**KEY POINTS**

- Unlike the US equivalent, a statement of satisfaction and release of charged property is not conclusive evidence of the release or other relevant change of circumstances under English law.
- Where a party claims there is an error in the statement of satisfaction and release, the courts will first construe the underlying contract and if appropriate go on to consider mistake.
- Options including an extension of time, subrogation and claims in negligence are open to a creditor who has failed to register a company charge in the first place.

Feature

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# Registration of company charges and company insolvency: dealing with costly mistakes

This article considers a recent US decision on the mistaken release of a security interest and reflects upon the options available to holders of unregistered company charges in the UK when the company goes into liquidation.

A recent case giving rise to cold sweats in US financial markets is the judgment of the US Court of Appeals for the Second Circuit in *Official Committee of Unsecured Creditors of Motor Liquidation Company v JP Morgan Chase Bank N.A*, 21 January 2015, Docket No 13-2187 (*Unsecured Creditors v JP Morgan*), one of many decisions dealing with the fall-out from the General Motors liquidation.

## THE FACTS

In 2001 General Motors entered into a synthetic lease financing transaction to obtain approximately US$300m from a syndicate of lenders. In 2006 General Motors was granted a term loan facility for approximately US$1.5bn from a different syndicate. JP Morgan was a lender and the administrative agent and secured party of record in both transactions.

Security interests were granted in respect of both the synthetic lease and the term loan. The financing statements required under the Uniform Commercial Code (UCC) were duly filed.

In 2008 General Motors instructed its solicitors, Mayer Brown LLP, to prepare the documents necessary to repay the synthetic lease and release the relevant security interests. By mistake the solicitors included a security interest filed under UCC-1 no 6416808 4 as one of the interests to be released. In fact this interest secured the term loan.

On 30 October 2008 General Motors repaid the synthetic lease and the UCC-3 termination statements were filed, including one in relation to UCC-1 no 6416808 4. The following year General Motors filed for bankruptcy and a dispute arose over the effect of the mistaken termination statement.

## THE ARGUMENT

UCC §9-509(d)(1) provided that a UCC-3 termination statement is effective only if the secured party of record "authorize the filing"' of the UCC-3.

JP Morgan argued that the filing of the UCC-3 in relation to UCC-1 no 6416808 4 was mistaken, unauthorised and therefore ineffective.

The Secured Creditors argued that JP Morgan had authorised the *act* of filing and their subjective mistake was irrelevant.

## THE DECISION

Upon a certified question the Delaware Supreme Court adopted the reasoning of the Unsecured Creditors. All that the UCC requires is that the secured party authorises the filing to be made. It does not require the secured party to subjectively intend or understand the effect of that filing. The law expected a secured party to review termination statements carefully.

On the facts the US Court of Appeals for the Second Circuit held that JP Morgan had authorised the filing to be made. Both JP Morgan and its solicitors had seen the draft documents and passed no adverse comments.

## REGISTRATION OF UK COMPANY CHARGES

Company charges in the UK are governed by the Companies Act 2006, not by the UCC. However, like the UCC the UK implements a system of registration.

The aim of registration is to give public notice of the existence of the security interest. In the UK company charges must generally be registered (within 21 days) to be perfected (s 859A of the Companies Act 2006). The exception for charges covered by the Financial Collateral Arrangements (No 2) Regulations 2003 remains. A registrable charge which is not registered is not binding against liquidators, administrators and other creditors (s 859H).

Where a debt has been partly or wholly satisfied, or the property charged has been released from the charge or has ceased to form part of the company's property, it is often appropriate to file a statement of satisfaction and release. Upon receiving such a statement the registrar is required to record the change of circumstances on the register (see s 859L).

## COMPARING THE POSITION IN ENGLAND AND WALES

Plainly the detail of *Unsecured Creditors v JP Morgan* depends on

the interpretation of the UCC. However, the UCC procedure bears some similarity to the UK system of registration of company charges. It is therefore worth asking: Is *Unsecured Creditors v JP Morgan* simply an interesting quirk of US liquidations or a cautionary tale for UK lenders?

## AN INTERESTING QUIRK

In relation to mistakes at the point of release, the short answer is that *Unsecured Creditors v JP Morgan* is an interesting quirk. The unhappy fate in that case of the not-so-secure secured lenders is fortunately unlikely to be repeated in England.

A statement of satisfaction and release is not conclusive evidence of the relevant change of circumstances, namely a partial or total satisfaction of the debt or release of the security. There is no guarantee against inaccuracy or even fraud in such statements. A liquidator, administrator or creditor will therefore not be able to rely on such a statement to defeat a charge.

## AND ALSO A CAUTIONARY TALE

However, a mistake in the statement of satisfaction and release may not merely be an administrative error as in *Unsecured Creditors v JP Morgan*. It may signify a mistake in the agreement between creditor and debtor for the release.

