstances of the sale.

5. Both the Uniform Trust Receipts Act and the Uniform Conditional Sales Act required a waiting period after repossession and before sale (five days in the Trust Receipts Act, ten days in the Conditional Sales Act). Under Subsection (3), the secured party in most cases is required to give reasonable notification of disposition to the debtor unless the debtor has after default signed a statement renouncing or modifying his right to notification of sale.

The secured party must also (except for consumer goods) give notice to any other secured parties who have in writing given notice of a claim of an interest in the collateral. This latter notice must be given before the debtor renounces his rights or before the secured party gives his notification to the debtor. Compare Section 9-505(2). Except for the requirement of notification there is no statutory period during which the collateral must be held before disposition. "Reasonable notification" is not defined in this article; at a minimum it must be sent in such time that persons entitled to receive it will have sufficient time to take appropriate steps to protect their interests by taking part in the sale or other disposition if they so desire.

6. Section 19 of the Uniform Conditional Sales Act required that sale be made not more than thirty days after possession taken by the conditional vendor. The Uniform Trust Receipts Act contained no comparable provision. Here again this article follows the

Trust Receipts Act, and no period is set within which the disposition must be made, except in the case of consumer goods which under Section 9-505(1) must in certain instances be sold within ninety days after the secured party has taken possession. The failure to prescribe a statutory period during which disposition must be made is in line with the policy adopted in this article to encourage disposition by private sale through regular commercial channels. It may, for example, be wise not to dispose of goods when the market has collapsed, or to sell a large inventory in parcels over a period of time instead of in bulk. Note, however, that under Subsection (3) every aspect of the sale or other disposition of the collateral must be commercially reasonable; this specifically includes method, manner, time, place and terms. See Section 9-507(2). Under that provision a secured party who without proceeding under Section 9-505(2) held collateral a long time without disposing of it, thus running up large storage charges against the debtor, where no reason existed for not making a prompt sale, might well be found not to have acted in a "commercially reasonable" manner. See also Section 1-203 on the general obligation of good faith.

Cross references. - Point 1: Sections 2-706 and 9-507(2).

Point 2: Section 9-112.

Point 3: Sections 9-102(1) (b) and 9-112.

Point 4: Section 2-706.

Point 6: Sections 9-505 and 9-507(2).

Definitional cross references. - "Account". Section 9-106.

"Agreement". Section 1-201.

"Chattel paper". Section 9-105.

"Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Contract". Section 1-201.

"Debtor". Section 9-105.

"Financing statement". Section 9-402.

"Gives" notification. Section 1-201.

"Good faith". Section 1-201.

"Goods". Section 9-105.

"Knowledge". Section 1-201.

"Person". Section 1-201.

"Proceeds". Section 9-306.

"Purchaser". Section 1-201.

"Receives" notification. Section 1-201.

"Rights". Section 1-201.

"Sale". Sections 2-106 and 9-105.

"Secured party". Section 9-105.

"Security agreement". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-201.

"Written". Section 1-201.

I. General Consideration.
II. Liability for Surplus or Deficiency.
III. Disposition of Collateral.

I. GENERAL CONSIDERATION.

Cross-references. - For allowance of a reasonable attorney fee for the debtor, if prevailing in a civil action pursuant to this section, see 39-2-2 NMSA 1978.

Compiler's note. - Sections 56-8-15 through 56-8-20 NMSA 1978, referred to in Subsection (3), were repealed by Laws 1983, ch. 44, § 1, effective July 1, 1983. For present comparable provisions, see 56-12-1 NMSA 1978 et seq.

Scope of section. - This section pertains to a situation in which a secured party has taken possession of collateral, disposed of it, and then proceeded to an action against

the debtor for a deficiency. Green Tree Acceptance, Inc. v. Layton, 108 N.M. 171, 769 P.2d 84 (1989).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

For article, "Consumer Class Actions Under the New Mexico Unfair Practices Act," see 4 N.M. L. Rev. 49 (1973).

For article, "The Impact of the Revised New Mexico Class Action Rules Upon Consumers," see 9 N.M.L. Rev. 263 (1979).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 624 et seq.

Purchase by pledgee of subject of pledge, 76 A.L.R. 705, 37 A.L.R.2d 1381.

Rights and remedies as between parties after repossession of property by seller, 99 A.L.R. 1288.

What constitutes a "public sale,", 4 A.L.R.2d 575.

Necessity and sufficiency of notice of sale to mortgagor where chattel mortgage is sought to be foreclosed without judicial proceedings by sale under power, 30 A.L.R.2d 539.

Rights and duties of parties to conditional sales contract as to resale of repossessed property, 49 A.L.R.2d 15.

Construction of term "debtor" as used in UCC § 9-504(3), requiring secured party to give notice to debtor of sale of collateral securing obligation, 5 A.L.R.4th 1291.

What is "commercially reasonable" disposition of collateral required by UCC § 9-504(3), 7 A.L.R.4th 308.

Loss or modification of right to notification of sale of repossessed collateral under Uniform Commercial Code § 9-504, 9 A.L.R.4th 552.

