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## Commercial Law

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## COMMERCIAL LAW

KARL JOHNSON\*

*A picture held us captive.*<sup>1</sup>

The utopian and semantic seductiveness of "Freedom of Contract" has long captivated the legal imagination. The phrase evokes a picture of moral clarity, of a simpler (and romanticized?) time when folks decided what they wanted from each other, struck a bargain and, if they were so inclined, wrote it down so there would be no mistake later about the commitments they had made. This private lawmaking—the bilateral creation of a set of rules to govern interpersonal relations—epitomized the sort of conduct which the public law ought to leave alone. When the bargain went sour and one of the parties sought the power of the state to implement the private rules, a court could display the maximum sensitivity to individual autonomy, and thereby cut the widest swath for personal freedom, by simply enforcing what the contractors had freely agreed to do.

But the least sophisticated consumer on the street can instruct the most distinguished jurist that this picture and its accompanying conceptual baggage has in daily life absolutely nothing to do with reality. "Freedom of Contract" is nonsense and an utter fiction for one whose pervasive experience with contracting amounts to signing standardized forms which are neither read nor meant to be; which even if read are nothing but mysterious incantations to the uninitiated; and which even if understood render the effort to understand a cruel and futile exercise, for the terms they contain are fixed and unalterable. When contracting consists of signing a standardized form, the process is not experienced as an incident of freedom but, instead, of tyranny: domination by the drafter, oppression and powerlessness by the nondrafter of the form "agreement." The bilateral, democratic private lawmaking envisioned in the myth of "Freedom of Contract" has been displaced by the unilateral imposition of rules of conduct upon one who has had no voice in their legislation.

None of these observations are new, of course,<sup>2</sup> and in fact the rapid

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1. L. Wittgenstein, *Philosophical Investigations* ¶115 (3d ed. 1967).

2. See, e.g., Dugan, *Good Faith and the Enforceability of Standardized Terms*, 22 Wm. & Mary L. Rev. 1 (1980); Dugan, *Standardized Forms: Unconscionability and Good Faith*, 14 New Eng. 711 (1979); Dugan, *Standardized Form Contracts—An Introduction*, 24 Wayne L. Rev. 1307 (1978);

growth of the law of products liability in tort evidences the dissatisfaction felt by courts and litigants with the inadequacy of traditional contract law to cope with standardized consumer contracts. But they deserve repetition when "Freedom of Contract" is solemnly and reflexively invoked to justify the enforcement of standardized forms when what really should be at issue is not freedom, but the lack of it.

This article will focus on three decisions of the New Mexico Court of Appeals, and the Supreme Court's reversal of one of them, implicating the doctrine of "Freedom of Contract" and demonstrating the need for deeper reflection upon its role in the enforcement of standardized contracts. The remainder of the article will examine a selection of other decisions by the New Mexico courts in the area of commercial and business law. All of the cases were decided during the Survey year, April 1981 through March 1982.

## I. CONTRACTS

### A. *Freedom of Contract*

In *Lynch v. Santa Fe National Bank*,<sup>3</sup> plaintiffs purchased real estate under contracts placed in escrow with the defendant bank. When the bank improvidently released the escrowed documents to the seller and the Lynches sued for damages, the bank admitted its negligence but denied liability because of an exculpatory provision in the escrow agreements. The trial court enforced the exculpatory clause, which provided that the bank was not liable for any acts or omissions done in good faith nor for any damages except those caused by its willful or gross negligence, and dismissed the complaint. The court of appeals affirmed.

The court began with the premise, supported by prior New Mexico cases, that exculpatory clauses are valid and will be enforced unless the agreement falls within certain limited exceptions to the rule. The most widely recognized exception voids the clauses in contracts calling for the performance of a public duty. Utilities and common carriers, for example, may not by contract escape the consequences of their own negligence.<sup>4</sup> The traditional scope of the exception has been expanded to encompass

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Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 Colum. L. Rev. 629 (1943) [hereinafter cited as Kessler]; Slawson, *Standard Form Contracts and Democratic Control of Lawmaking*, 84 Harv. L. Rev. 529 (1971) [hereinafter cited as Slawson].

3. \_\_\_ N.M. \_\_\_, 627 P.2d 1247 (Ct. App. 1981), *cert. denied* \_\_\_ N.M. \_\_\_, P.2d \_\_\_ (1981). Because of a printing error, *Lynch* does not appear in the New Mexico Reports at this time. For further discussion of the case, see Minzner, *Property*, *post* at 435, and Note, *Contracts—Exculpatory Provisions—A Bank's Liability for Ordinary Negligence: Lynch v. Santa Fe National Bank*, 12 N.M. L. Rev. 821 (1982).

4. Restatement (Second) of Contracts § 195 (1981); *Southwestern Pub. Serv. Co. v. Artesia Alfalfa Growers' Ass'n*, 67 N.M. 108, 353 P.2d 62 (1960).

contracts "where a public interest is involved,"<sup>5</sup> most notably in the landlord/tenant relationship and in the field of banking.<sup>6</sup>

The Lynches first argued that because the defendant is a bank, its contracts with members of the public necessarily involve the public interest and that exclusionary clauses contained within them are thus invalid. The court's curious response was the following argument. The New Mexico "public interest" exception contemplates only that "[a] party 'cannot contract against its negligence in the regular course of its business . . . ,'"<sup>7</sup> that is, the exception covers only "banking functions." Further, plaintiffs failed to prove that the bank's escrow service is a banking function: "Although defendant is a bank, that fact alone does not make defendant's escrow service either a banking function or a public service."<sup>8</sup> Therefore, the court concluded, the defendant's identity as a bank was irrelevant in determining the existence of a public interest.

The response is curious in three ways. First, it is a mighty elevation of form over substance to require proof that banks provide escrow. Judicial notice alone of the appellate cases in which banks have appeared in their role as escrow agents is more than enough to support that proposition. Second, even if proof *is* required, it is only of "the regular course of *its* [the defendant's] business"<sup>9</sup> and not of enterprise-wide practice. And the court had before it uncontradicted evidence that the contract involved in this case was a standardized form, prepared by the bank's attorney, and repeatedly used without variation for the individual customer!<sup>10</sup> Third, at least part of the public service that banks perform is to provide a secure institution to safeguard entrusted valuables. A bank that claims its public service stopped short of protecting entrusted real estate documents would surely shock its customers and should have shocked the court. It didn't, but the Lynches weren't through.

They next argued that even if the nature of the provider (the bank) failed to bring the contract within the public interest, the nature of the service (escrow) did. To bolster their argument they had a California case which reached exactly the result they desired. In *Akin v. Business Title Corp.*,<sup>11</sup> the court held invalid an exculpatory clause in an escrow company's contract because escrow involves the public interest. *Akin* employed the analysis developed some years earlier in *Tunkl v. Regents of*

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5. *Tyler v. Dowell, Inc.*, 274 F.2d 890, 895 (10th Cir. 1960); *Southwestern Pub. Serv. Co. v. Artesia Alfalfa Growers' Ass'n*, 67 N.M. at 118, 353 P.2d at 69.

6. A. Corbin, *Corbin on Contracts* § 559(I) (Kaufman Supp. 1982).

7. \_\_\_ N.M. at \_\_\_, 627 P.2d at 1252 (quoting dictum from *Southwestern Pub. Serv. Co. v. Artesia Alfalfa Growers' Ass'n*, 67 N.M. at 118, 353 P.2d at 69).

8. \_\_\_ N.M. at \_\_\_, 627 P.2d at 1252.

9. *Id.* at \_\_\_, 627 P.2d at 1252 (emphasis added).

10. *Id.* at \_\_\_, 627 P.2d at 1249.

11. 264 Cal. App. 2d 153, 70 Cal. Rptr. 287 (1968).

*University of California*,<sup>12</sup> in which the court invalidated a similar clause in a hospital's patient agreement. The two cases utilized a set of six characteristics, the presence of some or all of which invokes the public interest and thus invalidates an exculpatory clause. The six are, somewhat roughly, whether the party seeking exculpation (1) engages in a business generally thought suitable for public regulation, (2) performs a service of great importance to the public, (3) performs the service for the public generally, (4) possesses a decisive advantage of bargaining strength over members of the public, (5) uses a standard contract of adhesion, and (6) has control of the purchaser's property or person, subject to the risk of the seller's negligence.

Although *Akin* found all six characteristics present in an escrow transaction, both that court and the *Tunkl* court clearly viewed the characteristics not as necessary conditions but as factors not all of which need to be present to justify a finding that the contract involved the public interest.<sup>13</sup> Nevertheless, the court of appeals in *Lynch* found two of the characteristics missing and declined to follow *Akin*. The court first argued that New Mexico, unlike California, has left the escrow business largely unregulated; in this state, then, the business is *not* generally thought suitable for public regulation and the first *Tunkl* characteristic was missing.

