

# Client Alert

Financial Restructuring Practice Group

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## Delaware Supreme Court: A Mistakenly Authorized UCC Termination Statement is Effective to Terminate Original UCC Filing

On October 17, 2014, the Delaware Supreme Court entered an opinion holding that a UCC-3 termination statement that is authorized by the secured party is effective to terminate the original UCC filing even though the secured party did not actually intend to extinguish the underlying security interest.<sup>1</sup> Because the court determined that the relevant section of Delaware's Uniform Commercial Code (the "UCC") is unambiguous and contains no element of subjective intent, the court ruled that the subjective intent of the secured party is irrelevant when the secured party has reviewed and authorized the filing.<sup>2</sup>

### 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.<sup>3</sup>

On appeal, the Second Circuit determined that whether the termination statement was effective hinged on two distinct but closely related questions.

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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 also generally 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?<sup>4</sup> 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.”<sup>5</sup>

## 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.”<sup>6</sup> The court disagreed, concluding that the statute was unambiguous and therefore “not subject to judicial interpretation.”<sup>7</sup> 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 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.<sup>8</sup> 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.

With Delaware law settled, the matter will now return to the Second Circuit for a determination of whether the filing was, in fact, authorized by the Agent.

## Lessons Learned

The Delaware Supreme Court’s opinion 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 the 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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<sup>1</sup> *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.*, No. 325, 2014, 2014 Del. LEXIS 491 (Del. Oct. 17, 2014) ("Del. Op.").

<sup>2</sup> *Id.* at \*10–\*13.

<sup>3</sup> *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).

<sup>4</sup> *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.*, 755 F.3d 78, 84 (2d Cir. 2014).

<sup>5</sup> Del. Op. at \*8.

<sup>6</sup> *Id.* at \*10.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at \*16–\*17.