Mistakes Matter: Consequences of Authorized UCC Filings

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Abstract

On October 17, 2014, the Supreme Court of Delaware, interpreting language appearing in the uniform text of Uniform Commercial Code Article 9 as enacted in all states, resolved an important question concerning the filing of UCC-3 termination statements. The Delaware court ruled that, if a

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secured party authorizes the act of filing a termination statement, " 'the financing statement to which the termination statement relates ceases to be effective' " regardless of whether the authorizing party subjectively intended the legal consequences of the statement's filing.[1] *In other words, according to the Delaware court, "it [is] enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest."*[2] *The secured lender need not have intended or understood the termination statement's effect for it to extinguish the perfected status of the subject security interest.*

The ruling came in response to a certified question of Delaware law posed by the United States Court of Appeals for the Second Circuit (the "Second Circuit"). The dispute before the Second Circuit involved a UCC-3 termination statement filed with the Delaware Secretary of State. The termination statement referred to a security interest the secured party asserted it had not intended to release.[3]

Underlying Facts.

Two Loans. In October 2001, General Motors Corporation ("GM") entered into a "synthetic lease" real estate financing transaction involving approximately $300 million (the "Synthetic Lease").[4] JPMorgan Chase Bank, N.A. ("JPMorgan") was the administrative agent under the Synthetic Lease.[5] The Synthetic Lease lenders' security interests were perfected by the filing of UCC-1 financing statements in the

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[1]Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A., 103 A.3d 1010, 1012, 84 U.C.C. Rep. Serv. 2d 1046 (Del. 2014) (quoting Del. Code Ann. tit. 6, § 9-513(d)).

[2]Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A., 103 A.3d at 1011 (alteration by court; internal quotation marks omitted).

[3]*Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.,* 103 A.3d at 1011.

[4]In re Motors Liquidation Co., 755 F.3d 78, 79, 59 Bankr. Ct. Dec. (CRR) 182 (2d Cir. 2014).

[5]Motors Liquidation Co., 755 F.3d 78.

various counties where the real estate collateral was located and with the Delaware Secretary of State.[6]

In November 2006, GM and its subsidiary, Saturn Corporation, entered into a secured term loan facility (the "Term Loan") with a syndicate of lenders that advanced approximately $1.5 billion secured by a security interest in all of GM's equipment and fixtures at forty-two facilities located throughout the United States.[7] JPMorgan served as administrative agent and as a lender under the Term Loan, and in the former capacity caused the filing of numerous UCC-1 financing statements to perfect the lenders' security interests in the Term Loan collateral, including the filing of a financing statement with the Delaware Secretary of State.[8]

One Payoff. In October 2008, GM and JPMorgan worked together to close a payoff of the Synthetic Lease.[9] Following closing, UCC-3 termination statements were filed with respect to the intended UCC-1 financing statements securing the Synthetic Lease. But an additional UCC-3 termination statement was filed with the Delaware Secretary of State, this one referencing the UCC-1 financing statement securing the Term Loan.[10]

The Bankruptcy.

In June 2009, GM and certain of its affiliates filed petitions for relief under chapter 11 of the Bankruptcy Code.[11] Thereafter, counsel for JPMorgan informed the Official Committee of Unsecured Creditors of Motors Liquidation Company (the "Committee") that a UCC-3 termination statement relating to the Term Loan UCC-1 had been inadvertently filed in October 2008.[12] On July 31, 2009, the Committee commenced an adversary proceeding against JPMorgan in the United States Bankruptcy Court for the Southern

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[6]Motors Liquidation Co., 755 F.3d 78.

[7]Motors Liquidation Co., 755 F.3d 78.

[8]Motors Liquidation Co., 755 F.3d 78.

[9]*Motors Liquidation Co.*, 755 F.3d at 80–82.

[10]*Motors Liquidation Co.*, 755 F.3d at 82.

[11]*Motors Liquidation Co.,* 755 F.3d at 82.

[12]*Motors Liquidation Co.,* 755 F.3d at 82.

