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## Fixtures, Security Interests and Filing: Problems of Title Examination in New Mexico

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# FIXTURES, SECURITY INTERESTS AND FILING: PROBLEMS OF TITLE EXAMINATION IN NEW MEXICO

The law of fixtures forms the demilitarized zone in the conflict between realty interests and chattel interests. Basic fixture concepts evolving from real estate law have met increasing opposition from chattel interests as the economy of the United States has shifted from a land-oriented base to one emphasizing the sale of goods on credit. With the advent of the Uniform Commercial Code, new lines have been drawn, and an already complex problem has been intensified.

The quiet years following the adoption of the Uniform Commercial Code in New Mexico<sup>1</sup> have provided few guidelines for solving the fixture problem to land title examiners and those persons desiring to perfect security interests in personalty. A digest of the historical concept of fixtures and a discussion of the impact of the Uniform Commercial Code in other states is offered in this note so that possible problems peculiar to New Mexico may be anticipated.

Pre-Code definitions of fixtures range from the English concept that a fixture is a chattel which when attached to realty becomes a part of the realty but is removable by the annexor against the will of the owner of the realty,<sup>2</sup> to such variations as constructive annexation which gives fixture status to even such items as a key to a door. *Teaff v. Hewett*, the leading American case on fixtures, defined a fixture as “[A]n article which was a chattel, but which by being physically annexed or affixed to the realty, became accessory to it and part and parcel of it.”<sup>3</sup> While disaffirming the English view-

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1. The New Mexico version of the Uniform Commercial Code, N.M. Stat. Ann. §§ 50A-1-101 to -9-507 (Repl. 1962), was originally based on the 1958 Official Text. In 1967 the New Mexico statute was amended in order to adopt most of the changes found in the 1962 Official Text.

Full statutory citation will be omitted when referring to the New Mexico version of the Code. Citation to “Comments” are those accompanying the 1962 Official Text.

2. English law in regard to fixtures was found to be unsatisfactory because it failed to recognize the fundamentally different legal principles which were involved in cases where the fixture is owned by the owner of the land as opposed to those where the fixture is owned separately. Niles, *The Rationale of the Law of Fixtures: English Cases*, 11 N.Y.U. L. Rev. 560 (1934).

3. *Teaff v. Hewett*, 1 Ohio St. 511, 527 (1853) as quoted in Hollander, *Imperfections in Perfection of Ohio Fixture Liens*, 14 W. Res. L. Rev. 683, 86 (1963). Other definitions of fixtures are: “A fixture is an article that was once personal property, but has been installed in or attached to land or a building thereon in some more or less permanent manner, so that such article is regarded in law as part of the real estate.”

point of the movability of fixtures, the court suggested a test whereby the status of an article could be ascertained.<sup>4</sup> Use of this test introduced a new concept to the law of fixtures—the intention of the party making the attachment.<sup>5</sup>

The American shift to the intention test was foreshadowed by problems faced by English courts when they were called on to decide the question of ownership of fixtures as between landlord and tenant in the face of the rationale exempting certain types of fixtures from the prohibition against removal.<sup>6</sup> One major difficulty centered on the possibility of damage to the premises caused by the removal of the fixture. The landlord was entitled to the return of his property undamaged by the actions of the tenant, but certain items which had been attached could not be removed without material damage to the realty. If the damage would be extensive, the courts would not permit the article to be removed. This problem still plagues the courts, even in those states which adopted the Uniform Commercial Code.

Certain agreements could be made between the landlord and his tenant, the seller and buyer, and the mortgagor and the mortgagee concerning the status of particular articles to be placed on realty, but when there was a conflict of interest between different parties—such as the buyer of the real estate and the mortgagee of the article or the owner of the realty and the purchaser of the article, the agreements could not be enforced equitably.<sup>7</sup>

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R. Kratovil, Real Estate Law §10 (4th ed. 1964), "[A] fixture is a former chattel which, while retaining its separate physical identity, is so connected with the realty that a disinterested observer would think it a part thereof." Niles, *supra* note 2 at 98.

