



United States

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www.practicallaw.com/9-501-2871

OVERVIEW OF THE LENDING MARKET

1. Please give a brief overview of the main trends and important developments in the lending market in your jurisdiction in the last 12 months.

The US loan market has experienced some volatility over the past 12 months, being marked by rapid swings in market demand for new loans. At the beginning of 2010, much of the loan market activity focused on extending the maturity of existing loan facilities through amend and extend transactions, as few investors were willing to make new money loans. As the year has progressed, new syndicated loan financings have become more prevalent, including those concerning acquisition transactions. The size of the deals that banks are willing to underwrite has increased.

Increased competition among lending institutions and investors means that financing terms are more favourable to borrowers than those available at the beginning of 2010, with some deals done on terms similar to deals completed during the boom years preceding the global financial crisis. However, banks are more focused on downside protection for borrower defaults on loan facilities, and are increasingly concerned with collateral coverage for leveraged loans.

SECURITY: REAL ESTATE

2. Please briefly state what is considered real estate in your jurisdiction. What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

Real estate consists of an ownership or leasehold interest in land or tenements (real property). Real property law is governed by the law of the state where the real property is located. This chapter considers the general rules that apply in most states, with particular reference to the state of New York.

Common forms of security

Each state has its own form of real property security instrument. The most common are:

- **Mortgages.** The mortgage grants the lender a lien (in the US the term lien is often used synonymously with security interest or charge) on the real property (and any personal property that constitutes fixtures) as security for the payment and performance of certain obligations. The lender does not gain title to the real property unless there has been a valid foreclosure.

In a minority of states, however, a mortgage transfers title to the lender until the secured obligations are met.

- **Deeds of trust.** A deed of trust is a variant of the mortgage and is used in many states in its place. It usually involves a conveyance of the real property by the borrower to a third party, who holds it in trust for the lender as security for the debt.
- **Leasehold mortgages/leasehold deeds of trust.** A leasehold mortgage or deed of trust enables a lender to take a security interest in the borrower's interest as a tenant under a lease. Upon an event of default, the lender can foreclose on its leasehold mortgage and become the tenant under the lease, or transfer the tenancy to another entity. Leases often prohibit such mortgages or deeds of trust, or require the landlord's consent.
- **Assignments of leases and rents.** An assignment of leases and rents grants the lender a security interest over the rents received from the real property. This grant is contained in most commercial mortgages, though it can also be a grant in its own right. Usually an assignment provides the lender with the right to collect rents directly from tenants following an event of default, but many states require the lender to either take possession of the property, or appoint a receiver to exercise its rights under the assignment.

Formalities

Creation or attachment is the process by which a lender obtains a legally enforceable security interest in a borrower's asset. Perfection is the process by which the lender ensures that its security interest remains effective:

- In bankruptcy, against a bankruptcy trustee.
- Outside bankruptcy, against certain other creditors and third parties.

Creation/attachment. In all states, each security instrument granted over real property must be in writing and executed by the borrower. The borrower must be the legal owner of the real property or, in the case of a leasehold mortgage, the tenant under the lease. Each state has its own signature requirements. Generally, the lender does not need to sign the security instruments, and all signatures required must be notarised to record the document in the real estate records. Some states require multiple signatories and witnesses.

Perfection. In most states, the security instrument must be recorded in the applicable real estate records to perfect the lender's security interest in the real estate. These records are usually located in the county where the property is located. A legal description of the real property must be attached to the security instrument so that it is accurately indexed in the records.



SECURITY: TANGIBLE MOVABLE PROPERTY

3. Please briefly state what is considered tangible movable property in your jurisdiction, for example, machinery, trading stock (inventory), aircraft and ships? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

The Uniform Commercial Code (UCC) (a form of which has been enacted in each state) defines goods to include most forms of tangible movable property with respect to which a lien is granted in the United States. Goods are all assets that are movable when a security interest (see *Common forms of security*) attaches, such as equipment, inventory, farm products (including crops) and fixtures. The UCC defines fixtures as goods that have become so related to particular real property that an interest in them arises under real property law.

