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New Mexico's Uniform Commercial Code in Oil and Gas Transactions

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NEW MEXICO'S UNIFORM COMMERCIAL CODE IN OIL AND GAS TRANSACTIONS

New Mexico's version of the Uniform Commercial Code was adopted in 1962. Since that time, there has been no reported case dealing with its application to oil and gas transactions, an area of some concern to interests in this state.

The purpose of this Comment is, first, to explain why Article 6 of the Code on bulk transfers should not be ignored in oil sales and, second, to explore the creation of security interests created under Article 9 in a typical oil and gas financing situation, including how the security interests are perfected under both the Code and New Mexico's Article 9.

Article 6, Bulk Transfers, is intended to prevent a businessman, unable to face his debts, from selling his inventory to anyone for any price and departing for a friendlier climate. The article provides for notice to creditors before "a major part" of the inventory is transferred, so that creditors may stop the sale if they feel it necessary. If a transfer takes place in violation of Article 6, all "creditors of the transferor . . . holding claims based on transactions or events occurring before the bulk transfer" may levy on the goods up to six months following the date the transferee took possession of them, or longer if the transfer was "concealed." A transferee unwittingly under Article 6 may reap the whirlwind.

As discussed below, Article 6 may be construed to apply in the case of a transfer of a producing oil lease when there is oil in tanks awaiting delivery also transferred. It probably does not apply when the oil in tanks is transferred alone in the ordinary course of busi-

2. Reference will be made indiscriminately to either the 1962 official text of the Uniform Commercial Code, or the New Mexico Statutes Annotated, ch. 50A (Repl. 1962, Supp. 1969). N.M. Stat. Ann. § 2-107 (Repl. 1962), for example, is identical with Uniform Commercial Code § 2-107 (hereinafter cited as U.C.C. § 2-107). The official Code and New Mexico provisions are identical unless specifically indicated otherwise. Official comments cited are those of the 1962 official text.
ness. Awareness of the possibility of the article's application in the first situation necessitates planning to avoid it.  

We begin with the definition of a bulk transfer in Section 6-102(1):

A “bulk transfer” is any transfer in bulk and not in the ordinary course of the transferor's business of a major part of the materials, supplies, merchandise or other inventory (Section 9-109) of an enterprise subject to this Article. (Emphasis supplied.)

To the extent that a transfer of all oil stored in tanks to a transferee can be considered “in the ordinary course of business” the article will not apply. Purchase of oil in tanks, however, in conjunction with purchase of a producing oil lease, including the equipment on it, would not be a transfer in the ordinary course of business.

The article’s coverage is limited to “inventory,” with a reference to Section 9-109 in the secured transactions article for a definition of this term. This section says that “inventory” is, first of all, “goods.” To be inventory, the goods must be “held by a person who holds them for sale. . . .” Thus far, the oil awaiting delivery sounds like inventory under the Code. The Article 9 definition of “goods” must also be met. This includes “all things which are movable at the time the security interest attaches. . . .” We have, of course, no security interest involved here. We are concerned, rather, with the effect of a transaction on rights in specific property. There seems no better point at which to view the nature of both the transaction and the property than the time when the transaction allegedly affected (or “attached” if you will) the property. If this is correct, we look at the stored oil at the time of transfer and find that it is indeed “movable,” and thus falls under the label of “goods,” and more specifically, “inventory.”

Having failed to this point to escape Article 6, we must return to the definition of “bulk transfer” (quoted above) and look at what type of business is “an enterprise subject to this Article.” Section 6-102(3) tells us that “The enterprises subject to this Article are all those whose principal business is the sale of merchandise from stock, including those who manufacture what they sell.” At first blush, the enterprises defined do not sound much like the typical oil and gas lessee. “Merchandise” is not defined in the Code, although perhaps

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7. See Ryan, Effect of the Uniform Commercial Code on Oil and Gas Transactions, 18th Annual Inst. on Oil & Gas L. & Tax. 365, 383 (Sw. Legal Foundation, 1967). This article also contains a discussion of Article 2 on sales to oil and gas transactions.
9. Id. § 9-105(1)(f).
the purpose of its use, instead of the more general "goods," was to encourage the courts to put their own interpretation on the article's coverage in line with the purposes sought to be served.

