Billion Dollar UCC Blunder

By Jonathan W. Hugg / Jan 27, 2015

Lenders and their lawyers need to be aware of a recent federal appeals court ruling that the inadvertent termination of a UCC-1 by JPMorgan, securing a $1.5 billion loan, was effective - even though there was no dispute that the release of the lien was a mistake and that JPM never intended to abandon its collateral. The high profile of the lender, borrower, and lawyers, the massive value of the collateral involved, and the lack of any further possibility of appeal, will make the opinion an enduring warning of the potentially staggering consequences of seemingly mundane paperwork errors.

The case was Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.), decided by the United States Court of Appeals for the Second Circuit on January 21, 2015. General Motors obtained $300 million and $1.5 billion syndicated loans that JPM administered, each secured by different UCC-1s. In 2008, as the $300 million loan neared maturity, GM asked its counsel, an international New York law firm, to prepare the necessary documents to repay GM's lenders and release the collateral for that loan. Among these were UCC-3s, typically short, fill in the blank forms prepared by paralegals or clerks, used to end security interests created by UCC-1s. However, GM's lawyer prepared UCC-3s that terminated not only the UCC-1s for the $300 million loan, but also the UCC-1 for the $1.5 billion loan. Everyone involved in the transaction - GM, its counsel, JPM, and JPM's lawyer (another New York mega-law firm) - received and had an opportunity to review the UCC-3s, but missed the error. JPM's lawyer even complimented GM's lawyer, "Nice job on the documents." GM repaid the $300 million and JPM and its lawyer signed off on the UCC-3s and allowed GM's lawyer to file them, including the UCC-3 releasing the collateral for the $1.5 billion loan.

The mistake only surfaced a year later, in 2009, when GM filed for bankruptcy. The Committee of GM's unsecured creditors sought a determination from the Bankruptcy Court that the erroneously filed UCC-3 extinguished JPM's $1.5 billion lien, thereby rendering JPM just another unsecured creditor. JPM, however, argued that the UCC-3 was ineffective because it was filed by mistake, and no one had intended to release the collateral for the $1.5 billion loan. The Bankruptcy Court agreed with JPM, but the Court of Appeals reversed. The Court of Appeals held that the physical act of filing the UCC-3 was not a mistake; on the contrary, everyone knew of and had approved the filing. According to the Court, all that was necessary to terminate JPM's $1.5 billion security interest was for JPM to authorize its lawyer to permit the physical filing of the rogue UCC-3 form. It was irrelevant that JPM did not mean to release its lien and never told its lawyer to approve the termination of its UCC-1.

The Court's decision is a nightmare scenario for lenders and their lawyers. The lenders must now get in line with the unsecured creditors and will probably recover only pennies on the dollar. Meanwhile, because of their failure to review a three-page form (or because of disdain for such humdrum tasks?), the lawyers face reputational consequences, beyond likely losing a client, and probable large malpractice claims. Overall, the simple lesson is for lenders and lawyers never, ever to underestimate the significance of filing accurate loan documents, especially those releasing security interests, because courts will construe them in a strict and literal manner. More generally, the message is that the legal climate is still anti-bank, and that lenders and their lawyers must remain vigilant and critically scrutinize even their most routine transactions because unsympathetic courts will not rescue them from mistakes and oversights.

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