KING & SPALDING

Client Alert

Finance and Financial Restructuring Practice Groups

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Second Circuit: A Mistakenly Authorized UCC Termination Statement Is Effective to Terminate Original UCC Filing

On January 21, 2015, the United States Court of Appeals for the Second Circuit entered an opinion holding that an authorized UCC-3 termination statement is effective, for purposes of Delaware's Uniform Commercial Code (the "**UCC**"), to terminate the perfection of the underlying security interest even though the secured lender never intended to extinguish the security interest and mistakenly authorized the filing.[1]

Background

In 2006, General Motors Corporation ("**GM**") entered into a $1.5 billion secured term loan with a syndicate of financial institutions. To perfect certain of the security interests granted to the lenders, the administrative agent (the "**Agent**") filed a UCC-1 financing statement with the Delaware Secretary of State (the "**Original Filing**"). In 2008, a termination statement for the Original Filing was mistakenly included in a set of UCC-3 termination statements filed in connection with the payoff of an unrelated synthetic lease financing.

The inadvertent termination did not surface until GM filed for Chapter 11 in 2009. When the unsecured creditors committee (the "**Committee**") learned of the mistakenly filed termination statement, it commenced an adversary proceeding against the Agent asserting that the filing of the termination statement had effectively terminated the Original Filing causing the term loan to be unsecured.

Bankruptcy Court Opinion and Second Circuit Proceeding

The Bankruptcy Court rejected the Committee's claims on various grounds. Among other things, the Bankruptcy Court concluded that because neither the Agent nor GM intended to terminate the Original Filing, the termination statement was not "authorized" for purposes of § 9-509(d)(1) of the UCC and, therefore, was not effective to terminate the Original Filing.[2]

On appeal, the Second Circuit determined that whether the termination statement was effective hinged on two distinct but closely related questions. First, as a matter of law, what must a secured party do to "authorize" a termination statement under the UCC? Does the secured party only need to authorize the act of filing the termination statement, or must the secured party

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also authorize the termination of the underlying security interest? Second, as a factual matter, did the Agent grant GM's counsel the authority necessary to terminate the Original Filing?[3] Because the first issue was an issue of first impression under Delaware's UCC, the Second Circuit certified the question to the Delaware Supreme Court. The certified question assumed that "the secured party of record reviewed and knowingly approved the termination statement for filing."[4]

Delaware Supreme Court Opinion

Before the Delaware Supreme Court, the Agent argued that a filing is only effective if "the authorizing party understands the filing's substantive terms and intends their effect."[5] The court disagreed, concluding that the statute was unambiguous and therefore "not subject to judicial interpretation."[6] It found that, under the plain language of the statute, a filed UCC-3 termination statement is effective so long as the secured party of record has authorized the filing of the termination statement. Given the statute's clarity, the court found that subjective elements of intent or understanding are not necessary. The onus, the court noted, is on the secured party to review the termination statement and only authorize its filing if the termination statement is correct.

The Delaware Supreme Court also concluded that public policy favors its holding. The UCC facilitates the "efficient procession of commerce" by allowing parties to trust public filings.[7] If an inadvertently filed termination statement was ineffective, a creditor would need to obtain a court's determination that the parties subjectively intended the filing before being able to rely with certainty on the termination statement. This would, in the court's view, undermine and disrupt the secured lending markets.

Second Circuit Opinion

With Delaware law settled, the matter returned to the Second Circuit for a determination of whether the filing was, in fact, authorized by the Agent. The Agent argued that the filing was unauthorized because the Agent never instructed anyone to file a UCC-3 termination statement with respect to the term loan—it simply authorized GM's counsel to take the necessary actions to terminate the security interests associated with the synthetic lease.[8] The Second Circuit, however, disagreed. The court reasoned that although neither the Agent nor any of the other parties involved intended to release the security interests securing the term loan, the relevant inquiry is whether the Agent actually authorized the filing of the termination statement.[9] Reviewing the factual record, the court found that the Agent and its counsel reviewed and approved the closing checklist for the payoff, the draft UCC-3 termination statements, and the escrow agreement providing for the filing of the UCC-3 termination statements upon closing.[10] Based on these facts, the court concluded that the Agent clearly authorized the filing of the UCC-3 termination statement at issue. Accordingly, notwithstanding the lack of any actual intent to terminate the underlying security interest, the UCC-3 termination statement was effective.[11]

Lessons Learned

This case serves as an important reminder that secured parties should exercise caution when granting blanket authorizations to file termination statements in payoff letters or partial releases. If the secured party authorizes a third party to file termination statements, the filings should be closely reviewed and approved by the secured party prior to filing. Additionally, this case highlights the importance of conducting regular reviews of UCC filings to ensure that outstanding security interests remain perfected. Finally, the foregoing points are equally applicable in the bankruptcy context where piecemeal asset sales could require multiple partial releases of collateral.

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[1] *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, No. 13-2187, 2015 U.S. App. LEXIS 859, *13–*14 (2d. Cir. Jan. 21, 2015) ("**2d Cir. Op.**"). This Client Alert serves as an update to a prior King & Spalding Client Alert that was issued on November 6, 2014, regarding the Delaware Supreme Court's decision in this case. A copy of our prior Client Alert is available at **http://www.kslaw.com/imageserver/KSPublic/library/publication/ca110614b.pdf**.

[2] *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 486 B.R. 596, 646 (Bankr. S.D.N.Y. 2013).

[3] *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.*, 755 F.3d 78, 84 (2d Cir. 2014).

[4] *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank*, N.A., 103 A.3d 1010, 1014 (Del. 2014).

[5] *Id.*

[6] *Id.* at 1014–15.

[7] *Id.* at 1016.

[8] 2d Cir. Op. at *11.

[9] *Id.*

[10] *Id.* at *11–*13.

[11] *Id.* at *13–*14.