4. (1) Actual annexation to the realty, or something appurtenant thereto.
- (2) Appropriation to the use or purpose of the realty with which it is connected.
- (3) The intention of the parties making the annexation to make the article a permanent accession to the freehold—this intention being inferred from the *nature* of the article affixed, the relation and *situation* of the *party* making the annexation, the structure and mode of annexation, and the purpose or use for which the annexation has been made.

Niles, *supra* note 3 at 69, n. 19.

5. It should be noted that pre-Code thinking in some states recognized only two types of property—realty or personalty—and the later concept of a third type of property did not enter into their case law. The intention test also applied to licensees or tenants.

6. Traditionally, such removable fixtures were:
  - (a) Trade fixtures used by the tenant in his business and installed by him.
  - (b) Agricultural fixtures, including such items as fencing, sheds and bins which had been installed by the tenant for his own use while renting the premises.
  - (c) Domestic and ornamental fixtures installed by the tenant for his own comfort and convenience. R. Kratovil, *supra* note 3 at § 12. See also Niles, *supra* note 2 at 561.

7. Niles, *supra* note 2.

Under pre-Code law, the conditional seller or chattel mortgagee could remove the article in the event of default on the theory that the real estate mortgagee had not relied on the article at the time of making the real estate loan. Chattel interests would lose their priority to a subsequent purchaser or mortgagee of the premises unless a lien instrument was filed in a manner which gave notice to persons searching the real estate records. Additionally, if the holder of a pre-existing mortgage on the realty made subsequent advances in reliance on the land and the fixtures attached to it, the chattel lien would become second and inferior to the lien of the real estate mortgage.<sup>8</sup> This "feeding" of the collateral by the affixing of chattels to the realty proved a windfall for the realty mortgagee and worked to the detriment of the party selling chattels on credit.

Filing systems under pre-Code law were not uniform, and in many instances several places of filing were permitted or required. If the statutes required local filing, the party wishing to perfect his security interest had to choose between filing in the political subdivision in which the debtor resided or had his principal place of business, or in the subdivision in which the collateral was located. Because a mortgagee or the seller under a conditional sales contract had to decide just where to file in order to establish his priority over the rights of persons interested in realty, the lack of a precise definition of fixtures made his choice a gamble. This problem was accentuated if the debtor or conditional buyer owned several parcels of land or if the article was to be affixed later.<sup>9</sup>

The pervasive influence of real estate law in personalty transactions is apparent in pre-Code practice in New Mexico. The system of chattel filing, although separated from the real estate recording system, used instruments based on realty concepts. The bill of sale by which a chattel was conveyed was analogous to the deed

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8. R. Kratovil, *Fixtures and the Real Estate Mortgage*, 97 U. Pa. L. Rev. 180, 199 (1948).

9. A consideration of some of the advantages and disadvantages of the various types of filing requirements discloses that filing in the subdivision in which the collateral is to be located is satisfactory if the filing party is certain of the place where the article will be annexed. Until such annexation, however, his protection is limited to filing in areas where the debtor owns real property. In the case of a corporate debtor owning land in many different locations and an article which could be annexed at any of the locations, the mortgagee was required to gamble unless he filed in all of the possible locations. If the mortgagee chose not to be concerned about realty interests but only personalty liens, filing either in the subdivision where the article was to be located or in the domicile of the debtor or the place of business of the debtor left him subject to possible problems caused by different court interpretations of the law concerning foreign corporations, partnerships, or the permanency of location of movable chattels.

used in the conveyance of real property; the chattel mortgage was evidence of a debt secured by a chattel just as a real estate mortgage evidenced a debt secured by land; chattel mortgages were discharged by an instrument closely resembling the discharge of real estate mortgages; even the real estate contract had its counter-part in the conditional sales contract. The concept of "title" played an important part in the determination of ownership of a chattel and in the priority of liens against it. Although the filing system for personalty utilized the retention of the document rather than the recording and return, a lien instrument purporting to affect chattels falling within the fixture category had to be recorded in the real estate records to be effective against realty interests. The person interested in establishing his lien on a chattel was compelled to comply with a system based on realty concepts even if the chattel was not a fixture. Persons interested in realty, however, did not have to search the chattel records to insure the priority of their liens. Certain problems did arise when a real estate mortgage purported to include both realty and personalty, but dual filing provided some protection.

