THE UNAUTHORIZED FILING OF A UNIFORM COMMERCIAL CODE TERMINATION STATEMENT HAS NO LEGAL EFFECT

The United States Bankruptcy Court for the Southern District of New York (the "Court") recently addressed the question of whether the filing of a Uniform Commercial Code ("UCC") termination statement that unintentionally terminated a financing statement filed in an unrelated transaction is effective. In *Official Committee of Unsecured Creditors of Motors Liquidation Company v. JPMorgan Chase Bank, N.A.* (*In re: Motors Liquidation Company*), 2013 Bankr. LEXIS 814 (Bankr. S.D.N.Y. Mar. 1, 2013) (the "Motors Case"), the Court held that such a termination statement is effective only if the secured party of record under the financing statement authorizes (or authorizes its counsel to authorize) the filing of the termination statement and that, upon the facts and circumstances of the case, the secured party did not directly or through its counsel authorize the filing of the erroneous termination statement.

This decision rejects the Roswell case[1] statements that all termination statements are effective, even if filed without authorization or by mistake, and that the duty of further inquiry concerning the authorization for filing of financing statements only applies to initial financing statements and not to termination statements. The effect of the Motors Case is to impose a burden on potential creditors to determine whether termination filings revealed in their lien searches are effective. This decision is (i) favorable for all creditors because they do not need to monitor the public financing statement records for unauthorized or erroneous filings and (ii) instructive because of the analysis used to determine whether or not such a required authorization has been given by the secured party of record.

The Facts of the Motors Case

In October 2001, a syndicate of financial institutions led by Chase Manhattan Bank (succeeded by JPMorgan Chase Bank, N.A. ("JPMorgan")) as the administrative agent and General Motors Corporation ("GM") entered into a $300 million synthetic lease transaction (the "Synthetic Lease"). GM's obligations under the Synthetic Lease were secured by liens on 12 pieces of real estate (the "Properties") and personal property identified in the Synthetic Lease documentation and such security interest in personal property was perfected by the proper filing of two UCC-1 financing statements with the Delaware Secretary of State[2] (one by JPMorgan as

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1 *Roswell Capital Partners LLC v. Alt. Constr. Techs.*, No. 08-CV-10647, 2010 WL 3452378 (S.D.N.Y. Sept. 1, 2010), *aff'd*, *Roswell Capital Partners LLC v. Beshara*, 436 F. App'x 34 (2d Cir. 2011). The Court stated the reason it did not feel bound by the Roswell rationale, whether dictum or holding, is that "district court decisions are not binding on bankruptcy courts, except with respect to any district court mandate pursuant to an appeal." *See In re: Motors Liquidation Company*, 2013 Bankr. LEXIS 814 (Bankr. S.D.N.Y. Mar. 1, 2013 at 121).

2 UCC-1 financing statements were also filed in the counties where the Properties are located to obtain priority in fixtures over owners or encumbrancers of real estate.

administrative agent and one by the Auto Facilities Real Estate Trust 2001-1, as lessor of the Properties to GM (together, the "Synthetic Lease Delaware Financing Statements")).

In November 2006, another syndicate of financial institutions led by JPMorgan as their administrative agent made a $1.5 billion seven-year senior secured term loan (the "Term Loan") to GM and its then subsidiary Saturn Corporation ("Saturn"). This financing was secured by, among other things, a lien on all of GM's and Saturn's equipment and fixtures and such security interest was perfected by the proper filing of two UCC-1 financing statements with the Delaware Secretary of State[3] (one against GM (the "GM Term Loan Financing Statement") and one against Saturn).

On September 30, 2008, GM informed a partner at its outside law firm (the "Partner") that GM planned to repay the Synthetic Lease and requested that the Partner have prepared all documents necessary for the repayment of the Synthetic Lease and the release of JPMorgan's security interest in the collateral securing the Synthetic Lease. The Partner asked an associate to draft a synthetic lease termination agreement, closing checklist, UCC-3 termination statements and escrow agreement (collectively, the "Termination Documents"), and the associate asked a paralegal to do a lien search to obtain the initial filing numbers. The Delaware Secretary of State lien search disclosed the Synthetic Lease Delaware Financing Statements and the GM Term Loan Financing Statement. Unaware of the purpose of his search, the paralegal requested that another paralegal prepare (in addition to UCC-3 termination statements for fixture filings) a UCC-3 termination for each UCC-1 financing statement found in his Delaware Secretary of State lien search, including the GM Term Loan Financing Statement (the "Unrelated UCC-3"). All the Termination Documents (including the Unrelated UCC-3) were sent to JPMorgan's counsel by email under a subject heading of "GM/JPMorgan Chase Synthetic Lease" and JPMorgan's counsel responded by email, stating "Nice job on the documents" and continued with "[m]y only comment," and went on to state a comment that did not relate to the UCC-3 termination statements. Upon GM's payoff of the Synthetic Lease, GM's counsel filed all the UCC-3 termination statements previously sent to JPMorgan's counsel for review (including the Unrelated UCC-3).