Common forms of security

A security interest (that is, an interest in personal property or fixtures that secures payment or performance of an obligation) is the only form of security that is contemplated under the UCC. While the terms lien and pledge are often used in legal documentation, they are not UCC terms. A pledge is usually used to refer to the granting of a security interest in equity interests. A lien is often used to refer to general security interests, as well as related concepts such as title retention agreements and, with respect to securities, a purchase option, call or similar third-party rights relating to those securities (see *Question 7*).

Formalities

Attachment of security interests. A security interest in personal property and fixtures must attach to become valid and enforceable against the borrower. The security interest only attaches if all the following criteria are met:

- Value has been given by the secured creditor to the borrower (for example, the borrower has received the proceeds of the loans under the credit facility).
- The borrower has the right to transfer rights in the asset (the security interest will attach only to the rights that the borrower has in the asset, for example the borrower's ownership right, or leasehold right).
- There is a security agreement, and an evidentiary requirement is satisfied, for example:
 - authentication (for example, the borrower has signed the security agreement);
 - possession (for example, collateral, other than certificated securities, is in the possession of the secured party pursuant to the debtor's security agreement);
 - delivery (for example, certificated securities in registered form are delivered to the secured party pursuant to the debtor's security agreement); and
 - control (for example, the secured party has control of collateral that is deposit accounts, investment property, electronic chattel paper or letter of credit rights pursuant to the debtor's security agreement).

The security agreement must provide a description of the secured assets that reasonably identifies what is described. An "all

assets" or "all personal property" description is not sufficient for a security agreement.

Once attachment of a security interest in an asset occurs, certain related assets are also automatically attached to the security. For example:

- Supporting obligations (secondary obligations that support payment or performance).
- Identifiable proceeds of any secured asset.

Principal methods of perfecting security interests. The principal methods of perfecting security interests in personal property and fixtures are as follows:

- Filing a financing statement in the office of the Secretary of State (or alternative state-designated central office) of the state under whose laws the borrower is organised. The financing statement must include:
 - the borrower's name and type (for example, a corporation), address, jurisdiction of organisation and (depending on the state law of the jurisdiction of organisation) organisational identification number;
 - the lender's name and address; and
 - a description of the secured asset. In contrast to the position with a security agreement, it is sufficient to indicate secured assets as all assets or all personal property (when all assets that can be secured under the UCC have been granted as security).
- Possession or delivery of the secured asset.
- Obtaining control of the secured asset.

Some types of assets can be perfected by only one of the three principal methods, while others can be perfected by more than one. The federal and state law of each state governing any aspect of a particular transaction must be reviewed to determine the precise rules (see *below, Special rules*).

Security interest in proceeds. If a security interest over an asset is perfected, then a security interest in the proceeds of that asset automatically remains perfected for 20 days after the borrower receives those proceeds. After that the security interest in the proceeds becomes unperfected unless one of the following applies:

- A financing statement was filed to perfect the security interest in the original asset and the proceeds are:
 - assets over which a security interest can be perfected by filing a financing statement in the office where the original financing statement was filed; and
 - not acquired with cash proceeds.
- The proceeds are identifiable cash proceeds.
- The security interest in the proceeds is perfected as an original secured asset before the expiry of the 20-day period.

Automatic perfection over related assets. Perfection of a security interest in a secured asset also constitutes automatic perfection in certain related assets. For example, a security interest in "supporting obligations" (letter-of-credit rights or other secondary obligations that support payment or performance) of any secured asset is automatically perfected by perfection of a security interest in that asset.



Continued perfection in disposed assets. A lender's filed financing statement remains effective in relation to assets disposed of by the borrower in which the lender's security interest continues after the disposition, even if the lender knows of (or consented to) the disposition.

Continued perfection after assignment by secured party. A lender that receives an assignment of a perfected security interest is not required to make an additional filing to maintain the perfection of that security interest.