The advent of the Uniform Commercial Code did not diminish the difficulties encountered in the fixture field of pre-Code law.<sup>10</sup> The concept of only two types of property—real and personal—adhered to by the Ohio courts in *Teaff v. Hewett*, and later adopted by the New Mexico courts,<sup>11</sup> coupled with the complete negation of the concept of a removable fixture, clashed with the central concept of the Uniform Commercial Code fixture provisions granting a secured party the right to remove a fixture.<sup>12</sup> The concept of "title", long the mainstay of realty thinking, has been done away with by the Code,<sup>13</sup> further emphasizing the shift from policies favoring realty interests to those protecting security interests in chattels.

The hoped-for uniformity in the law of fixtures under the Code was denied by several factors, one of which was the decision of the editors in Section 9-313 to leave the definition of the term "fix-

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10. "The most difficult problems in the realty-personalty area under non-code law will remain the most difficult under the Code—the fixture problems." R. Coogan, W. Hogan & D. Vagts, *Secured Transactions Under the Uniform Commercial Code* 1681 (1963).

11. *Post v. Miles*, 7 N.M. 317, 34 P. 586 (1893).

12. Coogan & Clovis, *The Uniform Commercial Code and Real Estate Law: Problems for Both the Real Estate Lawyer and the Chattel Security Lawyer*, 38 Ind. L.J. 535 (1963).

13. Storke, *Article 9 of the Uniform Commercial Code and Colorado Security Law*, 37 U. Colo. L. Rev. 11 (1964).

tures" to the law of the states.<sup>14</sup> The definition used in New Mexico is based on the test as propounded in *Teaff v. Hewett* and illustrated by *Garrison General Tire Service, Inc. v. Montgomery*.<sup>15</sup> In *Garrison*, the court said:

This court has long subscribed to the three general tests to be applied in determining whether an article is to be considered a fixture. First annexation to the realty, either actual or constructive; second, adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated; and third, intention to make the article a permanent accession to the freehold. . . . And we have held that in determining whether personal property loses or retains its identity as a chattel by being placed on land, the general intention of the parties is a controlling factor.<sup>16</sup>

The Code itself provides some confusion concerning the definition of fixtures. Section 1-201(37) defines security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation. . . ." Other Code sections<sup>17</sup> suggest

14. UCC § 9-313(1):

The rules of this section do not apply to goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like and no security interest in them exists under this Article unless the structure remains personal property under applicable law. The law of this state other than this Act determines whether and when other goods become fixtures. This Act does not prevent creation of an encumbrance upon fixtures or real estate pursuant to the law applicable to real estate.

15. 75 N.M. 321, 404 P.2d 143 (1965). *See also* *Jones-Noland Drilling Co. v. Bixby*, 34 N.M. 413, 282 P. 382 (1929); *Patterson v. Chaney*, 24 N.M. 156, 173 P. 859, 6 A.L.R. 90 (1918); *Fairbanks v. Williams*, 25 N.M. 744, 177 P. 745 (1918); *Post v. Miles*, 7 N.M. 317, 34 P. 586 (1893).

16. 75 N.M. at 324, 404 P.2d at 145.

17. UCC § 9-104. Transactions Excluded From Article.

This Article does not apply

(j) except to the extent that provision is made for fixtures in Section 9-313, to the creation or transfer of an interest in or lien on real estate, including a lease or rents thereunder; or . . . .

UCC § 9-105. Definitions and Index of Definitions.

(1) In this Article unless the context otherwise requires:

(f) "Goods" includes all things which are movable at the time the security interest attaches or which are fixtures (Section 9-313), but does not include . . . .

