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United States Bankruptcy Court for the Southern District of New York Holds That a UCC-3 Filing Without Authorization Is No Filing at All

I. Introduction

On March 1, 2013, Judge Robert E. Gerber of the United States Bankruptcy Court for the Southern District of New York held in *Official Committee of Unsecured Creditors of Motors Liquidation Company v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Company)*[1] that (a) for an agent to effectively terminate a UCC-1 initial financing statement on behalf of a secured lender principal, the termination must be authorized by the principal and (b) the court must consider factors under non-UCC agency law to determine whether authorization has been granted, including whether the agent reasonably believed that the principal intended for the agent to terminate the UCC-1 initial financing statement.

This standard, which is based on the 2001 amendments to Article 9 of the Uniform Commercial Code ("UCC"), is a departure from earlier cases decided before (or without regard to) the 2001 amendments, which held that all UCC-3 termination statements are effective, even when filed by mistake. Under *Motors Liquidation Company*, when a UCC-3 termination statement is filed by an agent, the statement's effectiveness depends upon a factual inquiry into whether the filing was authorized by the principal, which may not be discernible from the UCC-3 itself. This decision is important to the lending industry, especially in situations similar to *Motors Liquidation Company*, where the secured party on whose behalf the UCC-3 termination statement was filed is owed other outstanding indebtedness. If a termination statement filed by an agent was not properly authorized, then a potential lender could find itself junior in priority to a previously granted security interest, notwithstanding the filing of a termination statement. Accordingly, to confirm that a prior security interest is no longer perfected by a UCC-1 financing statement, potential lenders should request documentation clearly demonstrating that any UCC-3 termination statements were authorized by the prior lender.

II. Background

In October 2001, General Motors Corporation ("GM") entered into a synthetic lease (the "Synthetic Lease"), pursuant to which it obtained up to approximately $300 million in financing from a syndicate of financial institutions. JPMorgan Chase Bank, N.A. ("JPMorgan") was one of the backup facility banks

under the Synthetic Lease, as well as the administrative agent. GM's obligations under the Synthetic Lease were secured by liens that were perfected by the filing of UCC-1 initial financing statements.

In November 2006, GM, together with one of its then subsidiaries, entered into a seven-year senior secured term loan facility (the "Term Loan") for approximately $1.5 billion in financing. The Term Loan was unrelated to the Synthetic Lease and was with a different syndicate of financial institutions, although JPMorgan again served as administrative agent. The lenders' security interests in the Term Loan collateral were perfected by the filing of 28 UCC-1 initial financing statements.

In October 2008, GM repaid the outstanding amount under the Synthetic Lease and filed three UCC-3 termination statements. Despite JPMorgan and GM only intending to terminate UCC-1s relating to the Synthetic Lease, one of the three UCC-3 termination statements inadvertently listed the filing number of a UCC-1 relating to the primary lien securing the Term Loan. JPMorgan and GM knew, or had notice of, the filing number to which the mistaken UCC-3 termination statement referred, but neither party realized that the filing number referred to a UCC-1 relating to the Term Loan and not the Synthetic Lease.

GM and its affiliated debtors commenced chapter 11 cases on June 1, 2009. Approximately two weeks later, counsel to JPMorgan discovered that one of the UCC-3 termination statements filed in connection with the repayment of the Synthetic Lease actually related to the Term Loan. On June 25, 2009, the Bankruptcy Court approved GM's $33 billion debtor-in-possession ("DIP") financing and authorized the repayment of the Term Loan from the DIP proceeds. In connection with the Term Loan's repayment, JPMorgan authorized the filling of UCC-3 termination statements with respect to the Term Loan, including a termination statement for the UCC-1 to which the erroneous, previously filed UCC-3 termination statement related.

