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Uniform Commercial Code—Secured Transactions—Default

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UNIFORM COMMERCIAL CODE—SECURED TRANSACTIONS—DEFAULT*—Under the Uniform Commercial Code, which is now effective in New Mexico,¹ when a security agreement² covers both real and personal property and a default occurs, the secured party³ may, at his option, proceed either against the personal property or against both the real and personal property.⁴ The default procedure⁵ of the Code applies if the secured party elects to pursue the personal property separately. If the secured party elects to take action as to both the real and personal property, he may do so in accordance with the rights and remedies of the state's real property law⁶ and thus deprive the debtor⁷ of his rights and remedies under the UCC.⁸ This deprivation may arise when a lender, in a superior bargaining position, will not finance a transaction unless he is given

* *Graham v. Stoneham*, 388 P.2d 389 (N.M. 1963).

1. New Mexico's version of the Uniform Commercial Code, N.M. Stat. Ann. §§ 50A-1-101 to -9-507 (1953), is based on the 1958 Official Text, promulgated jointly by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

All references to New Mexico's version of the Code, often designated as "UCC" both in the footnotes and text, will omit the full statutory citation.

2. UCC § 9-105(1)(b).

3. UCC § 9-105(1)(i).

4. UCC § 9-501(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.

See Comment, 39 Marq. L. Rev. 246, 252 (1956):

Subsection (4) [9-501(4)] permits a secured party to proceed either under the law relating to foreclosure of real estate mortgages, or under the law as provided in Section 9-501, if the security agreement covers both real and personal property. As conditional sales contracts do not often cover anything other than personal property, it is sufficient to state . . . that this provides a simplified and faster remedy where the collateral is both real and personal property.

This observation may be correct for states using the real estate mortgage type of financing, but not in a state using the real estate contract.

5. UCC §§ 9-501 to -507.

6. UCC § 9-501(4). See note 4 *supra*.

7. UCC § 9-105(1)(d) defines a "debtor" as 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, contract rights or chattel paper.

8. See the cases cited in note 22 *infra*.

This comment is concerned with the fact that a lender can choose the law that is to be applied when a default occurs.

a "security interest"⁹ which is at least partially secured by real property.

*Graham v. Stoneham*¹⁰ involved the sale and purchase of an auto-wrecking business. The transactions took place before the effective date¹¹ of the enactment of New Mexico's UCC. The debtors and the secured parties entered into a conditional sales agreement containing a bill of sale to the personalty and a warranty deed covering the real estate.¹² This agreement provided for specified monthly payments, additional security in the form of a promissory note cosigned by sureties, and a real estate mortgage to secure the note. The debtors then encountered financial difficulties while in possession; at this time the secured party agreed to accept reduced monthly payments. Payment was made at the lower rate until the debtor defaulted. The secured party then demanded and received repossession in accordance with his rights and remedies under the conditional sales agreement and began to operate the business.¹³

The secured parties, shortly after gaining repossession, sued the debtors and the sureties for damages suffered because of the loss of value of the inventory. The debtors answered that by repossessing without foreclosure or other legal proceedings the secured parties had made an election of remedies; therefore, having rescinded the contract, any action to recover the purchase price, *e.g.*, suing on the note and foreclosing the mortgage given as additional security, had been waived.¹⁴ The sureties defended on the grounds that there had been an election of remedies and, moreover, that they had been released by the secured parties' acceptance of payments other than specified in the agreement.¹⁵ The trial court held that the debtors

9. UCC § 1-201 (37) defines "security interest" as "an interest in personal property or fixtures which secures payment or performance of an obligation."

10. 388 P.2d 389 (N.M. 1963).

11. N.M. Laws 1961, ch. 96, § 10-101: "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."

12. Record, p. 2, *Graham v. Stoneham*, 388 P.2d 389 (N.M. 1963).

13. Record, p. 25.

14. *Graham v. Stoneham*, 388 P.2d 389, 390 (N.M. 1963).

15. In *Morgan v. Salmon*, 18 N.M. 72, 135 Pac. 553 (1913), it was held that if the contract were altered, whether or not it were to the injury or advantage of the surety, without the surety's consent, it ceased to be a contract and the surety's obligation ceased. However, in *Sproul Constr. Co. v. St. Paul Fire & Marine Ins. Co.*, 389 P.2d 194 (N.M. 1964), it was held that the rule of *strictissimi juris* is no longer applicable to compensated sureties.

The sureties in *Graham* were non-compensated and presumably would have been released by the secured parties' acceptance of reduced payments if the court had not dispensed with the case on the ground of election of remedies.

were liable for the rental value of the property during the time they were in possession and for decrease in value of the inventory, less the payments made to the secured parties.¹⁶ The sureties were held liable on the note.¹⁷ On appeal to the New Mexico Supreme Court, *held, Reversed*.¹⁸ Parties to a contract may provide that repossession and suit for the purchase price are cumulative remedies, but in the absence of such an agreement, repossession is considered an election of remedies and precludes further action.¹⁹ Rescission by repossession released the sureties²⁰ since the contract had ended. The secured parties had no better rights against the sureties than they had against the debtor.²¹

The *Graham* decision fairly represents the pre-Code law in New Mexico relating to real estate and conditional sales contracts,²² and the law under the UCC if the secured party goes against the real and personal property.²³ In effect, under the UCC as in *Graham*, the secured party is allowed to take advantage of a default by repossessing the property and retaining the payments as liquidated damages.²⁴

The UCC default procedure²⁵ has a dual purpose: (1) to assure the secured party's rights in the collateral following a default, and (2) to assure the debtor that he will not be penalized for his misfortune.²⁶ Whether or not the UCC can accomplish the second pur-

16. *Graham v. Stoneham*, 388 P.2d 389, 391 (N.M. 1963).

