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FISCAL IMPACT REPORT

SPONSOR Papen ORIGINAL DATE 2/14/06 HB _____
LAST UPDATED 2/15/06 SB _____

SHORT TITLE Guarantor Rights Act SB 197

ANALYST McSherry

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY06	FY07	FY08	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total		NFI	NFI	NFI		

(Parenthesis () Indicate Expenditure Decreases)

The proposed act relates to, or conflicts with, current federal law (see “Significant Issues” below for details). Relates to, or is inconsistent with, current state laws (see “Significant Issues” below for details).

SOURCES OF INFORMATION

LFC Files

Responses Received From
Attorney General’s Office (AGO)

SUMMARY

Synopsis of Bill

Senate Bill 197, “Guarantor Rights Act,” proposes to create the “Guarantor Rights Act” which would provide that guarantors of a debt for another will be given notice in the event the primary, or principal, obligor defaults. SB 197 further provides that a guarantor is entitled to receipt of certain information from a creditor regarding the status of the obligation, and that, should the creditor fail to provide the guarantor proper notice, the guarantor is relieved from any and all obligations to such creditor.

FISCAL IMPLICATIONS

There is no known fiscal impact associated with this bill.

SIGNIFICANT ISSUES

The bill proposes to impose a duty on creditors to notify guarantors of a default by the debtor which could be helpful to guarantors.

According to RLD, this legislation would hinder a financial institution's (creditors) ability to act on a guaranty signed by a guarantor, for a principal on a debt to a creditor. Financial institutions rely on the guarantor and his guaranty for payment on a debt because the guaranty is taken as an abundance of caution due to the fact that there is some degree of risk to the institution if the obligation was made without the guarantor's guaranty of payment should the principal default on the obligation.

AGO reports that, in 1984, the Federal Trade Commission ("FTC") promulgated the Trade Regulation Rule Concerning Credit Practices ("Credit Practices Rule").¹ The agency further reports that:

"The Credit Practices Rule deals with unfair remedies used by creditors in enforcing consumer credit contracts.

The FTC's rule prohibits the following six practices:

- 1) Confessions of judgment, *cognovits*, and other waivers of the right to notice and opportunity to be heard in the event of suit;
- 2) Debtors' waiver of certain protections concerning personal or real property exempt from attachment or execution, such as waiver of a homestead exemption;
- 3) Assignment of wages or other earnings before judgment;
- 4) Non-purchase money security interest in certain household goods (with some exceptions);
- 5) Pyramiding late charges by assessing more than one delinquency charge for one late payment; and
- 6) Failure to provide cosignors with a specified warning indicating the potential obligations of a cosignor.

The Credit Practices Rule applies to finance companies, retailers, and other creditors within the FTC's jurisdiction. The FTC's rule does not apply to most banks; however, the Federal Reserve Board and the Office of Thrift Supervision have enacted analogous rules for banks and savings and loan institutions.² Credit unions are covered by a comparable rule.³

The notice to cosignors required by the Credit Practices Rule, which warns cosignors of their potential obligations, must be in the form prescribed by the FTC, as follows:

"NOTICE TO COSIGNOR

You are being asked to guarantee this debt. Think carefully before you do. If the borrower doesn't pay the debt, you will have to. Be sure you can afford to pay if you have to, and that you want to accept this responsibility.

¹ 16 C.F.R. Section 444 (effective March 1, 1985).

² See 12 C.F.R. Sections 535, 227.11-.16.

³ 12 C.F.R. Section 706.

You may have to pay up to the full amount of the debt if the borrower does not pay. You may also have to pay late fees or collection costs, which increase this amount.

The creditor can collect this debt from you without first trying to collect from the borrower. The creditor can use the same collection methods against you that can be used against the borrower, such as suing you, garnishing your wages, etc. If this debt is ever in default, that fact may become part of *your* credit record.

This notice is not the contract that makes you liable for the debt.”

16 C.F.R. Section 444.3. Other restrictions and requirements apply.

It is, moreover, an unfair or deceptive trade practice for a lender or retail installment seller, directly or indirectly, to misrepresent the nature or extent of the cosignor’s liability to any person.

A creditor may add certain information, such as the date, account number, name, address, loan amount and other identifying information to the notice, but there are restrictions on the nature or type of information that can be added to the notice. The type size and style of the notice should be clear and conspicuous.

