NEW MEXICO LAW REVIEW

Volume 15
Issue 2 *Spring 1985*

Spring 1985

Commerical Law

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COMMERCIAL LAW

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I. INTRODUCTION

Although not accomplishing major changes in the area of commercial law during the survey year, the New Mexico appellate courts established some new trends and expanded upon existing ones. This Article discusses these trends in the areas of contracts, business associations, insurance law, and real estate contracts and points out some potential traps for the unwary practitioner.

II. CONTRACTS AND EXTRA-CONTRACTUAL THEORIES

A. Anti-Indemnity Clauses

In *Guitard v. Gulf Oil Co.*,[1] the New Mexico Court of Appeals interpreted an indemnity clause in a contract[2] in conjunction with of one of the state's limitation of indemnity statutes.[3] Drafters of contracts should be aware of the case even though, in this instance, the court found a rationale for enforcing the clause in spite of the statute. Unwarranted reliance on this decision, however, may be risky. Courts faced with similar questions in the future could find ample grounds to hold otherwise, and could determine that an indemnity provision which does not comply with the statutory requirements is void.

The plaintiff in *Guitard,* an employee of a third-party defendant, Harrison Western, sustained injuries when steel beams fell from a mining conveyance. Defendant Gulf Oil Company operated the mining project and Harrison Western was Gulf's contractor. After being sued by Guitard, Gulf sued Harrison Western for indemnification, contribution, and re-

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1. 100 N.M. 358, 670 P.2d 969 (Ct. App. 1983). *See also* Kelly, *Torts,* 15 N.M.L. Rev. ___ (1985), in this issue (discussing *Guitard*).

2. The clause in the contract stated:

> Contractor agrees to be responsible for and to indemnify and save harmless the Owner from all loss or damage and any or all claims and suits, and costs of defending same, arising by reason of accidents, injuries (including death) or damage to any persons or property in connection with the Work performed by Contractor. . . . Contractor shall not be liable for any loss, damage or claims which are determined to be due to the sole negligence of Owner.

100 N.M. at 362, 670 P.2d at 973.

3. N.M. Stat. Ann. § 56-7-2(A) (1978). *See* 100 N.M. at 361, 670 P.2d at 972.

covery of damages. Harrison Western claimed that under New Mexico's limitation of indemnity statute dealing with mines, the indemnity clause in its contract with Gulf was void.[4] The trial court agreed and granted Harrison Western's motion for summary judgment.

The court of appeals overruled the trial court. The appellate court interpreted the statutory language "arising from the . . . concurrent negligence of the indemnity" to mean that an indemnitee cannot avoid liability for his own negligence by inserting such a provision in his contract.[5] Gulf, therefore, was free to sue Harrison Western for that portion of the damages attributable to Harrison Western. Although the appellate court seemed to appreciate the public policy basis of the statute, which was to promote safety at wells and mines, obviously the court disagreed with the statutory scheme devised by the legislature to accomplish that purpose.

Gulf could have eased its burden if it had claimed a common-law right of indemnity rather than a right based on a contract provision. By so pleading, Gulf would have avoided the purview of the statute and any possible application of *Bartlett v. New Mexico Welder's Supply, Inc.*[6] because the abolition of joint and several liability did not undermine the common-law theory of indemnity. To the extent Gulf's liability was based upon its vicarious responsibility for the negligence of its contractor, Gulf would have a common-law right of indemnity against the contractor. To the extent the negligence of the contractor was not imputable to Gulf on a vicarious liability theory, Gulf would not be liable to the employee for the contractor's negligence and, therefore, would have no need for an indemnity claim, given New Mexico's abolition of joint and several liability.

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4. 100 N.M. at 360, 670 P.2d at 971. This limitation of indemnity statute states:

> Any agreement, covenant or promise contained in, collateral to or affecting any agreement pertaining to any well for oil, gas or water, or mine for any mineral, which purports to indemnify the indemnity against loss or liability for damages, for:
> (1) death or bodily injury to person; or
> (2) injury to property; or
> (3) any other loss, damage or expense arising under either Paragraph (1) or (2) or both; or
> (4) any combination of these, arising from the sole or concurrent negligence of the indemnity . . . or the agents or employees of the indemnities or any independent contractor who is directly responsible to the indemnity, or from any accident which occurs in operations carried on at the direction or under the supervision of the indemnity or an employee or representative of the indemnity or in accordance with the methods and means specified by the indemnity or employees or representatives of the indemnity, is against public policy and is void and unenforceable. This provision shall not affect the validity of any insurance contract or any benefit conferred by the Workmen's Compensation Act.

N.M. Stat. Ann. § 56-7-2(A) (1978). A similar statute, N.M. Stat. Ann. § 56-7-1 (1978), relates to contracts involving improvements to real property.

5. 100 N.M. at 361, 670 P.2d at 972.

6. 98 N.M. 152, 646 P.2d 579 (Ct. App.), *cert. denied*, 98 N.M. 336, 648 P.2d 794 (1982).

