

1.5 Billion Reasons To Be Careful With Your UCC Termination Statement

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The Uniform Commercial Code ("UCC") contains important rules that creditors must understand and follow if they want to create and maintain perfected and enforceable security interests in personal property collateral. How important? A case decided on January 21, 2015, by the United States Court of Appeals for the Second Circuit provided 1.5 billion reasons for one unfortunate creditor who made one little mistake.

The case involved a UCC financing statement that was mistakenly terminated by legal counsel for JPMorgan Chase. JPMorgan had two loans with General Motors. When General Motors paid off one of the loans, JPMorgan instructed its attorneys to terminate the numerous financing statements associated with the loan as part of the closing. These financing statements are usually identified by a long string of numbers. Unfortunately, the law firms involved in the deal terminated one too many financing statements. They included in the list one of the 28 financing statements that secured a \$1.5 billion loan that was not being paid off. Unfortunately for JPMorgan, the mistakenly-included financing statement was the key financing statement securing the \$1.5 billion loan. No one noticed the mistake until General Motors filed bankruptcy in 2009.

In the bankruptcy court, a committee of unsecured creditors of General Motors argued that JPMorgan had lost its security interest as a result of the error. JPMorgan countered, essentially, with a "blame the lawyers" defense. It argued that the erroneous termination statement was ineffective because the UCC requires the secured party of record to "authorize" the filing, and JPMorgan certainly didn't authorize the termination of that particular financing statement.

Five years and much litigation later, the Second Circuit held that the subjective intent of the secured party is irrelevant. If the secured party authorizes the erroneous filing, it is effective— even if the attorneys made a mistake and the secured party did not catch it. JPMorgan had approved the closing checklist that contained the erroneous termination statement and the draft UCC-3 termination statement, so it was out of luck even if it did not understand the effect of the termination. The result: JPMorgan's \$1.5 billion secured loan suddenly became unsecured.

Although the Second Circuit's decision is not binding in North Carolina, the best practice for creditors is to assume that North Carolina courts would reach the same conclusion. Therefore, creditors need to be extremely vigilant in loan closings involving multi-loan relationships. If an attorney is handling the transaction, review the closing checklist carefully. Mistakes happen, and there is no substitute for a second set of eyes. Conduct a post-closing review as well to be doubly sure that no mistakes were made.

And if you do mistakenly terminate a UCC-1 financing statement, you should immediately file a new UCC-1. It is your only option. Although you will be put at the back of the line of secured creditors, if there is one, you will at least be a perfected secured creditor again with rights superior to any subsequent creditor.

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