Once again the court had to strain both reality and logic to justify its holding. Escrow is widely enough regulated in a number of states to support the proposition that it is "generally thought suitable for public regulation" even though New Mexico does not in fact regulate it extensively. Further, while actual regulation may indicate that regulation is "generally thought suitable," the absence of regulation may have a variety of explanations and may not only be due to general perceptions about suitability for regulation. "Although escrow is generally thought suitable for public regulation, New Mexico has left it unregulated," is a perfectly consistent statement, but the court's argument here must call it a contradiction.

The court said that the *Lynches* also failed to prove the presence of the fourth characteristic, that the bank's bargaining strength was superior to their own. This surely came as a surprise to the plaintiffs, who had submitted "uncontradicted" evidence that:

the exculpatory clause is part of a standard printed form, prepared and approved for use by defendant's attorney; that defendant does not negotiate with a party seeking to utilize defendant as an escrow agent, rather, defendant presents the form to the party for filling in

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12. 60 Cal.2d 92, 383 P.2d 441, 32 Cal. Rptr. 33 (1963).

13. *Id.* at \_\_\_, 383 P.2d at 445, 32 Cal. Rptr. at 37; *Akin v. Bus. Title Corp.*, 264 Cal. App. 2d at \_\_\_, 70 Cal. Rptr. at 289.

the blanks and for signature; that a party cannot have the exculpatory clause removed by payment of an additional fee. . . . [D]efendant's form is presented to a party on a "take it or leave it" basis.<sup>14</sup>

That is not enough, said the court, without further proof that the Lynches could not "leave it." If there were other escrow agents who offered the service without the offending clause, the Lynches had an alternative to agreement with the bank; they could take their business elsewhere. The court paid scant attention to how the plaintiffs should have proved the absence of alternatives, but appeared to suggest that they must have shown an actual diligent but unsuccessful search for alternative terms, or that the search would have been futile because they would have found no alternatives in the market.

The thesis that absence of alternatives is a necessary element in proof of bargaining advantage did double duty for the court. It not only defeated plaintiffs' attempt to bring their case within the "public interest" exception but also doomed their alternative argument that disparity of bargaining strength alone is sufficient to invalidate an exculpatory clause.<sup>15</sup> In *Tyler v. Dowell, Inc.*,<sup>16</sup> the Tenth Circuit's statement of New Mexico law suggested this second exception to the "general rule" that exculpatory clauses are enforceable:

[E]xculpatory clauses in contracts of this kind are not favorites of the law. They are strictly construed against the promisee and will not be enforced if the promisee enjoys a bargaining power superior to the promisor, as where the promisor is required to deal with the promisee on his [or her] own terms. . . . Nor will a contract be enforced if it has the effect of exempting a party from negligence in the performance of a public duty, or where a public interest is involved.<sup>17</sup>

The *Lynch* court assumed that *Tyler's* statement of the law was correct, but voiced its reservation that the factual predicates were really independent. Superior bargaining power, the *Lynch* court speculated, may not be in itself a reason to invalidate an exculpatory clause in a contract, but instead may be just one factor in deciding whether the clause should not be enforced because of a public interest. But once the court altogether rejected plaintiffs' attempt to prove superior bargaining power, it was unnecessary for the court to determine the effect of the advantage alone, absent an involvement with the public interest.

The court arrived at the "absence of alternatives" thesis by parsing the

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14. \_\_\_ N.M. at \_\_\_, 627 P.2d at 1249.

15. *Id.* at \_\_\_, 627 P.2d at 1250.

16. 274 F.2d 890 (10th Cir. 1960).

17. *Id.* at 895.

*Tyler* language in a rather intriguing way. Superior bargaining power, said the *Tyler* court, is present "as where the promisor is required to deal with the promisee on his [or her] own terms."<sup>18</sup> The *Lynch* court interpreted this to mean that the bargaining advantage is present *only* where the promisor is required to deal with the promisee. So, the court concluded: "Plaintiffs were required to deal with defendant on defendant's own terms if plaintiffs were to obtain defendant's services, but that is not the meaning of 'required to deal.' 'Required to deal' involves the absence of alternatives. . . ."<sup>19</sup>

There are two purely logical problems with this argument. First, assuming *Tyler* is a correct statement of the law, the *Lynch* court illicitly transformed an instance or example of a rule ("as where") into a necessary condition, or *sole* instance, of the rule ("only where"). Second, the *Tyler* formulation is crucially ambiguous, and may be read to support either the bank or the Lynches. The profit and peril of the passive voice ("is required to deal") is that the writer may get away without identifying the actor. *Who* requires that the promisor deal on the promisee's own terms? It may be the market's lack of alternatives, as the court assumed, or it may be the promisee whose terms are a condition of doing business; if the latter, then the Lynches were indeed required to deal on the bank's terms. But it is impossible to choose, as the court attempted to do, between the two glosses on the basis of the meaning of "required."

*Akin* never explicitly mentioned the presence or absence of alternatives to exculpatory escrow, nor did that court ever reveal the measure of the plaintiff's proof on the matter. The *Lynch* court, however, inferred that, "[t]he references in *Akin* to a 'standardized contract of adhesion' and the 'practical necessity' of members of the public agreeing to the exculpatory clause suggests [sic] an absence of an alternative."<sup>20</sup> *Akin*, however, simply cannot sustain that interpretation. The first reference in *Akin* is footnoted to a commentator's explanation of "contract of adhesion" which focuses not upon the option to walk away but upon the manner in which the contract is formed: the absence "of the give and take of bargaining where the desires of one party are balanced to those of the other."<sup>21</sup> The second reference does not even concern bargaining advantage but is part of the discussion of escrow as an important public service, the first characteristic of the *Tunkl* analysis.<sup>22</sup> Further, it imports no more than the practical unavoidability of some members of the public using a given agent and is silent upon the variety, or lack of it, in escrow contracts.

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18. *Id.*

19. \_\_\_ N.M. at \_\_\_, 627 P.2d at 1250.

20. *Id.*

21. 264 Cal. App. 2d at \_\_\_ n. 4, 70 Cal. Rptr. at 290 n. 4.

22. *Id.* at \_\_\_, 70 Cal. Rptr. at 289-90.

That's the argument. With the exception of a parting salvo, which I reveal shortly, the court had little else to submit in its defense of the exculpatory clause. This detailed but I hope not overly belabored, examination is intended to show one thing and ask another: (1) the court had a terrible (and unsuccessful) time trying to find decent arguments to support its position; (2) why?

The position that the existence of alternatives equalizes bargaining power and consequently validates standardized contracts is not without its attractiveness. Friedrich Kessler's seminal essay<sup>23</sup> that provided the theoretical foundation for the use of "unfair bargaining power" to avoid the more onerous obligations of standard form contracts emphasized transactions in which the drafter occupied a monopoly position. The customer could not "leave" the contract with the objectionable clause because there were no competitors or because all competitors used a similar clause. *Henningsen v. Bloomfield Motors*,<sup>24</sup> which opened the way for judicial review of the fairness of adhesion contracts, invalidated a warranty disclaimer in an industry-wide contract. And as the *Lynch* court pointed out, *Tunkl* alludes to the significance of alternatives, noting that the patient in the admission room of a hospital is not in an ideal situation to do comparison shopping.<sup>25</sup>

Certainly the absence of alternatives in the market is reassuring to a court that wishes to avoid the harshness of a particular clause, for it can do so and remain well within the mainstream of traditional jurisprudence. All that is required is the observation that duress can be economic as well as physical or emotional. Lack of choice is coercive, particularly if the goods or services sought are essential, and removes a necessary condition to judicial enforcement—that the contract be *freely* entered. Conversely, the presence of choice eliminates the coercion because it provides the customer with bargaining power: her realistic option to walk away may either be exercised or used to lever concessions from the seller.

The presence or absence of alternatives is relevant, however, *only* within that traditional construct which I have called the "picture" of "Freedom of Contract." So the remainder of *Lynch* comes as no surprise. Enforcement of the exculpatory clause, the court said, is ultimately a policy decision. The policy of allocating the risk of negligence which motivated the courts in *Akin* and *Tunkl*, however, avoids the "basic issue" which

involves the policy of freedom of contract and is concerned with

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23. Kessler, *supra* note 2.

24. 32 N.J. 358, 161 A.2d 69 (1960).