Failure of secured party to make "commercially reasonable" disposition of collateral under UCC § 9-504(3) as bar to deficiency judgment, 10 A.L.R.4th 413.

Sufficiency of secured party's notification of sale or other intended disposition of collateral under UCC § 9-504(3), 11 A.L.R.4th 241.

Nature of collateral which secured party may sell or otherwise dispose of without giving notice to defaulting debtor under UCC § 9-504(3), 11 A.L.R.4th 1060.

Secured transactions: what is "public" or "private" sale under UCC § 9-504(3), 60 A.L.R.4th 1012.

UCC: value of trade-in taken on sale of collateral for purposes of computing surplus or deficiency, 72 A.L.R.4th 1128.

72 C.J.S. Pledges §§ 49, 50; 79 C.J.S. Secured Transactions § 161 et seq.

II. LIABILITY FOR SURPLUS OR DEFICIENCY.

When failure to sell collateral does not bar judgment. - The referee in bankruptcy did not err in awarding a judgment in favor of appellee notwithstanding his failure to sell the collateral which secured appellants' debt where the judgment was based on the depletion of the inventory. With v. Amador, 596 F.2d 428 (10th Cir. 1979).

Burden of proof on value of collateral. - In a suit for a deficiency, where the value of the collateral is at issue, there is a presumption that the value of the repossessed collateral at resale is equal to the value of the outstanding debt. When the sale is conducted in accordance with Subsection (3) the sum received at sale is evidence of the market value; but when the sale is not conducted according to the code, the amount received is not evidence of the market value of the collateral, and the secured party will have the burden of proving the market value by other evidence. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

III. DISPOSITION OF COLLATERAL.

U.C.C. encourages commercial sales of collateral. - The U.C.C. encourages sales of repossessed collateral through regular commercial channels as opposed to public auction which often times yields only disappointing results. Security Fed. Sav. & Loan v. Prendergast, 108 N.M. 572, 775 P.2d 1289 (1989).

Good faith duty of creditor to dispose of collateral reasonably. - The requirements of Subsection (3) place upon the creditor the good faith duty to the debtor to use reasonable means to see that a reasonable price is received for the collateral. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

Notice of sale should be given to a "public" reasonably expected to have an interest in the collateral and should be published in a manner reasonably calculated to assure such publicity that the collateral will bring the best possible price from competitive bidding of a strived-for lively concourse of bidders. Villella Enters., Inc. v. Young, 108 N.M. 33, 766 P.2d 293 (1988).

Cash only auction sales. - "Cash only" terms of auction sale of farm equipment pledged as security for a note did not render the sale commercially unreasonable, where there was no evidence to suggest that this was not the normal practice of the auction company. First Nat'l Bank v. Ruttle, 108 N.M. 687, 778 P.2d 434 (1989).

Loan of collateral does not constitute "disposition" under Subsection (1). Cordova v. Lee Galles Oldsmobile, Inc., 100 N.M. 204, 668 P.2d 320 (Ct. App. 1983).

Creditor electing to sell in regular course of business must comply with section. - Once the creditor elects to retain collateral, and follow the mechanics of 55-9-505 NMSA 1978, he can do as he pleases with the property, but where he intends to sell the property in the regular course of his business, which is in substance selling the property as contemplated by this section, he must account for a surplus in conformity with this section. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980).

Commercially reasonable sale to bring better price. - The importance of a commercially reasonable sale lies in the fact that the amount of the deficiency judgment will be inversely proportional to the sales price; if the price is high, the amount of the judgment will be low, and vice versa. The "method, manner, time, place and terms" tests are really proxies for "insufficient price," and their importance lies almost exclusively in the extent they protect against an unfairly low price. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

In determining commercial reasonableness, each case will turn on its particular facts but generally, evidence as to every aspect of the sale including the amount of advertising done, normal commercial practices in disposing of particular collateral, the length of time elapsing between repossession and resale, whether deterioration of the collateral has occurred, the number of persons contacted concerning the sale and even the price obtained will be pertinent. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

Burden of proof on creditor that sale commercially reasonable. - In light of the specific requirement of Subsection (3) as to commercial reasonableness, a creditor, when suing for a deficiency, should allege and prove that disposition of the collateral was conducted in compliance with that statute; the creditor must allege and, unless admitted, prove that the sale was commercially reasonable. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

Creditor must show some unreasonableness to avoid directed verdict. - Once a creditor suing for a deficiency has made a prima facie case indicating a commercially reasonable sale, the debtor may be required to elicit some evidence of commercial unreasonableness to avoid a directed verdict on the issue, but when this is done, it becomes a question for the trier of the facts. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

Price as factor in determining commercial reasonableness. - A debtor will not rebut a prima facie presumption of commercial reasonableness merely by contending that the price obtained for the collateral was too low. Nonetheless, the price obtained is a relevant factor. Villella Enters., Inc. v. Young, 108 N.M. 33, 766 P.2d 293 (1988).

Secured party required to give notice. - Notice of the time and place of sale under the code is required to be given the debtor by a secured party. Foundation Discts., Inc. v. Serna, 81 N.M. 474, 468 P.2d 875 (1970).