B. Modification of Contract Terms

In two cases decided during the survey year, the court of appeals discussed the circumstances under which it will modify written terms of a contract. *State ex rel. Conley Lott Nichols Machinery Co. v. Safeco Insurance Co. of America*[7] involved the lease of equipment for a highway construction project. The defendant contractor completed the project earlier than expected and returned the equipment to the plaintiff lessor prior to the expiration of the lease term. The contractor refused to pay the lease payments due for the two-month period following the equipment's return and preceding the lease's expiration. The lessor then sued to collect rent, charges for overtime use of the machinery, and attorney's fees.

Before trial, the court refused to allow the contractor to present evidence on trade custom and usage to support its claim that the contract terms should be modified to allow the contractor to return the equipment at the completion of the project and thus avoid liability for payments for the remaining term of the lease. After determining that the Uniform Commercial Code (UCC) sections relied on by the contractor[8] apply to leases of goods as well as sales of goods, the court of appeals held that the contract was not amenable to the construction sought by the contractor. In upholding the terms of the contract, the court stated:

> Evidence as to usage of trade is admissible in construing a written contract (whether or not the language is ambiguous) to add to, subtract from or qualify the terms of the agreement or to explain their meaning, even if contradictory to the words therein. . . . Parol evidence is not admissible, however, when it would change the basic meaning of the contract and produce an agreement wholly different from, wholly inconsistent with the written agreement and which tends to distort the expressly stated written understanding of the parties.[9]

Unconscionability of a contract provision as the basis for modifying the contract was at issue in *Bowlin's, Inc. v. Ramsey Oil Co.*[10] The case arose when Bowlin's discovered a shortage in deliveries that Ramsey Oil made to one of Bowlin's retail outlets. The contract between Bowlin's and Ramsey Oil and Texaco, Inc., another defendant, allowed a two-day period following delivery within which Bowlin's was required to notify Texaco of any shortage. Failure to comply with the notice provision resulted, by the terms of the contract, in waiver of the claim.

Bowlin's asserted that the notice clause was unconscionable, unenforceable, and without reasonable commercial purpose. The trial court

7. 100 N.M. 440, 671 P.2d 1151 (Ct. App. 1983).
8. N.M. Stat. Ann. §§ 55-1-205, 55-2-202 (1978).
9. 100 N.M. at 444, 671 P.2d at 1155 (Ct. App. 1983) (citations omitted).
10. 99 N.M. 660, 662 P.2d 661 (Ct. App.), *cert. denied*, 99 N.M. 644, 662 P.2d 645 (1983).

agreed. The appellate court, however, recognized that "a determination of unconscionability in a contract clause is a matter of law."[11] It reviewed the considerable amount of evidence presented to the trial court as well as various provisions of the UCC which are applicable.[12] The court held that the clause was not unconscionable because the agreement was not an adhesion contract and did not result from fraud, duress, or unequal bargaining power.

In view of the fact that unconscionability is a matter of law, and because the applicable statute provides that the issue of unconscionability is always determined by the court and never by a jury,[13] it would enhance the efficiency of the court system if questions such as this were presented to the trial court in the form of a motion for partial summary judgment, or perhaps in the form of a bifurcated hearing, prior to the trial on the merits of the case as a whole. If this procedure had been followed in the *Bowlin's* case, much valuable time of all the litigants and the court might have been saved.

Recognition of the parties' ability to agree on the terms of a contract and the New Mexico courts' willingness to enforce those terms is a welcome change from the all too frequent eagerness displayed by some courts to become an additional party to the business deal.

C. Release of Claims

The court of appeals, which firmly held the parties to their written word in the *Nichols* and *Bowlin*'s cases, took a markedly different stand in the case of *Hendren v. Allstate Insurance Co.*[14] In *Hendren,* the plaintiff suffered serious personal injuries in an automobile accident and claimed against his father's uninsured motorist policy. A claims adjuster for the insurance company then interviewed him. Eventually, Hendren signed a release of claims and trust agreement after representations by the insurance company agent that the agreement would result in payment for the full amount allowable under the policy.

Hendren later discovered that his settlement could have been double or triple the agreed upon amount.[15] He sued, claiming that the release was signed under a mistake of law and fact and that the claims adjuster

11. *Id.* at 666, 662 P.2d at 667.

12. *See* N.M. Stat. Ann. §§ 55-2-302, -303, -602, -607, -608 (1978).

13. N.M. Stat. Ann. § 55-2-302.

14. 100 N.M. 506, 672 P.2d 1137 (Ct. App. 1983).

15. Nine months after the *Hendren* decision, the New Mexico Supreme Court decided Lopez v. Foundation Reserve Ins. Co., 98 N.M. 166, 646 P.2d 1230 (1982), which recognized that insured motorist coverage could be aggregated when one policy covers more than one vehicle. *Id.* at 172, 646 P.2d at 1236. In the *Hendren* case, either two or three autos were insured, so the coverage could have been up to either $30,000 or $45,000. 100 N.M. at 508, 672 P.2d at 1139.

underrepresented the amount of available coverage. The appellate court denied the claims of mistake of law and fact.