25. — N.M. at —, 627 P.2d at 1250 (quoting *Tunkl*, 60 Cal. 2d at —, 383 P.2d at 447, 32 Cal. Rptr. at 39).

when that freedom is to be restricted. . . . *General Electric Credit Corporation v. Tidenberg*, 78 N.M. 59, 428 P.2d 33, 40 A.L.R. 3d 1151 (1967) states: "[P]ublic 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."<sup>26</sup>

The picture in *Lynch*, then, is this: the plaintiffs apparently could have successfully avoided the exculpatory clause if during the transaction they had comported with the court's view of "proper" contracting behavior. The Lynches should have (1) read the standard form, front and back, (2) noticed the exculpatory clause, (3) understood or consulted their lawyer about its significance, and either (4) negotiated the bank out of the term, or (5) diligently (but without success) searched for alternative escrow without the clause. That this picture is utterly removed from reality, in all but the most extraordinary situations in which a person is confronted with a standard form contract, hardly bears saying.

Nobody but lawyers on a case and a few social deviants even *looks* at the back side of a standardized form, much less tries to bargain about what appears there. For one thing, detailed attention to every standard form contract we sign or receive—from tickets to receipts to credit slips to contracts for insurance—would raise prohibitively the transaction costs to the customer of most of these exchanges. We just do not have the time or inclination to digest all the legal jargon, much less the money to hire a lawyer to do it for us. For another, understanding the form is fruitless, even if we were odd enough to take the time to do it; the other party simply is not going to bargain with us about what we discover on the flipside of the form, and the employee with whom we deal no doubt does not even have the authority to do so if she wished. If we want the product or service we grit our teeth, sign the form, and just hope that the 'stuff on the back doesn't come back to haunt us. This is not, of course, what I tell my clients to do. I tell them to read everything before they sign it. But I don't, and I know from experience that they don't either. And why should they? In fact, empirical evidence has suggested what the demise of the mirror-image rule<sup>27</sup> has reflected: even more sophisticated business people, armed with their own attorneys and standard forms, pay almost no attention to what is contained in those forms and allow them to exert little influence over their business relationships.<sup>28</sup>

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26. — N.M. at —, 627 P.2d at 1253.

27. See U.C.C. § 2-207 (1978) (N.M. Stat. Ann. § 55-2-207 (1978)); Restatement (Second) of Contracts § 61 (1981).

28. McCaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 Am. Soc. Rev. 55 (1963) [hereinafter cited as McCaulay], reprinted in D. Black, *The Social Organization of Law* 75 (1973).

Of course, when the relationship ends and litigation begins, the form becomes all-important. But why should that be? One reason why it should *not* be is that using the form to resolve the dispute consistently favors the litigant who drafted the form over the nondrafter, and all too often results in the unearned redistribution of wealth from the consumer to the enterprise. A second reason why it should not be is that dominance of the form diverts the attention of the parties in negotiation of a contract dispute, and of the court in its resolution of it, from what should be the focus: a fair and just settlement of the problem. The form has nothing to do with this issue, however, and this is the third reason. There is no moral or legal reason why the one who writes the fine print ought to be advantaged with the power to dictate the behavior of the other. The essence of contract has always been mutual assent, but it is only the captivation of the picture of "Freedom of Contract" which lends even an air of plausibility to the proposition that one who signs a standard form contract assents to the multitude of unread and unbargained-for terms contained in the form.

If the picture falsifies the reality of typical modern contracting, the invocation of "Freedom of Contract" has value implications vastly at odds with the lofty ideal the phrase imports. No one's freedom is enhanced by allowing one party to write the rules of the game and present them as a *fait accompli* to the other. The law enforces domination, not liberation, when it allows the bank at the time of litigation to avoid the effects of its own negligence simply because, unbeknownst to the Lynches, it planted a bomb on the reverse side of the standard form.

But the influence of the picture is so strong. Take, for instance, *Boss Barbara, Inc. v. Newbill*,<sup>29</sup> also decided in the court of appeals during the Survey year but later reversed by the supreme court. At issue was a clause in a commercial lease prohibiting sublease without the lessor's consent. Unable to obtain the necessary consent, plaintiffs successfully sought in the trial court a ruling that the clause required the lessor to consent to a commercially reasonable sublessee. The court of appeals, however, reversed the trial court's determination that the lease clause contained an implied condition that consent to sublease could not be unreasonably or arbitrarily withheld. The lease clause, the court of appeals held, "gives the lessor an unqualified right to withhold such consent."<sup>30</sup>

The clause merely required the lessor's consent to sublease; conditions of the consent were neither specified nor denied. New Mexico law was equally silent, but other states presented a choice between a "majority

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29. 20 N.M. St. B. Bull. 1042 (Ct. App. July 9, 1981), *rev'd*, 97 N.M. 239, 638 P.2d 1084 (1982).

30. 20 N.M. St. B. Bull. at 1044.

position . . . that the lessor can withhold consent without justification when the lease requires his [or her] written consent. . . ."<sup>31</sup> and "[t]he contrary position . . . that . . . such consent cannot be withheld unreasonably or arbitrarily."<sup>32</sup> Opting for the former, the court of appeals "decline[d] to rewrite"<sup>33</sup> the questionable clause. Stylistically it certainly could have used it: the clause consists of *one* sentence which occupies an entire column of the state bar bulletin!<sup>34</sup>

As the court of appeals' words suggest, the picture is that the *parties* have written the contract, freely undertaking obligations that the law, given the dictates of freedom, may only enforce. Thus, the court argued that the absence of any qualification to the "sublease consent" provision implies that the parties could not reasonably be expected to read into the clause an additional requirement of justifiable refusal. If the parties had desired that qualification, the court declared, they could have written it into the contract. The court added, as if perfectly consistent with these two arguments: "The lease in question is a form lease used extensively throughout the state. The large number of parties to these form leases should be able to rely on the plain language of their leases."<sup>35</sup>

The emphasis on the numbers suggests that the court's concern is with the certainty of legal rules. Although the thesis that the certainty established by the rule of law permits rational planning and hence capitalist development is philosophically venerable, it remains empirically doubtful.<sup>36</sup> Even if it could be established, however, that certainty in contractual terms is an independent value worth pursuing, our democratic system should not permit purchase of certainty at the expense of proper rule-making procedure. So here lies the contradiction between the court of appeals' three arguments: standard form contracting, the factual premise of the certainty argument, eliminates the necessary factual premise of the first two arguments, the picture of contracting as bilateral, consensual private rulemaking, the product of mutual assent negotiated in give-and-take bargaining. For it is hardly relevant how the parties could reasonably be expected to interpret language one or both could not reasonably be expected even to have read. Nor is how the lessee might have drafted the clause a meaningful inquiry when she in fact did not and, moreover, lacked any power to alter what was already written there.

The court's picture, of course, could have been representative. The lessee, contemplating sublease, might have read or had a lawyer go over

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31. *Id.*

32. *Id.*

33. *Id.* at 1045.

34. *Id.* at 1043.

35. *Id.* at 1044.

36. McCauley, *supra* note 28.

the lease, picked out the offending clause and negotiated for its removal. We don't know whether this sort of thing happened, because the court tells us absolutely nothing about the transactional setting. The missing information is vital, for without some facts such as these, the use of "Freedom of Contract" to enforce standardized terms is worse than irrelevant; it legitimates oppression and domination.

What, then, ought to be done with all the fine print? Read it carefully, at least when a restraint on alienation is involved, answered the supreme court, reversing the court of appeals.<sup>37</sup> Although the supreme court's opinion begins to point the direction of the solution, it ends by superimposing the same familiar picture of contract over the ignored social realities. The supreme court tendered two justifications for its conclusion that the sublease consent provision demanded reasonable behavior from the lessor. First, said the court, the lease is "governed by general contract principles of good faith and commercial reasonableness. . . . New Mexico law has consistently required fairness, justice and right dealing in all commercial practices and transactions. . . . [W]e construe [the clause] to require that the landlord act reasonably when withholding his [or her] consent to a sublease agreement."<sup>38</sup> Second, the identical construction is dictated by the axiom that "[r]easonable restraints upon the alienation of property are to be strictly construed so as to operate within their exact limits."<sup>39</sup> Because the lease did not specifically permit the lessor to withhold consent arbitrarily, "in the absence of more specific language"<sup>40</sup> that right cannot be implied.

What is implied by appending the "good faith, commercial reasonableness, fairness, justice and right dealing standard" to the second rationale is that the standard may be implemented simply by more careful drafting. Surely two parties could *explicitly* agree that the lessor should have an absolute right of refusal. "Good faith et al." must then demand only that they say so, and the lessor's solution becomes the interpolation of one more clause into the column-long lease provision. The supreme court thus fully shares the fundamental assumptions about contracting procedure which guided the court of appeals, that the parties should be free to strike their own bargain and, moreover, that a standardized form adequately represents the bargain's terms. For both courts, parties who have freely agreed have *defined* "fairness" for their transaction. A judicial decision about what's fair is necessary only when the parties haven't agreed, only when the form is silent. It is solely upon this factual inter-

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37. *Boss Barbara, Inc. v. Newbill*, 97 N.M. 239, 638 P.2d 1084 (1982). This case is also discussed in this issue in Minzner, *Property*, *post* at 435.