Test for notification good faith effort not whether notice received. - In construing the requirements of notification to be sent a debtor under Subsection (3), the test of notification is not whether the debtor receives the notice but only whether the secured party has made a good faith effort and took such steps as a reasonable person would have taken to give notice. Begay v. Foutz & Tanner, Inc., 95 N.M. 106, 619 P.2d 551 (Ct. App. 1979), rev'd on other grounds sub nom. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980).

Requirement of reasonable notification is a question of fact to be determined only after considering all the facts and circumstances of the individual case. Ridley v. First Nat'l Bank, 87 N.M. 184, 531 P.2d 607 (Ct. App. 1974), cert. denied, 87 N.M. 179, 531 P.2d 602 (1975).

Written not verbal notice satisfactory under code. - Where the record discloses that no formal written notice of the time and place of sale was given to defendant, the fact that defendant may have had verbal notice that there would be a sale of the collateral does not satisfy the requirements of the code. Foundation Discts., Inc. v. Serna, 81 N.M. 474, 468 P.2d 875 (1970).

Failure to achieve commercial reasonableness not forfeiture of deficiency. - A secured party's failure to comply with Subsection (3) does not result in a forfeiture of the right to a deficiency; the secured party has the right to recover the claimed deficiency less any loss occasioned by its failure to sell in a commercially reasonable manner. Clark Leasing Corp. v. White Sands Forest Prods., Inc., 87 N.M. 451, 535 P.2d 1077 (1975).

A secured party's failure to comply with Subsection (3) does not constitute an absolute bar to a deficiency judgment; instead, the secured party has the burden of showing what amount a sale would have brought if done in compliance with the UCC, and, the difference between what the sale brought when performed improperly and what it should have brought, if done correctly, will be the damages allowed to the debtors. If such amount does not equal the total deficiency, the secured party may recover the amount remaining unpaid. First Nat'l Bank v. Jiron, 106 N.M. 261, 741 P.2d 1382 (1987).

When a secured party has not complied with the notice provisions of Subsection (3), it still may obtain a deficiency judgment if it proves the market value of the collateral. Such

proof must be by evidence other than the sum received at sale. First Nat'l Bank v. Ruttle, 108 N.M. 687, 778 P.2d 434 (1989).

When the collateral has been sold in a manner that does not comply with the provisions of the UCC, there is a rebuttable presumption that the collateral was worth an amount at least equal to the outstanding balance. To overcome the presumption, the secured party has the burden of proving the value of the collateral by evidence other than the sum received at the sale. First Nat'l Bank v. Jiron, 106 N.M. 261, 741 P.2d 1382 (1987).

"Commercially reasonable" requirement may be waived. - Guarantors of promissory note waived contract defense that sale of collateral securing promissory note was not conducted in commercially reasonable manner. United States v. Lattauzio, 748 F.2d 559 (10th Cir. 1984).

Sale of unadvertised mobile home by automobile dealer. - Sale of mobile home was commercially reasonable, even though the vehicle was never advertised for sale, where the vehicle was placed on the premises of a dealer in used autos, and where customers could view repossessed vehicles and make written offers to purchase them. Security Fed. Sav. & Loan v. Prendergast, 108 N.M. 572, 775 P.2d 1289 (1989).

Bank's auction of farm equipment. - Bank's decision to auction farm equipment pledged as security for a note was reasonable, where the bank's loan officer testified he contacted several dealers in farm equipment in the area, and none were interested in purchasing the equipment auctioned. First Nat'l Bank v. Ruttle, 108 N.M. 687, 778 P.2d 434 (1989).

55-9-505. Compulsory disposition of collateral; acceptance of the collateral as discharge of obligation.

(1) If the debtor has paid sixty percent of the cash price in the case of a purchase money security interest in consumer goods or sixty percent of the loan in the case of another security interest in consumer goods, and has not signed after default a statement renouncing or modifying his rights under this part a secured party who has taken possession of collateral must dispose of it under Section 9-504 [55-9-504 NMSA 1978] and if he fails to do so within ninety days after he takes possession the debtor at his option may recover in conversion or under Section 9-507(1) [55-9-507(1) NMSA 1978] on secured party's liability.

(2) In any other case involving consumer goods or any other collateral a secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor if he has not signed after default a statement renouncing or modifying his rights under this subsection. In the case of consumer goods, there shall be no statement renouncing or modifying a right under this subsection. In the case of consumer goods no other notice need be given. In other cases notice shall be sent to any other secured party from whom the secured party has received (before sending his notice to the debtor or before

the debtor's renunciation of his rights) written notice of a claim of an interest in the collateral. If the secured party receives objection in writing from a person entitled to receive notification within twenty-one days after the notice was sent, the secured party must dispose of the collateral under Section 9-504 [55-9-504]. In the absence of such written objection the secured part may retain the collateral in satisfaction of the debtor's obligation.

History: 1953 Comp., § 50A-9-505, enacted by Laws 1961, ch. 96, § 9-505; 1985, ch. 193, § 37.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 23, Uniform Conditional Sales Act.