UCC § 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:

(c) . . . ; but a filing is required for a fixture under Section 9-313 or . . . .

that Section 9-313 is a comprehensive fixture section, but the title of the section and the language in Section 9-312 limit the effect.<sup>18</sup>

Security interests in fixtures under Section 9-313 of the Uniform Commercial Code are perfected as against a prior real estate interest if the fixtures are affixed to the realty after the security interest has attached. If the interest is perfected by filing before a sale to or lien through judicial proceedings favoring one who has no knowledge of the interest, it is prior to any interest in the realty except to the extent a prior lienholder has made or contracted for subsequent advances without notice.

The method of perfecting a security interest under the Uniform Commercial Code varies from pre-Code New Mexico law. The instruments used under the Code consist of a security agreement, which is comparable to the chattel mortgage previously used, and a financing statement which is a notice instrument filed to indicate that a security agreement has been made or will be made. Either of these instruments may be filed to perfect the security interest, but if the security agreement is filed, it must contain the information required to be shown on the financing statement.

Under Section 9-204 (1) of the Code, a security interest cannot attach until there is agreement that it attach, value is given, and the debtor has rights in the collateral. None of these preliminary steps will show of record, and they may take place in any order; therefore, priority may be claimed and not be denied until evidence is disclosed in a court action. This secrecy creates an unusual advantage for the secured party.<sup>19</sup> Because knowledge of a security interest on the part of another lien claimant is the equivalent of perfection to him, the fact that a financing statement may be filed before any se-

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(d) . . . ; but filing is required for a fixture under Section 9-313  
or . . . .

UCC § 9-307. Protection of Buyers of Goods.

(2) In the case of consumer goods and in the case of farm equipment having an original purchase price not in excess of \$2500 (other than fixtures, see Section 9-313), a buyer takes free of a security interest even though perfected if . . . .

18. UCC § 9-313. Priority of Security Interests in Fixtures.

UCC § 9-312. Priorities Among Conflicting Security Interests in The Same Collateral.

(1) The rules of priority stated in the following sections shall govern where applicable: . . . ; Section 9-313 on security interests in fixtures as against interests in real estate; . . . .

19. Hollander, *Imperfection in Perfection of Ohio Fixture Liens*, 14 W. Res. L. Rev. 683, 89 (1963).

curity agreement has been executed may affect the priority of the lien.

New Mexico did not adopt the options provided in the Uniform Commercial Code concerning the place of filing but provided for three successive alternative places to file for collateral other than fixtures.<sup>20</sup> The section dealing with fixtures, however, is more certain and definitive than the recommended sections and requires filing with the real estate records.<sup>21</sup> It would seem, therefore, once an article is determined to be a fixture and the location of the affixation is known, persons interested in perfecting an interest in realty will be able to rely on the real estate records.

A concept strange to land title examiners is embodied in Code provisions permitting the removal of fixtures from realty upon payment of damages to the owner of the real property. Particular attention should be directed to the provision requiring payment only for the cost of the repair of the damage to the realty and not for diminution in value of the premises.<sup>22</sup> Under pre-Code law, if the removal of the fixture would cause material damage to the freehold, such removal was not permitted.<sup>23</sup> In certain instances, the advantages of this section, basically the right to remove the collateral in the event of default, will not be readily available to the secured

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20. N.M. Stat. Ann. § 50A-9-40(1) (a) (Supp. 1967):

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, and in addition, when the collateral is crops, in the office of the county clerk in the county where the land on which the crops are growing or to be grown is located;

21. N.M. Stat. Ann. § 50A-9-401(1) (b) (Supp. 1967):

when the collateral is goods which at the time of (sic) security interest attaches are or are to become fixtures, then *with the real estate records* in the office where a mortgage on the real estate concerned would be filed or recorded; (emphasis supplied).

22. UCC § 9-313. Priority of Security Interests In Fixtures.

(5) When under subsections (2) or (3) and (4) a secured party has priority over the claims of all persons who have interests in 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 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.