38. 97 N.M. at 241, 638 P.2d at 1086.

39. *Id.*

40. *Id.*

pretation that the two courts differ: whether an unqualified right of refusal speaks or is silent upon the subject of qualifications. But in this view the "fairness" standard is nothing more than a trap for the unwary drafter, and the protection evaporates precisely at the point when it is needed most—in the presence of the comprehensive, carefully prepared standard form contract.

The court of appeals itself suggested a better solution in the third of these cases, *Stock v. ADCO General Corp.*<sup>41</sup> Plaintiff Stock had solicited bids for physical damage insurance on his tractor-trailer fleet, selecting a proposal submitted by Pierce Agency. Pierce obtained the insurance from Stuyvesant Insurance Company through ADCO, who was both Pierce's broker and Stuyvesant's general agent. When the policy arrived in the mail, predictably neither Stock nor anyone at Pierce read it and so no one noticed that the policy covered only certain "named drivers" and that one of Stock's drivers had been left off the list. Just as predictably, the omitted driver had a wreck. Stuyvesant refused to pay, and Stock sued Pierce, Stuyvesant, and ADCO. The principles of "Freedom of Contract" notwithstanding, the court of appeals upheld judgment against all three defendants.

Stock admitted that he received the policy, that its language was clear and unambiguous, and that he had an opportunity to examine it for a reasonable time. That constituted acceptance of the terms of the policy, the insurer argued, and if the court of appeals' rationale in *Lynch* and *Boss Barbara* provided any guidance, we should have expected the court to agree. It did not. The exclusion of the unnamed driver, the court held was unenforceable because Stock "did not reasonably expect"<sup>42</sup> the policy to contain the named driver provision. That his expectations would have evaporated upon an informed reading of the policy did not detain the court; Stock was under no duty "to read the policy word for word."<sup>43</sup> In fact, he didn't read a *single* word, but "simply placed the unopened policy in his office file."<sup>44</sup> Nonetheless, Stock was entitled to the satisfaction of his reasonable expectations regardless of what the fine print said.

"Freedom of Contract" receives nary a mention in the opinion. Indeed, the court of appeals even upheld the trial court's determination that Stuyvesant's reliance on the clear language of the policy and consequent refusal to pay the claim after Pierce and Stock had made their expectations known was so "unreasonable and unconscionable"<sup>45</sup> that Stuyvesant should

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41. 96 N.M. 544, 632 P.2d 1182 (Ct. App. 1981), *cert. denied*, 96 N.M. 543, 632 P.2d 1181 (1981).

42. 96 N.M. at 546, 632 P.2d at 1184.

43. *Id.*

44. *Id.* at 545, 632 P.2d at 1183.

45. *Id.* at 548, 632 P.2d at 1186.

pay Stock's attorney fees.<sup>46</sup> The court finally suggested that Stuyvesant's behavior was, moreover, sufficiently "inequitable" to invoke the rule that a unilateral mistake accompanied by fraud or other inequitable conduct by the other party justifies contract reformation.<sup>47</sup>

The yawning chasm in both direction and tone between the court of appeals' opinions in *Stock* and *Lynch/Boss Barbara* has a number of potential explanations, none of which adequately distinguish the two positions. Among them was the assistance in *Stock* of a close state supreme court precedent, *Pribble v. Aetna Life Insurance Co.*,<sup>48</sup> requiring an insurer to pay for an occupational injury clearly excluded by the policy. The insurer's agents had mistakenly assured plaintiff that the policy covered the injury. Upon the strength of those assurances, plaintiff undertook an extended treatment program for which the insurer then refused to pay, asserting that the insured had an obligation to read the policy. Refusing to "mechanically charge" the plaintiff with the duty to read and understand the insurance contract, the supreme court held instead that the insured was

only bound to make such examination of such documents as would be reasonable for him [or her] to do under the circumstances; that he [or she] will only be held to that which he [or she] would be thereby alerted; and if the language is such that a layman would not understand its full impact were he [or she] to attempt to plow through it, the documents will yield the maximum protection consistent with their language and the reasonable expectation of [the insured].<sup>49</sup>

Despite the suggestion of the last clause, the court held that the injury was covered, thus enforcing a "reasonable expectation" of the insured which was completely inconsistent with the contract language.

While the existence of the close precedent may have made the *Stock* court's task easier, that psychological supposition hardly explains why *Pribble* should not have equally relieved the plaintiffs in *Lynch* and *Boss Barbara* from the burdens of reading, understanding, and negotiating about their standardized contract terms. Insurance contracts are indeed enveloped in a specialized body of law replete with canons of construction which to a degree protect the insured from overreaching by the drafter. Insurance contracts are also among the lengthiest of standardized forms, although whether they are also among the more indecipherable I would hate to speculate. But to view *Pribble* and *Stock* as insurance cases and for that reason inapplicable outside a narrow enterprise is wholly arbitrary.

46. N.M. Stat. Ann. § 39-2-1 (1978), provides that an insurer who acts unreasonably in failing to pay a claim may be assessed the prevailing insured's attorney fees.

47. 96 N.M. at 549, 632 P.2d at 1187.

48. 84 N.M. 211, 501 P.2d 255 (1972).

49. *Id.* at 216, 501 P.2d at 260.

If the law recognizes the obvious fact that policy holders neither read nor understand their "contracts," and makes the corresponding value judgment that neither should they be expected to do so, why not recognize the same equally obvious fact (and make the same equally realistic value judgment) across the range of standard form contracting?

The active though innocent misrepresentation in *Pribble*—the policy didn't say what the agent said it said—is certainly absent in *Lynch* and *Boss Barbara*, but this second potential device for distinguishing the two positions endangers the reliance *Stock* placed in *Pribble's* precedent. There was no active misrepresentation in *Stock*. Perhaps sensitive to this difference, the court portrayed the defendant's failure to call the named driver provision to *Stock's* attention as an omission to reveal terms so salient that the nondisclosure was at least close enough to *Pribble's* misrepresentation. The role of the "misrepresentation" in both cases is to create, or at least to allow, reasonable expectations which the court will enforce even if it means ignoring contract language. In *Pribble*, this result is not particularly surprising; that a party who misrepresents the terms of a written contract is bound to the representations made, on the theory that the negligent failure to read the contract is a lesser evil than the misrepresentation of its terms, might even be designated a "general rule."<sup>50</sup>

*Stock* carries *Pribble* into new territory, however, where *Lynch* and *Boss Barbara* are found. For if one party has a duty to bring to the notice of the other any terms of a standardized contract which would defeat the other's reasonable expectations, the bank in *Lynch* and the lessor in *Boss Barbara* failed to fulfill that obligation. The most basic principles of tort law teach us that we have a right to expect from others both due care (*Lynch*) and behavior appropriate for the "reasonable person" (*Boss Barbara*). Form clauses which permit escape from those standards defeat the reasonable expectations of the party against whom they are imposed, and so under *Stock* ought not to be enforced.

A third possible but unsuccessful way of distinguishing *Stock* lies in the case's peculiar facts. First, a contract of insurance is normally preceded by a quotation to the potential insured and an application submitted to the agent. Neither the quotation nor application in *Stock*, the court pointed out, contained any mention of the named driver provision; its inclusion in the policy was therefore not "what the insured reasonably expected from the quotation"<sup>51</sup> and application, and that variance was fatal to the clause's enforceability. Second, the named driver provision

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50. Restatement (Second) of Contracts § 20(2)(a) (1981); J. Calamari & J. Perillo, *The Law of Contracts* § 9-43 (2d ed. 1977).

51. 96 N.M. at 545, 632 P.2d at 1183.

is truly extraordinary in insurance policies. Pierce had never seen such an endorsement in 27 years in the insurance business,<sup>52</sup> and Stuyvesant had even "furnished ADCO with a supply of special red stickers to be attached to the face page of the policy, which warned of the endorsement and its limited coverage."<sup>53</sup> ADCO, unfortunately, failed to attach the sticker to Stock's policy.

While precontracting behavior for insurance may be more formalized than in some other areas in which standard form contracts are used, the procedure is essentially the same. Agreement in principle is reached upon the basic terms of the transaction, followed by the presentation for signatures of the form document which purportedly memorializes the agreement. But the pre-standard form understandings, whether written or oral, contain only a smattering of what finally appears in the "contract." The parties simply do not discuss the vast majority of standard clauses, so their interaction before the standard form intervenes can rarely be a *source* of expectations about what the form contains. Rather, in insurance or any other field, the interaction can normally at most leave reasonable expectations untouched. A host of provisions were included in Stock's policy that were absent from the quotation and application, but that fact alone does not mean that Stock could have reasonably expected none of them and thus have invalidated the entire written policy. The expectations were created by what law, morality, experience, and common sense instruct we have a right to expect from others; the quotation and application in *Stock*, just as the bank's and lessor's silence in *Lynch* and *Boss Barbara*, merely failed to dispel the expectations.