Purposes. - 1. Experience has shown that the parties are frequently better off without a resale of the collateral; hence this section sanctions an alternative arrangement. In lieu of resale or other disposition, the secured party may propose under Subsection (2) that he keep the collateral as his own, thus discharging the obligation and abandoning any claim for a deficiency. This right may not be exercised in the case of consumer goods where the debtor has paid 60% of the price or obligation and thus has a substantial equity, and may be exercised in other cases only on notification to the debtor, unless the debtor has signed after default a statement renouncing or modifying his rights under this section, and (except in the case of consumer goods) to any other secured party who has given written notice of a claim of an interest in the collateral. In the latter case, notice must be given before the secured party receives the debtor's renunciation or before he sends his notice to the debtor. The secured party may keep the goods in lieu of sale on failure of anyone receiving notification to object within twenty-one days.

2. When an objection is received by the secured party he must then proceed to dispose of the collateral in accordance with Section 9-504, and on failure to do so would incur the liabilities set out in Section 9-507. In the case of consumer goods where 60% of the price or obligation has been paid the disposition must be made within 90 days after possession taken. For failure to make the sale within the 90-day period the secured party is liable in conversion or alternatively may incur the liabilities set out in Section 9-507.

In the absence of objection the secured party is bound by his notice.

3. After default (but not before) a consumer-debtor who has paid 60% of the cash price may sign a written renunciation of his rights to require resale of the collateral.

Cross references. - Sections 9-504 and 9-507(1).

Definitional cross references. - "Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Debtor". Section 9-105.

"Knows". Section 1-201.

"Notice". Section 1-201.

"Person". Section 1-201.

"Purchase money security interest". Section 9-107.

"Receives" notification. Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

"Send". Section 1-201.

"Signed". Section 1-201.

"Written". Section 1-201.

Remedies of Subsection (2) are accessible to all secured parties including pawnbrokers dealing in Indian pawn with Indian debtors, and they may avail themselves of the remedies provided by the code. Begay v. Foutz & Tanner, Inc., 95 N.M. 106, 619 P.2d 551 (Ct. App. 1979), rev'd on other grounds sub nom. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980) (decided under prior law).

Creditor selling collateral in regular course of business must comply with 55-9-504 NMSA 1978. - Once the creditor elects to retain collateral, and follow the mechanics of this section, he can do as he pleases with the property, but where he intends to sell the property in the regular course of his business, which is in substance selling the property as contemplated by 55-9-504 NMSA 1978, he must account for a surplus in conformity with 55-9-504 NMSA 1978. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980).

When creditor retains collateral in discharge of debt, he becomes owner. Begay v. Foutz & Tanner, Inc., 95 N.M. 106, 619 P.2d 551 (Ct. App. 1979), rev'd on other grounds sub nom. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980).

Failure to sell collateral not always election to retain. - Where a decrease in inventory constitutes a willful and malicious conversion of collateral and a violation of

30-16-18 NMSA 1978, failure to sell the repossessed collateral will not be treated as an election under this section to retain the collateral in satisfaction of the obligation. With v. Amador, 596 F.2d 428 (10th Cir. 1979).

Creditor may retain collateral in excess of debt and interest owed. - Since Subsection (2) permits retention of collateral in satisfaction of a debt and places no limitation on the value of the collateral retained, presumably a creditor could lawfully retain collateral having a value substantially greater than the amount of the debt and lawful interest satisfied without running afoul of the usury statute; therefore the safeguard in such case is the right of the debtor to object and thereby require sale of the collateral. Begay v. Foutz & Tanner, Inc., 95 N.M. 106, 619 P.2d 551 (Ct. App. 1979), rev'd on other grounds sub nom. Reeves v. Foutz & Tanner, Inc., 94 N.M. 760, 617 P.2d 149 (1980) (decided under prior law).

Secured party retaining collateral need not notify unsecured creditors. - Subsection (2) does not require a secured part who decides to retain collateral in satisfaction of a debt to notify unsecured creditors. Michel v. J's Foods, Inc., 99 N.M. 574, 661 P.2d 474 (1983)(decided under prior law).

Recovery allowed for failure to sell truck within 90 days. - Plaintiff was entitled to recover damages in conversion from defendant for failure to comply with default provisions of uniform commercial code, where defendant, who repossessed plaintiff's pick-up truck after plaintiff had paid defendant more than 60% of purchase price, failed to sell truck within 90 days of possession. Crosby v. Basin Motor Co., 83 N.M. 77, 488 P.2d 127 (Ct. App. 1971).

Creditors allowed to assert counterclaims. - There is no language in 55-9-505 NMSA 1978, or elsewhere in the commercial code, which would preclude the full exercise of the right to interpose counterclaims under Rule 13, N.M.R. Civ. P. Charley v. Rico Motor Co., 82 N.M. 290, 480 P.2d 404 (Ct. App. 1971).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For comment on *Graham v. Stoneham*, 73 N.M. 382, 388 P.2d 389 (1963), see 4 Nat. Resources J. 175 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 704 et seq.

Rights and duties of parties to conditional sales contract as to resale of repossessed property, 49 A.L.R.2d 15.