The Official Committee of Unsecured Creditors (the "Committee") appointed in the chapter 11 cases of GM and its affiliated debtors subsequently commenced an adversary proceeding and moved for partial summary judgment, seeking a ruling that the primary lien securing the Term Loan had been terminated before the commencement of GM's chapter 11 cases through the filing of the erroneous UCC-3, which would render most of the debt under the Term Loan unsecured. JPMorgan cross-moved for summary judgment seeking the opposite determination: that JPMorgan's authorization was needed under Article 9 of the UCC to terminate the lien under the Term Loan, that JPMorgan did not provide authorization, and that the lien remained in place.

III. The Bankruptcy Court Decision

In a 74-page decision, Judge Gerber held that, under Article 9 of the UCC, as amended in 2001, the termination of a UCC-1 initial financing statement is ineffective unless properly authorized. The Court further stated that, since the 2001 amendments, the UCC no longer requires that a UCC-3 termination statement be executed by a secured party. Instead, a UCC-3 termination statement may be filed by anyone, provided that, as required by UCC § 9-509, "the secured party of record authorizes the filing."

In reaching this conclusion, the Court considered the interplay between UCC §§ 9-513(d), 9-510, and 9-509(d), finding that "under UCC § 9-513(d), the filing of a termination statement *generally* causes the initial financing statement to which the termination statement relates to no longer be effective. But because UCC § 9-513's effect is 'except as otherwise provided in [UCC §] 9-510,' one must then look to UCC § 9-510, which requires one to look to § 9-509 to ascertain whether there has been authorization."[2] Thus, the issue before the Court – whether the erroneous UCC-3 effectively terminated the UCC-1 relating to the Term Loan – turned on whether GM (the agent who made the

filing) received the requisite authorization from JPMorgan (the principal on whose behalf the filing was made).

The UCC does not define "authorization," so the Bankruptcy Court looked to the law of agency to determine whether GM had the requisite authority from JPMorgan. Under principles of agency law, the Court concluded that actual authority is created by "direct manifestations" of the grant of authority from the principal to agent, with an emphasis on the agent's reasonable understanding at the time it takes action. Following an extensive factual analysis, the Bankruptcy Court determined that "[t]he undisputed facts here . . . conclusively establish that JPMorgan intended to grant, and granted, authority to GM to terminate UCC-1s only with respect to the Synthetic Lease. As importantly or more so, this was GM's belief as well."[3] On these facts, the Bankruptcy Court held that JPMorgan did not authorize the termination of the UCC-1 with respect to the Term Loan, and that JPMorgan's actions in connection with the payoff of the Synthetic Lease were not effective in terminating that UCC-1. The Court therefore granted JPMorgan's motion for summary judgment and denied the Committee's motion for partial summary judgment.[4]

IV. Authority Cited by the Committee Was Not Persuasive

The Bankruptcy Court dismissed the broad assertion by the Committee that UCC filings that mistakenly terminate a security interest are legally effective as being inconsistent with the 2001 amendments to Article 9. The Court stated that the Committee relied on opinions that either were decided prior to the amendments, dealt with UCC statements filed by the secured creditor *itself* where authorization was not an issue,[5] or were incorrectly decided, and criticized in particular a 2010 decision by the District Court for the Southern District of New York in *Roswell Capital Partners LLC v. Alternative Construction Technologies*.[6] The Bankruptcy Court agreed with the District Court's first rationale for its decision, which was affirmed by the Second Circuit, that the secured lenders' security interest was extinguished upon conversion of their debt to equity. The Bankruptcy Court disagreed, however, with the District Court's second rationale (which was not addressed by the Second Circuit), that even a mistaken termination of a financing statement releases the secured creditor's lien against the debtor's property, because it did not give effect to the changes under the 2001 amendments to Article 9 and relied on precedent that predated those amendments. In support of its position, the Bankruptcy Court cited to several courts that similarly disagreed with the second rationale in *Roswell Capital*, including the Supreme Court of New York in *AEG Liquidation Trust v. Toobro N.Y. LLC*[7] and the Eighth Circuit in *Lange v. Mutual of Omaha Bank (In re Negus-Sons, Inc.)*.[8]