The extraordinary nature of the suspect clause in *Stock* is likewise at most a difference in degree and not kind. That the provision deviated from usual insurance policies was important to the court because Stock "thought he would receive a physical damage insurance contract like those he had received previously from other agents and other companies."<sup>54</sup> Past experience is certainly one legitimate indicator of what expectations are reasonable, but that analysis is independent of how unusual the clause is. Even if the named driver provision were more common throughout the industry, and even if it had appeared in Stock's prior policies, there is no reason to assume he should have been aware of the limitation unless it had caused him trouble before. In fact, according to the court, he didn't even have an obligation to notice the clause, unusual or not, unless it was part of the pre-standard form understanding. Similarly, the plaintiffs in *Lynch* would hardly have been less shocked by the revelation that the bank to whom they had entrusted important papers

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52. *Id.* at 548, 632 P.2d at 1186.

53. *Id.* at 545, 632 P.2d at 1183.

54. *Id.* at 546, 632 P.2d at 1184.

had no obligation to take care of them had they then discovered that exculpatory clauses in escrow are common. An unusual provision may strengthen the conclusion that the clause is outside the party's experience, thus allowing for reasonable expectations otherwise. But those expectations may not be dispelled by even a common provision which remains unexperienced.

In my view, then, *Stock* is not only correct but also directly applicable to *Lynch* and *Boss Barbara* and its application there would have changed the outcome of those two cases in the court of appeals. If we free ourselves from the picture, "Freedom of Contract" cannot supply a plausible basis for the enforcement of unilaterally created rules of behavior. Private lawmaking through contract is democratically justifiable only in the presence of mutual assent, the traditional hallmark of contract law whose factual basis has been eroded by the standard form "agreement." The real "contract," then, consists initially only of those terms to which the parties have actually manifested knowing assent: the "bargained-for exchange." Other rules supplied by the drafter of the standard form become part of the contract only if their correspondence with the reasonable expectations of the other party can be proved.<sup>55</sup>

If the clause which the other party would not reasonably expect is really central to the drafter's willingness to undertake the obligation, she may always dispel the other's expectations by bringing it to the latter's informed notice, thus making the clause part of those provisions to which there is mutual assent. Only when the drafter has been forced to sell the weakness as well as the strength of what is offered does the customer have notice of the importance of shopping for different terms.<sup>56</sup> Should no alternatives be available in the market, of course, the customer's assent to the original terms offered may still be impugned under the rubric of good faith and unconscionability<sup>57</sup> or, as *Lynch* suggests, because of superior bargaining power. But this is a second stage of judicial analysis of the transaction. The first should be the determination of what terms are actually part of the bargain, which requires an examination less of the fine print than of the reasonable expectations of the party who didn't get a chance to draft it.

The "practical effect" of the holding of *Stock*, the court of appeals concluded, "will be to encourage warnings of some kind when an insured is issued a policy different from that which he reasonably expects. . . ."<sup>58</sup> That is a result which justice and fairness commend to all fields of contract law.

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55. See Slawson, *supra* note 2.

56. *Id.*

57. U.C.C. §§ 1-203, 2-302 (1978) (N.M. Stat. Ann. §§ 55-1-203, 55-2-302 (1978)); Restatement (Second) of Contracts §§ 205, 208 (1981).

58. 96 N.M. at 547, 632 P.2d at 1185.

### B. Formation

Two cases during the Survey year concerned interesting problems of contract formation: offer and acceptance in *Corr v. Braasch*,<sup>59</sup> and consideration in *Church v. Church*.<sup>60</sup> In *Corr*, the failure of real estate sellers and a broker to agree on the broker's commission prevented the formation of a contract between the buyer and sellers, even though the buyer and sellers had reached agreement on the terms of the sale itself. The buyer sent an offer to purchase through the broker who, unbeknownst to the buyer, added a clause to the purchase agreement requiring the sellers to pay the broker a six percent commission. When the sellers received the offer, they changed some of its terms, and in particular changed the commission from six percent to \$5,000, a reduction of \$6,500. The buyer later initialed the other modifications, but neither buyer nor broker initialed the reduction in commission. When the sellers decided not to go through with the sale, the buyer sued.

The trial court enforced the purchase agreement as modified, finding that the broker had accepted the \$5,000 commission figure. The supreme court reversed that finding for lack of substantial evidence, and then faced the problem of what to do with the remainder of the contract, given that no agreement had been reached between the sellers and broker. The trial court had concluded as a matter of law that the purchase agreement was two separate contracts: one between the buyer and sellers, the other between the sellers and broker. The supreme court appeared to believe that under the trial court's ruling, failure of the second contract would not affect the validity of the first, so it also reversed that part of the ruling:

To hold that [the sellers] are bound by the sales portion of the agreement yet are not bound by the commission provision would be to selectively enforce the terms of the clause inserted by [the broker] and would introduce precedent for subdividing any contract with multiple terms despite the written manifestation of the parties.<sup>61</sup>

Despite these words, the supreme court's determination of this issue depended not at all on the "written manifestations." Instead, it was based on the sellers' oral testimony that because the down payment offered was lower than they wanted, they would not sell the property at all with the six percent commission.

The supreme court concluded from this evidence that the two promises were crucially related for the sellers: they were willing to deal upon the terms offered by the potential buyer *only if* the broker agreed to reduce the commission. Agreement on the second promise was thus a condition

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59. 97 N.M. 279, 639 P.2d 566 (1981).

60. 96 N.M. 388, 630 P.2d 1243 (Ct. App. 1981).

61. 97 N.M. at 281, 639 P.2d at 568.

for the sellers' willingness to undertake the first. Consequently, the court held that the sellers' alteration of the commission kept their response from being an acceptance of any part of the proffered purchase agreement; it was, instead, a counteroffer which was never accepted by the buyer or broker. No acceptance, no contract, no sale.

The issue of how many contracts were involved is unfortunately something of a red herring and invites a misreading of the case. The sellers were asked for two promises, one to the broker and one to the buyer. Separate contracts or not, all that matters is the relationship between the two promises, namely whether the second was conditional upon agreement to the first. The trial court could ignore that issue because it found that there was in fact agreement to the first, although its conclusion of law that the two were "separate" contracts suggests that it might have felt they were also independent. The issue, however, as the supreme court's handling of it reveals, is not one of law; the case thus may *not* be cited for the proposition that multiple promises in a single transaction are part of one contract and must stand or fall together. Rather, the case turns on the unremarkable principle that as a factual matter, a party may make agreement on one matter a precondition to agreement on another. When that happens and the first part of the deal falls through, so consequently does the second.

The court of appeals decided the second formation case, *Church*,<sup>62</sup> using Virginia law but it is instructive for the light it sheds upon similar causes of action under New Mexico law. The plaintiff had worked to put her husband through four years of medical school, but from the second year onward, the future Dr. Church carried on an extramarital relationship. Upon graduation, the new Dr. Church immediately filed for divorce. His wife responded with a suit for fraud, unjust enrichment, and breach of an oral contract. The wife's claim alleged that in return for a one-half interest in her husband's increased earning power after medical school, she agreed to and did provide: (1) emotional support and services as a housewife, (2) financial support for living expenses, and (3) the cost of his medical education. The court of appeals held that under Virginia law, the plaintiff had a duty to provide the services of a wife and that element could therefore provide neither consideration for the contract nor a basis for recovery in fraud or unjust enrichment. However, the court held that the plaintiff had no duty to provide either living or educational expenses and so reversed the trial court's dismissal of the complaint for failure to state a claim.

The opinion suggests, accurately it appears, that New Mexico law would recognize only the third item as sufficient consideration to support

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62. 96 N.M. 388, 630 P.2d 1243 (Ct. App. 1981).

the contract. In New Mexico, a spouse has a legal duty not only to render the familial services of a wife<sup>63</sup> or husband<sup>64</sup> but also to provide financial support for the other.<sup>65</sup> Because Virginia law contains no corresponding obligation of financial support, the court did not have to decide whether the cost of the doctor's education is "support" money. In this state, however, if that cost were deemed part of "support," its use as consideration would be barred by the same mutual duty that prevents ordinary living expenses from constituting consideration. Conveniently, the opinion supplies dictum to point the direction for New Mexico law: "[T]raditionally, the funds provided by a wife to pay for her husband's medical education would be considered an item *separate from* funds provided for his support."<sup>66</sup>

*Church* thus suggests that New Mexico would recognize an enforceable contract for a wife's earning her " 'Ph.T.' (putting hubby through school),"<sup>67</sup> with consideration supplied by the wife's provision of educational expenses. The usefulness of the action in New Mexico, however, is limited by our community property law: the educational contribution must come not from her own earnings, community property which the student-husband would already have full power to manage and dispose of,<sup>68</sup> but from her separate property.