The court applied a four part test to the misrepresentation claim. It noted that the misrepresentation: (1) must be proved by clear and convincing evidence; (2) must be of a material fact; (3) must be made to be relied upon; and (4) must in fact be relied upon.[16] In this case, the limit of coverage was obviously a material fact. The court also found that the agent should have known that Hendren would rely upon her statements. Finally, the court inferred that Hendren did rely on the agent's representations because the agent told Hendren that he would waste his money if he hired an attorney, and Hendren did not seek legal counsel.

Particularly disturbing to the court was the agent's assertion to Hendren that he need not retain an attorney. Because of the agent's statements regarding the maximum coverage under the policy and her advice against seeking legal representation, the court found that the insurance company overreached and that summary judgment, therefore, was improper.

Decisions of this kind should caution practitioners. In conflict situations such as the claims agent encountered in this case, attorneys have much to lose if they fail to suggest or to recommend that unrepresented parties seek independent legal advice. The disparity between Hendren's expertise regarding intra-policy stacking and that of the insurance company also affected the court's decision.[17] Likewise, an attorney's expertise in comparison with that of a layman might trigger a duty to suggest that the layman seek counsel.

D. UCC Warranties

1. Law of Sales Versus Law of Contracts

Perfetti v. McGhan Medical[18] presented the court of appeals with an opportunity to contrast the law of sales with the law of contracts. Instead of clarifying the distinctions, however, the court's decision leaves us without focus.

The plaintiff in *Perfetti* suffered from the implantation of an unsatisfactory mammary prosthesis produced by McGhan Medical. The prosthesis had two compartments, an inner one filled with gel and an outer one filled with saline solution. After twenty-five months of use, the outer envelope deflated because of a leakage of the solution. The trial court presented three theories of liability to the jury: (1) product's liability;

16. 100 N.M. at 509, 672 P.2d at 1140 (citing Prudential Ins. Co. of America v. Anaya, 78 N.M. 101, 428 P.2d 640 (1967)).

17. 100 N.M. at 510-11, 672 P.2d at 1141-42.

18. 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983).

(2) express warranty; and (3) implied warranty. This section discusses the two warranty issues.

The appellate court reviewed the express warranty issue on the basis of section 55-2-313(1)(a).[19] The court noted that an "affirmation of fact or promise"[20] made by McGhan Medical to the surgeon who implanted the prosthesis "which relates to the goods and becomes part of the basis of the bargain"[21] would benefit the plaintiff because the surgeon acted as her agent.[22] In addition, the court recognized that, "if there is an affirmation of fact which is a part of the basis of the bargain, there is no independent 'reliance' requirement as to that affirmation of fact."[23] The confusion arose when the court proceeded from this point to discuss the affirmation which the plaintiff claimed was an express warranty:

> *Warning*
> McGhan Medical Corporation is aware of the potential for leakage in inflatable implants over an undefined time period. Considering the chemical and physical properties of the material used in the manufacture of the inflatable implants, deflation is not expected. However, long term results cannot be guaranteed by the manufacturer.[24]

The court stated two reasons for concluding that instructing the jury on an express warranty theory was error. First, the plaintiff claimed that only the last sentence of the warning constituted the affirmation. The appellate court denied this claim because to recognize it would be to allow words to be taken out of context. The court assumed, but did not decide, that the affirmations formed a basis of the bargain and were, therefore, an express warranty, but that there was no evidence that McGhan Medical had breached the affirmation.

The court's second reason for finding no breach of express warranty is more disturbing. The court asserted that "affirmations must be part of the bargain."[25] This statement brings into question the court's earlier statement that no independent reliance is necessary. According to Official

19. N.M. Stat. Ann. § 55-2-313(1) (1978) states that:
> Express warranties by the seller are created as follows:
> (a) any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise;
> (b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description;
> (c) any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

20. 99 N.M. at 650, 662 P.2d at 651.
21. *Id.*
22. *Id.* at 650-51, 662 P.2d at 651-52.
23. *Id.* at 651, 662 P.2d at 652.
24. *Id.*
25. *Id.* at 652, 662 P.2d at 653.

Comment 1 to section 55-2-313, an express warranty depends on "dickered" aspects of the bargain. What is a "dickered" aspect if not a negotiated term upon which the proponent of that term relied in reaching the bargain? How can an express warranty ever be found in the sale of goods if this type of negotiation is required? Is the court saying that consumers cannot enforce an express warranty printed on a pamphlet inside the carton of a small household appliance? Such an affirmation could rarely be recognized as a dickered term. It is an unusual person who chooses a toaster on the basis of the affirmations contained in the written warranty. While such legal requirements as reliance and "dickered" aspects may be meaningful in the context of a negotiated contract, they are unseemly encumbrances in the law of sales.

