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Client Alert

Current Issues Relevant to Our Clients

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Delaware Supreme Court Rules That A Mistaken Filing Can Terminate Security Interest

The Delaware Supreme Court ruled recently that a secured party's security interest in collateral can be terminated upon the filing of a UCC termination statement even though there was a mistake in the document.[1] The ruling arises out of a dispute in the GM bankruptcy case involving the secured status of lenders and could result in a $1.5 billion loan being rendered unsecured.

GM Bankruptcy Dispute

Prior to its bankruptcy filing in June 2009, GM had entered into two separate and unrelated secured financing transactions: (1) a $300 million synthetic lease financing transaction in 2001; and (2) a $1.5 billion term loan facility in 2006. Although the two transactions were unrelated and had separate groups of lenders, JPMorgan served as the administrative agent and secured party of record for both transactions.

In September 2008, GM repaid the $300 million facility and instructed its counsel to prepare documents related to the repayment and release of JPMorgan's security interest in the collateral securing that facility. GM's counsel prepared several termination statements but included among them a statement that incorrectly listed the security interest that had been granted to JPMorgan for the unrelated $1.5 billion term loan facility. Even though the documents were reviewed by GM, its counsel and JPMorgan's counsel, no one noticed the error and GM's counsel filed the termination statements (including the statement terminating the unrelated term loan security interest) with the Delaware Secretary of State in October 2008.

This mistake went unnoticed until after GM filed for chapter 11 reorganization. On July 31, 2009, the unsecured creditors committee brought an action against JPMorgan seeking a determination that the filing of the termination statements, notwithstanding the mistake, was effective to terminate the term loan security interest and render the term loan lenders unsecured. The bankruptcy court ruled in favor of JPMorgan, finding that because neither JPMorgan nor GM intended the legal consequences of filing the erroneous termination statement, the filing of that statement was unauthorized and thus not effective to terminate the term loan security interest.

Appeal to the Second Circuit and Certified Question to the Delaware Supreme Court

The creditors committee appealed the bankruptcy court's decision directly to the Second Circuit Court of Appeals in New York. The Second Circuit found that the appeal raised two closely related and intertwined questions: (1) what precisely must a secured party authorize for a termination statement to be effective, and (2) did JPMorgan grant to GM's counsel the relevant authority to file the termination statement?

Because this was a case of first impression that related to interpretation of Delaware law, the Second Circuit asked the Delaware Supreme Court for assistance in answering the first question - what exactly must the secured party authorize for filing? Is it enough that a secured party authorize the act of filing a particular termination statement? Or must the secured party intend to terminate the particular security interest that is identified for termination on the termination statement?

Delaware Supreme Court's Answer

In answering the certified question, the Delaware Supreme Court assumed that the secured party has reviewed and knowingly approved the termination statement for filing. The Court then ruled that the plain language of the relevant statute only required the secured party to review and knowingly approve the filing of a termination statement for the security interest to be extinguished, and that the effectiveness of the termination did not depend on the subjective intent or understanding of the secured party: "parties in commerce are entitled to rely upon a

filing authorized by a secured lender and assume that the secured lender intends the plain consequences of its filing."

The Court rejected JPMorgan's argument that a filing was only effective if the authorizing party understood and intended the effect of the filing. Accordingly, the Court placed the burden of ensuring the accuracy of a termination statement solely on the secured party, finding no room in the statute for the secured party's subjective intent. The Court also stated that because the UCC is a system of notice filing, parties must be able to rely in good faith on the plain terms of authorized public filings. To inject the subjective intent or understanding of the secured party would disrupt and undermine the secured lending markets. The Court further stated that it would not be unfair to expect a secured party to review a termination statement carefully and only file the statement once it is sure that the statement is correct.

Back to the Second Circuit

The dispute now goes back to the Second Circuit, which will take up the question of whether GM's counsel had authority as JPMorgan's agent to file the termination statements. At issue will be how the Second Circuit interprets applicable principles of agency law, which should determine whether the authority JPMorgan granted to its agent extended to the mistaken filing.

1. *Official Comm. Of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.*, No. 325, 2014, 2014 Del. LEXIS 419, 2014 WL 5305937 (Del. Oct. 17, 2014). (Available at: http://courts.delaware.gov/opinions/download.aspx?ID=213480)

For More Information

We will continue to update once the Second Circuit rules on the unresolved authority issues. If you have questions regarding this Client Alert, please contact Mark D. Rasmussen (312.845.3276), Joon P. Hong (212.655.2537), Hannah M. Wendling (312.845.3910) or your primary Chapman attorney, or visit us online at chapman.com.