The Bankruptcy Court also took issue with the District Court's assertion in *Roswell Capital* that the UCC places the burden of monitoring for potentially erroneous UCC-3 filings on existing lenders, who are aware of the state of affairs of their security interests, rather than potential lenders who do not know whether a termination statement was authorized. The Bankruptcy Court noted that, as stated in Official Comment 2 to UCC § 9-502, the UCC is a "notice filing" regime where a filing indicates only that a person may have a security interest in collateral, but further inquiry by concerned parties remains necessary to ascertain the complete state of affairs.[9] The Bankruptcy Court concluded that "[w]hen the authorization underlying a previously filed termination statement matters to a subsequent lender (as it usually will), the lender can simply include any necessary further inquiry as part of its due diligence."[10] This holding places the burden of ascertaining the effectiveness of a UCC-3 termination statement squarely on potential lenders and heightens the importance of their diligence efforts.

V. Conclusion

Motors Liquidation Company is a clear departure from cases decided before (or without regard to) the 2001 amendments to Article 9 of the UCC, which held that all UCC filings are effective, even when mistaken. The Bankruptcy Court's decision requires that an agent received the requisite authorization from the secured party to terminate a financing statement, which necessitates a fact-based analysis by a potential lender during the diligence process. If a termination was not properly authorized, then a potential lender may find itself junior in priority to a prior lender, notwithstanding the filing of a UCC-3 termination statement. Finding a UCC-3 termination statement filed on behalf of a prior lender is therefore only the start of the inquiry of a potential lender into the termination of a UCC-1 initial financing statement. When attempting to confirm that a UCC-1 financing statement has been effectively terminated, the potential lender should request documentation, such as a payoff letter or other documentation, sufficient to show that the filing of the UCC-3 termination statement was authorized by the secured party. This level of diligence into the termination of initial financing statements is needed to avoid being inadvertently primed by a security interest that was perfected by a UCC-1 financing statement and subsequently terminated without authorization.

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[1] 2013 WL 772863 (Bankr. S.D.N.Y. March 1, 2013).

[2] *Id*. at *12 (emphasis in original).

[3] *Id*. at *2.

[4] The Committee filed a notice of appeal on the docket of the adversary proceeding on March 7, 2013 [Docket No. 76]. The Bankruptcy Court certified its judgment for direct appeal to the Second Circuit. *Id*. at *33.

[5] *See, e.g., Crestar Bank v. Neal (In re Kitchen Equip. Co. of Va., Inc.)*, 960 F.2d 1242, 1247 (4th Cir.1992) (holding with respect to UCC filing by secured creditor prior to 2001 amendments to Article 9, that termination statement's effects on secured interest is "dramatic and final"); *Koehring Co. v. Nolden (In re Pacific Trencher & Equip., Inc.*), 27 B.R. 167, 168 (B.A.P. 9th Cir. 1983) (in decision issued before 2001 amendments to Article 9, erroneous termination statement signed by secured creditor effected lapse in perfection), *aff'd* 735 F.2d 362 (9th Cir. 1984).

[6] 2010 WL 3452378 (S.D.N.Y. Sep. 1, 2010), *aff'd by summary order on other grounds*, 436 F. App'x 34 (2d Cir. 2011).

[7] 32 Misc.3d 1202(A), 2011 WL 2535035, at *9 n.1 (N.Y. Sup. Ct. Jun. 24, 2011) ("[T]he court declines to follow the SDNY Court's analysis in *Roswell Capital*.").

[8] 2011 WL 2470478 (Bankr. D. Neb. June 20, 2011), *aff'd*, 460 B.R. 754, 757 n.10 (B.A.P. 8th Cir. 2011) ("*Roswell's* holding appears to be contrary to the plain language of the Uniform Commercial Code."), *aff'd on opinion of BAP*, 701 F.3d 534 (8th Cir. 2012) (per curiam).

[9] The Bankruptcy Court also disagreed with the *Roswell Capital* court's statement that the Official Comment refers only to "financing statements" and not to termination statements because the definition of "financing statement" in UCC § 9-102(39) includes "any filed record relating to the initial financing statement," which includes termination statements. *See Motors Liquidation Company*, 2013 WL 772863, at *31.

[10] *Id.*