

# Avoiding Nightmare Mistakes When Releasing Security Interests

Have you heard about the recent \$1.5 billion (yes, billion) mistake that resulted from the erroneous filing of a UCC-3 termination statement? Did it give you nightmares? It should. For those unfamiliar with the situation, a brief summary is provided below.<sup>1</sup>

In October 2001, General Motors obtained approximately \$300 million in a synthetic lease financing transaction (the "Synthetic Lease") from a syndicate of lenders for which JPMorgan Chase Bank, N.A. ("Chase") was the administrative agent and secured party of record on the UCC-1 financing statements filed in connection with the Synthetic Lease (collectively, the "Synthetic Financing Statements").

Five years later, General Motors obtained an approximately \$1.5 billion term loan facility (the "Term Loan") from a different syndicate of lenders. Again, Chase was the administrative agent and the secured party of record on the UCC-1 financing statements filed in connection with the Term Loan, one of which covered, among other things, all of General Motors' equipment and fixtures at 42 of General Motors' facilities (the "Term Loan Financing Statement").

As the Synthetic Lease neared maturity in 2008, General Motors planned to repay the amount due on the Synthetic Lease and requested that its counsel for the Synthetic Lease prepare documents necessary to release the security interests held by the lenders in connection with the Synthetic Lease. In preparing the release documentation, General Motors' counsel correctly identified and prepared UCC-3 termination statements to release the Synthetic Financing Statements, but also incorrectly identified and prepared a UCC-3 termination statement to release the Term Loan Financing Statement. Even though drafts of the UCC-3 termination statements were sent to each of General Motors, Chase and Chase's counsel to review, no one noticed the error. The UCC-3 termination statements were then filed.

The error went unnoticed until 2009 when General Motors filed for Chapter 11 reorganization in the U.S. Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"). Chase informed the Committee of Unsecured Creditors (the "Committee") that a UCC-3 termination statement terminating the Term Loan Financing Statement was inadvertently filed and that Chase had intended to

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terminate only the Synthetic Loan Financing Statements. The Committee initiated litigation against Chase seeking a determination that the UCC-3 termination statement releasing the Term Loan Financing Statement was effective.

The Bankruptcy Court determined that the UCC-3 filing releasing the Term Loan Financing Statement was unauthorized and therefore not effective to terminate the Term Loan Financing Statement. The Committee appealed to the Second Circuit Court of Appeals (the "Second Circuit") and the Second Circuit certified the following question to the Delaware Supreme Court: "Under UCC Article 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 that is listed on the UCC-3?"<sup>2</sup>

The Delaware Supreme Court concluded that if the secured party of record authorizes the filing of a UCC-3 termination statement, then that filing is effective regardless of whether the secured party subjectively intends or understands the effect of that filing. The Delaware Supreme Court went on to say that "[b]efore a secured party authorizes the filing of a termination statement, it ought to review the statement carefully and understand which security interests it is releasing and why ...."<sup>3</sup> Although Chase never intended to terminate the Term Loan Financing Statement, it authorized the filing of a UCC-3 termination that did just that.

The end result is that the Term Loan Financing Statement was effectively terminated, which released the security interest held by the lenders for the \$1.5 billion Term Loan made to General Motors. The lenders became unsecured creditors on par with General Motors' other unsecured creditors, at least with respect to the massive amount of collateral described in the Term Loan Financing Statement.

The case described above should be a cautionary tale for anyone involved with the preparation or review of security interest release documents; particularly UCC-3 termination statements. Mistakes like the one above can be avoided by careful attention to detail. In an effort to help you sleep better tonight, we've provided a short list of things to check when preparing documentation for release of UCC security interests.

- Determine the scope of the security interest being released. Should the entire

security interest be released? Should only a part of the security interest be released?

- The answer to this question will determine whether you need to file a UCC-3 termination statement or a UCC-3 amendment statement.
- File a UCC-3 termination statement if you are releasing the entire security interest.
- File a UCC-3 amendment statement to either amend the collateral description or release certain collateral if only part of the security interest in collateral is being released. Be sure to confirm the description of the collateral being released.
- Examine the underlying UCC-1 financing statement that is being terminated or amended to ensure that it corresponds to the security interests being released.
- Confirm that the correct filing number and initial filing date are submitted on the UCC-3 termination statement or UCC-3 amendment statement.
- Confirm the jurisdiction in which the UCC-3 termination statement or UCC-3 amendment statement should be filed.
- Confirm that no other obligations remaining outstanding are secured by the security interest being released.
- Confirm that you have authorization from the secured party to file a UCC-3 termination statement or UCC-3 amendment statement. Authorization can often be included in a payoff letter from the secured party.

The bottom line when it comes to preparing and reviewing documentation to release a security interest is to take your time and thoroughly think through what security interests are being released.

If you have any questions about this e-alert, UCC-3 termination statements or releasing security interests, please contact your Reinhart attorney or any member of the Reinhart [Banking and Finance Department](#).

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