Special rules. Certain property has requirements falling outside the UCC under state and federal law. The following (apart from real property) are the most significant in the context of syndicated lending:

- **Federally pre-empted property.** This includes certain intellectual property and certain aircraft, railroads and ships. The perfection of a security interest generally requires filing in the following specialised registries:
 - **Intellectual property.** See *Question 6*;
 - **Aircraft and certain aircraft-related assets.** The Federal Aviation Administration (49 U.S.C. § 44107);
 - **Railroads and related assets.** The Surface Transportation Board (49 U.S.C. § 11301); and
 - **Certain vessels.** The Secretary of Transportation (46 U.S.C. § 31321).
- **Insurance policies.** See *Question 5, Formalities: Security interests in insurance policies*.

Set-offs, landlord liens, workmen's liens and materialmen's liens are also outside the UCC.

Perfection of security interests in tangible movable property. A security interest over goods (other than non-inventory goods covered by a certificate of title) can be perfected by either:

- Filing a financing statement.
- Taking possession (either directly or by an agent of the secured party).

The usual procedure is to perfect by filing (special rules govern filings to perfect security interests in goods that are fixtures).

A security interest over goods held by a bailee and not represented by a document can also be perfected by obtaining the bailee's written acknowledgement that the bailee holds the goods for the lender's benefit.

A security interest over goods held by a bailee and represented by a negotiable document can also be perfected by perfecting a security interest in the negotiable document, which is done by the lender by either:

- Filing a financing statement that covers that document.
- Obtaining possession of that document.

A security interest over goods held by a bailee and represented by a non-negotiable document can also be perfected by either:

- The bailee receiving notice of the lender's security interest in those goods.
- Issuing the document in the lender's name.

Although vehicles are goods under the UCC, certificate of title statutes in each state govern perfection of security interests over vehicles unless they constitute inventory. Typically, perfection is achieved by noting the existence of the lien on the vehicle's certificate of title.

SECURITY: SHARES AND FINANCIAL INSTRUMENTS

4. What are the most common forms of security granted over financial instruments, such as shares and other securities (both in certificated and dematerialised form)? How are they created and perfected?

Common forms of security

A security interest over the following is commonly created in a security agreement:

- Instruments (a writing evidencing a right to payment, which is not a security agreement or lease and which is transferred by delivery with endorsement).
- Investment property (securities, security accounts and the securities entitlements credited to them, commodities contracts and commodities accounts).
- Chattel paper (records that evidence a monetary obligation and a security interest in specific goods).

Formalities

Creation of security interests in financial instruments. See *Question 3, Formalities: Attachment of security interests*.

Perfection of security interests in financial instruments. Perfection depends on the type of property:

- **Instruments.** The two principal methods of perfection in instruments are:
 - filing a financing statement;
 - possession or delivery of the financial instrument.
- **Investment property.** The two principal methods of perfection in investment property are:
 - filing a financing statement;
 - obtaining control of the investment property.

The rules regarding control depend on whether the investment property is a:

- certificated security (a security represented by a certificate);
- uncertificated security;
- security entitlement (the rights and property interest of an entitlement holder in relation to a specified financial asset) or securities account;
- commodity contract (for example, a commodity futures contract or option on a commodity futures contract) or commodity account.

In relation to certificated and uncertificated securities, the lender can also perfect by taking delivery. For a certificated security, delivery can be achieved by one of the following:

- obtaining physical possession of the security certificate;



- having a third party (other than a securities intermediary) do so on the lender's behalf;
- having a securities intermediary do so if the security is registered in the lender's name, payable to the lender's order or endorsed to the lender (and not to the securities intermediary or blank).

For an uncertificated security, delivery can be achieved by having the uncertificated security registered in the issuer's records in either the:

- lender's name;
- name of a third party (other than a securities intermediary) on the lender's behalf.

- **Chattel paper.** A security interest over tangible chattel paper can be perfected by either:

- filing a financing statement;
- taking possession.

A security interest over electronic chattel paper can be perfected by:

- filing a financing statement;
- obtaining control, which is accomplished when the records composing the paper:
 - establish a single, authoritative, unique and identifiable original copy;
 - make clear that copies of the one authoritative copy are copies; and
 - make readily identifiable as authorised or unauthorised any revisions to the authoritative copy.

The UCC provides for certain circumstances under which chattel paper can be sold free of a security interest that was perfected by filing. The safest commercial practice, therefore, is to take possession or control (as applicable) and file as a precautionary measure.