The Official Comments to Section 6-102 shed some further light on the purpose sought to be served. Comment 2 calls attention to the definitions of the enterprises subject to the article, and explains that the definitions do not include enterprises:

... whose principal business is the sale not of merchandise but of services. While some bulk sales risk exists in the excluded businesses, they have in common the fact that unsecured credit is not commonly extended on the faith of a stock of merchandise.

If the courts are to adopt the "underlying purpose and policies" test encouraged by the Code,10 the question asked should not be whether "oil" is "merchandise," but whether there is a bulk sales risk,11 and whether the lessee's creditor's normally grant unsecured credit on the faith of the oil awaiting delivery located on the lease. To the extent that creditors have relied on the oil on the premises in granting unsecured credit, they should be protected in harmony with the policy of the article. This is so even if the oil lessee is "primarily" in the business of providing "services" rather than "merchandise," because the rationale for the protection is based, not on the nature of the business, but on commercial practices and the reasonable expectations of the unsecured creditors. If the purposes of the article are met by its application, the court might well apply it to the purchase of a producing lease in which "a major part" of the inventory (oil) is purchased.

What follows if there is a bulk transfer of the oil here? The most serious consequence is set out in Section 6-102(2):

A transfer of a substantial part of the equipment (Section 9-109) of such an enterprise is a bulk transfer if it is made in connection with a bulk transfer of inventory, but not otherwise.

10. Id. § 1-102(1) : This Act shall be liberally construed and applied to promote its underlying purposes and policies.

11. In calculating the coverage of Article 6, the Code framers have taken into account the fact that bulk transfers have only been a problem in the sales area. For this reason, the creation of a security interest is not within the Article 6 protection. U.C.C. §§ 6-103 (1), 9-111. The Official Comment to Section 9-111 states:

Whatever the reasons may be, it seems to be true that the bulk transfer type of fraud has not often made its appearance in the security field... Since compliance with the bulk transfer laws is onerous and expensive, legitimate financing transactions should not be required to comply when there is no reason to believe that other creditors will be prejudiced.
Again we are referred to Article 9 to determine what the Code means by "equipment." Referring to that article, we find that practically every item of equipment expected to be transferred in the purchase of a producing lease is included within the term "equipment," down to and including the well casing.\(^{12}\) If, then, there is a bulk transfer of inventory, as discussed above, and a "major part" of the equipment is also transferred, both fall under the Article 6 protection and the transferor's creditors may levy on either or both up to six months following possession by the transferee.\(^{13}\)

In order to avoid the application of Article 6, the first reaction might be to separate the sales. The sales of inventory and equipment, however, need only be "in connection" with one another for the article's sanctions to apply. Thus, a court might find that, even if the sales were not simultaneous, nevertheless they were a "step transaction" and thus connected to one another. This sort of reasoning might even apply to a purchase, in good faith, of the oil in tanks, followed shortly thereafter by a purchase of equipment. The court might say, because the sales were "connected," that the first sale was not one "in the ordinary course of business" and the article would apply.

Remember that only if there is a bulk sale of inventory will a connected bulk sale of equipment also fall under the article. One writer recommends that all oil in tanks be excluded completely from the purchase agreement, and that the seller do his own collecting from the pipeline purchaser for all his "inventory."\(^{14}\) Any other category of goods which looks like inventory should also be avoided. This way there is no transfer of inventory, and Article 6 does not apply, even if there is a transfer of a "major part" of the lessee's equipment.

Whether Article 6 will apply to the purchase of a producing lease is in the realm of speculation. If it is found to apply, the main Article 6 danger to the transferee is only that he will fail to recognize the possibility of application, and take steps to avoid it or comply with it.

