If so, submit an article for possible publication in a future issue of the Commercial Law Newsletter. Publishing an article with the Commercial Law Newsletter is a great way to get involved with the UCC Committee and the ComFin Committee. Articles can survey the law nationally or locally, discuss particular UCC or Commercial Finance issues, or examine a specific case or statute. If you are interested in submitting an article, please contact one of the following Commercial Law Newsletter Editors **Sidney Simms, Harold J. Lee, Suhuyini Abudulai, Hilary Sledge-Sarnor, Glen Strong** or **Celeste B. Pozo.**

The Perils of UCC-3 Terminations

By Whang-Ki Josh Jang, Shawn Bagdasarian and Steven E. Economou

Introduction

January 21, 2015 was an ominous day for JP Morgan Chase Bank, N.A. ("JPMorgan") and its lawyers. On that day, the United States Court of Appeals for the Second Circuit was asked to consider in *Official Committee of Unsecured Creditors of Motors Liquidation Company v. JPMorgan Chase Bank, N.A. (In re: Motors Liquidation Company)*[1] what happens when a UCC-3 termination statement that was authorized and filed is later discovered to have unintentionally terminated the wrong UCC-1 financing statement. Would the intent of the secured party matter at the time of the filing in determining the effectiveness of the UCC-3 termination, or would the filing of a UCC-3 termination statement be merely a mechanical action? JPMorgan, the secured party in this case, fought desperately for the former interpretation – that the intent of the secured party does matter. The reason was obvious: the security of JPMorgan's $1.5 billion term loan (the "Term Loan") to General Motors ("GM") was on the line. The court ruled against JPMorgan and revealed the perils of inadvertent filings.

Summary of the Case

Before we proceed to the court's analysis and holding, let us take a closer look at the events that led up to the Second Circuit's rulings. In 2001, GM entered into a synthetic lease of $300 million (the "Synthetic Lease"), with respect to which JPMorgan was both a lender and administrative agent. Then, in 2006, GM entered into the Term Loan with JPMorgan, as both a lender and administrative agent again.[2] Both loans were secured and properly perfected by UCC-1 financing statements.

In 2008, GM informed its counsel, Mayer Brown LLP, that it intended to pay off the Synthetic Lease in full.[3] Mayer Brown then prepared three UCC-3 termination statements to effect the termination of JPMorgan's security interests with respect to the Synthetic Lease. Copies of these termination statements were distributed to GM, JPMorgan and JPMorgan's counsel, Simpson Thacher & Bartlett LLP, for approval and authorization to file.[4] Unfortunately, one of the three UCC-3s terminated the UCC-1 financing statement securing the Term Loan. This mistake became apparent after GM filed for bankruptcy in 2009, when the Committee of Unsecured Creditors filed suit against JPMorgan in order to ensure that the UCC-3 termination on the Term Loan was valid, cementing JPMorgan's status as an unsecured party in the bankruptcy proceedings.[5]

The steps taken by Mayer Brown, JPMorgan and Simpson Thacher to terminate the security interest in the Synthetic Lease were hardly unusual. GM notified Mayer Brown that it wanted to repay the Synthetic Lease, and that termination documents would be required. A partner at Mayer Brown assigned the matter to an associate, who in turn assigned the task of running lien searches against GM to a paralegal. The paralegal was unfamiliar with the matter and unaware that there was both a Synthetic Lease and Term Loan secured by these filings, and included in the list of security interests to be terminated the UCC-1 financing statement associated with the Term Loan. With this list, the associate then prepared a closing checklist and the necessary termination documents.[6]

No one at Mayer Brown, Simpson Thacher, or JPMorgan noticed the inclusion of the Term Loan financing statement among the ones being terminated. In fact, the court even noted that after receiving drafts of the termination documents, an attorney at Simpson Thacher responded, "nice job […]"[7]

In its inquiry, the court certified to the Delaware Supreme Court the question of whether it is "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 that is listed on the UCC-3."[8] The Delaware Supreme Court explained that if the secured party authorizes the filing of the UCC-3, it is effective regardless of whether the secured party "subjectively intends or otherwise understands the effect of the plain terms of its own filing."[9] With that, the court made clear that neither subjective intent nor even a basic understanding of the UCC-3 are required, and that they will not factor into the analysis of the ultimate validity of a UCC-3 termination so long as proper authority has been granted by the secured party.