Construction and operation of U.C.C. § 9-505(2) authorizing secured party in possession of collateral to retain it in satisfaction of obligation, 55 A.L.R.3d 651.

72 C.J.S. Pledges §§ 49, 50; 79 C.J.S. Secured Transactions § 179.

55-9-506. Debtor's right to redeem collateral.

At any time before the secured party has disposed of collateral or entered into a contract for its disposition under Section 9-504 [55-9-504 NMSA 1978] or before the obligation has been discharged under Section 9-505 (2) [55-9-505 (2) NMSA 1978] the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral as well as the expenses reasonably incurred by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorneys' fees and legal expenses.

History: 1953 Comp., § 50A-9-506, enacted by Laws 1961, ch. 96, § 9-506.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. Section 18, Uniform Conditional Sales Act.

Purposes. - Except in the case stated in Section 9-505(1) (consumer goods) the secured party is not required to dispose of collateral within any stated period of time. Under this section so long as the secured party has not disposed of collateral in his possession or contracted for its disposition, and so long as his right to retain it has not become fixed under Section 9-505(2), the debtor or another secured party may redeem. The debtor must tender fulfillment of all obligations secured, plus certain expenses: if the agreement contains a clause accelerating the entire balance due on default in one installment, the entire balance would have to be tendered. "Tendering fulfillment" obviously means more than a new promise to perform the existing promise; it requires payment in full of all monetary obligations then due and performance in full of all other obligations then matured. If unmatured obligations remain, the security interest continues to secure them as if there had been no default.

Under Section 9-504 the secured party may make successive sales of parts of the collateral in his possession. The fact that he may have sold or contracted to sell part of the collateral would not affect the debtor's right under this section to redeem what was left. In such a case, of course, in calculating the amount required to be tendered the debtor would receive credit for net proceeds of the collateral sold.

Cross references. - Sections 9-504 and 9-505.

Definitional cross references. - "Agreement". Section 1-201.

"Collateral". Section 9-105.

"Contract". Section 1-201.

"Debtor". Section 9-105.

"Secured party". Section 9-105.

"Writing". Section 1-201.

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 564 et seq.

Buyer's right of redemption on repossession of property by seller, 99 A.L.R. 1296.

72 C.J.S. Pledges §§ 47, 48; 79 C.J.S. Secured Transactions § 184.

55-9-507. Secured party's liability for failure to comply with this part.

(1) If it is established that the secured party is not proceeding in accordance with the provisions of this part disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of this part. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten percent of the principal amount of the debt or the time price differential plus ten percent of the cash price.

(2) The fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. If the secured party either sells the collateral in the usual manner in any recognized market therefor or if he sells at the price current in such market at the time of his sale or if he has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold he has sold in a commercially reasonable manner. The principles stated in the two preceding sentences with respect to sales also apply as may be appropriate to other types of disposition. A disposition which has been approved in any judicial proceeding or by any bona fide creditors' committee or representative of creditors shall conclusively be deemed to be commercially reasonable, but this sentence does not indicate that any such approval must be obtained in any case nor does it indicate that any disposition not so approved is not commercially reasonable.

History: 1953 Comp., § 50A-9-507, enacted by Laws 1961, ch. 96, § 9-507.

ANNOTATIONS

OFFICIAL COMMENT

Prior uniform statutory provision. None.

Purposes. - 1. The principal limitation on the secured party's right to dispose of collateral is the requirement that he proceed in good faith (Section 1-203) and in a commercially reasonable manner. See Section 9-504. In the case where he proceeds, or is about to proceed, in a contrary manner, it is vital both to the debtor and other creditors to provide a remedy for the failure to comply with the statutory duty. This remedy will be of particular importance when it is applied prospectively before the unreasonable disposition has been concluded. This section therefore provides that a secured party proposing to dispose of collateral in an unreasonable manner, may, by court order, be restrained from doing so, and such an order might appropriately provide either that he proceed with the sale or other disposition under specified terms and conditions, or that the sale be made by a representative of creditors where insolvency proceedings have been instituted. The section further provides for damages where the unreasonable disposition has been concluded, and, in the case of consumer goods, states a minimum recovery.

A case may be put in which the liquidation value of an insolvent estate would be enhanced by disposing of all the debtor's property (including that subject to a security interest) in the liquidation proceeding and in which, if a secured party repossesses and sells that part of the property which he holds as collateral, the remainder will have little or no resale value. In such a case the question may arise whether a particular court has the power to control the manner of disposition, although reasonable in other respects, in order to preserve the estate for the benefit of creditors. Such a power is no doubt inherent in a federal bankruptcy court, and perhaps also in other courts of equity administering insolvent estates. Traditionally it was not exercised where the secured party claimed under a title retention device, such as conditional sale or trust receipt. See In re Lake's Laundry, Inc., 79 F.2d 326 (2d Cir. 1935) and the remarks of Clark, J., concurring, in In re White Plains Ice Service, Inc., 109 F.2d 913 (2d Cir. 1940). It has been held that distinctions in results based on these distinctions in form have been made obsolete by this article. In re Yale Express System, Inc., 370 F.2d 433 (2d Cir. 1966), 384 F.2d 990 (2d Cir. 1967).