Article 9 of the Code deals with secured transactions. Two objectives of the article were to unitize personal property secured

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\(^{12}\) Under Section 9-109(2), "equipment" is "goods" if it is "used or bought for use primarily in business." Under the same section, "equipment" is also any goods which "are not included in the definitions of inventory, farm products or consumer goods," and is thus the catch-all label for anything not falling within the other categories, expanding the already general definition still further. To add to the generality of the definition, Article 9 defines "goods" as including also "fixtures," a term meaning whatever state law says it means. U.C.C. §§ 9-105(1)(f), -313(1).

\(^{13}\) Id. § 6-111; N.M. Stat. Ann. § 50A-6-110 (Repl. 1962).

\(^{14}\) Ryan, supra note 7, at 385.
financing, and to provide a simplified filing system which would give adequate notice to lenders.\textsuperscript{15} New Mexico has, for all practical purposes, refused the benefits of a simplified filing system. On this specific point, one writer comments:

\ldots some of the oil producing states just do not have the Uniform Commercial Code at all. \ldots Without offending all of them but still hitting the worst offenders, I would have to state that Nebraska, New Mexico, and Wyoming have woefully missed the boat and can be regarded as Neanderthals in a 20th century business community.\textsuperscript{16}

This charge is based on the fact that New Mexico refused to adopt one of the three choices for place of filing financing statements, and adopted instead a system which retains local filing even for transactions which are not necessarily likely to remain local.\textsuperscript{17} Because the criticism is made in a business context, the effects of New Mexico's choice must be explored in a business context.

A typical form of financing in the oil and gas industry includes a mortgage covering the leasehold and mineral interest, the equipment on the lease, and an assignment of production from the lease.\textsuperscript{18} How New Mexico's filing provision affects this transaction is best examined by beginning with how Article 9 classifies the security interests created, followed by an analysis of how each classification fits into the filing provision.

Taking the leasehold and mineral interest first, we see that both the lease and the mineral estate are interests in real estate under applicable New Mexico case law.\textsuperscript{19} Section 9-104(j) tells us that

\begin{quote}
15. The Comment to § 9-101 gives the Code drafters' view of what Article 9 is designed to accomplish:

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 \textit{less cost} and with \textit{greater certainty}.

\ldots

The scheme of the Article is to make distinctions, where distinctions are necessary, along \textit{functional rather than formal} lines.

\ldots

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 \textit{more accessible} but the cost of procuring credit information, and, incidentally, of maintaining the files, is greatly reduced. (Emphasis supplied.)

\end{quote}

\begin{quote}
16. Ryan, supra note 7, at 394.


\end{quote}
Article 9 does not apply "to the creation or transfer of an interest in . . . real estate" (except fixtures) "including a lease . . ." The lease and the mineral interest are dealt with under state law applicable to real estate transactions and are outside Article 9 coverage. The lease, of course, will be filed locally with the real estate records, not under the Code filing provisions.

Next is the security interest in the equipment. Under Article 9, you will remember from the discussion of bulk transfers, "goods" include "fixtures." "Goods" are divided into consumer goods, inventory, farm products and equipment. "Equipment" under the Code is not only broadly defined as goods used primarily in business, but is also the catch-all term for goods not falling into one of the other categories. The goods must be held for sale to be inventory, and the machinery under consideration is clearly not consumer goods or farm products. In short, all operating machinery down to and including the well casing falls within the Article 9 definition of equipment.

For equipment, the security interest attaches at the time the security agreement is executed in most cases. Section 9-204(1) says that the interest attaches when 1) there is agreement that it attach, 2) the debtor has rights in the collateral, and 3) value is given. It should be noted here that "value" includes a binding commitment to extend credit.

The next question is how to perfect the security interest for increased protection from later secured creditors, unsecured creditors, trustees in bankruptcy, later purchasers, etc. Under Section 9-303(1), the security interest is perfected when 1) it has attached, and 2) when all applicable steps required for perfection have been taken. Assuming that the interest has attached, a financing statement must be filed to perfect a security interest in equipment (Section 9-302(1)). There is no special form required for a financing statement. It must, however, contain at least the mailing addresses of both debtor and secured party, a statement indicating the types, or describing the items, of collateral, and be signed by both parties (or in some cases only the secured party need sign).