SECURITY: CLAIMS AND RECEIVABLES

5. What are the most common forms of security granted over claims and receivables (such as debts or rights under contracts)? How are they created and perfected?

Common forms of security

A security interest over the following is commonly created in a security agreement:

- Accounts, that is, rights to payments of monetary obligations:
 - for property sold or otherwise disposed of;
 - for services rendered;
 - for policies of insurance issued;
 - for secondary obligations incurred;
 - for energy provided;
 - for use or hire of a vessel;
 - arising out of the use of a credit or charge card; or
 - as winnings in a government sponsored lottery.

- Commercial tort claims (a claim arising in tort regarding the claimant's business, but which does not include personal injury or death).
- Letters of credit and letter of credit rights (a right to payment for performance under a letter of credit).
- General intangibles (any personal property other than the types of personal property listed in Article 9 of the UCC, but including payment intangibles, contracts, intellectual property and software).

Formalities

Creation of security interests in claims and receivables. See *Question 3, Formalities: Attachment of security interests*.

For commercial tort claims, the security agreement must also specifically identify the claims subject to the security interest.

Perfection of security interests in claims and receivables. The following are the methods by which a security interest can be perfected in accounts, general intangibles and letter of credit rights:

- **Accounts.** A security interest is perfected only by filing a financing statement.
- **Commercial tort claims.** A security interest is perfected only by filing a financing statement, which must specifically identify the claims subject to the security interest.
- **General intangibles.** A security interest is perfected only by filing a financing statement, unless filing in a specialised register is required to perfect security interests over certain federally pre-empted property (see *Question 3, Formalities: Special rules*).
- **Letter of credit rights.** A security interest over a letter of credit right (other than a letter of credit right that constitutes a supporting obligation for another secured asset) can be perfected only by the lender obtaining control of that right. This happens if the issuer or nominated person has consented to an assignment of the proceeds of the letter of credit under Article 5 of the UCC (or other applicable law). However, perfection of the lender's security interest does not entitle the lender to draw under the letter of credit.

Security interests in insurance policies. The UCC applies to insurance policies only to the extent that payments under a policy constitute proceeds of a lender's other secured assets. State insurance laws, in general, do not otherwise specifically address how a lender creates and perfects a security interest in an insurance policy. However, judicial decisions in New York suggest that the following steps should generally be taken:

- The lender should give notice to the borrower's insurer that the security interest exists and ask the insurer to acknowledge the interest and agree to make payments as the lender directs.
- The lender should seek to have itself named as a loss payee (that is, an individual entitled to receive insurance monies) or as an additional insured under the borrower's insurance policy.
- The insurer should represent that it has received no other notification of a grant of a security interest in the insurance policy.



SECURITY: INTELLECTUAL PROPERTY

6. What are the most common forms of security granted over registered and unregistered intellectual property (such as patents, trade marks, copyright and designs)? How are they created and perfected?

Common forms of security

A security interest over the following intellectual property is commonly created in a security agreement:

- Patents (and licences of patents).
- Trade marks and trade secrets (and licences of trade marks).
- Copyright (and licences of copyright).

Formalities

Creation of security interests in intellectual property. See *Question 3, Formalities: Attachment of security interests*.

Perfection of security interests in intellectual property. The term general intangibles (see *Question 5, Common forms of security*) under the UCC covers certain forms of intellectual property, including patents, trade marks, trade secrets and copyrights. While security interests in the physical embodiments of intellectual property assets (for example, inventory and master recordings) are perfected at the state (UCC) level, federal statutes provide for the recording of registered copyright, trade mark and patent security interests. However, the scope of their pre-emptive rights over the UCC varies and in some cases is unclear. For example, there is US case law (*In Re Peregrine Entertainment Inc.*, C.D.Cal. 1990) indicating that a security interest in federally registered copyrights can only be perfected by recording the security interest at the federal level. Prudent lenders record against intellectual property at the state (UCC) level and record at the following registries:

- The US Copyright Office for registered copyrights (17 U.S.C. § 205).
- The US Patent and Trademark Office for patents (25 U.S.C. § 261) and registered trade marks (15 U.S.C. § 1060).