On June 1, 2009, GM filed a petition under chapter 11 of the Bankruptcy Code. Approximately two weeks later JPMorgan's counsel discovered that GM's counsel had caused the Unrelated UCC-3 to be filed in October 2008 thereby potentially terminating the perfection of the security interest granted by GM to JPMorgan to secure the Term Loan. On June 25, 2009, an order was issued authorizing, among other things, debtor-in-possession financing ("DIP Financing") and the repayment of the Term Loan, and on June 30, 2009 the outstanding amount under the Term Loan ($1,481,656,507.70) was repaid in full (the "Payoff Amount") out of the proceeds of the DIP Financing. The Official Committee of Unsecured Creditors (the "Committee") filed a complaint seeking a ruling that the principal lien securing the Term Loan was not perfected, making most of the Term Loan unsecured. JPMorgan moved for summary judgment, seeking a ruling that because it did not authorize the termination of the financing statement, the financing statement was still effective to perfect its lien.

[3] UCC-1 financing statements were also filed in the counties where the fixtures are located to obtain priority over owners or encumbrancers of real estate.

The Decision

The Court had to decide whether the Unrelated UCC-3 was effective to terminate the perfection of JPMorgan's security interest in the collateral pledged by GM to secure the Term Loan. To be effective, the filing of the Unrelated UCC-3 by GM's counsel (or its agent) had to be authorized by JPMorgan as the secured party of record or by its agent.[4] If there were no authorization by JPMorgan, the Unrelated UCC-3 would be ineffective[5] and JPMorgan's security interest in all collateral securing the Term Loan would continue to be perfected. This would permit JPMorgan to retain the Payoff Amount.

The Court found that none of GM, JPMorgan nor their respective counsel actually intended to terminate the financing statement relating to the Term Loan. In fact, the parties to the Motors Case first learned that the Unrelated UCC-3 related to the Term Loan in June 2009, after GM had filed its chapter 11 petition.

The Committee argued that UCC filings that mistakenly terminate a security interest are legally effective and, in any event, intent was irrelevant since GM's counsel had received authorization to file the Unrelated UCC-3 based upon, among other things, the following:

- GM's counsel sent both JPMorgan and its counsel a closing checklist that referred to the Unrelated UCC-3 (which contained the date and number of the GM Term Loan Financing Statement (but did not indicate expressly that it related to the Term Loan rather than the Synthetic Lease)).

- GM's counsel sent both JPMorgan and its counsel a copy of the proposed form of Unrelated UCC-3 (which contained the same reference to the date and file number of the GM Term Loan Financing Statement (but did not indicate expressly that it related to the Term Loan)).

- Neither JPMorgan nor its counsel objected to the closing checklist or the proposed form of the Unrelated UCC-3. To the contrary, JPMorgan's counsel told GM's counsel: "Nice job on the documents."

To determine whether JPMorgan authorized the filing of the Unrelated UCC-3, the Court had to look to agency law because "authorization" is not defined in the UCC.[6] Under the law of agency, authority is defined as "the power of the agent to affect the legal relations of the

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4 *See* UCC Section 9-509(d)(1): "A person may file an amendment . . . only if . . . the secured party of record authorizes the filing; . . ."

5 *See* UCC Section 9-510(a): "A filed record is effective only to the extent that it was filed by a person that may file it under UCC Section 9-509."

6 *See* Official Comment 5 to UCC Section 9-509: "Law other than this Article . . . generally determines whether a person has requisite authority to file a record under this section."

principal by acts done in accordance with the principal's manifestations to the agent."[7] An agent has actual authority to perform an act if the principal either expressly or implicitly grants the agent the authority to perform the act.[8] The Court held there was no actual or implied authority for the filing of the Unrelated UCC-3. Judge Robert Gerber said that "GM was not authorized to act except with respect to the Synthetic Lease Properties, and filing the Unrelated UCC-3 was not "necessary," "usual" or "proper" to bring the UCC-1s with respect to the Synthetic Lease Properties to an end."[9] Judge Gerber explained that neither GM nor JPMorgan intended that the Termination Documents cover anything other than the Synthetic Lease and therefore the filing of the Unrelated UCC-3 was unauthorized and therefore not effective. JPMorgan and its counsel received the Termination Documents under emails that indicated they related to termination of the Synthetic Lease (and gave no indication that any Termination Document related to the Term Loan).