The term "signed" is liberally defined, and is sufficient if it is only a

21. Id. § 9-109(2).
22. Id. § 1-201(44) (a). The Code also incorporates the common law concept of consideration directly into the meaning of value under this section. Id. § 1-201(44) (d).
23. N.M. Op. Att’y Gen. 1962-2. See also U.C.C. § 9-402. Immediately on passage of the New Mexico version of the Code, the Attorney General was asked for advice on a number of filing points. See e.g., N.M. Ops. Att’y Gen. 1962-1, -2, -12, -20, -30, -126, -132.
24. Id.; U.C.C. § 9-402(1), -402(2).
symbol executed or adopted by a party with present intention to authenticate a writing." A suggested form is included in Section 9-402(3). A caveat to the courts on reading the provision technically is also added: "A financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." What must be filed, and when it must be filed under both the New Mexico and the official version of the Code are the same. The difficulty arises over where the financing statement must be filed in order to complete the perfection process.

The first provision which concerns us is the same in all recommended alternatives in the official Code and in the New Mexico version:

(1) The proper place to file in order to perfect a security interest is as follows:

... (b) when the collateral is goods which at the time the security interest attaches are or are to become fixtures, then in the office where a mortgage on the real estate concerned would be filed or recorded. ... 27

This provision will cause the same problems under the Code as it did under pre-Code law, because the Code drafters left the problem of definition of "fixtures" to existing law. The New Mexico law of fixtures is uncertain because of the lack of state precedent, but this problem has been treated before. It will suffice for present purposes to assume that some of the equipment on the lease will become fixtures, and the financing statement will be filed with the real estate records. That equipment which remains will require other treatment. This, of course, is consistent with the notion that peculiarly local transactions, particularly those dealing with realty and fixtures, should be filed locally because the interest in them is likely to be an essentially local interest, rather than one in which "outsiders" would be interested and which might require a central location for

25. U.C.C. § 1-201(39).
26. Id. § 9-402(5).
filing. Whether this is generally true or not, either a central location or a location in the county is a reasonable place for a lender to search for records concerning land. Viewed from an expense point of view, it seems clear that the more economical move from the state’s point of view would be central filing, perhaps by computer, with service points in major cities throughout the state. From the individual lender’s point of view, checking one source is invariably easier and cheaper than checking numerous sources, no matter whether the lender is in Las Cruces or New York. But the Code has not recommended this alternative. Perhaps the future increase in individual mobility and burgeoning interstate business will dictate increased centralization.

For now, we are concerned with the more prosaic task of determining where to file financing statements on those items of equipment which are not to become fixtures, but which will be used by the lessee in extracting oil and gas from the lease. This sort of equipment (drilling rigs, bits, drillstems, etc.) is moved freely about by the lessee from lease to lease as his business dictates.

Under all the alternatives recommended by the Code drafters, the financing statement must be filed in the office of the Secretary of State. Because of the unsatisfactory consequences of the New Mexico provision, this alternative should have been chosen by New Mexico. It has the merit of certainty, a desirable plus in a system which has been, in the past, notorious for its numerous traps for the unwary, much less the wary. With central filing, no matter where the lessee takes his equipment, it will remain subject to the perfected security interest, the existence of which would be discoverable by subsequent lenders. This, of course, would require serial number identification of the equipment in question. Specific identification may be desirable when the lender wants to retain a security interest in specific equipment because of its cost, age, condition, marketability, or some other desirable commercial quality. The alternative, probably more desirable for the debtor-lessee, would be to have the security interest on all equipment “kept on the leasehold,” so that he would be able freely to transfer machinery elsewhere without carrying the security interest with the equipment. The lender might also prefer this type of agreement from a convenience point of view, simply because the location of the collateral, if there is any, will be certain.

The New Mexico version of subsection (1) of Section 9-401

31. This statement assumes that the equipment is to remain in New Mexico.
makes the place of filing depend on the residence of the debtor.\textsuperscript{32} If the debtor is a resident of the state, then the filing is in his county of residence. If the debtor is a non-resident of the state, then the financing statement is filed in the county where the goods are kept.