2. In view of the remedies provided the debtor and other creditors in Subsection (1) when a secured party does not dispose of collateral in a commercially reasonable manner, it is of great importance to make clear what types of disposition are to be considered commercially reasonable, and in an appropriate case to give the secured party means of getting, by court order or negotiation with a creditors' committee or a representative of creditors, approval of a proposed method of disposition as a commercially reasonable one. Subsection (2) states rules to assist in the determination, and provides for such advance approval in appropriate situations. One recognized method of disposing of repossessed collateral is for the secured party to sell the

collateral to or through a dealer - a method which in the long run may realize better average returns since the secured party does not usually maintain his own facilities for making such sales. Such a method of sale, fairly conducted, is recognized as commercially reasonable under the second sentence of Subsection (2). However, none of the specific methods of disposition set forth in Subsection (2) is to be regarded as either required or exclusive, provided only that the disposition made or about to be made by the secured party is commercially reasonable.

Cross references. - Point 1: Sections 1-203, 9-202 and 9-504.

Definitional cross references. - "Collateral". Section 9-105.

"Consumer goods". Section 9-109.

"Creditor". Section 1-201.

"Debtor". Section 9-105.

"Knows". Section 1-201.

"Notification". Section 1-201.

"Person". Section 1-201.

"Representative". Section 1-201.

"Rights". Section 1-201.

"Secured party". Section 9-105.

"Security interest". Section 1-201.

Notice of private collateral sale need not mention possible rebates. - Notice of a private sale of collateral which states a redemption amount accurate at the time but which fails to mention possible rebates is not unreasonable as a matter of law. Richardson Ford Sales, Inc. v. Johnson, 100 N.M. 779, 676 P.2d 1344 (Ct. App. 1984).

Damages not cumulative for violations on same disposition of collateral. - Because this section does not specifically authorize separate statutory damages for each asserted violation of Part 5, and because the statutory damage is not cumulative, the statutory damage for violation of Part 5 may be recovered only once, even though two violations are alleged. Crosby v. Basin Motor Co., 83 N.M. 77, 488 P.2d 127 (Ct. App. 1971).

Creditor may offset unpaid obligation against damages. - Recovery under this section does not prohibit creditor from collecting offset for unpaid truck repaid bill as the

same offsets available to creditor under 55-9-505 NMSA 1978 are available under this section, and the recovery in favor of the debtor would be applied against the amount found owing to creditor under the counterclaim. Charley v. Rico Motor Co., 82 N.M. 290, 480 P.2d 404 (Ct. App. 1971).

No offset when obligation already extinguished. - In a suit for loss caused by failure to comply with the provisions of the disposition of collateral code, creditor-defendant, having repossessed plaintiff's pickup truck, was not entitled to offset amount owing on truck where creditor had already applied proceeds from the sale of the truck to plaintiff's unpaid account, thereby extinguishing it as an obligation. Crosby v. Basin Motor Co., 83 N.M. 77, 488 P.2d 127 (Ct. App. 1971).

Law reviews. - For article, "Breach of the Peace and New Mexico's Uniform Commercial Code," see 4 Nat. Resources J. 85 (1964).

For article, "Buyers and Sellers of Goods in Bankruptcy," see 1 N.M. L. Rev. 435 (1971).

Am. Jur. 2d, A.L.R. and C.J.S. references. - 68A Am. Jur. 2d Secured Transactions § 737 et seq.

Rights in proceeds of vehicle collision policy, under "loss-payable" clause, of conditional seller, chattel mortgagee or the like, of vehicle where there has been improper repossession or foreclosure after the damage, 46 A.L.R.2d 992.

Rights and duties of parties to conditional sales contract as to resale of repossessed property, 49 A.L.R.2d 15.

72 C.J.S. Pledges § 30; 79 C.J.S. Secured Transactions § 185 et seq.

ARTICLE 10
EFFECTIVE DATE, REPEALER AND MISCELLANEOUS

ANNOTATIONS

Compiler's note. - Section 10-101 of ch. 96, Laws 1961 provides: "This act shall become effective at midnight on December 31st following its enactment. It applies to transactions entered into and events occurring after that date." Approved March 23, 1961.

Section 10-102 of ch. 96, Laws 1961 provides: "(1) The following acts and all other acts and parts of acts inconsistent herewith are hereby repealed:

"Sections 20-2-17 through 20-2-19 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1897, chapter 73, sections 125 through 127, as amended) and sections 22-

16-1 through 22-16-5 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1852-1853, page 81, as amended) and sections 24-3-1 through 24-3-4 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1905, chapter 79, sections 126 through 129, as amended) and sections 26-1-38 through 26-1-42 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1907, chapter 107, section 1, subsection 217, as amended, Laws 1903, chapter 94, sections 1 and 2, as amended, and Laws 1907, chapter 107, section 1, subsections 218 and 219, as amended) and sections 26-2-11 and 26-2-22 New Mexico Statutes Annotated, 1953 compilation (being Laws 1909, chapter 63, sections 10 and 21, as amended) and sections 33-1-25 through 33-1-35 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1959, chapter 179, sections 1 through 11) and sections 40-21-38 and 40-21-39 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1853-1854, page 25, as amended) and sections 48-9-1 through 48-9-17 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1929, chapter 138, sections 1 through 17) and sections 48-10-5 through 48-10-9 New Mexico Statutes Annotated, 1953 Compilation (being Laws 1923, chapter 20, section 1, Laws 1925, chapter 88, section 1, Laws 1929, chapter 49, section 1, and Laws 1923, chapter 55, sections 1 and 2) and sections

