

**ALERTS**

## Finance, Insolvency & Restructuring And Appellate Law Alert - Whose Burden Is It To Check For Mistakes In UCC Filings? Delaware Supreme Court Flips Bankruptcy Court's Ruling In GM Bankruptcy Case

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On Oct. 27, the Delaware Supreme Court ruled that even inadvertent mistakes in UCC filings count – the burden rests on the filing party to detect errors, and not on affected parties who come across them in a search. This ruling upsets the 2013 decision of the bankruptcy court and will ultimately determine the character of a \$1.5 billion security interest in the General Motors (GM) bankruptcy.

### *Background*

Before GM entered bankruptcy, a group of lenders made a \$1.5 billion term loan to GM. In 2008, GM's attorneys filed UCC-3 statements intending to terminate perfection of the lenders' security interest in an earlier (and unrelated) loan to GM. Unfortunately, the paralegal tasked with the job of assembling the paperwork inadvertently included a termination statement bearing the filing number of the \$1.5 billion term loan. Many individuals from GM, the lenders and various law firms involved in the filing reviewed the paperwork and approved the filing without noticing the mistake – until GM entered bankruptcy.

The Official Committee of Unsecured Creditors sought a determination that, thanks to the error (which the lenders brought to its attention), the lenders' security interest was unperfected, which, under applicable bankruptcy law, would make the loan largely unsecured.

### *Bankruptcy court lets the lenders off the hook*

On March 1, 2013, the bankruptcy court (Judge Robert E. Gerber) ruled in favor of the lenders, finding that the effect of the erroneous filing depended upon whether it had been “authorized.”

What constitutes an “authorized” filing? The bankruptcy court found that, based on principles of agency law, the lenders did not give, and GM did not have, actual authority to file the financing statement terminating perfection of the security interests for the term loan. As a result, the faulty termination statements had no legal effect.

The case went up on direct appeal to the Court of Appeals for the Second Circuit, which certified the question to the Delaware Supreme Court.

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## *Delaware Supreme Court puts the lenders back on the hook*

On Oct. 27, the Delaware Supreme Court ruled that "it is enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest." Under the Delaware UCC, parties in commerce are entitled to rely upon a filing authorized by a secured lender and assume that the secured lender intends the plain consequences of its filing.

In other words, it was enough that the lenders had knowingly approved for filing a termination statement purporting to extinguish perfection of the security interest.

The case now goes back to the Second Circuit, which may have room to let the lenders off the hook. The Delaware Supreme Court left open the "fact-based question of whether [the lawyers] had authority as . . . agent [for the lenders] to file the termination statement."

For the time being, though, UCC filers should be aware that the burden is on them to carefully review filings and catch any mistakes before statements are filed -- or at least before anyone searching the filings does.

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