The trial court also instructed the jury on two theories of implied warranty: merchantability and fitness for a particular purpose. The defendant claimed error on the basis of both theories. The appellate court agreed that, in a personal injury case, a claim based on a theory of product liability may be identical to a claim of breach of implied warranty of merchantability. However, until the New Mexico Supreme Court limits the use of Uniform Jury Instructions to resolve this redundancy, trial courts do not err if they allow instruction on both theories.

With regard to the claim of breach of warranty of merchantability, the court inquired into the UCC requirement of privity of contract.[26] After citing authority from other jurisdictions,[27] the court held that privity of contract between the defendant and either the plaintiff or her surgeon was not required. It is frustrating that the court acknowledged that section 55-2-318 extends the warranty benefits to those persons beyond the persons referred to in Comment 3 to the section[28] and then provided no guidance toward a better understanding of the extent of those included in the distributive chain. This case challenged the court to define further the class of people protected by the implied warranty of merchantability under the New Mexico UCC, but the challenge was ignored.

2. Comparative Negligence

The recent increase in the number of jurisdictions recognizing comparative fault as a defense in negligence actions has spawned claims of comparative fault as a defense to implied warranty actions. In *Bowlin's,*

26. *See* N.M. Stat. Ann. § 55-2-314 (1978).

27. The court seems to have been guided by Western Equip. v. Sheridan Iron Works, 605 P.2d 806 (Wyo. 1980), and Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976).

28. Comment 3 to N.M. Stat. Ann. § 55-2-318 (1978) states:

> The first alternative expressly includes as beneficiaries within its provisions the family, household and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

Inc. v. Ramsey Oil Co.,[29] the New Mexico Court of Appeals decided a case complicated by tangled theories of liability and damages. This situation frequently arises when trial lawyers and judges mingle contract theories with tort theories and further confuse one tort theory with another. Without citing authority, the court of appeals stated that: "[C]omparative liability is not part of the Uniform Commercial Code under which this case is decided."[30] While this statement is correct in the context of *Bowlin*'s, it may not be applicable in other situations.

Other jurisdictions have addressed this issue; their courts' rationales are interesting. In *Correia v. Firestone Tire and Rubber Co.*,[31] a wrongful death case with cross-claims by the defendant against the decedent's employer, the United States District Court for the District of Massachusetts asked the Massachusetts Supreme Judicial Court to decide certain questions of law. Among the questions certified to the state court was: "Does Massachusetts recognize contributory or comparative negligence or fault as a full or partial defense to an action for personal injury or wrongful death based on breach of warranty?"[32] The court answered "No."[33]

The issue with which the Massachusetts court wrestled was essentially the same as our court of appeals encountered in *Perfetti*;[34] that is, is there a distinction between a theory of strict liability and one of breach of implied warranty? Both courts concluded that if there is any distinction, and none is identified by either court, it is slight. The Massachusetts court, however, went further in its discussion and noted that an action for strict liability is justified on a much different basis than an action in negligence.[35] Therefore, the theory of implied warranty, like that of strict liability, is inconsistent with the theory of comparative negligence.

29. 99 N.M. 660, 662 P.2d 661 (Ct. App.), *cert. denied*, 99 N.M. 644, 662 P.2d 645 (1983), *discussed supra* notes 10-13 and accompanying text.

30. 99 N.M. at 672, 662 P.2d at 673.

31. 388 Mass. 342, 446 N.E.2d 1033 (1983).

32. *Id.* at ___, 446 N.E.2d at 1039.

33. *Id.*

34. 99 N.M. 645, 662 P.2d 646 (Ct. App. 1983). *See supra* notes 18-28 and accompanying text.

35. Simply stated, the policy of negligence liability presumes that people will, or at least should, take reasonable measures to protect themselves and others from harm. This presumption justifies the imposition of a duty on people to conduct themselves in this way. A person harmed by one whose conduct falls below the standard established by law for the protection of others against unreasonable risk, Restatement (Second) of Torts § 282 (1965), may recover against the actor. However, if the injured person's unreasonable conduct also has been a cause of his injury, his conduct will be accounted for in apportioning liability or damages.

Strict liability is justified on a much different basis. . . . Recognizing that the seller is in the best position to ensure product safety, the law of strict liability imposes on the seller a duty to prevent the release of "any product in a defective condition unreasonably dangerous to the user or consumer" into the stream of commerce. Restatement (Second) of Torts § 402A(1) (1965). This duty is unknown

The assertion by the court in *Bowlin*'s that consideration of contributory negligence is inappropriate in a breach of implied warranty case is correct. It would have been helpful, however, if the court of appeals had presented some rationale, such as that set forth by the Massachusetts court, for this statement.