SECURITY: PROBLEM ASSETS

7. Are there types of assets over which security cannot be granted or is difficult to grant? Consider the following and give brief details of any additional requirements:

- Future assets.
- Fungible assets.
- Other assets.

Future assets

A security interest can be granted over future assets. However, security interests in assets that will be acquired in the future do not attach until the borrower actually acquires the asset. Additional filings or other steps are required for certain categories of after-acquired property, such as intellectual property and commercial tort claims.

Additionally, a security interest does not attach to assets that the borrower acquires after bankruptcy, unless the future assets are

proceeds of pre-bankruptcy assets to which the security interest has already attached.

Fungible assets

A security interest can be granted over fungible assets. However, perfecting a security interest in certain fungible assets (most notably, cash proceeds) can require the secured party to take additional steps (see *Question 3, Formalities: Security interest in proceeds*).

Other assets

A security interest cannot be granted in certain licences, such as licences issued by the Federal Communications Commission (see *Question 8*).

SPECIAL PURPOSE VEHICLES (SPVs) IN SECURED LENDING

8. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the debtor's assets, rather than to take direct security over those assets? If so, please give brief details of the practice and risks associated with it.

SPVs are often used to specifically address regulatory issues that prevent creditors from taking a direct security interest in certain assets. As a result, lenders frequently require borrowers to:

- Establish one or more SPVs to hold those assets.
- Prohibit the SPV from incurring debt or other obligations.
- Pledge the capital stock of the SPV as collateral for the loans (resulting in the functional equivalent of a direct pledge of the assets of the SPV).

The SVP structure is used, for example, in connection with Federal Communications Commission (FCC) licences, given that US federal law prohibits the pledge of an FCC licence as security by the holder of the FCC licence. Certain regulated industries, however (such as insurance), prohibit the pledge of the equity interests of the SPV.

QUASI-SECURITY

9. What types of quasi-security structures (that is, legal structures used instead of taking security but which have a similar effect to security) are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest? Consider the following and give brief details of the structure and risks associated with it:

- Sale and leaseback.
- Factoring.
- Hire purchase.
- Retention of title.
- Negative pledge.
- Other structures.

Sale and leaseback

This involves the sale of property with a concurrent lease from the buyer on sale.



A bankruptcy court can recharacterise a sale and leaseback as a financing and grant of a security interest instead of a lease, so that the buyer (lessor) of the subject property would lose its ownership interest over the property and become a secured creditor of the seller (lessee). In determining whether a sale and leaseback should be recharacterised, a bankruptcy court examines the substance of the transaction, including whether the:

- Sale price was based on the fair market value of the property.
- Rent reflects the fair rental value of the property.
- Term of the lease is for the entire (or nearly the entire) useful life of the property.
- Seller (lessee) has an option to purchase the property at a price below fair market value at the time of the purchase.

Lenders should ensure that their loan documents prohibit the borrower from subsequently creating security interests in favour of other creditors (*see below, Negative pledge*).

Factoring

This involves the sale of accounts receivable at a discount. The discount assumes the risk for delay and the possibility of non-payment. Whether there is a risk that a bankruptcy court will treat an accounts receivable factoring as a true sale (as opposed to a disguised secured transaction) depends on several factors, including:

- Which party bears the credit risk if the account debtor does not fulfil its obligations or is insolvent.
- The intention of the parties transacting to create either a true sale or a secured transaction.

Hire purchase

Hire purchase (known as closed-end leasing or lease purchase) is a type of lease of property where ownership of the property is transferred to the lessee at the end of the lease.

Retention of title

This is a contract for the sale of goods where title to the goods remains vested in the seller until the buyer fulfils certain obligations (usually payment of the purchase price). Retention of title clauses are less common in the US than in the UK. This may be because:

- The UCC limits the effectiveness of these clauses by treating a retention of title contract as the grant of a security interest and imposing the same attachment and perfection requirements on it.
- Under US bankruptcy law, a stay of creditors' rights under Chapter 11 counters the effectiveness of the retention of title clause.

