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Don’t Let a Typo (or Other Clerical Mistake) Ruin Your Lien – Part 2

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Last month, we wrote about a typo in a security agreement that lead to a bank losing its lien on collateral. Now the U.S. Second Circuit Court of Appeals has issued a decision that reminds us that the “law of unintended consequences” has real-world impact. The case is *Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, NA,* case 13-2187, decided January 21, 2015.

Article By
Insurance Litigation Steptoe Johnson
Steptoe & Johnson PLLC
Business Essentials: Know How

Bankruptcy & Restructuring
Financial Institutions & Banking
2nd Circuit (incl. bankruptcy)

- In 2001, General Motors (“GM”) entered into a $300 million synthetic lease with a syndicate of lenders and JPMorgan Chase Bank, N.A. (“JPMorgan”), as administrative agent. The UCC-1 financing statements named JPMorgan as secured party and they included two that were filed with the Delaware Secretary of State (“Synthetic Lease UCCs”).
- Five years later, GM entered into a separate $1.5 billion term loan with JPMorgan as administrative agent and a different lending syndicate. This loan was secured by, among other collateral, GM’s equipment and fixtures. JPMorgan was the secured party on twenty-eight UCC-1 financing statements, including one filed with the Delaware Secretary of State (“Term Loan UCC”).
- In 2008, GM decided to prepay the synthetic leases and asked its outside counsel, Mayer Brown LLP, to prepare the payoff documents and lien terminations. When it prepared them, Mayer Brown accidentally listed the Term Loan UCC along with the two Synthetic Lease UCCs to be released. These documents were sent to both JPMorgan and its outside counsel, Simpson Thacher & Bartlett LLP, for their review. No one - not GM, not Mayer Brown, not JPMorgan, not Simpson Thacher - noticed that the Term Loan UCC was erroneously included in this list. When the synthetic leases were paid off, a UCC-3 termination for the Term Loan UCC was among those filed with the Delaware Secretary of State.
- The mistaken filing of the UCC-3 termination for the Term Loan UCC was not noticed until GM filed for bankruptcy in 2009. The Official Committee of Unsecured Creditors of Motors Liquidation Co. (“Committee”) filed the underlying action seeking a decision that the erroneous filing of the UCC-3 for the Term Loan “was effective to terminate the Term Loan security interest and render JPMorgan an unsecured creditor on par with other General Motors unsecured creditors.” The parties filed cross motions for summary judgment and the Bankruptcy Court decided that the filing of the UCC-3 termination for the term loan was not authorized and was not effective to terminate the term loan security interests.

Before deciding on the Committee’s appeal of the Bankruptcy Court decision, the Second Circuit sought a ruling from the Delaware Supreme Court on a limited question of interpreting UCC Article 9 – “is it enough that the secured creditor review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?” The Delaware Supreme Court ruled that if a secured party authorizes the filing of a UCC-3 termination statement, then that filing is effective “regardless of whether the secured party subjectively intends or understands the effect of that filing”.

With this ruling by the Delaware Supreme Court, the Second Circuit addressed the issue of whether or not JPMorgan authorized the filing of the UCC-3 termination statement for the term loan. Among other facts, the Court noted that the termination documents (which included a closing checklist identifying the Lease UCCs and the Term Loan UCC, the draft UCC-3 termination statements for them, and an escrow agreement with closing instructions) were sent to a managing director at JPMorgan who supervised the prepayment of the synthetic lease and to Simpson Thacher, that JPMorgan did not raise any concern about the documents and that the Simpson Thacher attorney even complimented Mayer Brown on the termination documents (quote "Nice job on the documents"). The Court ruled that even though the facts presented clearly showed that JPMorgan never intended to terminate the Term Loan UCC, the actions of JPMorgan and its counsel constituted authorization to file the UCC-3 for the term loan and that, therefore, the Term Loan UCC has been terminated. In the Court's words, "JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed."

For banks and other creditors with secured credit facilities, this decision is a strong incentive to review your portfolio management procedures for loan payoffs and to direct staff and legal counsel to carefully check that any lien releases are narrowly focused on the specific credit facility being terminated.