Relatedly, the court scrutinized whether JPMorgan had granted Mayer Brown the proper authority to file the UCC-3 termination that inadvertently included the erroneous UCC-1 financing statement.[10] Relying on agency law, the court explained that "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 that identified the Main Term Loan UCC-1 for termination and that JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed."[11] The Second Circuit ultimately held that "although the termination statement mistakenly identified for termination a security interest that the lender did not intend to terminate, the secured lender authorized the filing of the document, and the termination statement was effective to terminate the security interest."[12] JPMorgan lost its security for the Term Loan and became an unsecured creditor.

Potential Solutions

The outcome of this case could have been avoided simply with a stronger attention to detail in the process that was used to prepare and file these documents. The steps taken above by all parties appear to be normal practice. However, now that it is clear that the intention of a secured party does not matter once it authorizes the filing of an approved UCC-3 termination statement, it is even more important for law firms to come up with new strategies in order to avoid such situations and to protect themselves from potential malpractice claims. We have outlined below a few different processes that could be used to avoid such oversights in the future.

Financing Statement Formatting Strategy

Secured parties should utilize the optional reference portion on the bottom of UCC-1 financing statements. One option is for firms to indicate the client and matter reference number on every UCC-1 financing statement that it drafts and files, in order to have standard reference points that everyone in the firm can utilize to double check the specific transaction with respect to which the UCC-1 financing statement was created. Additional detail could be added to this portion of the UCC-1 in situations where there is a greater possibility for confusion; for example, the addition of either "Synthetic Lease" or "Term Loan" in the GM case. This would be an ideal way for others within the firm who happen upon a transaction they are not familiar with, to confirm that the security interests being terminated are associated with the correct transaction.

Law Firm Operations

In addition, the simple act of institutionalizing a thorough review process could avoid such mistakes. As attorneys, we are often subject to multiple pressing deadlines, and that can lead to a lack of ownership of documents and to reviews that are not as intensive as they could be. At times, we may even rush because we expect someone else involved in the transaction to take a more careful look at the documents before they are considered final. Using the example at hand, we can understand why someone with intimate knowledge of the deal needs to take responsibility for a final, thorough review. UCC-1 financing statements include a lot of important information that could be easily overlooked by someone unfamiliar with a matter. Only being able to understand where the secured party and debtor are listed is not enough; many times there are multiple filing dates associated with multiple transactions, and it is reasonable to see how mistakes like this get made. Establishing (i) an "owner of the document" and (ii) standard best practices for the review of particular documents can ensure that careless mistakes are avoided.

Conclusion

The GM case illustrates the dangers of a lack of oversight over what should be a fairly routine task. Rather than finding themselves secured, JPMorgan was left in the vulnerable position of an unsecured creditor for the sum of $1.5 billion in the midst of a bankruptcy proceeding. The takeaway is that while UCC-3 termination statements might be easy to file, the stakes can be high and the repercussions of mistakes catastrophic. Luckily, the risks can be mitigated by such quick fixes as utilizing the optional filer reference data section and putting procedures in place that establish legitimate review. With those simple steps, firms can avoid malpractice liability and ensure that their clients are properly protected, even in the worst of situations.

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Secured Lending to Series of LLCs: Beware What You Do Not (and Cannot) Know - Part I

By Norman M. Powell

Editor's Note: This article is the first of three installments focusing on "series LLCs". This first part provides an introduction and overview of series LLCs—including what they are and are not, and what they can and cannot do. The second part (in the upcoming Summer edition of the Commercial Law Newsletter) will focus on the UCC consequences of series LLCs, while the third part (in the upcoming Fall 2015 edition of the Commercial Law Newsletter) will focus on the Bankruptcy Code implications for series LLCs.

Introduction

A "series LLC" is a limited liability company that has one or more "series." In some ways a "series" is like a subsidiary of its