III. BUSINESS ASSOCIATIONS

A. Piercing the Corporate Veil

In deciding *Harlow v. Fibron Corp.*,[36] the New Mexico Court of Appeals discussed requirements for piercing the corporate veil. Most practitioners involved in the practice of commercial law are faced, at one time or another, with an irate client who is a creditor of an insolvent or bankrupt corporate debtor and who is frustrated by the knowledge that there are personal assets of the principals of the corporation sufficient to pay the debt which are protected by the existence of a corporate entity. It is helpful to have judicial guidelines when advising these clients of the likelihood of successfully piercing the corporate veil.

In *Harlow,* the plaintiff purchased defective fiberglass pipe from Kinetics, Inc., a New Mexico corporation and one of the defendants in the lawsuit. James Brock, another defendant, was a shareholder and president of Kinetics. He was also president and controlling shareholder of two other defendant companies, Midwest Equipment Co. and Mid-Tex Construction Co. Kinetics was in financial difficulty by 1976, four years after its incorporation, and Midwest, Mid-Tex, and Brock all began paying Kinetics' debts. Meanwhile, Harlow obtained a judgment against Kinetics for damages incurred as a result of the purchase of defective pipe.[37] Fibron purchased the assets of Kinetics in December 1978, without knowledge of the judgment. Harlow filed a New Mexico state court action claiming that Fibron had violated the bulk transfer provisions of the Uniform Commercial Code.[38] Harlow later amended his complaint to include claims to pierce the corporate veil and to recover for fraud.

> in the law of negligence and it is not fulfilled even if the seller takes all reasonable measure to make his product safe. The liability issue focuses on whether the product was defective and unreasonably dangerous and not on the conduct of the user or the seller.

388 Mass. at ___, 446 N.E.2d at 1039-40. The court notes that, in a strict liability context, a user relinquishes the law's protection when he unreasonably uses a product which he knows to be defective and dangerous and only then should his conduct be considered in determining liability. This conduct then becomes the proximate cause of his injuries and the bar to his recovery is based on this proximate cause element, not on contributory negligence or assumption of the risk. *See id.*

36. 100 N.M. 379, 671 P.2d 40 (Ct. App. 1983).

37. *Id.* at 381, 671 P.2d at 42. The judgment was rendered in an Oklahoma state court. Harlow then sought full faith and credit on the Oklahoma judgment in federal court in Oklahoma. He obtained a default judgment in the amount of $327,885.81. This judgment was registered in federal court in New Mexico.

38. *Id. See* N.M. Stat. Ann. §§ 55-6-101 to -110 (1978).

The court of appeals noted that there are three requisites for obtaining the equitable remedy of piercing the corporate veil. They are the existence of: (1) an alter ego; (2) an improper purpose; and (3) proximate causation.[39] *Harlow* is instructive because it is the first case in which the court plainly states that findings of all three elements are necessary. If the defending corporation is a mere instrumentality, that is, if it was not operated "in a legitimate fashion to serve the valid goals and purposes of that corporation but . . . functioned under the domination and control and for the purposes of some dominant party,"[40] then the court must look to see if the corporation used the domination and control for an improper purpose. If the court also finds an improper purpose, then evidence of proximate causation must exist. Only in the case where all three requirements are present will the court allow the corporate veil to be pierced.

Although the court in *Harlow* did not decide whether the facts of the case met the alter ego requirement, it did decide that the plaintiff did not prove an improper purpose. The court, therefore, refused to pierce the corporate veil.

B. Fiduciary Duties of Partners

In the context of *Covalt v. High*,[41] the New Mexico Court of Appeals discussed the fiduciary duties of a partner. The court decided that, under the facts of the case, a partner does not have a duty to negotiate and to obtain an increase in the rental being received on partnership property.

The partnership in question was a general partnership which existed without a written partnership agreement. Its purpose was to purchase real estate and construct an office and warehouse for rental to Concrete Systems, Inc.[42] Initially the corporation rented the building for five years. At the end of that period, the partnership and the corporation negotiated increases in the rental amount, but did not execute a new lease.

In January 1979, Covalt demanded that the partnership raise the rent charged the corporation from $1,850 per month to $2,850.[43] High did not agree. In August 1980, a written agreement dissolved the partnership. Covalt then filed suit requesting a sale of the partnership property, an accounting, and an award of punitive and actual damages.

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39. 100 N.M. at 382, 671 P.2d at 43 (citing C. Krendl & J. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 Denver L.J. 1, 15 (1978)).

The "alter ego" requirement is referred to elsewhere as the "instrumentality" or "domination" requisite. The term "alter ego" is used by the court and in this Article because that is the term used by the courts in previous New Mexico decisions.

40. 100 N.M. at 382, 671 P.2d at 43 (quoting C. Krendl & J. Krendl, *supra* note 39, at 16).

41. 100 N.M. 700, 675 P.2d 999 (Ct. App. 1983).

42. *Id.* at 701, 675 P.2d at 1000. The plaintiff, Covalt, owned 25% of the shares of the corporation and the defendant, High, owned 75% of the corporation.