What happens if the company's liquidator argues that the statement of satisfaction and release reflects the underlying agreement perfectly?

First and foremost this will depend on the construction of the contract.

If the creditor argues that the properly construed contract reflects a mistake, it must prove either that the parties were both mistaken about a fundamental fact or that it was unilaterally mistaken about a term of the contract. Mistake is notoriously difficult to establish.

An argument that an agent lacked authority to make such a contract will probably also run into difficulties. For the purposes of English law, an agent authorised to negotiate and make a deal is likely to have ostensible authority to negotiate and make the bad deal now complained of.

## THE EVEN BIGGER PROBLEM

*Unsecured Creditors v JP Morgan* highlights errors at the release stage. Those errors, however, are much more problematic in English law if they consist of a failure to register a company charge in the first place. What options are open to a creditor in this position?

- **Extension of time:** Pursuant to s 859F, the court may grant an extension of time if:
  - the failure to comply with the registration requirements was:
    - accidental or due to inadvertence or to some other sufficient cause; or
    - is not of a nature to prejudice the positon of the creditors or shareholders of the company; or
  - that on other grounds it is just and equitable to grant relief.

  This discretionary power will rarely be of comfort to a lender making an application where a company is insolvent. If a winding up has commenced then an application will not be made save in exceptional circumstances. The situation is little better if a winding up has not commenced but the company is insolvent or a meeting of creditors has been convened. Here, even if the application is granted, it is likely to be on terms that any subsequent liquidator has a right to apply to set aside the permission (*Re LH Charles & Co Ltd* [1935] WN 15 and *Re Braemar Investments* [1989] Ch 54). The co-operation of the company directors will often be of dubious help. Where directors, knowing of a company's insolvency, consent to an application for an extension of time, there is a risk that the proceedings will constitute a preference and that any charge will be set aside by the court in a subsequent liquidation (see *Bowen v Defries & Co* [1904] 1 Ch 37).
- **Subrogation:** It is possible that the holder of an unregistered charge could claim a security interest by subrogation. This would apply if the charge-holder discharged a prior security interest over the company's assets which was valid and enforceable (by registration if necessary).

  Such a subrogated charge arises by operation of law and probably falls outside the registration regime (see para 39-66 of *Goff & Jones The Law of Unjust Enrichment* (8th ed)). See also the case of *Menelaou v Bank of Cyprus UK Limited* [2013] EWCA Civ 1960, discussed at (2013) 10 JIBFL 621.

  Whether the court would be persuaded is another matter. In the context of company charges over land, the courts have held that the creditor has foregone any right to be subrogated to a vendor's lien by stipulating for a charge (see *Burston Finance Ltd v Speirway Ltd* [1974] 1 WLR 1648).
- **Drafting:** Skilled draftsmen in finance departments can avert many of the risks of secured lending but it is difficult to see how drafting can avert this particular risk. Parties cannot "contract out" of the system of registration and perfection. It is possible that clever wording may improve the prospects of obtaining subrogation rights.
- **Protocol 1, Art 1 of the European Convention on Human Rights:** This option involves ambitiously challenging the entire system of registration. Article 1 of the First Protocol provides protection against being deprived of one's possessions except in the public interest and subject to the conditions provided for by law.

  The argument once found favour with the Company Law Review Steering Group in 2001 but is unlikely to be upheld by the courts. Compliance with the registration system is easy and

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low-cost. The deprivation is partial: relating to third parties but not to the debtor itself. Further, the register serves an obvious public purpose.

- **The Blame Game Options:** On the right facts it may be possible that on the right facts it may be possible for a syndicate bank to bring a negligence action against the arranging and/or agent bank. In practice the arranging bank's duties and potential liability is likely to be heavily circumscribed in the documents.

Similarly, there may be legal recourse against the legal advisers. The Supreme Court case of *AIB v Redler* [2014] 3 WLR 1367 is a recent example of legal advisers held liable for a lender's defective security. In reality the effectiveness of this remedy will in part depend upon the extent of professional indemnity insurance and the capacity of the advisers to subsume any shortfall.

## CONCLUSION

Lenders continue to be vulnerable to everyday mistakes by such advisers and agents. Nothing can substitute for careful and timely registration of a company charge and equally careful negotiations and drafting if the agreement underpinning that charge is subsequently amended. ■

*Further Reading:*

- Releases of guarantees and security [2009] 5 JIBFL 245.
- The interpretation of contracts relating to financial transactions: Part 4: the doctrine of good faith and practical guidance [2014] 8 JIBFL 536.
- LexisNexis Loan Ranger blog: Can a chargor be estopped from challenging the validity of an incorrectly executed legal charge?