State law versions of the Credit Practices Rule are permitted; however, such versions must provide a level of protection to consumers that is substantially equivalent to, or greater than, the level of protection afforded by the FTC rule.” (

AGO asserts that, in general, SB 197 provides less protection to consumers than the FTC Credit Practices Rule.

“To the extent that the requirements or prohibitions of SB 197 afford a level of protection to consumers that is less than the protection provided by the FTC rule, SB 197 will be preempted by the Credit Practices Rule. However, to the extent SB 197 provides greater protection, e.g., that a guarantor shall be entitled to receive certain information from the creditor regarding the debt, such provisions may stand.

SB 197 conflicts or is inconsistent with certain provisions of the Uniform Commercial Code (UCC). Article 9, Secured Transactions, defines a “secondary obligor” as (A) an obligor whose obligation is secondary; or (B) an obligor who has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor or property of either. UCC, N.M.S.A. 1978, Section 55-9-102(71). Thus, a “guarantor” as defined pursuant to SB 197 appears to conflict or is inconsistent with terms or phrases for the same or similar parties under the UCC, and may implicate their rights and obligations thereunder.

The release of the guarantor from all obligations in the event the creditor fails to provide notice of default may, moreover, conflict with the rights and obligations of guarantors, secondary obligors and cosignors under the UCC, the common law, and possibly, other

statutes.

Further, certain terms as utilized by, or defined under, SB 197 are ambiguous or may conflict with the same or similar terms as defined under the UCC. Thus, for example, “person” as defined pursuant to the UCC means “an individual, corporation, partnership, joint venture, trust estate or unincorporated association.” “Person”, however, is not defined pursuant to SB 197. It is therefore unclear whether “person” refers only to a natural person or whether it is intended to include legal entities such as corporations, partnerships and other business organizations.”

DFA points out that Senate Bill 197 defines the terms creditor, guarantor, guaranty and principal in new ways, but that the problem is that all of these terms are already defined in the Uniform Commercial Code (see the following citations to the U.C. C. also see the following existing definitions for the same terms.)

1. General Provisions, 55-1-101 through 55-1-310.
2. Sales, 55-2-101 through 55-2-725.
- 2A. Leases, 55-2A-101 through 55-2A-532.
3. Negotiable Instruments, 55-3-101 through 55-3-805.
4. Bank Deposits and Collections, 55-4-101 through 55-4-504.
- 4A. Funds Transfers, 55-4A-101 through 55-4A-507.
5. Letters of Credit, 55-5-101 through 55-5-118.
6. Bulk Transfers, 55-6-101 through 55-6-110.
7. Documents of Title, 55-7-101 through 55-7-807.
8. Investment Securities, 55-8-101 through 55-8-511.
9. Secured Transactions, 55-9-101 through 55-9-710.
10. Effective Date, Repealer and Miscellaneous, 55-9-101 through 55-9-710.
11. Amendment to Other Statutes, 55-9-101 through 55-9-710.
12. Effective Date and Transition Provisions, 55-12-101 through 55-12-111.

DFA further points out that:

The current definition in the U.C.C. for guarantor: 70) "secondary obligor" means an obligor to the extent that:

- (A) the obligor's obligation is secondary; or
- (B) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor or property of either;

The current definition for creditor in the U.C.C.: 3) "creditor" includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate;

Currently the annotations to the U.C.C. state that the term "secondary obligor" refers to asurety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995).) 39) "surety" includes a guarantor or other secondary obligor;

70) "secondary obligor" means an obligor to the extent that:

- (A) the obligor's obligation is secondary; or
- (B) the obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor or property of either”

The bill proposes to impose a duty on creditors to notify guarantors of a default by the debtor which could be helpful to guarantors.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts or is inconsistent with current federal law (see “Significant Issues” above for details).

Conflicts or is inconsistent with current state law (see “Significant Issues” above for details).

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

AGO contents that if SB 197 were not enacted, consumers and businesses would still have the same legal protections they have now under the FTC’s Trade Regulation Rule Concerning Credit Practices provides important protections to consumers and businesses alike. Certain additional protections, however, would not be provided.

If not enacted a guarantor’s obligation to a creditor would not be exonerated.

EM/mt