43. *Id.* By this time, Covalt no longer worked for the corporation, but he retained his 25% ownership.

The trial court found that High had breached a fiduciary duty of fairness to Covalt by failing to negotiate an increase in rent. The appellate court disagreed. The court of appeals aptly pointed out that this case exemplifies the importance of first arriving at an agreement between partners with regard to the details of the conduct of partnership business and then committing the agreement to paper.

Absent a written partnership agreement, the law imposes one. In such a situation, the Uniform Partnership Act gives the majority of the partnership the authority to decide on the management or conduct of partnership business.[44] When the partnership is evenly divided on an issue, as in *Covalt,* the status quo continues. The scenario changes somewhat when the dispute is not between partners but instead is between the partnership and a third person. In the latter situation, in spite of an internal dispute, any partner has the authority to bind the partnership with respect to third persons.

The *Covalt* court concluded that the proper remedy in that case was dissolution of the partnership. While this is not a particularly surprising or innovative result, it is of some interest that the court refused to impose a fiduciary duty. A rental increase probably would have benefitted the partnership, but lacking a written provision outlining the duty, the court had little choice but to apply the statute.

IV. INSURANCE MATTERS

A. Punitive Damages and Attorney's Fees

The policy considerations involved in determining whether states should allow insurance coverage for punitive damages make the question a difficult one to answer. In *State ex rel. Conley Lott Nichols Machinery Co. v. Safeco Insurance Co. of America,*[45] the New Mexico Court of Appeals held that, because "[n]either the terms of the surety bond nor the statutory provisions requiring the surety bond obligated Surety for payment of punitive damages assessed against the Contractor,"[46] the trial court should not have instructed the jury that the liability of the surety in this case was as broad as the contractor's liability.[47] The court concluded that the language of the surety bond did not extend to liability for punitive damages. Unfortunately, because of this conclusion, the court did not find it necessary to discuss insurance against punitive damages.

44. *See* N.M. Stat. Ann. § 54-1-18(H) (1978).

45. 100 N.M. 440, 671 P.2d 1151 (Ct. App. 1983), *discussed supra* notes 7-9 and accompanying text.

46. 100 N.M. at 445, 671 P.2d at 1156.

47. *Id.* In *Nichols Machinery,* a lessor sued the contractor and surety for the damages incurred by lessor when the contractor failed to pay the full amount of heavy equipment leases. The surety was joined because it provided the payment bond which N.M. Stat. Ann. § 13-4-19 (1978) obligated the contractor to obtain.

The court did address one matter of first impression in New Mexico: whether a surety must pay attorney's fees and other collection costs demanded by the contractor's lessor. In *Nichols Machinery,* the lease agreements between the lessor and the contractor provided that if the lessor turned the account over to an attorney for collection, the lessee was to pay the attorney's fees and other costs of collection. Basing its rationale on a United States Supreme Court decision[48] on a similar issue involving the Miller Act,[49] and noting that the New Mexico Little Miller Act is, in pertinent part, identical to the federal act,[50] the New Mexico court held that reasonable attorney's fees are allowed where the underlying contract specifically allows for the collection of such fees.

With regard to proof of reasonableness of attorney's fees, the *Nichols Machinery* court reiterated the factors set forth in *Fryar v. Johnsen.*[51] Practitioners should assume that when they must prove the reasonableness of attorney's fees as an element of damages in a contract action they should gather information for presentation to the courts in accordance with the *Fryar v. Johnsen* factors.

B. Conditions Subsequent Versus Exclusions

The question before the New Mexico Supreme Court in *Security Mutual Casualty Co. v. O'Brien*[52] was whether an exclusion in an insurance policy must be causally connected with the accident before coverage may be denied on the basis of the exclusion. The supreme court disagreed with the trial court and the court of appeals and held that a causal connection between a policy exclusion and an accident did not have to be shown by an insurance company in denying coverage.

Security Mutual involved exclusions to a hull policy and a liability policy on an airplane. The exclusions stated that neither policy applied while the aircraft was in flight unless the airworthiness certification or

48. United States *ex rel.* Sherman v. Carter, 353 U.S. 210 (1957).

49. 40 U.S.C. § 270(a)-(e) (Supp. IV 1980). The Miller Act requires the general contractor on federal construction projects to provide a labor and material bond from a surety company to insure that the subcontractors, materialmen, and laborers working on the project are paid. As a practical matter, bonds provided with respect to federal construction projects are essentially identical in form to bonds provided with respect to state or private construction projects.

50. 100 N.M. at 446, 671 P.2d at 1157. *See* N.M. Stat. Ann. §13-4-19 (1978).

