Banking Update

April 30, 2013 • Jonathan J. Wegner, Editor

BAIRD HOLM LLP
ATTORNEYS AT LAW

Accidental Filing of UCC Termination Statements – Can the Mistake be Fixed?

When a loan is paid off, one of the next steps may be for the lender to release its security interests in the borrower's collateral. This is most often done by using a form UCC-3. By checking the box marked "Termination" the secured party states that the specified financing statement is no longer effective. Anyone who searches that borrower's UCC records thereafter will see that the lender's filing has been terminated.

This article talks about accidental filings of termination statements—when that termination statement is filed by mistake. Does the lender's security interest cease to exist, or can that mistake be "undone"?

The question comes up more than you might think. Unfortunately, the courts don't agree on the effect of a mistakenly filed termination statement.

Two recent cases illustrate the point, and each one should cause lenders to look at their filing procedures more carefully.

In one case, which arose in connection with the General Motors bankruptcy, the lawyer for JPMorgan Chase Bank authorized the GM lawyer to file a UCC termination statement on a $1.5 billion loan—by mistake. The parties had documented a payoff, so the lawyer for the Bank looked at the UCC-3, told the borrower to go ahead and file the termination statement, and the borrower's lawyer did just that.

The problem was that those two lawyers weren't working on that $1.5 billion loan transaction, but rather on a completely different transaction involving a real estate lease. Same lender (Chase) and same borrower (GM), but different debts.

Also in this issue

3 Treasury's Auction of its TARP Capital Purchase Program Investments

4 A Will for your Avatar: Estate Planning for Digital Assets

5 Flood Insurance Could Bring Flood of Anti-Servicer or Anti-Mortgagee Litigation

6 Upcoming Speaking Engagements

JPMorgan Chase Bank did not catch the mistake until after GM filed bankruptcy a few months later. In a bankruptcy case, security interests that are not perfected as of the filing of the bankruptcy, can be set aside by the court. As a result, the lender can find itself unsecured.

A lawsuit in the bankruptcy court raised the question of whether a mistakenly filed termination statement is "authorized" and therefore effective.

The court held that although the termination statement was filed with permission of the Bank, that permission was given by mistake, because it referred to the wrong underlying financing statement. The termination statement was therefore not "authorized."

The court pointed out that prior to 2001, UCC termination statements could only be filed if they were signed by the secured party. However, since its 2001 amendment, Article 9 no longer requires the execution of a UCC-3 by the secured party. Instead, it may be filed without any signature, and by anyone, provided that the filing has been "authorized" by the secured party. Importantly, said the court, "there now is no automatic consequence by reason of the filing of a termination statement. The fact that a termination statement has been filed does not by itself mean that the initial statement came to an end. It all depends on whether the termination of the underlying initial financing statement was authorized. If the requisite authorization was lacking, the termination was ineffective."

The court found that because it was filed by mistake, it was not authorized, and therefore Chase did not lose its security interest.

"There now is no automatic consequence by reason of the filing of a termination statement. "

Compare that outcome to another recent case involving Hickory Printing Group, Inc. There, the lender also mistakenly filed a UCC-3 termination and accidentally terminated the Bank's security interest. One difference in that case was that although the Bank had two loans (a line of credit and a term loan), they were cross-collateralized against the same collateral, using one UCC financing statement. When the term loan was paid off, the bank filed a termination statement, not realizing that it was effectively terminating its security interest with respect to collateral for the line of credit. Once again, the Debtor filed bankruptcy not long afterward.

Unlike the GM court, the Court in Hickory Printing found that although the Bank did not intend to terminate its collateral for the term loan, the filing of the termination statement was "authorized" and therefore effective. The court also found that even though not long afterward the Bank filed a "correction" statement attempting to remedy its mistake, that statement did not resurrect the security interest.

What lessons can lenders learn from these cases?

First, make sure that you have a policy and procedure in place that will minimize the chances of accidental or incorrect filings. For example, you may want to require at least one other bank officer or lawyer, other than the bank's UCC preparer, to check them before filing. Lenders may want to make notations in the file or on your system when the borrower has more than one loan, to minimize the risk that other loans are not inadvertently affected by a payoff.

Second, if you are using a lawyer or title company to process a closing where the lender is to be paid off, make sure the written instructions to that lawyer or title company only authorize the termination of specific financing statements pertaining to that particular loan.

Finally, if you are relying, for a new loan, on collateral that once was the subject of some other lender's UCC, a phone call or e-mail to that lender seeking written verification that the loan has been paid off and the collateral is no longer encumbered, might be in order. If that lender accidentally terminated its UCC, it is better to find that out before you make that loan. ■

T. Randall Wright

Treasury's Auction of its TARP Capital Purchase Program Investments

During the 2008 and 2009 financial crisis, the United States Treasury (the "Treasury") established several programs in an attempt to stabilize the economy. One of these programs was the Troubled Assets Relief Program ("TARP") Capital Purchase Program ("CPP"). The purpose of the CPP was to provide immediate and temporary funding to viable financial institutions. Over 700 financial institutions throughout the United States took advantage of this program and borrowed funds from the Treasury. In exchange, the Treasury took an ownership position in the financial institutions through the issuance of preferred stock (or for S-corps, a subordinated debt security).