ARTICLE 11
AMENDMENT TO OTHER STATUTES

ANNOTATIONS

Compiler's note. - Laws 1961, ch. 96, §§ 11-101 to 11-118 purported to enact Article 11 of the Uniform Commercial Code. In fact, those sections merely amend sections which are now designated as 6-12-12, 14-8-4, 14-11-10, 38-7-1, 42-9-17, 48-3-7, 48-7-1, 56-5-1 to 56-5-4, 56-6-1, 56-6-3, and 56-6-6 to 56-6-8 NMSA 1978.

ARTICLE 12
EFFECTIVE DATE AND TRANSITION PROVISIONS

55-12-101. Effective date; ["old U.C.C." and "new U.C.C." defined].

This act shall become effective at 12:01 a.m. on January 1, 1986.

As used in this article, unless the context requires otherwise:

(a) "old U.C.C." means the Uniform Commercial Code, as effective in New Mexico, immediately prior to the effective day of this act.

(b) "new U.C.C." means the Uniform Commercial Code, as effective in New Mexico, as amended by this act.

History: 1978 Comp., § 55-12-101, enacted by Laws 1985, ch. 193, § 39.

ANNOTATIONS

Compiler's note. - This section appears as § 11-101 in the Uniform Act.

Meaning of "this act". - The term "this act", referred to at the beginning of the section, means Laws 1985, ch. 193, which extensively amends the Uniform Commercial Code. For present compilation of the provisions of ch. 193, see the Table of Disposition of Laws in Volume 14 NMSA 1978.

55-12-102. Preservation of old transition provision.

The provisions of Laws 1961, Chapter 96, Section 10-102, Subsection (2), shall continue to apply to the new U.C.C. and for this purpose the old U.C.C. and the new U.C.C. shall be considered one continuous statute.

History: 1978 Comp., § 55-12-102, enacted by Laws 1985, ch. 193, § 40.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.", see 55-12-101 NMSA 1978.

Compiler's note. - Laws 1961, Chapter 96, Section 10-102, Subsection (2), referred to near the beginning of this section, provides that the act does not apply to transactions entered prior to the act's effective date. Section 10-101 of ch. 96 makes the Uniform Commercial Code effective on January 1, 1962.

This section appears as § 11-102 in the Uniform Act.

55-12-103. Transition to new U.C.C.; general rule.

Transactions validly entered into after January 1, 1962, and before January 1, 1986, and which were subject to the provisions of the old U.C.C. and which would be subject to this act as amended if they had been entered into after the effective date of the new U.C.C. and the rights, duties and interests flowing from such transactions remain valid after the latter date and may be terminated, completed, consummated or enforced as required or permitted by the new U.C.C. Security interests arising out of such transactions which are perfected when the new U.C.C. becomes effective shall remain perfected until they lapse as provided in the new U.C.C., and may be continued as permitted by the new U.C.C., except as stated in Section 12-105 [55-12-105 NMSA 1978].

History: 1978 Comp., § 55-12-103, enacted by Laws 1985, ch. 193, § 41.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-103 in the Uniform Act.

Meaning of "this act". - This act, referred to near the middle of the first sentence, means Laws 1985, ch. 193, which extensively amends the Uniform Commercial Code. For present compilation of the provisions of ch. 193, see the Table of Disposition of Laws in Volume 14 NMSA 1978.

55-12-104. Transition provision on change of requirement of filing.

A security interest for the perfection of which filing or the taking of possession was required under the old U.C.C. and which attached prior to the effective date of the new U.C.C. but was not perfected shall be deemed perfected on the effective date of the new U.C.C. if the new U.C.C. permits perfection without filing or authorizes filing in the office or offices where a prior ineffective filing was made.

History: 1978 Comp., § 55-12-104, enacted by Laws 1985, ch. 193, § 42.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-104 in the Uniform Act.

55-12-105. Transition provision on change of place of filing.

(1) A financing statement or continuation statement filed prior to January 1, 1986 which shall not have lapsed prior to January 1, 1986 shall remain effective for the period provided in the old U.C.C., but not less than five years after the filing.

(2) An effective financing statement or continuation statement filed before January 1, 1986, in the place or places that were proper to perfect a security interest under the old U.C.C. shall continue to apply to the collateral described therein for the period specified in Subsection (1), without being filed in the place or places that are proper to perfect a security interest under the new U.C.C.

(3) The effectiveness of any financing statement or continuation statement filed prior to January 1, 1986 may be continued by a continuation statement as permitted by the new U.C.C., except that if the new U.C.C. requires a filing in an office where there was no previous financing statement, a new financing statement conforming to Section 12-106 [55-12-106 NMSA 1978] shall be filed in that office.