District of New York (the "Bankruptcy Court"), seeking, among other things, a determination that the filing of the UCC-3 was effective to terminate the Term Loan UCC-1, that the security interest in the Term Loan collateral was unperfected on the petition date, and that most of the indebtedness under the Term Loan was therefore unsecured.[13]

The Bankruptcy Court's Decision. On cross-motions for summary judgment, the Bankruptcy Court concluded that the filing of the UCC-3 termination statement relating to the Term Loan UCC-1 was unauthorized because, even though JPMorgan had "arguably consented to the filing[,]" JPMorgan did not intend, and GM did not believe that JPMorgan intended, the legal consequences of the UCC-3—namely, the termination of the Term Loan UCC-1.[14] The Bankruptcy Court then certified the case for direct appeal to the Second Circuit.[15]

The Second Circuit Frames Two Questions and Certifies the First Question. On June 17, 2014, the Second Circuit issued its opinion certifying a question of law to the Delaware court. In its opinion, the Second Circuit explained that it was certifying one of two distinct, yet "closely related," questions:

> First, the question we certify . . ., is what precisely a secured lender of record must authorize for a UCC-3 termination statement to be effective: Must the secured lender authorize the termination of the particular security interest that the UCC-3 identifies for termination, or is it enough that the secured lender authorize the act of filing a UCC-3 statement that has that effect? Second, a question we will address upon receipt of the Delaware court's answer: Did JPMorgan grant [its counsel] the relevant authority—that is, alternatively, authority either

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[13] *Motors Liquidation Co.,* 755 F.3d at 82. Under Section 544 of the Bankruptcy Code (11 U.S.C.A. § 544), a trustee is afforded "strong arm" power by means of which the trustee can avoid security interests that are unperfected as of the commencement of the bankruptcy case. The collateral formerly subject to such security interests can then be used to satisfy unsecured claims against the estate.

[14] In re Motors Liquidation Co., 486 B.R. 596, 605–06, 80 U.C.C. Rep. Serv. 2d 90 (Bankr. S.D. N.Y. 2013); *Motors I*, 755 F.3d at 82.

[15] *Motors I*, 755 F.3d at 82.

> to terminate the [Term Loan UCC-1] or to file the UCC-3 statement that identified that interest for termination?[16]

The Second Circuit further explained that these "two questions must be taken up separately" and noted that, with respect to the question certified, the determination of what it is that a secured party must authorize "is an issue of statutory interpretation."[17] The Second Circuit noted that upon receipt of the Delaware court's answer to the first question, regarding the interpretation of the Delaware statute, the Second Circuit would address the second question, regarding the applicable principles of agency law.[18]

Restating the first of these questions, the Second Circuit posed the following question to the Delaware court:

> Under UCC Article 9, as adopted into Delaware law by Del. Code Ann. tit. 6, art. 9, for a UCC-3 termination statement to effectively extinguish the perfected nature of a UCC-1 financing statement, is it enough that the secured lender 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?[19]

The Delaware Supreme Court Rules on the First Question. The Delaware court recognized the question's "precise" nature and noted that the question in effect asked the Delaware court to assume "the secured party of record has itself reviewed and knowingly approved the termination statement for filing."[20] For the Delaware court, the certified question removed from the equation the issue of *whether* the UCC-3 in this particular case was authorized by the secured party, and instead focused on *what* must be authorized: either (1) the filing of the termination statement itself, or (2) the filing plus the legal consequences of the filing.

The Delaware court's analysis began with Section 9-513 of Delaware's UCC, which states that " 'upon the filing of a termination statement with the filing office, the financing

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[16] *Motors I*, 755 F.3d at 84.

[17] *Motors I*, 755 F.3d at 84.

[18] *Motors I*, 755 F.3d at 84.

[19] *Motors I*, 755 F.3d at 86.

[20] *Motors II*, 2014 Del. LEXIS 491, at *8.

statement to which the termination statement relates ceases to be effective.' "[21] The Delaware court then turned to Section 9-510, which it found to plainly state that a termination statement is effective if the statement was "filed by a person who is entitled to do so under § 9-509[.]"[22] Finally, the Delaware court turned to Section 9-509(d)(1), which states that a person may file a termination statement if the " 'secured party of record authorizes the filing[.]' "[23]

The Delaware court found that Section 9-509(d)(1) unambiguously states that, "for a termination statement to have the effect specified under § 9-513 of the Delaware UCC, it is enough that the secured party authorizes the filing."[24] To reach its result, the Delaware court applied standard principles of statutory construction. The Delaware court found that the UCC's relevant provisions are unambiguous and therefore " 'not subject to judicial interpretation.' "[25] The Delaware court explained that, had the Delaware General Assembly wished to condition a UCC-3's effectiveness on the authorizing party's subjective intent, it could have written the statute to include an intent requirement. The Delaware court also stated that its decision was supported by sound policy, observing, "If parties could be relieved from the legal consequences of their mistaken filings, they would have little incentive to ensure the accuracy of the information contained in their UCC filings."[26] In addition, the Delaware court further explained, if an inquiry into intent were necessary every time a creditor sought to rely on a UCC-3 statement, then "no creditor could ever be sure that a UCC-3 filing is truly

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[21] *Motors II*, 2014 Del. LEXIS 491, at *9 (quoting Del. Code Ann. tit. 6, § 9-513(d)).

