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Secured Lenders And Their Counsel Can't Overlook Minor Details

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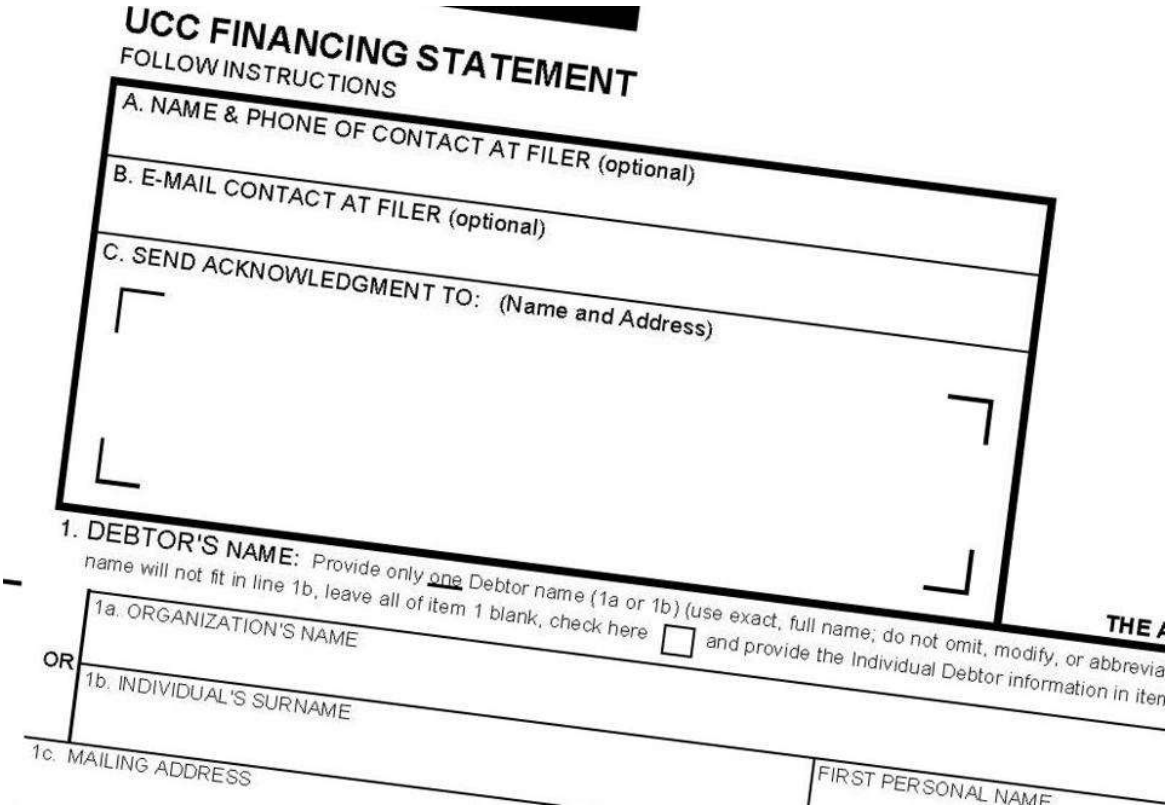

UCC-1 filings are easy to make correctly and a disaster if done wrong. U.S. GOVERNMENT

Many types of commercial financing rely on security. For a real estate loan, the main security usually consists of a mortgage. For other types of

financing, including real estate mezzanine loans, the main security will consist of a "security interest," a pledge, under the Uniform Commercial Code. Either way, if the borrower defaults, the security gives the lender a relatively straight path to its collateral. The lender doesn't need to go to the trouble of suing the borrower to obtain and then try to enforce an ordinary judgment.

If a lender wants good security, it usually must make a filing in some public office to disclose the lender's claim to its security. That way, other future prospective lenders and buyers will know about the lender's claim. Taking this step should also improve the lender's position if its borrower goes bankrupt.

Sometimes, a lender or its counsel forgets to make a required filing or manages to screw it up. That enables future lenders and buyers to claim a first priority interest in what should have been the first lender's collateral – but those future lenders and buyers can ignore the first lender's claim. So the filing represents a crucial step in closing any secured loan. It's easy and simple, and no big deal, except when it isn't done right or isn't done at all.

A pending New York lawsuit illustrates the perils. Here, a lender took a pledge of some claims that a borrower had against various third parties. Immediately after the closing, the lender's counsel was supposed to publicly file a UCC-1 financing statement that would have notified the world of the lender's claim to its collateral.

Eight months later, someone figured out that the first lender's UCC-1 financing statement hadn't been filed. In the meantime, another lender had filed its own UCC-1 financing statement claiming a lien on the exact same collateral. The second lender prevailed because the first lender hadn't filed its UCC-1 financing statement in time. When the shared borrower filed bankruptcy, the second lender was paid in full and the

first lender recovered nothing. The first lender sued its counsel for malpractice.

The litigation seems quite straightforward, based on failure of the lender's counsel to take an ordinary step after the closing, i.e., to file the UCC-1 financing statement. The litigation reminds secured lenders and their counsel of a few important lessons.

When a deal closes, everyone is tempted to move on to the next thing. They shouldn't. Their post-closing checklist and procedures merit the same level of attention as the closing itself.

One attorney or paralegal ought to have sole responsibility to handle post-closing filings. And a second person ought to be responsible for checking that the filings happen.

Soon after a deal closes, perhaps a third person should identify what filings should have been made, and run update searches to make sure they got made. It's called a collateral audit. It's cheap insurance.

Malpractice lawsuits are not efficient solutions to these problems. Any secured lender ought to maintain its own post-closing checklist and make sure it is followed.

A careful lender or its counsel can file the necessary UCC-1 financing statement before the loan closing if the borrower consents in writing. So

maybe the lender should do that, and not close until an updated search confirms the filing was actually made. That way it can't possibly fall between the cracks.

UCC-1 filings are easy to make correctly and a disaster if done wrong or not at all. Anyone in the secured lending business, and its counsel, must approach the process with a fastidious attention to detail and process.

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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**

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