### C. Remedies

The buyer's two goods-oriented remedies under the Uniform Commercial Code, rejection and revocation of acceptance, received the attention of the New Mexico court in two cases during the Survey year, *Celebrity, Inc. v. Kemper*<sup>69</sup> and *O'Shea v. Hatch*.<sup>70</sup>

In a straightforward application of the Code's provisions, *Celebrity* outlined the procedure which the buyer should have followed, but didn't, to reject an entire shipment of goods because of defects in some of them. Plaintiff *Celebrity* had sold goods for several years to *Kemper*, a retailer. Although *Celebrity's* invoice provided for all returns to be made within five days and with its prior written authorization, the practice had been for the salesperson on her next call to inspect any defective items and make an adjustment to the account. This time, however, the salesperson refused to make an adjustment when notified of the defective items. *Kemper* did nothing further until, three months later, he received a demand

63. *Tellez v. Tellez*, 51 N.M. 416, 186 P.2d 390 (1947).

64. *Hurley v. Hurley*, 94 N.M. 641, 615 P.2d 256 (1980).

65. 96 N.M. at 392, 630 P.2d at 1247 (citing N.M. Stat. Ann. § 40-2-1 (1978)).

66. 96 N.M. at 396, 630 P.2d at 1251 (emphasis added).

67. *Id.* at 391, 630 P.2d at 1246.

68. N.M. Stat. Ann. § 40-3-14 (1978).

69. 96 N.M. 508, 632 P.2d 743 (1981).

70. 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

for payment and the threat of a lawsuit from Celebrity. When Kemper boxed up all of the unsold goods, whether defective or not, and returned them, Celebrity acted on its threat. The trial court found that Kemper had effectively rejected the entire shipment and had no obligation to Celebrity for the purchase price. The supreme court reversed, holding that Kemper had effectively rejected only the defective goods and thus remained liable for the purchase price of the remainder.

Kemper clearly *could* have rejected the entire shipment, the court pointed out, because of the defects in some of the goods: where the seller's tender fails in any respect, the buyer may reject the whole, accept the whole, or accept any commercial unit or units and reject the rest.<sup>71</sup> Further, his rejection of the defective goods was effective upon notification to the salesperson, despite the provision of the invoice stipulating an exclusive manner of rejection. Kemper was entitled to rely on their course of dealing, the court reasoned, until the refusal to make adjustments put him on notice that Celebrity invoked the express terms of the contract. At this point, however, he had only attempted to reject the nonconforming goods. His further attempt at rejection, the reshipment three months later of the conforming goods, failed because "as a matter of law"<sup>72</sup> it was not "within a reasonable time after their delivery."<sup>73</sup> The failure to make an effective rejection constituted acceptance,<sup>74</sup> the court concluded, and gave the seller the right to recover the purchase price<sup>75</sup> for the conforming goods.

Additionally, the court noted, Kemper's attempted rejection of the remainder of the shipment failed to specify the particular defects prompting the return, which the Code requires when the seller either requests it or when she could have cured the defects had they been specified.<sup>76</sup> There are two flaws in this secondary rationale. First, there was no indication that either of the conditions requiring particularization of defects was met. Second, the court had held that the rejection of the defective goods was effective. If particularization were necessary, the requirement was presumably satisfied by calling the defects to the salesperson's attention; when the conforming goods were returned, there were no further defects left to specify. If the court wanted an alternative ground for its decision, it had a better one available than the absence of particular notice. Kemper not only failed to make an effective rejection; his acts of pricing the goods and putting them up for sale (and even selling some of them which his

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71. N.M. Stat. Ann. § 55-2-601 (1978).

72. 96 N.M. at 509, 632 P.2d at 744.

73. N.M. Stat. Ann. § 55-2-602(1) (1978).

74. N.M. Stat. Ann. § 55-2-606(1)(b) (1978).

75. N.M. Stat. Ann. § 55-2-709(1)(a) (1978).

76. N.M. Stat. Ann. § 55-2-605(1) (1978).

customers later returned!) were "inconsistent with the seller's ownership"<sup>77</sup> and thus independently constituted acceptance.<sup>78</sup>

The supreme court's willingness to find the buyer's three-month silence unreasonable as a matter of law contrasts interestingly with its own decision a year earlier in *Ybarra v. Modern Trailer Sales, Inc.*<sup>79</sup> and with the court of appeals decision in *O'Shea*<sup>80</sup> this Survey year. In both, the courts declined to set limits as a matter of law for similar determinations under the Code and preferred to leave the finding of reasonableness a matter for the trier of fact. Like the buyer who rejects goods, a buyer who accepts but, upon failure of the seller to cure as promised or upon discovery of a previously hidden defect, now wishes to revoke the acceptance, must also act within "a reasonable time after the buyer discovers or should have discovered the ground for it. . . ."<sup>81</sup> In *Ybarra*, however, the supreme court refused to hold that *four years* was, as a matter of law, an unreasonable time within which to revoke acceptance of a mobile home. Unlike the silent Kemper, the buyer in *Ybarra* had during the four years repeatedly complained to the seller, who in turn had repeatedly but unsuccessfully attempted to fix the defect. Nevertheless, *Ybarra's* stance is that reasonableness under the Code is a factual matter. That suggests that the issue of "reasonable time" for notice of rejection should be reviewed for substantial evidence rather than, as in *Celebrity*, as a matter of law.

*O'Shea* indicates that the court of appeals shares that inclination. The defendants, the Hatches, sold the O'Sheas a colt in response to their request for a horse with a gentle disposition suitable for both show and riding by children. Although, represented as a gelding, the horse was not: it had an undescended testicle. Acting like a stallion, the horse was unsuitable for either of the purposes for which the O'Sheas purchased it. When the O'Sheas discovered the problem some three months after the sale, they demanded their money back. The Hatches refused but offered to pay for removal of the other testicle, which was done but to no avail. The horse still didn't act like a gelding. The court reported no further contact between the parties for the next three and one-half years, during which time the O'Sheas continued to ride and show the horse. They then filed suit for damages, arguing that they had rightfully revoked their acceptance of the horse. The trial court agreed and so did the court of appeals.

Whether the revocation was effective was doubly important. First, if

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77. N.M. Stat. Ann. § 55-2-606(1)(c) (1978).

78. *Id.*

79. 94 N.M. 249, 609 P.2d 331 (1980).

80. 97 N.M. 409, 640 P.2d 515 (Ct. App. 1982).

81. N.M. Stat. Ann. § 55-2-608(2) (1978).

the plaintiffs had reaccepted the horse after the operation, they failed from that point forward to give notice to the seller of any breach; failure to notify of breach within a reasonable time of discovery bars the buyers from *any* remedy.<sup>82</sup> Second, even if the buyers could overcome the first hurdle by relying on the pre-operation notice, their damages for breach of warranty would have been less than for rightful revocation.<sup>83</sup> The issue centered on the effect of the buyers' use of the horse after they told the sellers they wished to return it and get their money back. When the buyers had the operation on the horse and continued to ride and show it, the sellers argued, they lost their right to revocation and reaccepted the horse by acts "inconsistent with the seller's ownership."<sup>84</sup> The court rejected the argument and held that the plaintiffs' post-revocation behavior, did not, as a matter of law, render the revocation ineffective.

The legal effect of the operation did not detain the court, nor should it have. The court noted that the sellers not only consented, they *suggested* it to cure the defect, and so the buyers exercised no "dominion or ownership of the horse"<sup>85</sup> when they procured the operation. The effect of riding and showing the horse for three and one-half years after revocation is more troublesome. The court began its argument with the clearly correct proposition that, "[w]here a buyer notifies a seller of 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."<sup>86</sup> Although the court did not provide the statutory support for that assertion, the Code contains it. A revoking buyer "has the same rights and duties with regard to the goods involved as if he [or she] had rejected them."<sup>87</sup>

In the absence of any instructions from the seller, the rejecting (and therefore revoking) buyer "may store the rejected goods for the seller's account or reship them to him [or her] or resell them for the seller's account. . . ."<sup>88</sup> In addition, a buyer in possession of goods who rightfully rejects or revokes acceptance has a security interest in the goods for any payments made on their price and for expenses incurred in handling them, and may "hold such goods and resell them"<sup>89</sup> to satisfy the security interest. Although the court only mentioned in passing that the buyer without a security interest has an obligation after rejection to hold the goods with reasonable care for a time sufficient to permit the seller to

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82. N.M. Stat. Ann. § 55-2-607(3)(a) (1978).

83. Compare N.M. Stat. Ann. § 55-2-714 with § 55-2-711(1) (1978).

84. N.M. Stat. Ann. § 55-2-606(1)(c) (1978).

85. 97 N.M. at 414, 640 P.2d at 520.