The 1967 New Mexico amendment to Section 9-401(1) cleared up much of the uncertainty previously existing about the residence of New Mexico corporations and unincorporated associations.\textsuperscript{33} For a corporation, the lender must determine the county where its "registered and principal office or place of business is located as set forth in its articles or certificate of incorporation or agreement."\textsuperscript{34} In order to be sure that the most recent articles of incorporation are obtained, the lender must check with the Corporation Commission in Santa Fe (where the Secretary of State's office is also located) to find the legal residence of the corporation. He must then return to the county thus determined and search the records before credit is granted. The same process is required for corporations organized outside New Mexico which have been authorized to do business within the state.\textsuperscript{35} In this situation, New Mexico has provided an extra step in the searching process (checking the Corporation Commission records in Santa Fe) in order to avoid the uncertainty of local filing based on residence. Parenthetically, it might be noted that the argument that checking the records is too inconvenient under a

\begin{itemize}
\item[32.] N.M. Stat. Ann. § 50A-9-401(1)(a) (Supp. 1969): The proper place to file in order to perfect a security interest is as follows:
\begin{enumerate}
\item in the office of the county clerk in the county of the debtor's residence or, if the debtor does not reside in this state and the collateral is goods, then in the office of the county clerk in the county where the goods are kept.
\end{enumerate}
\item[33.] Id. § 50A-9-401(1)(d) (Supp. 1969): (d) for the purpose of this section,
\begin{enumerate}
\item a corporation or incorporated association organized under the laws of this state shall be deemed to reside in the county where its registered or principal office or place of business is located as set forth in its articles or certificate of incorporation or agreement;
\item an unincorporated association organized under the laws of this state shall be deemed to reside in the county where its statement of organization is filed;
\item a partnership shall be deemed to reside in the county where its principal place of business in this state is located;
\item a corporation organized outside of this state and authorized to do business in this state shall be deemed to reside in the county where its principal office in this state is located as set forth in documents filed with the state corporation commission; and
\item all other nonindividual debtors shall be deemed non-residents of New Mexico.
\end{enumerate}
\item[35.] See id. § 50A-9-401(1)(d)(iv).
\end{itemize}
totally centralized filing system is clearly not the reason for maintain-
ing our local filing system if we can go so far as to check Santa Fe
records so that we may accurately maintain our local system with
some degree of certainty of notice.

The lender to an out-of-state corporation which has not registered
to do business in New Mexico may find it totally impossible to check
accurately previous security interests in the equipment under New
Mexico’s provision. New Mexico Statutes Annotated 50A-9-401
(1)(a) (Supp. 1969) requires that, if the debtor does not reside
in New Mexico and the collateral is goods (as here), the place to
file is in the county where the goods are kept. If the goods are moved
into another county, no refiling is necessary in that county.36 Unless,
then, the creditor can verify the location of the goods during the
time before the security agreement is executed,37 he cannot be sure
that his interest will be senior. He may, of course, check all county
records in New Mexico if he wishes to go to that trouble and ex-
pense. This and other difficulties38 might well lead the lender to re-
fuse credit to corporations recently registered to do business, or not
registered at all. Only if the initial registration in the state took
place before enactment of the Code in New Mexico would the lender
be safe in checking only the files in the county of residence in New
Mexico for prior security interests in equipment.39 As may be seen,
this sort of provision discriminates in favor of established New Mex-
ico corporations, and could tend to discourage outside industry from
locating here, when by all accounts New Mexico needs additional
industrial development.

No particular problem is evident in the treatment of unincorpo-
rated associations.40 Dealing with partnerships, however, especially
large ones, the lender has the burden of choosing at his peril the
principal place of business of the partnership. He must not only
check those counties which a previous lender might have thought to
be a principal place of business, but must also file in each of the coun-
ties he feels to be a principal place of business. Central filing, of
course, would solve the problem with no risk of surprise on the part
of the lender.