Negative pledge

This is a provision in the loan documentation prohibiting the debtor from encumbering its assets with additional liens, other than certain permitted liens arising by operation of law, in the ordinary course of business or as otherwise agreed among the parties. Actual notice of the negative covenant ensures that subsequent creditors take security subject to the existing lender's security.

The loan documentation can be structured so that, if the borrower grants a security in violation of the negative pledge, the creditor in respect of that loan documentation is automatically granted a security interest in the affected assets.

Other structures

Conditional sale. This involves the sale of property or goods which is completed only if certain conditions (typically, payment in full of the purchase price) are met by one or both parties to the transaction. The UCC treats a conditional sale in the same way as a completed sale with the buyer's grant of a security interest.

Set-off. US law recognises a debtor's right to reduce the amount of debt by any sum the creditor owes the debtor.

GUARANTEES

10. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are commonly used in the US as a form of credit support for the debtor's obligations. Guarantees are typically provided by each of the debtor's US subsidiaries (under US federal income tax law, the provision of guarantees by the debtor's non-US subsidiaries can raise adverse tax consequences for the debtor) and by any of the debtor's US parent companies. Guarantees are created by the creditors (or their agent) entering into a guarantee agreement with each entity providing the guarantee.

RISK AREAS FOR LENDERS

11. Do any laws affect the validity of a loan, security or guarantee (or the terms on which a loan, security or guarantee are made)? For example, rules on:

- Financial assistance.
- Corporate benefit.
- Loans to directors.
- Usury.

Financial assistance

The applicable rules prohibit the company from purchasing its own shares. No specific rules apply to the grant of security (or the provision of a guarantee) by a company to secure (or guarantee) debt to purchase its own shares (or the shares of its holding company).

Corporate benefit

Generally, under state law, if the directors of the subsidiary company decide to grant security (or provide a guarantee) in respect of a loan to its parent, the courts traditionally defer to the directors' business judgement if the decision was made:

- On an informed basis.
- In good faith.
- With loyalty to the company.

(*See also Question 23, Fraudulent conveyances*.)

Loans to directors

Companies with publicly traded securities in the US are prohibited from extending credit (in the form of a personal loan) to any director or executive officer of that company, with certain limited exceptions (*Securities Exchange Act of 1934*).



Usury

State usury laws, which can be criminal or civil statutes, generally prohibit creditors from knowingly charging or receiving interest at a rate exceeding a specified percentage. For example, New York's criminal usury statute sets the maximum interest rate at 25%. Certain jurisdictions, however, do not have usury law limitations in connection with loans made to commercial enterprises. Nonetheless, many loan documents contain "usury savings clauses" providing that under no circumstances will the amount of interest charged or received exceed the maximum legal rate.

12. Can a lender, merely by making a loan or holding or enforcing a security or guarantee, be liable under environmental laws for the actions of the borrower, security provider or guarantor?

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) imposes strict, joint and several liability on (among others) owners or operators of facilities. A secured lender is exempt under the security interest exemption if, without participating in a facility's management, it holds indications of ownership primarily to protect its security interest.

Liability depends on whether the security has been enforced.

Pre-enforcement

A secured lender is not considered to be participating in a facility's management unless it either:

- Exercises decision-making control over the borrower's environmental compliance.
- Exercises control so that it has responsibility for the day-to-day decision making regarding environmental compliance, or substantially all of the operational aspects of the business other than environmental compliance.

Post-enforcement

A secured lender is not considered to be participating in a facility's management if it complies with both of the following:

- Within 12 months of the date on which the foreclosed-on property is available for sale, the secured lender:
 - lists the property for sale with an appropriate broker or agent; or
 - advertises the property for sale on at least a monthly basis in a trade publication or newspaper of general circulation.
- It does not reject, or fail to act for more than 90 days in relation to, any written, bona fide and firm offer of fair consideration for the property which is received after six months from the time it acquired title.

The following considerations and potential problems for the lender are also relevant:

- The federal CERCLA scheme does not necessarily preclude lender liability under state superfund statutes, many of which do not include a security interest exemption.
- There is no shelter provision to transfer the protections of the security interest exemption to a subsequent purchaser of contaminated or potentially contaminated property. This can make it difficult to obtain full value from the sale of a facility after foreclosure.