The Court considered whether each of the Termination Documents provided authorization and to what the authorization pertained. Although JPMorgan did sign a synthetic lease termination agreement, its express authorization to file termination statements related, when read literally, only to the existing financing statements filed in connection with the Synthetic Lease, including the Properties (which did not include the collateral securing the Term Loan). The Court stated that the failure of JPMorgan to object to the inclusion of the Unrelated UCC-3 on a closing checklist did not constitute an authorization by JPMorgan to file the Unrelated UCC-3. The Court viewed the remark made to GM's counsel by JPMorgan's counsel regarding the closing checklist[10] simply as a generalized remark that could not be an authorization of any kind, or at least not an authorization to file the Unrelated UCC-3 in the absence of evidence that JPMorgan's counsel knew the Unrelated UCC-3 related to the Term Loan or had an actual intent to terminate the GM Term Loan Financing Statement. The Court found that the Unrelated UCC-3 did not provide any authorization since it did not have JPMorgan's signature or include any authorization language. The inclusion by GM's counsel of JPMorgan's name in item 9a of the Unrelated UCC-3, titled "Secured Party of Record Authorizing this Amendment," cannot be deemed a grant of authority by JPMorgan. Moreover, even if the Unrelated UCC-3 did provide an authorization of some type, it did not provide authorization to terminate the GM Term Loan Financing Statement since it made no reference to the Term Loan other than the reference to the "Initial Financing Statement File Number" and only with inquiry could you discover the reference was to the GM Term Loan Financing Statement. Lastly, the Court determined the escrow agreement authorized the title company to record and file specified documents but such documents did not include the Unrelated UCC-3. To the contrary, the escrow agreement instructed the escrow agent to return the Unrelated UCC-3 (among other things) to GM's counsel and did not contain any instructions to GM's counsel concerning filing. The Court discounted as possible authorization that it may have been foreseeable the documents delivered by the escrow agentto GM's counsel would have been filed.

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7 *See* Restatement (Third) of Agency, Section 2.01.

8 *See* Restatement (Third) of Agency, Sections 2.01 and 2.02.

9 *See In re: Motors Liquidation Company*, 2013 Bankr. LEXIS 814 (Bankr. S.D.N.Y. Mar. 1, 2013 at 109).

10 "Nice job on the documents."

The doctrine of apparent authority[11] was found by the Court to be inapplicable to the facts of the Motors Case because there were no statements to third parties with respect to the Term Loan upon which apparent authority could be asserted. Moreover, the Court found that the filing of the Unrelated UCC-3 was not ratified by JPMorgan or its counsel because "the act of ratification, whether express or implied, must be performed with full knowledge of the material facts relating to the transaction, and the assent must be clearly established and may not be inferred from doubtful or equivocal acts or language."[12] Lastly, the Court rejected the statements in the Roswell case to the effect that all termination statements are effective even if filed by mistake (whether or not authorized).

The Court concluded that, since there was no authorization to file the Unrelated UCC-3, the Unrelated UCC-3 was ineffective. Accordingly, JPMorgan's lien was perfected and no portion of the Payoff Amount should be recaptured from JPMorgan to benefit the unsecured creditors.

UCC Section 9-518 addresses claims concerning inaccurate or wrongfully filed records. It permits a "correction statement" to be filed by a debtor to give notice of an inaccurate or unauthorized financing statement filing. The 2010 Revisions to Article 9 of the UCC, made by the National Conference of Commissioners on Uniform State Laws and the American Law Institute with a proposed effective date of July 1, 2013, include revisions to the Official Text of and the Comments to UCC Section 9-518. The term "correction statement" used in the Official Text will be changed to a more accurate term "information statement" (since it has no legal effect), and both a secured party of record and a debtor will be permitted (but not required) to file an information statement if it believes a financing statement[13] is filed without authorization. In addition Comment 2 to UCC Section 9-518 will be revised to provide in part: "Just as searchers bear the burden of determining whether the filing of [an] initial financing statement was authorized, searchers bear the burden of determining whether the filing of every subsequent record was authorized."

A payoff letter can provide the proof of authorization required to file a termination statement. A lender providing new financing to a borrower often requires as a condition to funding that the borrower obtain a payoff letter from an existing lender whose loan is being refinanced. The payoff letter will typically contain an acknowledgment by the existing secured lender that, upon payment of the payoff amount, all liens securing the existing secured debt are released and the borrower (and sometimes the new lender as well) is authorized upon payment of the payoff amount to file UCC termination statements.

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[11] *See In re: Motors Liquidation Company*, 2013 Bankr. LEXIS 814 (Bankr. S.D.N.Y. Mar. 1, 2013) at 97-98 where the Court refers to the Restatement (Third) of Agency Section 2.03, which provides, "Apparent authority is the power held by an agent or other actor to affect a principal's legal relations with third parties when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations."

[12] *Id.* at 32 where Court refers to *Holm*, 89 A.D.2d at 233, 455 N.Y.S.2d at 432.

[13] Defined by UCC Section 9-102(a)(39) as "a record or records composed of an initial financing statement and any filed record relating to the initial financing statement."

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If you have any questions regarding this memorandum, please contact Cindy J. Chernuchin (212-728-8606, cchernuchin@willkie.com), William E. Hiller (212-728-8228, whiller@willkie.com), Michael I. Zinder (212-728-8298, mzinder@willkie.com), or the Willkie attorney with whom you regularly work.

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