36. Id. § 50A-9-401(3) (Repl. 1962).
37. Id. § 50A-9-403 (Repl. 1962, Supp. 1969). The financing statement must be
refiled at least every five years for continuous perfection.
38. See, e.g., Coogan, Hogan & Vagts, 1 Secured Transactions Under the U.C.C.,
supra note 29, at § 614(2), specifically discussing the New Mexico variations on place of
filing. Section 614 is appropriately labeled “Out of the Frying Pan.”
39. This applies only to security interests created under the Code.
The unincorporated association and the out-of-state partnership which have no "principal place of business" within the state are, under Section 50A-9-401(1)(d)(v), non-residents, and financing statements concerning their equipment (goods) must be filed where the goods are located.\textsuperscript{41} This presents the same hazards discussed above under non-resident corporations not registered to do business in New Mexico.\textsuperscript{42}

An individual, of course, is unlikely to be the debtor in our situation. The large amounts of capital required to develop properties normally discourage much individual development of oil and gas leases. If, however, there were an individual debtor involved, a resident of New Mexico, the added difficulty of determining his past residences (possibly multiple) becomes involved.

Thus far, we have covered the method of filing security agreements on equipment in New Mexico under our hypothetical mortgage of a producing oil and gas lease. Recall now that the last item on the agreement was an "assignment of production." This brings us again to the problem of categorizing this item under the Code, in order to be able to fit it into the filing provision.

As previously discussed, the interest in minerals in place is an interest in real estate.\textsuperscript{43} To avoid controversy, Section 9-204(2)(b) provides that the debtor has no rights "in oil, gas or minerals until they are extracted. . . ." One of the necessary conditions to the attachment of the security interest is that there is agreement that the "debtor has rights in the collateral."\textsuperscript{44} An additional special requirement for oil and gas transactions says:

\[\ldots\] a security interest is not enforceable against the debtor or third parties unless

\[\ldots\]

(b) the debtor has signed a security agreement which contains a description of the collateral and in addition, when the security interest covers \ldots oil, gas or minerals to be extracted \ldots , a description of the land concerned.\textsuperscript{45}

Although the description must be in the security agreement for it to be enforceable, this does not carry over into Section 9-402(1) governing formal requirements of the financing statement, so it need

\textsuperscript{41} Id. § 50A-9-401(1)(a).
\textsuperscript{42} See notes 36-38 supra and accompanying text.
\textsuperscript{43} See note 19 supra and accompanying text.
\textsuperscript{44} U.C.C. § 9-204(1).
\textsuperscript{45} Id. § 9-203(1).
not be included there for notice purposes. It may be, however, that a description of the land concerned should be included to meet the requirements of Section 9-110 of "reasonable identification."

Because, then, the security interest does not attach until the mineral is severed from the realty, we need not worry about characterization for Article 9 purposes until that point. As discussed under the section on bulk transfers, the oil or gas immediately on extraction is, at least for a very short time, inventory of the lessee awaiting sale. Shortly thereafter, a "contract right" may arise. This is defined by Section 9-106 as a "right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." The lessee, upon performance (delivery) has a right to payment which is not evidenced by an instrument or chattel paper. The next step, of course, is delivery to the purchaser. At this stage, the lessee's right is characterized as an "account," which, Section 9-106 says, is "any right to payment for goods sold . . . which is not evidenced by an instrument or chattel paper." (emphasis added). Inventory, of course, is one of the four types of "goods" under Article 9. The goods have been sold to the buyer, the lessee has a right to payment, and again no instrument or chattel paper is involved.

To further complicate the picture, and to characterize the next step in the transaction, the idea of "proceeds" must be introduced:

"Proceeds" includes whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of. The term also includes the account arising when the right to payment is earned under a contract right. Money, checks and the like are "cash proceeds." All other proceeds are "non-cash proceeds." 46

46. "Chattel paper" is defined in Section 9-105(1)(b) as:

... a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods. 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.

"Instrument" defined in Section 9-105(1)(g) is:

... a negotiable instrument... or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease. . . .

Dealing with chattel paper first, notice that there is no security interest here in "specific goods" as required by the definition. Although there may be an "instrument" involved in the transaction, it will not evidence a "right to payment not yet earned by performance," but will evidence the lender's right to payment on the mortgage debt.

47. Here again the lessee-debtor's right to payment by the buyer will not be evidenced by an instrument. The only instrument possibly involved would be a note from lessee-debtor to lender.