51. 93 N.M. 485, 601 P.2d 718 (1979). *Fryar* was a worker's compensation case in which the court discussed facts which must be proved to recover attorneys' fees. Those factors are: (1) the time and labor required—the novelty and difficulty of the questions involved and skill required; (2) the fee customarily charged in the locality for similar services; (3) the amount involved and the results obtained; (4) the time limitations imposed by the client or by the circumstances; and (5) the experience, reputation, and ability of the lawyer or lawyers performing the services. These factors have been used by the courts since 1979 when determining fees in contexts other than worker's compensation. *Id.* at 487, 601 P.2d at 720. *See* Model Code of Professional Responsibility DR 2-106 (1979).

52. 99 N.M. 638, 662 P.2d 639 (1983).

certificate was in full force and effect at the time of the accident.[53] In answering the question before it, the court noted that there is New Mexico law to the effect that an insurer does not have to show a causal connection between a policy exclusion and an auto accident to deny coverage.[54] The court further recognized that both the case before it and the earlier case, which required a showing of substantial prejudice, involved policy exclusions.

The court next acknowledged the distinction between a condition subsequent, which has the effect of terminating or suspending insurance, and an exclusion, which states that no insurance ever existed with respect to the excluded activity. The court's conclusion was that a showing of substantial prejudice is relevant to cases involving condition subsequent clauses, but is not relevant to cases involving policy exclusions.

In reaching its conclusion, the *Security Mutual* court relied on the misleading distinction between an exclusion and a condition subsequent. The distinction must be based on the policy reasons for the court's requirement of proof, rather than whether an exclusion or a condition subsequent is involved.

In the 1980 case of *Foundation Reserve Insurance Co. v. Esquibel,*[55] the court, quoting a Washington decision, stated: "The risk-spreading theory of liability 'should operate to afford to affected members of the public—frequently innocent third persons—the maximum protection possible consonant with fairness to the insuror.'"[56] The court then held that if the condition subsequent which is breached by the insured is a material or substantial breach, the insuror must show that it has suffered substantial prejudice as a result of the breach before coverage can be denied. *Sanchez v. Kemper Insurance Co.,*[57] decided in 1981, also involved breach of a condition subsequent.[58] But in Sanchez, the court held that no prejudice need be shown. Yet, the issue in both cases was whether the insurance company had to show that the breach by the insured of the condition subsequent caused prejudice to the company. Since the question was the same and the answer different, the court must have distinguished between the cases on a basis other than that they involved breaches of conditions subsequent.

A careful reading of *Peterson v. Romero,*[59] *Foundation Reserve,* and

53. *Id.* at 639, 662 P.2d 640.

54. *Id. See* Peterson v. Romero, 88 N.M. 483, 542 P.2d 434 (Ct. App. 1975).

55. 94 N.M. 132, 607 P.2d 1150 (1980).

56. *Id.* at 134, 607 P.2d at 1152 (quoting Oregon Auto Ins. Co. v. Salzberg, 85 Wash. 2d 372, 376-77, 535 P.2d 816, 819 (1975)).

57. 96 N.M. 466, 632 P.2d 343 (1981).

58. In *Foundation Reserve,* the "condition" breached was a cooperation clause; in *Sanchez,* it was a time-to-sue provision.

59. 88 N.M. 483, 542 P.2d 434 (Ct. App. 1975).

Sanchez shows that the distinction is based upon the policy basis for the denial of coverage. If the parties to the insurance contract bear the brunt of the denial of coverage, as in *Peterson, Sanchez,* and *Security Mutual,* courts have held that no prejudice or causal relationship must be shown. If, however, there is a third-party beneficiary of the insurance policy who stands to suffer most from denial of coverage, as in *Foundation Reserve,* the court should require a showing of causal connection or prejudice before allowing the insurance company to deny coverage.

V. REAL ESTATE CONTRACTS

The real estate financing device known in New Mexico as the real estate contract reached the height of its appeal during the years of soaring mortgage interest rates. Since interest rates charged by commercial lenders have subsided somewhat and since the flexibility of mortgage terms and rates has increased, the real estate contract has again become merely one of several options.

The paramount advantage of the real estate contract from the seller's point of view is that it provides an efficient remedy upon default. The standard contract provision allows the seller, when the purchaser is in default, to demand that the default be cured. If the default remains uncured for a certain period after the demand, the seller may record an affidavit specifying the default and forfeiture in the County Clerk's office, remove the deeds from escrow, record the special warranty deed from purchaser to seller (thus merging both equitable and legal title to the property in seller), and retain all payments made by purchaser as liquidated damages. The seller thus avoids the expensive and time-consuming exercise of a foreclosure lawsuit. Or does he?