86. *Id.* at 416, 640 P.2d at 522.

87. N.M. Stat. Ann. § 55-2-608(3) (1978).

88. N.M. Stat. Ann. § 55-2-604 (1978).

89. N.M. Stat. Ann. § 55-2-711(3) (1978).

remove them,<sup>90</sup> the O'Sheas' payment of the purchase price clearly gave them a security interest in the horse.

So the court was correct that the revoking buyer may retain possession of the goods, but the statutory rights to store, reship, or resell hardly justify their continued use. The court could have made use of the Official Comment's suggestion that, "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."<sup>91</sup> Even so, the illustration contains not a hint that a buyer may continue to use the goods as her own for three and a half years after revocation. Nevertheless, the court continued:

[W]hether 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. . . .

Continued possession and reasonable use of property after the buyer has notified seller of revocation of acceptance, under the U.C.C. does not as a matter of law constitute waiver of the right to revoke acceptance.<sup>92</sup>

Again the court mentioned no statutory mandate either for the assertion that reasonable use after revocation is permitted or for the assertion that it is a matter of fact, not law, whether such use constitutes acceptance because it is inconsistent with the seller's ownership.

The court cited a number of cases, however, which support both propositions, but under considerably different factual circumstances.<sup>93</sup> In all but one of the cases, the continued use of goods after revocation lasted at most a couple of months, rather than years;<sup>94</sup> in the other, the duration of use is unclear, but may have been almost two years.<sup>95</sup> Second, and more importantly, in each of the cases the court suggested that the continued use was in fact reasonable, either because (1) the failure to use would have had such serious repercussions upon the buyer's business that continued use mitigated damages,<sup>96</sup> or (2) continued use, namely contin-

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90. 97 N.M. at 614, 640 P.2d at 522.

91. U.C.C. § 2-604, official comment (1978).

92. 97 N.M. at 415-16, 640 P.2d at 521-22.

93. *Mobile Home Sales Management, Inc. v. Brown*, 115 Ariz. 11, 562 P.2d 1378 (Ct. App. 1977); *Minsel v. El Rancho Mobile Home Center, Inc.*, 32 Mich. App. 10, 188 N.W.2d 9 (1971); *Johannsen v. Minnesota Valley Ford Tractor Co., Inc.*, 304 N.W.2d 654 (Minn. 1981); *Fablok Mills, Inc. v. Cocker Machine and Foundry Co.*, 125 N.J. Super. 251, 310 A.2d 491 (App. Div. 1973).

94. *Mobile Home Sales Management, Inc. v. Brown*; *Minsel v. El Rancho Mobile Home Center, Inc.*; *Johannsen v. Minnesota Valley Ford Tractor Co., Inc.*

95. *Fablok Mills, Inc. v. Cocker Machine and Foundry Co.*

96. See *Johannsen v. Minnesota Valley Ford Tractor Co.*, and *Fablok Mills, Inc. v. Cocker Machine and Foundry Co.*

ued occupation of a mobile home, was the best way to safeguard the property pending the seller's instructions.<sup>97</sup>

It is difficult to imagine that over three years of riding and showing a horse which the buyer claimed was suitable for neither was an appropriate way to mitigate damages or to safeguard the property. Although the record was silent on these matters, the court nevertheless held that the finding that the revocation was effective was supported by substantial evidence because the *sellers* failed "to show how any delay may have prejudiced them, or to show that the delay could have been avoided."<sup>98</sup> Because the sellers *caused* the delay by their failure to contact the buyers to arrange for removal of the property, it doesn't make much sense to allow them to avoid the effects of the delay by proving either that it was prejudicial or avoidable. But if "use" is substituted for "delay" in the court's formulation (the sellers failed to show how any *use* may have prejudiced them, or to show that the *use* could have been avoided), it reflects the factors which influenced the courts whose opinions are used for support here: the continued *use* is prejudicial and avoidable if it is unsuitable to mitigate damages or to safeguard the property.

*O'Shea*, then, amounts to an allocation of the burden of proof. Once the buyer has proved revocation of acceptance, her continued use of the goods in the absence of the seller's instructions will not negate the revocation and constitute a reacceptance of them unless the seller can prove that the use was "unreasonable"—either prejudicial to the seller or reasonably avoidable. This result makes revocation of acceptance a truly powerful remedy for the buyer, who often is in the predicament of possessing neither satisfactory goods nor the money to purchase a substitute, because she has already paid the seller. When the seller refuses the revocation, the buyer has the unhappy options of reselling, returning or storing the goods and doing without (often at great inconvenience and detriment), or of continuing to use the defective goods until the frustration becomes so great that she resorts to a lawsuit. Thus, for instance, when a buyer trades in her old car for a new lemon but can't afford to return it and sue for rescission, to require her to do so is a hardship contrary to the "rule of reasonableness" which underlies the entire Code.<sup>99</sup> Equally reasonable is that the party claiming waiver, as at common law, be required to bear the burden of proving the waiver. But even when the use is reasonable, of course, the seller ought to be compensated for its value, and one New Mexico case has suggested that the use value is recoverable

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97. See *Mobile Home Sales Management, Inc. v. Brown*, and *Minsel v. El Rancho Mobile Home Center, Inc.*

98. 97 N.M. at 416, 640 P.2d at 522.

99. See *Pavesi v. Ford Motor Co.*, 155 N.J. Super. 373, 382 A.2d 954 (Ch. Div. 1978), *overruled on other grounds*, *Ramirez v. AutoSport*, 88 N.J. 277, 440 A.2d 1345 (1982).

by the seller as an offset to the successful buyer's award.<sup>100</sup> Unfortunately for the Hatches, they failed to ask for the offset.

Finally, the court's unwillingness to set boundaries on the extent or duration of the use as a matter of law is well-founded. A finding that the buyer's acts are "inconsistent with the seller's ownership" and thus constitute acceptance requires essentially a determination that the acts are "inconsistent with his [or her] claim that he [or she] has rejected the goods."<sup>101</sup> What is important is whether the buyer has in fact changed her mind and decided to keep the goods instead of returning them, and for that investigation no one set of facts should be legally determinative. Like the resolution of a somewhat similar issue, what constitutes a "reasonable time" under the Code, the buyer's intentions in using goods can only surface in a thorough examination of "the nature, purpose and circumstances"<sup>102</sup> of the use.

#### D. Insurance

One important case involving a contract of insurance has been discussed above.<sup>103</sup> Four others deserve a brief mention.

In *Guess v. Gulf Insurance Co.*,<sup>104</sup> on an issue of first impression, the supreme court held that an insured can institute a direct action against an insurer for uninsured motorist benefits. The court rejected the insurer's position that a prior action and judgment against the uninsured motorist is a prerequisite to an action against the insurer. Lest anyone miss the point, in *Wood v. Millers National Insurance Co.*,<sup>105</sup> the court delivered an identical holding on a substantially identical policy less than four months later, repeating the entire analysis and inexplicably failing to mention the earlier case. The court twice held that neither state law requiring insurers to offer uninsured motorist coverage<sup>106</sup> nor the policy itself required a prior action against the motorist. Both policies contained the thoroughly typical clause providing that the insurer would not be bound by a judgment against the tortfeasor unless the action had been prosecuted with the written consent of the company. Not only does the clause not expressly require a prior suit, the court concluded, "[t]here would be no reason to require the insured to first sue the tortfeasor and

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100. *Gawlich v. American Builders Supply, Inc.*, 86 N.M. 77, 519 P.2d 313 (Ct. App. 1974).

101. U.C.C. § 2-606, official comment 4 (1978).

102. N.M. Stat. Ann. § 55-1-204(2) (1978).

103. *Stock v. ADCO General Corp.*, 96 N.M. 544, 632 P.2d 1182 (Ct. App. 1981), *cert. denied*, 96 N.M. 543, 632 P.2d 1181 (1981), discussed *supra* at text accompanying notes 41-58.

104. 96 N.M. 27, 627 P.2d 869 (1981).

105. 96 N.M. 525, 632 P.2d 1163 (1981).