[22] *Motors II*, 2014 Del. LEXIS 491, at *9.

[23] *Motors II*, 2014 Del. LEXIS 491, at *9-10 (quoting 6 *Del. C.* § 9-509(d)(1)).

[24] *Motors II*, 2014 Del. LEXIS 491, at *10.

[25] *Motors II*, 2014 Del. LEXIS 491, at *10. (quoting Leatherbury v. Greenspun, 939 A.2d 1284, 1288 (Del. 2007)).

[26] *Motors II*, 2014 Del. LEXIS 491, at *15–16.

effective, . . . unless a court determined after costly litigation that the filing was in fact subjectively intended."[27]

The Delaware court concluded that "for the reasons we have articulated, for a termination statement to become effective under § 9-509 and thus to have the effect specified in § 9-513 of the Delaware UCC, it is enough that the secured party authorizes the filing to be made, which is all that § 9-510 requires."[28] "The Delaware UCC contains no requirement[,]" the Delaware court explained, "that a secured party that authorizes a filing subjectively intends or otherwise understands the effect of the plain terms of its own filing."[29] In so ruling, the Delaware court did not express a view on the factual question that the Second Circuit had reserved for itself: whether, in the particular case before it, the secured lender indeed had reviewed and knowingly approved the filing.

Conclusion.

The Delaware court's decision continues a long line of cases recognizing the effectiveness of authorized, but erroneous, UCC filings.[30] This principle was stated dramatically in a 2006 decision regarding release of a lien noted on a certificate of title: "the intent of the secured party is not relevant to questions of perfection and errors can be fatal."[31] Of course, the mere presence of a filed record in the UCC filing system does not ensure its effectiveness, and searchers of UCC records continue to bear the risks involved in taking those filed records at face value. A prudent searcher of the UCC records would be well-advised, subject to cost-benefit

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[27] *Motors II*, 2014 Del. LEXIS 491, at *18.

[28] *Motors II*, 2014 Del. LEXIS 491, at *19–20.

[29] *Motors II*, 2014 Del. LEXIS 491, at *20.

[30] E.g., In re Kitchin Equipment Co. of Virginia, Inc., 960 F.2d 1242, 17 U.C.C. Rep. Serv. 2d 322 (4th Cir. 1992); In re Pacific Trencher & Equipment, Inc., 27 B.R. 167, 35 U.C.C. Rep. Serv. 742 (B.A.P. 9th Cir. 1983), decision aff'd, 735 F.2d 362, 38 U.C.C. Rep. Serv. 1121 (9th Cir. 1984); In re Silvernail Mirror and Glass, Inc., 142 B.R. 987, 18 U.C.C. Rep. Serv. 2d 322 (Bankr. M.D. Fla. 1992); In re York Chemical Industries, Inc., 30 B.R. 583, 36 U.C.C. Rep. Serv. 1066 (Bankr. D. S.C. 1983).

[31] In re Lortz, 344 B.R. 579, 585, Bankr. L. Rep. (CCH) P 80633, 60 U.C.C. Rep. Serv. 2d 90 (Bankr. C.D. Ill. 2006).

and other considerations, to conduct due diligence and to determine, for example, whether a filed termination statement was authorized. Indeed, nothing in the Delaware court's decision alters or is inconsistent with the well-established rule that a filed record is effective only to the extent it was filed by a person that may file it.[32] But the Delaware court's decision provides that the proper focus of any such inquiry is the filing of the UCC-3, not any subjective understanding of its legal consequence.

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[32]See Sections 510(a) and 509(a) of the official text of Uniform Commercial Code Article 9, promulgated in 1998 by the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws) and the American Law Institute, which generally took effect on July 1, 2001, as amended through the 2010 amendments thereto, which generally took effect on July 1, 2013.