48. U.C.C. § 9-306(1).
Proceeds, as may be seen from the definition, are what are received when the "account" is erased by payment to the lessee. Tracing backwards, however, we find that the "account" is proceeds both from the "inventory" and the "contract right." Thus, if our security agreement covered "inventory from production" and "contract rights for the sale of production," this would cover "accounts" and also the "proceeds" of the account, or the money received, by virtue of Section 9-306(2) which provides for automatic continuation of the security interest in identifiable proceeds.

Let us say, however, that our security agreement provides that the secured party's interest in the production is in "inventory, contract rights, accounts, and proceeds." We now turn again to the question of where to file to perfect the security interests in the production, both under the official version of the Code, and under New Mexico's provision.

Again note that, under any of the alternative choices of the official Code, the financing statement must be filed in the office of the Secretary of State. In New Mexico, however, if the debtor is a resident of the state, the financing statement is filed in the county of his residence. The problems involved in determination of residence have been discussed under the filing of a security interest on equipment, and need not be covered again. The party who lends to the non-resident, however, is required to file his financing statement both in the county where the goods (inventory) are kept, and with the Secretary of State (because only when the collateral is "goods" does the secured party file his financing statement dealing with a non-resident in the county where the goods are located). In this situation, although the goods are covered by Section 50A-9-401(1) (a), accounts and contract rights are not, and they fall under the "other" provision for central filing in Section 50A-9-401(1) (c).

Here is the same sort of discrimination observed under the equipment financing statement filing discussion, in favor of the resident debtor, whose lender need only file once to perfect his interest. Not present in this case, however, is the problem of the difficulty of the search for prior outstanding interests. Previous interests in contract rights, accounts and proceeds will be filed centrally. Previous inventory interests will be filed in the county where the goods are located.

49. *Id.* § 9-401(1) (1st, 2nd and 3rd alternative subsections).
   (1) The proper place to file in order to protect a security interest is as follows:
       (a) . . . if the debtor does not reside in this state and the collateral is goods,
       then in the office of the county clerk in the county where the goods are kept . . .
   
       (c) in all other cases in the office of the secretary of state.
which will be, handily, the same county in which the land is located and no other. This is so because of Section 9-307(1):

A buyer in ordinary course of business (subsection (9) of Section 1-201) . . . 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.

This provision effects the "floating lien." The lien (security interest) attaches to the inventory, remember, when the debtor has rights in the collateral (and there is agreement that it attaches and value is given), which occurs on severance of the oil and gas from the ground. Now we learn that the security interest is destroyed as soon as a buyer in ordinary course takes the goods, even if he has knowledge of the security agreement. This, however, under our hypothesized situation, does not theoretically affect the lender's security, because the security interest "attaches" at that time to the rights the debtor-lessee obtains in exchange for the inventory ("accounts" or "proceeds" of inventory). As a practical matter, the interest in accounts may be of little value. Because, then, under, ordinary circumstances, the lessee will not transport his inventory off the lease as inventory, the filing need only be made in the "county where the goods are kept."

One caveat must be briefly looked at before leaving the subject of the place of filing. Section 9-103 provides:

(1) If the office where the assignor of accounts or contract rights keeps his records concerning them is in this state, the validity and perfection of a security interest therein and the possibility and effect of proper filing is governed by this Article; otherwise by the law (including the conflict of laws rules) of the jurisdiction where such office is located.

This section applies to both resident and non-resident debtors who have given a security interest in accounts or contract rights. There may, of course, be several places in which the assignor keeps his records concerning the accounts and contract rights, and to be perfected, the law of the jurisdiction in which each office is located should be

51. Unless, of course, the lease has been assigned from a state resident to a non-resident. In this event the assignor must be tracked down, his residence determined (perhaps by a check of the corporation commission records in Santa Fe), and a check made of the records in his county of residence. Again, this problem could be completely avoided by adoption of one of the official Code alternatives for Section 9-401(1).
52. U.C.C. § 9-204. Remember that under Section 9-204(2)(b), the debtor has no rights in the collateral for purposes of Article 9 until the oil and gas are extracted.
consulted before filing. Notice that the law of these jurisdictions (if the records are located in more than one state) will also control the validity of the security interest. Local Code variations should be checked, then, at the drafting stage, to make the security interest valid in all jurisdictions if this is possible. Because at least some information concerning the accounts and contract rights will be maintained at the well-head, it is perhaps best to assume that filing under New Mexico's Article 9 is also indicated in most cases.

