In January, JPMorgan Chase lost a court battle with General Motors’ creditors’ committee regarding the accidental termination of JPMorgan’s UCC securing a $1.5 billion loan. Ruskin Moscou Faltischek attorney Jeffrey A. Wurst dissects the court cases surrounding the notorious GM bankruptcy and resulting fallout from JPMorgan’s costly mistake.

In its decision, the Second Circuit details how GM’s lawyers prepared the release and terminated the synthetic lease. In a throw-the-associate-under-the-bus explanation, the partner at Mayer Brown assigned the work to an associate who, with the help of a paralegal, searched the records of UCC-1 financing statements recorded against GM in the state of Delaware.
Creditors that a UCC-3 termination statement relating to the term loan had inadvertently been filed, and that they had only intended to terminate liens related to the synthetic lease. They claimed the “inadvertent filing” was unauthorized and ineffective. Notwithstanding, the Committee commenced an adversary proceeding against JPMorgan seeking a determination that, despite the error, the UCC-3 termination statement was effective to terminate JPMorgan’s security interest in assets securing the term loan and, as a result, JPMorgan was an unsecured creditor on pari with the other GM unsecured creditors.

The bankruptcy court, in a nearly 80-page decision, held: “…the Court is unable to agree that there is a general principle of law that ‘UCC Filings that Mistakenly Terminate a Security Interest Are Legally Effective.’ The question is rather whether they have been authorized...[and here] the requisite authority was lacking.” Thus, the bankruptcy court concluded the UCC-3 filing was unauthorized and, therefore, not effective to terminate the security interest securing the term loan. In the same document the court certified a direct appeal to the court of appeals.

An Appeal
The Second Circuit considered the appeal and identified two questions: 1) what a secured lender must authorize for the filing of a termination statement, which it identified as an issue of statutory interpretation; and 2) whether under agency law JPMorgan granted authority for the filing of the termination statement. Inasmuch as the Uniform Commercial Code is state (not federal) law, and despite the code being substantially the same state to state, questions of state law were at issue. GM was a Delaware corporation, and the UCC financing statement at issue was filed in Delaware, so the Second Circuit needed a ruling on Delaware law. Accordingly, the Second Circuit Decision certified the following question to the Delaware Supreme 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 listed on the UCC-3?

Delaware Supreme Court
In considering the question, the Delaware Supreme Court focused on the statutory construction of: UCC 9-513(d) ("Except as otherwise provided in Section 9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective"); 9-510 ("A filed record is effective only to the extent that it was filed by a person that may file it"); and 9-509(d)(1) ("A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if: (1) the secured party of record authorizes the filing...").

In reaching its conclusion, the Second Circuit quoted the Delaware Supreme Court:

The normal course would have been to first appeal to the District Court and then appeal its decision to the Circuit Court. On rare occasions when it is apparent that a matter will need to be adjudicated by the Circuit Court, lower courts certify the matter for a direct appeal, seeing significant time and expense in achieving a final resolution.

Second Circuit Decision
In reaching its conclusion, the Second Circuit quoted the Delaware Supreme Court:

Having concluded that JPMorgan had authorized the UCC-3 termination statement, the court turned to the question of whether Mayer Brown had authority under agency law to effect the filing. From these facts it is clear that, although JPMorgan never intended to terminate the Main Term Loan UCC-1, it authorized the filing of a UCC-3 termination statement that had that effect. “Actual authority . . . is created by a principal’s manifestation to an agent that, as reasonably understood by the agent, expresses the principal’s assent that the agent take action on the principal’s behalf.” JPMorgan and Simpson Thacher’s repeated manifestations to Mayer Brown show that JPMorgan and its counsel knew that, upon the closing of the synthetic lease transaction, Mayer Brown was going to file the termination statement identifying the Main Term Loan UCC-1 for termination, and JPMorgan reviewed/assented to the filing of that statement.

Petition for Rehearing En Banc
On February 4, 2015, JPMorgan filed a Petition for Rehearing En Banc, asking the Second Circuit Court of Appeals to rehear/reconsider the appeal on the grounds that the decision is a departure from existing agency law: “that one may be an agent for one purpose does not make him or her an agent for every purpose.”

The take-away: Know what you are authorizing when you put your signature to a document, and do not rely solely on others. This case may result in an extremely expensive lesson for JPMorgan and Simpson Thatcher.

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