The Treasury now holds illiquid investments in several financial institutions and is faced with the dilemma of being a shareholder or debt holder for indefinite periods of time.

Nearly five years later, the Treasury now holds illiquid investments in several financial institutions and is faced with the dilemma of being a shareholder or debt holder for indefinite periods of time. Although TARP recipients can repay any assistance provided by the Treasury at any time, subject to prior regulatory approval, the Treasury generally cannot demand repayment. For these reasons, in 2012, the Treasury initiated a strategy to wind down its outstanding TARP bank investments in the CPP. The Treasury outlined its three options: (i) wait for the TARP recipients to voluntarily repay, (ii) sell its investments, or (iii) restructure its investments to facilitate repayment or sale. The first option is challenging as TARP CPP recipients are not required to raise capital and repay the Treasury, and waiting for voluntary repayment generally does not align with the Treasury's goal of this program acting as an emergency (and temporary) program.

The Treasury has heavily relied on the third option to wind down its program and commenced Dutch auctions of its investments in preferred stock and subordinated debt. The Dutch auction process accepts bids for the amount of preferred shares/debt that investors are willing to purchase and the price they are willing to pay. The auctioned shares/debt are assigned to the bidders from the highest bids down, until all of the allotted shares/debt are assigned. The Treasury's first auction relating to CPP investments occurred in March 2012, and the Treasury has continually been auctioning its investments since that time. Often, the Treasury sells its investments in CPP at a discount to the original par value. The financial institutions with outstanding TARP CPP funds and the price received at auction are posted on the Treasury's website (www.treasury.gov).

The Treasury notifies financial institutions that their preferred shares or subordinated debt are being considered for auction. Once a financial institution is selected for auction, such institution is required to enter into a Placement Agency Agreement with the placement agents who are retained by the Treasury to place (i.e. sell) the Treasury's investment to new investors. A few days before the auction, the Treasury issues a press release announcing the names of the auction participants and related details. After that press release, the auction occurs the following week and lasts approximately four business days. Redacted versions of the Placement Agency Agreements also are posted on the Treasury's website (www.treasury.gov).

Each month, the Treasury continues selling its CPP investments and intends to continue until nearly all of its CPP investments are sold. The Treasury has already received approximately $3 billion in proceeds from CPP auctions and has indicated that it may retain certain CPP investments, which investments the Treasury expects will be repaid at par. As the Treasury continues to sell its CPP investments, a program that received a lot of attention and criticism will cease its existence and merely be a historical program enacted to provide relief during the 2008 – 2009 crisis. ■

Amber N. Preston

A Will for your Avatar: Estate Planning for Digital Assets

When obtaining an estate plan, people generally have the goal of passing their real and personal property in an orderly way according to their wishes. However, as the world's business and activities are increasingly conducted electronically, people generally neglect to form a plan to deal with some of the assets they use most on a daily basis: digital assets and accounts.

Personal representatives handling decedents' estates have been confronted with the difficult problem of having insufficient information and access to important accounts and passwords, such as online bank accounts, bills set on automatic pay, e-mail data and contacts, and social media accounts. This issue especially affects banks, where the goal of providing smooth and simple account transition between a decedent and a joint owner or beneficiary is sometimes at odds with laws and regulations concerning privacy and confidentiality.

As this problem has become more widespread, the Uniform Law Commission has started to develop a model set of laws that states will be able to adopt to deal with this problem. However, without this model law in effect, estate planning attorneys and information technology professionals have devised a number of solutions to deal with the sometimes uncomfortable issue of granting passwords to personal representatives after a decedent's death or to an attorney-in-fact during a principal's incapacity, while maintaining sufficient privacy during life. Banking customers planning for end-of-life transition of accounts would be prudent to consider these ideas, not only for their online bank and financial accounts, but for their entire digital profile.

Recommendation #1: Create an Inventory of Online Accounts and Passwords and Store the Document in a Safe Place

The first recommendation to help people manage digital assets after death is for a person to go through all of their online accounts, including their bank accounts, e-mail, social media, retirement accounts, and services with automatic pay established, and to write down their log-in information and passwords. A person should not store this information on their computer, in case the computer is hacked or stolen. Instead, this information should be stored in a safe but accessible place, such as in a safety deposit box or with a very trusted person. Upon that person's death or incapacity, this list of passwords can be used to access important accounts, terminate services no longer needed, transfer assets to beneficiaries, and settle an estate.

Recommendation #2: Establish a Social Media or Digital Asset Will

The second recommendation is for a person to create an inventory of accounts and passwords as provided for in recommendation #1, but then take extra steps by providing specific instructions on how a personal representative should use the information provided and analyzing the terms and policies of each account and website. The United States General Services Administration has recommended that people establish these Wills, generally referring to these documents as a "Social Media Will" or a "Digital Asset Will." To establish a Social Media Will, a person should:

- Document their online accounts and passwords and place this document in a private but accessible location.

- Appoint an online personal representative or executor to handle the Will after the person's death.