New Mexico courts have made exceptions to the enforcement of the terms of real estate contracts when the resulting forfeiture results in unfairness which "shocks the conscience of the court."[60] Absent such unfairness, the parties are free to enforce the contract as written.[61]

The court in *Eiferle v. Toppino*[62] found facts which shocked its conscience. The real estate contract involved was a standard form which provided for a down payment, assumption of the existing mortgage, and monthly payments of the owner's equity. After five years of payment

60. *See generally* Note, *Increased Risks of Forfeiture and Malpractice Resulting from the Use of Real Estate Contracts:* Albuquerque National Bank v. Albuquerque Ranch Estates, Inc., 15 N.M.L. Rev. 99 (1985); Note, *The Future of the Real Estate Contract in New Mexico:* Huckins v. Ritter, 14 N.M.L. Rev. 531, 533-38 (1984); *and* Note, *The Real Estate Contract in New Mexico:* Eiferle v. Toppino, 8 N.M.L. Rev. 247, 249-59 (1978) (discussing real estate contracts in New Mexico).

61. *See* Bishop v. Beecher, 67 N.M. 339, 355 P.2d 277 (1960).

62. 90 N.M. 469, 565 P.2d 340 (1977). *See* Note, *The Real Estate Contract in New Mexico:* Eiferle v. Toppino, 8 N.M.L. Rev. 247 (1978).

pursuant to the contract, the mortgagee returned a dishonored check to the purchaser and demanded payment of existing delinquencies within eleven days. The sellers were notified of the mortgagee's demand. The purchasers met the demand within the time period allowed by the mortgagee, but the sellers had sent their own demand letter prior to the date the default of the mortgage was cured. Thereafter, the escrow agent refused to accept payments from the purchaser because the twenty-five dollar fee required by the contract for sending a demand letter had not been paid. The seller exercised his remedy under the contract and filed the special warranty deed. On appeal, the New Mexico Supreme Court remanded the case for a hearing to determine the amount of delinquencies and to set a reasonable time within which the purchaser could cure. The opinion in *Eiferle* indicates that the circumstance which "shocked the conscience of the court" was the fact that the seller ignored the mortgagee's allowance of time to make the payment and proceeded to take the property.

In *Hale v. Whitlock*,[63] the court agreed that the trial court had properly exercised its equity jurisdiction in allowing the purchaser time to pay off the entire balance of the contract rather than suffer forfeiture.[64] This decision gave some credence to the argument that the equity of redemption exists in the context of a real estate contract.

The real estate contract case decided during this survey year, *Huckins v. Ritter*,[65] further defined the circumstances under which exceptions to the forfeiture provisions should be made. In *Huckins*, the purchaser made a down-payment of approximately one-third of the purchase price of the property. The sale occurred in July 1981; payment of the seller's equity was due in October 1981. The purchaser only occupied the property until February 1982. The court held that to allow seller to retain the full down payment would constitute an unwarranted forfeiture.

The difficulty created by this line of cases, of which *Huckins* is the latest addition, is that it leaves the seller of property by real estate contract in an uncertain position should the purchaser default and the seller exercise his rights under the contract. One possible solution to the problem is to draft real estate contracts so as to attempt to avoid situations which, in the past, have shocked the courts. One large real estate firm, which

63. 92 N.M. 657, 593 P.2d 754 (1979).

64. The real estate contract in *Hale* was entered into by the parties in 1966. For the next 11 years, the purchaser paid sporadically and the seller did not object to the delinquencies. In 1977, the seller sold her interest in the contract and the new owner demanded payment of all delinquencies. The purchaser brought a declaratory action in which the trial court found that the seller was entitled to retake the property, but allowed the purchaser time to pay the entire contact balance.

65. 99 N.M. 560, 661 P.2d 52 (1983). *See* Note, *The Future of the Real Estate Contract in New Mexico:* Huckins v. Ritter, 14 N.M.L. Rev. 531 (1984).

handles many sales by real estate contract, has drafted its form contract to allow what is essentially a redemption period beyond the usual notice period. However, the limitations of this sort of defensive drafting are obvious. Most purchasers and sellers by contract use a standard printed form and cannot or do not seek modification of the form before executing it. Because of the nature of the judiciary, perhaps the legislature is a more appropriate forum for seeking a greater degree of predictability in enforcement of real estate contracts.[66]

VI. CONCLUSION

One of the most important policies which the courts can promote in the area of Commercial Law is certainty of result. This policy has, to a large degree, been undermined in the past by court decisions which appear to have subordinated the expressed intent of the parties to after the fact judgments as to what would be a "fair" result, apparently giving little weight to the thought that, in almost all cases, the most "fair" result is the result previously agreed upon by the parties and evidenced by the contract. Similar confusion has been generated by the courts' failure to arrive at a coherent set of legal principles upon which the rights and obligations of the parties can be determined under various sets of circumstances. These rights and obligations of the parties, in many instances, are substantively different, depending upon whether the court, in a particular instance, applies tort, contract, or other sets of legal principles. The recent decisions of our New Mexico courts, however, reflect a reversal of this trend and further reflect a recognition by our courts of the substantive importance of certainty of result.

A notable exception to this trend is in the area of real estate contracts, in which the courts continue to decide cases almost entirely upon what they perceive to be "fair" in a particular case, with very little substantive guidance as to overall principles which would promote the principle of certainty of result.

66. *See* Note, *supra* note 65, at 541-43.