New Mexico's filing provision has been vastly improved by the 1967 amendment, which lent certainty to the determination of residence at least of corporations and unincorporated associations. For the corporation, however, the residence may only be accurately obtained by a check of the records of the Corporation Commission, "across the street," so to speak, from where the complete check would be made with a completely centralized filing system. The cost of a central filing system, both to the state and to the individual lender searching the records, should be considerably less than a local system, not only through economies of scale, but through elimination of multiple filing within the state, and the necessity in some cases for searching the records in more than one county. Efficiency should also be improved with the volume of requests to be handled and financing statements to process. Computerization of the entire process, with service points throughout the state would give the lender immediate access to the information, perhaps by telephone to a service point if he is not close enough to make the trip personally.

The argument for local filing for some transactions is set forth by the Code Comments:

... 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.  

One of the connotations of "convenience" here is that the local system saves time. This would be so if there were any guarantee that the desired records were kept in a local filing area. As pointed out,

54. Although not an exactly parallel situation, some idea of the volume of credit inquiries to be expected with central filing may be obtained from the fact that the Credit Bureau of Albuquerque processes approximately 20,000 requests for credit information per month. Interview with Paul Johnson, Manager, Credit Reporting Department, Credit Bureau of Albuquerque, Albuquerque, Jan. 21, 1970. A central filing office might conservatively expect 5,000 requests per month. Taking an arbitrary charge of $2.50 per report, the office would produce $150,000 per year to help defray expenses.
55. U.C.C. § 9-401, Comment 1.
there is a good deal of uncertainty about this, and other records besides the "local" one may need to be checked as well. It is probably true that most credit inquiries come from local sources, but it is probably also true that a substantial percentage of inquiries are not local, but require a telephone call or a letter, much as a central filing system would require.

It should be noted here that one of the reasons for a central filing system is convenience of all concerned. Although the official Code suggests the office of the Secretary of State as the central filing location, there is no reason why this could not be modified in unusual circumstances, such as exist in New Mexico. For convenience, it would seem that the central filing office in New Mexico should be located in Albuquerque, both the center of the state and the center of nearly half the state's population. This would further the Code policy of convenience and decrease the costs for a larger number of New Mexico citizens.

The major reason for a central filing location is certainty. Gone is the multiple filing problem, and with it the problem of searching in more than one county. Gone are the residence problems and the consequences of misjudgment or failure to check residence accurately. A check at one location within the state would provide the desired information. Out-of-state lenders would feel more disposed to lending in New Mexico, and a good deal of lawyers' time (and clients' money) now spent puzzling over where to file and where to search would be saved.

There is always, when a change like this is contemplated, a fear that jobs will be lost and now-useful citizens placed on the welfare rolls. In the first place, the elimination of the office of county clerk is not at all contemplated. The only recommendation made is that all or most of the "security interest" files be removed. Untouched are real estate records, mechanics' and materialmen's liens, other statutory liens outside the Code structure, the voter registration records, marriage licenses, and so on. The few people who no longer have jobs because of the change could be retrained in some other work, or could go to work for the new central filing office. Out-of-state lenders' increased willingness to do business in New Mexico should soon benefit the entire economy even if new industry is not attracted by the benefits of central filing.

In the interest of industrial development of the state, it is to be

56. According to the Credit Bureau of Albuquerque (see Interview, supra note 54) approximately 25% of the requests for credit information come from outside the City of Albuquerque.

hoped that the state legislature will soon realize the dampening effect on incoming capital of a filing system which is either inordinately complicated, does not provide notice, or both. There are enough uncertainties in the lending business without adding a highly unnecessary and, at this stage, even anachronistic local filing system.

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