- State how their directives on how the personal representative should handle their online accounts after death. However, this specific consideration is more important for social media and e-mail rather than financial accounts, where the main concern is allowing a person to have access to accounts to handle an estate.

- For the account owner's protection, place a condition in the Will requiring presentation of a death certificate for a personal representative to take actions; and

- Review the privacy terms and policies of each website to see if specific steps should be taken for different websites or accounts.

Recommendation #3: Enroll in an Online Service

Finally, a number of companies provide services that manage online accounts and passwords. Two common services are SecureSafe and Legacy Locker, which generally and automatically take similar steps as recommended in the above. SecureSafe provides a free service for fifty passwords and one beneficiary and an unlimited service for $13 per month. Legacy Locker provides a free limited account or a paid account for $30 per month or $300 for life. With any online service where passwords are stored, a person should research whether such a website has sufficient security.

Similar to other estate planning techniques, this type of planning can save loved ones from unnecessary expenditures, time and legal expenses, and headaches.

With any online service where passwords are stored, a person should research whether such a website has sufficient security. ■

Daniel P. Fisher

Flood Insurance Could Bring Flood of Anti-Servicer or Anti-Mortgagee Litigation

Spring rains help flowers bloom but also bring to mind possibilities of freshwater floods. Flood insurance definitely has its place in prudent mortgage lending. Mishandling of flood insurance covenants by a mortgage loan servicer or mortgagee, however, can lead to a "flood" of anti-servicer or anti-mortgagee litigation. Read on for an important update on such litigation.

A Mr. Casey and a Mr. Skinner filed a purported New York class action suit known as *Casey v. Citibank, et al.* They alleged several causes of action related to flood insurance. According to the U.S. District Court for the Northern District of New York, here are Casey's allegations:

Casey's mortgage contained this provision:

Fire, Flood, and Other Hazard Insurance. Borrower shall insure all improvements on the Property, whether now in existence or subsequently erected, against any hazards, casualties, and contingencies, including fire, for which Lender requires insurance. This insurance shall be maintained in the amounts and for the periods that Lender requires. Borrower shall also insure all improvements on the Property, whether now in existence or subsequently erected, against loss by floods to the extent required by the Secretary [of the Department of Housing and Urban Development ("HUD")].

After allegedly accepting flood insurance at a level of less than $35,000 for several years, Citi demanded that Casey increase coverage by $107,780 and eventually force-placed coverage in that amount. Casey's objections caused him to sue. He alleged, among other things, damages in increased premiums that breached the mortgage (breach of contract) and also subjected Citi to liability under New York's Deceptive Practices Act. The defendant banks moved to dismiss the suit. The court recently denied the motion, ruling that Casey's claims are viable at least for now. The court noted that the lender's discretion in the second-to-last sentence quoted above arguably did not apply to flood insurance. Instead, Casey arguably could satisfy any flood insurance covenant by providing only the minimum flood coverage "required by" HUD, as per the last quoted sentence above.

Citi, being only the servicer of Skinner's mortgage, lacked discretion to require various amounts of flood insurance.

Citi's motion to dismiss Skinner's claims related to breach of mortgage also failed but for a different reason. The terms of Skinner's mortgage apparently did not include the last-quoted sentence above and also contained some different language elsewhere. But Citi was not the lender, in the court's view. The discretionary power to require

insurance in Skinner's mortgage was only for the lender. Citi, being only the servicer of Skinner's mortgage, lacked discretion to require various amounts of flood insurance.

Many states, such as Nebraska and Colorado, have an unfair deceptive acts and practices statute that authorizes certain private suits. In states with such a statute, an aggrieved mortgagor may have at least two claims for relief. But even in states lacking the statute, the mortgagor could assert a contract claim for breach of mortgage. Whether or not your state has such a statute, be alert to possible breaches of mortgages and deeds of trust related to flood insurance. ■

Thomas O. Ashby

Upcoming Speaking Engagements

Jesse D. Sitz and Jonathan J. Wegner will present at National Business Institute's Business Law Boot Camp. The seminar will take place on May 21, 2013 at the Scott Conference Center in Omaha. ■

Banking Update

Banking Update is intended for distribution to our clients and to others who have asked to be on our distribution list. If you wish to be removed from the distribution list, please notify aremington@bairdholm.com.

Baird Holm Banking Group

Enforcement Action Defense & Litigation Defense

William G. Dittrick

Kenneth W. Hartman

Mergers, Acquisitions & Compliance

Douglas D. Murray

Amber N. Preston

Jonathan J. Wegner

John S. Zeilinger

Lending

Jon E. Blumenthal

Lawrence E. Kritenbrink

Jacqueline A. Pueppke

Drew K. Theophilus

Steven C. Turner

Creditors' Rights & Bankruptcy

Thomas O. Ashby

Brandon R. Tomjack

T. Randall Wright

Eric J. Adams

Human Resources

Kelli P. Lieurance

Scott S. Moore

Payments & Technology

Grayson J. Derrick

Terrence P. Maher

James E. O'Connor

Baird Holm

1700 Farnam St
Suite 1500
Omaha, NE 68102

402.344.0500
402.344.0588