23. Niles, *supra* note 3 at 67.



party because of the difficulty in obtaining permission for the removal, especially in the situation where the encumbrancer is a large number of people who have invested in bonds secured by the mortgage on the realty.

No solution to the exchange problem—new fixtures for old—has been incorporated in the removal provision. Real estate mortgagees may maintain that their mortgages were made in reliance on certain collateral, including fixtures necessary for the operation of the unit. If, however, there is a need for replacement, persons seeking perfection of a security interest in the new chattel will contend that they should be granted protection for their credit sale. The use of a subordination agreement may be a partial solution to the problem.

Title search problems have been increased somewhat by the adoption of the Uniform Commercial Code. A lien affecting realty may be created by someone other than the owner, and under the system of notice filing required by the Code, it is difficult to complete a truly correct search of the records as contemplated under existing real estate search procedures because of the presence of "strangers" in the chain of title. Two additional factors intensify the problem: any search of the records is limited by a time factor, and if a financing statement is filed prior to the closing of the search and is indexed under a name not within the scope of the search, there is a possibility that priority will be established in contravention of accepted standards. The New Mexico version of the Uniform Commercial Code requires that the financing statement contain a description of the real estate concerned when the lien affects fixtures.<sup>24</sup> No specific instructions are given, however, concerning the adequacy of the description required. Comment 1 of Section 9-402 states "any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described." From this it might be inferred that a street number or similar location description would suffice under the Code. Such descriptions would not be integrated into the tract indices now maintained by commercial title companies. If the description is sufficient to give generally the location of the fixture for the purpose of finding it in case of default, it could still be deficient under the highly specialized search procedures now in use.

Although the Uniform Commercial Code is gaining widespread acceptance, a few states have had second thoughts about the fixture

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24. N.M. Stat. Ann. § 50A-9-402.

sections. As might be expected, Ohio found that the shift in emphasis favoring chattel interests was just too much to live with, and, soon after the adoption of the Code, it passed an amendment restoring priority to realty interests.<sup>25</sup> California decided to omit Section 9-313 from its version of the Code on the ground that the lack of an adequate definition of "fixtures" would only add to the confusion already existing in that field in California law.<sup>26</sup> Florida amended the Code to require that the description contained in financing statements be required to be the legal description which would constitute constructive notice under other laws of the state.<sup>27</sup>

Although there seems to be a consensus concerning the desirability of Section 9-313 of the Uniform Commercial Code, there have been some suggestions for improving the handling of fixture interests. The continuing use of dual or multiple filings to safeguard security interests in fixtures—filing in realty and personalty records in as many locations as thought necessary—might be discontinued by the use of a system of central filing if the definition problem could be solved.<sup>28</sup> It has also been suggested that the secured party be permitted to choose personalty filing on fixtures if he is not concerned with the possibility of prior real estate liens.<sup>29</sup> Proposals have also been made to provide for single filing with dual indexing.<sup>30</sup>

Improvements in the mechanics of filing would depend also upon filling in some of the gaps in the Uniform Commercial Code by requiring that an exact definition be established for "fixture" and "trade fixture"; by requiring that the financing statement set forth the name of the record owner of the real estate as well as the legal description; and by giving definite instructions to the filing officers concerning the location of the filings and the manner of indexing.

The conflict between realty interests and chattel interests will remain, but much can be done to integrate the systems under the guidance of the Uniform Commercial Code.

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25. "[T]he real estate lien has been restored to its pre-Code positions . . ." Hollander, *supra* note 19 at 698.

26. Kripke, *Fixtures Under the Uniform Commercial Code*, 64 Colum. L. Rev. 44 (1964).

27. Fla. Stat. § 679.9-110 (1966), as amended, ch. 67-264, Laws of 1967.

28. Shanker, *A Further Critique of the Fixture Section of the Uniform Commercial Code*, 6 B.C. Ind. & Com. L. Rev. 61 (1964-65).

29. Kripke, *supra* note 25.

30. *Filing Under the Uniform Commercial Code, Article 9*, 38 U. Colo. L. Rev. 598 (1966).