106. N.M. Stat. Ann. § 66-5-301(A) (1978).

recover a judgment since the insurance company is not bound by the judgment under the terms of the policy."<sup>107</sup>

In *People's State Bank v. Ohio Casualty Insurance Co.*,<sup>108</sup> the supreme court reversed a summary judgment for the insurer because the alleged waiver of the time-to-sue limitation of the policy presented a substantial issue of fact. The policy barred suit after one year from the date of loss and the plaintiff missed the deadline by four months. During that year, however, the insurer's initial denial of coverage was followed by three settlement offers from Ohio's agent, the last of which expired five days after expiration of the time-to-sue limitation. The court concluded that the facts presented two substantial issues making the case inappropriate for summary judgment: (1) whether the agent had authority to waive the time-to-sue provisions, and (2) whether the negotiations had in fact waived the provision. Although "[n]egotiations alone are insufficient to support a finding of waiver if the negotiations are terminated within adequate time for the insured to institute an action on the policy,"<sup>109</sup> here the final offer expired after the time limitation. Despite the insurer's argument that the letter containing the final offer also specified that Ohio waived no rights under the policy and thus removed any doubt on the issue of waiver, the court held that the jury could draw a reasonable inference in favor of the insured that the offer "would lull the insured into reasonably believing that its claim would be settled without suit. . . ."<sup>110</sup>

Finally, *Hartman v. Shambaugh*<sup>111</sup> clarified recovery under a policy of title insurance when title to a portion of the insured property fails. The measure of damages should be determined by actual value rather than purchase price. Further where, as with urban property, the value of an entire tract of land is diminished by failure of title to a portion of it, "the proper measure of damages requires consideration of impairment of the value to the entire lot."<sup>112</sup> The court held that the impairment is to be measured at the time the defect is discovered rather than at the time of purchase.<sup>113</sup>

## II. BUSINESS ASSOCIATIONS

Although the Survey year was relatively quiet in this area, there were four decisions which broke no new ground but of which the practitioner

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107. 96 N.M. at 29, 629 P.2d at 871.

108. 96 N.M. 751, 635 P.2d 306 (1981).

109. *Id.* at 753, 635 P.2d at 308.

110. *Id.*

111. 96 N.M. 359, 630 P.2d 758 (1981). For further discussion of this case, see Minzner, *Property, post* at 435, and Note, *Title Insurance—New Mexico Sets the Date for Determination of Value in Title Insurance Cases: Hartman v. Shambaugh*, 12 N.M. L. Rev. 833 (1982).

112. 96 N.M. at 362, 630 P.2d at 761.

113. *Id.* at 364, 630 P.2d at 763.

ought to be aware. *Ulibarri Landscaping Material, Inc. v. Colony Materials, Inc.*<sup>114</sup> dealt with the master-servant relationship; *Citizens Bank of Clovis v. Williams*<sup>115</sup> and *Evans Products Co. v. O'Dell*<sup>116</sup> with partnerships; and *Cruttenden v. Mantura*<sup>117</sup> with corporations.

In *Ulibarri*, the court of appeals held that an employer is liable for negligent conversion by its employee when, even though without knowledge of the conversion, the employer accepts the benefits of the tortious acts. The defendant instructed its employee to dig and remove scoria from a community pit. In doing so, the employee also removed some \$40,000 worth of the material which had been stockpiled by and belonged to the plaintiff. The defendant accepted and used the plaintiff's material, but there was no evidence that it knew of the conversion. Nevertheless, the court held that the defendant's "acceptance of the converted material was a sufficient ratification of [its employee's] action to subject it to liability to the plaintiff."<sup>118</sup> That result seems so fair (because defendant otherwise would have received a tremendous windfall at the plaintiff's expense) that it is a wonder that the issue was even litigated. Indeed, the employer's liability for its overzealous employee's conversion or trespass within the scope of employment, even absent any retention of benefits or ratification, is a well-established part of the principle of *respondeat superior*.<sup>119</sup>

In *Citizens Bank of Clovis*,<sup>120</sup> the issue was the applicability of the statute of frauds to an oral agreement dissolving a partnership and dividing partnership assets which included real property. The trial court found that the oral agreement provided for an equal distribution of partnership assets, including land which had been purchased and contributed to the partnership by one partner, Spencer, who died prior to the commencement of the action. The plaintiff, as Spencer's personal representative, argued that because the land was part of Spencer's capital contribution to the partnership (which in absence of agreement would have been returned to Spencer upon dissolution)<sup>121</sup> the oral agreement constituted the transfer of Spencer's interest in the land in violation of the statute of frauds. Consequently, the plaintiff concluded, the oral agreement was unenforceable and the land belonged to Spencer's estate.

The supreme court disagreed, noting first that partnerships are generally

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114. 97 N.M. 266, 639 P.2d 75 (Ct. App. 1981), *cert. denied*, \_\_\_ N.M. \_\_\_, 644 P.2d 1039 (1982).

115. 96 N.M. 373, 630 P.2d 1228 (1981).

116. 96 N.M. 500, 632 P.2d 735 (1981).

117. 97 N.M. 432, 640 P.2d 932 (1982).

118. 97 N.M. at 270, 639 P.2d at 79.

119. Restatement (Second) of Agency § 244 (1958).

120. 96 N.M. 373, 630 P.2d 1228 (1981).

121. N.M. Stat. Ann. § 54-1-18(A) (1978).

permitted to carry on business informally;<sup>122</sup> even the agreement initially creating the partnership need not be written.<sup>123</sup> Moreover, the court pointed out, the "interest of a partner in the partnership is personal property and not real property, even if land is one of the assets. . . ."<sup>124</sup> The dissolution agreement thus concerned the transfer only of personal property and the statute of frauds was inapplicable.

The designation of partnership property as personalty in the Uniform Partnership Act<sup>125</sup> was apparently intended to deal with certain problems in the administration of a deceased partner's estate<sup>126</sup> rather than to circumvent the statute of frauds. The court's use of the concept, however, is a straightforward application of the clear language of the Act and has the additional advantage of retaining the characteristic informality of the partnership.

*Evans Products*<sup>127</sup> and *Cruttenden*<sup>128</sup> both involved unsuccessful attempts to pierce the insulation provided by the formal business organizations of the limited partnership in the former, and the corporation in the latter. The plaintiff in *Evans Products* sought to recover against a limited partner for a debt owed by the insolvent limited partnership. Unlike a general partner, a limited partner is not personally liable for partnership debts unless she takes part in the control of the business.<sup>129</sup> The plaintiff argued that the requisite control could be found in the defendant's participation as a general partner in a related partnership which, although ostensibly separate from the limited partnership, was in reality merely a division of it. The defendant's position of control in the subsidiary, the plaintiff concluded, implicated the defendant in the control of the insolvent parent, and thus rendered him liable for its debts despite his limited partner status in the parent.

On appeal, the supreme court upheld the lower court's refusal to pierce the veil of the limited partnership. The court concluded that the finding that the two partnerships were separate and distinct was supported by substantial evidence: (1) although the two principals were the same in both partnerships, they intended to form two separate entities, (2) one partnership contained an additional member, (3) the businesses were maintained at separate locations, (4) the Certificate of Limited Partnership forbade participation in the kind of business in which the general partnership was engaged, (5) the businesses maintained separate bank fi-

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122. 96 N.M. at 375-76, 630 P.2d at 1230-31.

123. See N.M. Stat. Ann. § 54-1-7 (1978).

124. 96 N.M. at 375, 630 P.2d at 1230 (citing N.M. Stat. Ann. § 54-1-26 (1978)).

125. N.M. Stat. Ann. § 54-1-26 (1978).

126. See, e.g., Annot., 80 A.L.R.2d 1107 (1961 & 79-82 Supp. 1979).

127. 96 N.M. 500, 632 P.2d 735 (1981).

128. 97 N.M. 432, 640 P.2d 932 (1982).

129. N.M. Stat. Ann. § 54-2-7 (1978).

nancing and accounts, and (6) the assets of the businesses were not commingled. This evidence typifies the traditional characteristics thought important to a determination of entity insulation. The court's holding is clearly correct.

Like *Evans Products*, *Cruttenden* was decided on the issue of substantial evidence and is thus less important for its precedential value than for its instructions to litigants on what sort of facts they ought to be trying to prove to either sustain or shred the corporate veil. Here the plaintiff attempted to have a parent corporation garnish the wages of an employee of its wholly-owned subsidiary. The trial court ordered the garnishment but the supreme court reversed for lack of substantial evidence that the subsidiary maintained no "independent" existence but was merely the "alter ego" or "instrumentality" of the parent.<sup>130</sup> Without such evidence, the court concluded, "service on the parent corporation does not subject the subsidiary corporation to local jurisdiction."<sup>131</sup>

The only evidence in the record of the relationship of the two corporations was that one was in fact a subsidiary of the other and that certain of the parent's contracts had been assigned to the subsidiary. That is not enough, the court properly held, since without more, a "subsidiary and its parent corporation are viewed as independent corporations."<sup>132</sup> Somewhat gratuitously in light of the paucity of the plaintiff's evidence, the court did set out ten factors for guidance in the determination of whether a subsidiary is a mere "alter ego" of its parent.<sup>133</sup> The plaintiff satisfied none of them, of course, but should you be contemplating trying to get to a parent through its subsidiary, I commend them to your attention.

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130. 97 N.M. at 434, 640 P.2d at 934.

131. *Id.*

132. *Id.*

133. *Id.* at 434-35, 640 P.2d at 934-35.