(4) If the record of a mortgage of real estate would have been effective as a fixture filing of goods described therein if the new U.C.C. had been in effect on the date of recording the mortgage, the mortgage shall be deemed effective as a fixture filing as to such goods under Subsection (6) of Section 9-402 [55-9-402 NMSA 1978] of the new U.C.C. on January 1, 1986.

History: 1978 Comp., § 55-12-105, enacted by Laws 1985, ch. 193, § 43.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-105 in the Uniform Act.

55-12-106. Required refilings.

(1) If a security interest is perfected or has priority when this act takes effect as to all persons or as to certain persons without any filing or recording, and if the filing of a financing statement would be required for the perfection or priority of the security interest against those persons under the new U.C.C., the perfection and priority rights of the security interest continue until January 1, 1989. The perfection will then lapse unless a financing statement is filed as provided in Subsection (4) or unless the security interest is perfected otherwise than by filing.

(2) If a security interest is perfected when the new U.C.C. takes effect under a law other than the Uniform Commercial Code which requires no further filing, refiling or recording to continue its perfection, perfection continues until and will lapse on January 1, 1989, unless a financing statement is filed as provided in Subsection (4) or unless the security interest is perfected otherwise than by filing, or unless under Subsection (3) of Section 9-302 [55-9-302 NMSA 1978] the other law continues to govern filing, or unless the security interest is perfected under Sections 62-13-8 through 62-13-12.1 NMSA 1978.

(3) If a security interest is perfected by a filing, refiling or recording under a law repealed by this act which required further filing, refiling or recording to continue its perfection, perfection continues and will lapse on the date provided by the law so repealed for such further filing, refiling or recording unless a financing statement is filed as provided in Subsection (4) or unless the security interest is perfected otherwise than by filing.

(4) A financing statement permitted by Section 12-105 [55-12-105 NMSA 1978] or 12-106 [this section] may be filed before the perfection of a security interest would otherwise lapse. Any such financing statement may be signed by either the debtor or the secured party. It must identify the security agreement, statement or notice (however denominated in any statute or other law repealed or modified by this act), state the office where and the date when the last filing, refiling or recording, if any, was made with respect thereto, and the filing number, if any, or book and page, if any, of recording and

further state that the security agreement, statement or notice, however denominated, in another filing office under the U.C.C. or under any statute or other law repealed or modified by this act is still effective. Section 9-401 [55-9-401 NMSA 1978] and Section 9-103 [55-9-103 NMSA 1978] determine the proper place to file such a financing statement. Except as specified in this subsection, the provisions of Section 9-403(3) [55-9-403(3) NMSA 1978] for continuation statements apply to such a financing statement.

History: 1978 Comp., § 55-12-106, enacted by Laws 1985, ch. 193, § 44.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-106 in the Uniform Act.

Meaning of "this act". - This act, referred to in the first sentence of Subsection (1), near the beginning of Subsection (3), and twice in the third sentence of Subsection (4), means Laws 1985, ch. 193, which extensively amends the Uniform Commercial Code. For present compilation of the provisions of ch. 193, see the Table of Disposition of Laws in Volume 14 NMSA 1978.

55-12-107. Transition provisions as to priorities.

Except as otherwise provided in Article 12 [55-12-101 to 55-12-108 NMSA 1978], the old U.C.C. shall apply to any questions of priority if the positions of the parties were fixed prior to January 1, 1986. In other cases questions of priority shall be determined by the new U.C.C.

History: 1978 Comp., § 55-12-107, enacted by Laws 1985, ch. 193, § 45.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-107 in the Uniform Act.

55-12-108. Presumption that rule of law continues unchanged.

Unless a change in law has clearly been made, the provisions of the new U.C.C. shall be deemed declaratory of the meaning of the old U.C.C.

History: 1978 Comp., § 55-12-108, enacted by Laws 1985, ch. 193, § 46.

ANNOTATIONS

Cross-references. - For definition of "old U.C.C." and "new U.C.C.," see 55-12-101 NMSA 1978.

Compiler's note. - This section appears as § 11-108 in the Uniform Act.

55-12-109. Saving clause.

(a) Chapter 55, Article 8 NMSA 1978 does not affect an action or proceeding commenced before that article takes effect.

(b) If a security interest in a security is perfected at the date Chapter 55, Article 8 NMSA 1978 takes effect and the action by which the security interest was perfected would suffice to perfect a security interest under that article, no further action is required to continue perfection. If a security interest in a security is perfected at the date Chapter 55, Article 8 NMSA 1978 takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under that article, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under Chapter 55, Article 8 NMSA 1978 is taken within that period. If a security interest is perfected at the date Chapter 55, Article 8 NMSA 1978 takes effect and the security interest can be perfected by filing under that article, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect.

History: 1978 Comp., § 55-12-109, enacted by Laws 1996, ch. 47, § 69.

ANNOTATIONS

Effective dates. - Laws 1996, ch. 47 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective May 15, 1996, 90 days after adjournment of the legislature. See Volume 14 NMSA 1978 for "Adjournment Dates of Sessions of Legislature" table.