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Paralegal's Mistake Costs Lender (JPMorgan Chase) a $1.5 Billion Security Interest in Loan

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Lawyers for the Profession® Alert

In re Motors Liquidation Co., ___ F.3d ___, 2015 WL 252318 (2d Cir. 2015)

Brief Summary

The U.S. Court of Appeals for the Second Circuit held that JPMorgan Chase Bank, N.A.'s security interest in a $1.5 billion loan to General Motors (GM) was terminated after an error by a paralegal at the law firm representing the borrower went unnoticed by counsel for the borrower and the lender (JPMorgan).

Complete Summary

In October 2001, GM entered into a synthetic lease financing transaction (Synthetic Lease), by which it obtained approximately $300 million in financing from a syndicate of lenders including JPMorgan. GM's obligation to repay was secured by liens on real estate, and JPMorgan was identified on the UCC financing statements as the secured party of record.

Five years later, GM entered into a completely unrelated loan agreement (the Term Loan), whereby GM received approximately $1.5 billion in financing from a different syndicate of lenders. The lenders took security interests in a large number of GM assets, and JPMorgan again served as administrative agent and secured party of record. Among the UCC financing statements filed for the Term Loan was the "Main Term Loan UCC-1" statement.

In September 2008, GM contacted its counsel for the Synthetic Lease and explained that it planned to repay the amount due. GM requested that its counsel prepare the documents necessary for JPMorgan and the lenders to be repaid and to release the security interests the lenders held in GM's property.

One of the steps to pay off the Synthetic Lease and terminate the lenders' security interests in GM's property was to create a list of security interests held by GM lenders that would need to be terminated. A partner at the firm representing GM assigned an associate to draft documents to pay off the Synthetic Lease. In turn, the associate "asked a paralegal who was unfamiliar with the transaction or the purpose of the request to perform a search for UCC-1 financing statements that had been recorded against GM in Delaware." The paralegal identified three UCC statements. Two related to the Synthetic Lease. The third UCC financing statement, however, was the Main Term Loan UCC-1 statement for the unrelated Term Loan. Neither the paralegal nor the

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associate realized that only the first two UCC statements were related to the Synthetic Lease and that the third UCC statement related instead to the Term Loan. The closing checklist prepared by counsel for GM, the borrower, identified the Main Term Loan UCC-1 for termination. Counsel for GM then drafted three UCC-3 statements; two for the security interests related to the Synthetic Lease and one to terminate the Main Term Loan UCC-1.

Copies of the closing checklist and draft UCC-3 termination statements were circulated to individuals at the borrower and its law firm, and to the lender and the law firm representing JPMorgan. No one at GM or JPMorgan, or either of the law firms representing them, noticed the error even though copies of the closing checklist and draft UCC-3 termination statements were sent to individuals at each organization for review. All three UCC-3's were filed with the Delaware Secretary of State, including the UCC-3 that terminated the Main Term Loan UCC-1.

It was not until GM's bankruptcy in 2009 that the mistake was discovered. JPMorgan then informed the committee of unsecured creditors (the Committee) that a UCC-3 termination statement relating to the Term Loan had been inadvertently filed in October 2008. JPMorgan argued that since it had only intended to terminate liens related to the Synthetic Lease, the UCC-3 termination statement relating to the Term Loan was therefore unauthorized and ineffective.

The Committee disagreed and on July 31, 2009, it commenced an action against JPMorgan in the U.S. Bankruptcy Court for the Southern District of New York. The Committee sought a determination that, despite the error, the UCC-3 termination statement was effective to terminate the Term Loan security interest and render JPMorgan an unsecured creditor on par with the other GM unsecured creditors. JPMorgan disagreed, reasoning that the UCC-3 termination statement was unauthorized and therefore ineffective because no one at JPMorgan, GM, or their law firms had intended that the Term Loan security interest be terminated. On cross-motions for summary judgment, the bankruptcy court concluded that the UCC-3 filing was unauthorized and therefore not effective to terminate the Term Loan security interest. *In re Motors Liquidation Co.*, 486 B.R. 596, 647–48 (Bankr. S.D.N.Y. 2013).

On appeal to the Second Circuit, the Committee and JPMorgan offered competing interpretations of UCC Section 9-509 (d)(1), which provides that a UCC-3 termination statement is effective only if "the secured party of record authorizes the filing." The court recognized that the question of what the UCC requires a secured lender to authorize to extinguish a perfected security interest presented a significant issue of Delaware state law and certified the question to the Delaware Supreme Court. The Delaware Supreme Court then explained 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."

With the Delaware Supreme Court interpretation in hand, the Second Circuit went on to answer the question: "Did JPMorgan authorize the filing of the UCC-3 termination statement that mistakenly identified for termination the Main Term Loan UCC-1?" The Second Circuit noted that JPMorgan relied on its counsel and the attorney's only comment to the draft UCC-3 termination statements or the closing checklist was: "Nice job on the documents." Although the Second Circuit understood that no one at JPMorgan, its law firm, GM or its law firm took action intended to affect the Term Loan, it also found that what JPMorgan intended to accomplish was a distinct question from what actions it authorized to be taken on its behalf. The Second Circuit found that while "JPMorgan never intended to terminate the Main Term Loan UCC-1, it authorized the filing of a UCC-3 termination statement that had that effect." Thus, JPMorgan's security interest in the $1.5 billion loan to GM was terminated.

Significance of Opinion

This decision is significant because it underscores the dangers of tiered case management and of delegating work to support staff, and the need for quality control protocols in high-stakes transactions. It further demonstrates that one never knows what will happen in litigation. Despite the fact that all parties and all counsel acknowledged the paralegal's mistake, the bankruptcy court and the appellate court disagreed regarding the effect of the mistake.

For more information, please contact Terrence P. McAvoy.

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