17. *Ibid.*

18. 388 P.2d at 392.

19. *Ibid.*

20. UCC § 1-201(40) defines "surety" to include a "guarantor."

21. 388 P.2d at 392.

22. *Dunken v. Guess*, 40 N.M. 156, 56 P.2d 1123 (1936), was an action to quiet title in the vendor. The vendee contended that the vendor's title could not be quieted unless the purchase money was returned to him. The court held that the vendee could not recover the money advanced. In *Nelms v. Miller*, 56 N.M. 132, 241 P.2d 333 (1952), the court held that the vendee's interest had been forfeited, but that the vendor had waived his rights because the vendee had been allowed to remain in default for several years. *Bishop v. Beecher*, 67 N.M. 339, 355 P.2d 277 (1960), held that forfeiture and retention of payments was justified when the conscience of the court was not shocked. See also *Joe Heaston Tractor & Implement Co. v. Claussen*, 59 N.M. 486, 287 P.2d 57 (1955), where the court said that if there had not been a clause in the contract providing for cumulative remedies, the vendor could have taken possession and retained the payments as liquidated damages.

23. See UCC § 9-501(4), quoted in note 4 *supra*.

24. See the cases cited in note 22 *supra*.

25. UCC §§ 9-501 to -507.

26. The law abhors a forfeiture, and it is not unreasonable to believe that the default provision of the UCC was drafted and adopted with the thought that it would mitigate such harshness.

pose, protection of the debtor, is doubtful so long as the secured party can choose the applicable legal remedy.

Suppose a secured party in the same position as the secured parties in *Graham* is not given an option²⁷ but is forced to proceed against the personal property, whether or not the security agreement covers both real and personal property. The secured party could repossess both the real²⁸ and personal²⁹ property. This will work a forfeiture as to the real property but will make the UCC applicable to the personal property.

Under the Code, once repossession of the personal property is accomplished, the secured party "may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure."³⁰ The rights and remedies of repossessing and then bringing suit are cumulative.³¹ There is no reason for denying cumulative remedies, because the rights, obligations, and remedies provided by Article 9³² apply whether title to collateral is in the secured party or the debtor.³³

The secured party may, however, decide that it would be commercially feasible to sell, lease, or otherwise dispose of any or all of the personal property.³⁴ The secured party adopting this procedure must account to the debtor for any surplus, and unless otherwise

27. See UCC § 9-501(4), quoted in note 4 *supra*.

28. See the cases cited in note 22 *supra*.

29. UCC § 9-503:

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.

30. UCC § 9-501(1).

31. *Ibid.*

32. UCC § 9-202: "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."

33. The New Mexico Supreme Court, before the adoption of the UCC, apparently recognized that cumulative remedies can exist if provided for in the agreement. In *Joe Heaston Tractor & Implement Co. v. Claussen*, 59 N.M. 486, 287 P.2d 57 (1955), as interpreted in *Bishop v. Beecher*, 67 N.M. 339, 355 P.2d 277 (1960), the supreme court said that in case of a default by the vendee, the vendor could take possession and sell at a public sale and then bring suit for any deficiency.

34. See UCC § 9-504(1). The proceeds from the disposition must be applied to (1) the reasonable expenses of repossessing and holding until the disposition, (2) the satisfaction of the debt owed the secured party, and (3) the satisfaction of any subordinate security interest.

agreed, the debtor will be liable for any deficiency.³⁵ Neither the secured party nor the debtor will be placed in an inequitable position by this UCC result.

The UCC provides still another default procedure which, though assuring the secured party of his rights in the collateral, is directed specifically at benefiting the debtor. For instance, in a situation such as occurred in the *Graham* case, the secured party could have proposed to retain possession³⁶ in satisfaction of the obligation.³⁷ The retention may have been beneficial to the secured party since the business was a going concern. However, the secured party's decision to repossess and retain possession does not end the debtor's rights under the UCC, as it did in *Graham* under New Mexico's real property laws. The debtor may object in writing within thirty days³⁸ from the receipt of the secured party's proposal to retain, in which case the secured party *must* dispose of the collateral. If no objection is made, the secured party may retain the collateral in satisfaction of the debt.³⁹

The UCC seems to be seeking to deal fairly with the debtor and at the same time to protect the secured party's interest in the collateral. To accomplish both objectives effectively, the secured party should not be allowed the option of proceeding under the UCC *or* the real property laws at his option when the security agreement covers both types of property. It may be that in a state employing only the mortgage to finance real property sales, the debtor will receive some of the protection the UCC intended for him.⁴⁰ On the other hand, in states (including New Mexico) where the conditional sales contract is also used in real estate transactions, the vendee's rights may be forfeited, the property repossessed, and the payments retained by the vendor without foreclosure proceedings.

35. UCC § 9-504(2).

36. UCC § 9-505(2). However, if the secured party had a purchase money security interest (UCC § 9-107) in consumer goods and sixty per cent of the purchase price had been paid, he must dispose of the collateral unless, after default, the debtor signs a statement renouncing or modifying his rights under the UCC. UCC § 9-505(1).

37. This is precisely the point at which the parties' rights and remedies in *Graham* ended. It is obvious that this was not a satisfactory solution since the secured party in *Graham*, believed he deserved a deficiency judgment, and the debtor had to forfeit all of the previous payments.

38. UCC § 9-505(2).

39. *Ibid.*

40. In jurisdictions using the mortgage instead of the real estate contract as a security device, the debtor may be entitled to receive any surplus on disposition, and the debtor's equity may be more easily redeemed.

New Mexico's UCC does not sufficiently protect a debtor when the security agreement covers real and personal property; corrective legislation should be undertaken to close this loophole.

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