

CLIENT ALERT

UCC Termination Statements Require Authorization To Be Effective

Mar.25.2013

On March 1, 2013, the U.S. Bankruptcy Court for the Southern District of New York held that the termination of a Uniform Commercial Code ("UCC") Article 9 initial financing statement where such termination is filed by a third party "agent" of the borrower is ineffective to terminate a secured party's perfected status absent specific authorization by the secured party¹. While this decision does not represent groundbreaking new Article 9 law, it does underscore yet again the importance of attention to detail and due diligence when addressing Article 9 financing statement matters.

Background

A secured party (the "Secured Party") acted as administrative agent for two wholly-unrelated financing facilities with the same borrower (the "Borrower"). In 2001, the Borrower entered into a \$300 million synthetic lease transaction (the "Synthetic Lease") with the Secured Party serving as one of the backup facility banks and the administrative agent. In connection with the Synthetic Lease, UCC financing statements were properly filed to perfect security interests granted to the other lenders and the Secured Party. In 2006, the Borrower entered into an unrelated seven-year senior secured term loan facility for \$1.5 billion (the "Term Loan") with the Secured Party once again serving as the administrative agent. UCC financing statements were properly filed to perfect security interests granted to the Secured Party to secure the Term Loan. In keeping with common practice, neither the Synthetic Lease nor the Term Loan financing statements contained descriptive information about the financing facilities as such information is not required by Article 9.

In October 2008, the Borrower commenced a process to payoff and terminate the Synthetic Lease only. As part of the process, payoff documents were prepared. Those documents included UCC-3 termination statements and a document to be executed by the Secured Party which specifically authorized the Borrower or its designees to terminate the financing statements relating to the Synthetic Lease. The payoff documents were distributed to and were reviewed by all parties to the payoff transaction. The payoff occurred and the UCC-3s were filed. Apparently, at the time of the Synthetic Lease payoff, a termination statement for the Term Loan related financing statement had been inadvertently included in the group of documents provided to all parties to the Synthetic Lease payoff transaction for review and approval. After document approval, and upon payoff, all of the approved termination statements were filed by the Borrower, including the Term Loan termination statement.

In 2009, the Borrower filed a Chapter 11 bankruptcy petition. As part of its debtor-in-possession financing arrangement, the Borrower received Bankruptcy Court authority to repay the pre-bankruptcy petition Term Loan. Shortly thereafter, the Creditors' Committee, which had reserved its right to challenge the payment, filed a suit against the Secured Party alleging that the perfected status of the Term Loan had been vitiated in 2008. The Creditors' Committee argued that the Term Loan termination statement filed in connection with the payoff of the Synthetic Lease ended the perfected status of the Term Loan, and therefore, the Creditor's Committee should recover the Term Loan payment for the benefit of the debtor's estate. The Secured Party argued that it had not provided authorization to the Borrower to terminate the financing statement relating to the Term Loan

and without such authorization, the termination was ineffective. The Creditors' Committee argued that it should be able to rely on the approval of the termination statement and filing for evidence of termination of the Term Loan security interest.

The Bankruptcy Court's Decision

In a lengthy decision, the Court focused on the 2001 revisions to Article 9 and the requirement that authorization is necessary for a filing in the UCC records to be effective. The Court felt that the issue at hand – and what the UCC left up to case law – was what constitutes requisite authorization for the filing of a termination statement when a third party files the termination statement on the secured party's behalf. As "authorization" is not defined under the UCC, the Court turned to agency law to determine whether the Borrower, as an "agent" had been authorized by the Secured Party to terminate the filing related to the Term Loan.

After reviewing general agency principles, the Court concluded that the agent must *reasonably believe* that the principal intended for the agent to terminate the initial financing statement for that particular financing. Based upon testimony, the Court concluded that the Secured Party only intended to grant, and only granted, authority to the Borrower to terminate the Synthetic Lease related financing statements and that the Borrower, as agent, believed that it was only given the authority to terminate the Synthetic Lease related financing statements. That the Secured Party and its counsel had reviewed and advertently approved the filing of the Term Loan termination statement was not sufficient evidence to demonstrate that the Secured Party had, for Article 9 purposes, intended to authorize the Borrower to terminate the financing statement. Therefore, failing to find evidence of authorization to file the specific termination statement related to the Term Loan, the Court found that the Term Loan financing statement remained effective, and therefore, the Secured Party was perfected on the date the Chapter 11 proceeding was filed. As a result, the Secured Party would not be required to disgorge the Term Loan payment it received from proceeds of the debtor-in-possession loan.

Implications

The Court's decision is a stark reminder that paying attention to details is an all important aspect of secured financing. In particular, potential secured creditors should be mindful that when entering into a financing arrangement with a new borrower, collecting information with respect to termination statements of record is a necessary part of due diligence. A request for evidence of authorization relating to filed terminations is an appropriate due diligence request. It is equally important for potential borrowers to obtain and maintain payoff letters and authorizations received when financing arrangements are paid off. Having these records in your file will prove highly beneficial when entering into new financing arrangements.

¹*Official Committee of Unsecured Creditors of Motors Liquidation Company v. JP Morgan Chase Bank NA (In re: Motors Liquidation Company)*, 2013 Bankr. LEXIS 814 (Bankr. S.D.N.Y. Mar. 1, 2013).

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Scott Lessne

Senior Counsel – Washington, D.C.

Phone: +1 202.624.2597

Email: slessne@crowell.com