- The Environmental Protection Agency and the courts retain considerable discretion to determine when a secured lender has stepped into the shoes of management and controls the day-to-day operations of the facility. These determinations are made on a case-by-case basis.
- The security interest exemption does not affect liability that can arise under other sections of CERCLA or comparable state law. Such liability can be incurred, for example, if the secured lender becomes a generator of hazardous waste by controlling the borrower's waste disposal during the period the borrower is winding-up.

STRUCTURING OF DEBT AGREEMENTS

13. Is contractual subordination of debt possible and common? If so, how can it be achieved, for example by an inter-creditor agreement between senior, mezzanine and junior creditors? Is structural subordination possible?

Contractual subordination is possible and common. It is most commonly achieved by including subordination provisions in the instrument governing the debt that will be subordinated. These provisions specifically state that they are for the benefit of the holders of the senior debt.

Structural subordination can be achieved by structuring the debt so that the debt to be subordinated is incurred by a holding company while the debt that is to be senior is incurred by the operating subsidiary. As a result, the debt to the holding company will only be satisfied following the payment in full of the obligations of the operating subsidiary and the distribution of any remaining assets to the holding company.

14. Is debt traded in your jurisdiction? If so, what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Secured debt is actively traded in the US. To facilitate this, security interests are held by an agent for the benefit of the secured lenders. Transfer of the debt obligations also results in the transfer of the related security interest without the need for any action on the part of the new buyer of the secured debt.

15. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction? If not:

- Is an agency arrangement created under the law of another country recognised in your jurisdiction?
- Can a facility agent enforce rights on behalf of the other syndicate lenders in the courts in your jurisdiction?

Facility agents for the syndicated lender group are common for syndicated loans and are recognised under US law. Security interests are granted to a facility agent on behalf of the secured parties (for example, the lenders and agents to whom the debtor owes obligations). The facility agent is authorised by the secured



parties, pursuant to the terms of the security agreement, to enforce remedies under the UCC and otherwise on behalf of the secured parties.

16. Is the trust concept (such as a security trustee holding security on behalf of two or more creditors) recognised in your jurisdiction? If not:

- Is a trust created under the law of another country recognised in your jurisdiction?
 - Can a security trustee enforce its rights in the courts in your jurisdiction?
-

Trusts are recognised under US law. However, the UCC will generally treat a trust whose purpose is to secure payment or performance of an obligation as the grant of a security interest, subject to the same rules for attachment and perfection as a security interest.

Trusts created under the law of another jurisdiction are recognised in US courts and the rights of a security trustee can generally be enforced.

17. Do the different types of security in your jurisdiction need to be documented separately or does your jurisdiction allow a single security document?

Security interests in real property are documented separately from security interests in other assets. However, security interests in most personal property can be governed by a single document.

18. Are there any rules on how loans (including syndicated loans) should be documented for the loan to be enforceable?

This is governed by US general contract law: there are no other specific rules outlining how to document loans to ensure that they are enforceable.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. Please briefly state the circumstances in which a creditor can enforce its loan, guarantees or security (for example, when an event of default occurs). What requirements must the creditor comply with?

In addition to statutory and common law remedies for breach of contract, the circumstances in which a secured creditor can enforce its security are generally set out in the loan agreement as events of default. Typical events of default include:

- The failure to pay the principal or (subject to a short grace period) interest on loans, or other fees or amounts due.
- A representation or warranty that is false or misleading in any material respect when made (or deemed to be made).
- Default in the performance of certain affirmative covenants that cannot be remedied (for example, a non-permitted use of loan proceeds) or of any negative covenant.

- Default in the performance of the remaining affirmative covenants (subject to a short grace period).
- Cross-default in relation to other debts.
- Insolvency or certain bankruptcy proceedings.
- Change in control.
- Failure of validity, perfection or priority of security.

If an event of default occurs, lenders can typically terminate further lending commitments, accelerate principal and interest on loans and/or enforce their security, if necessary (*see Question 20*).

20. How are the main types of security interest usually enforced? What requirements must a creditor comply with (for example, a mandatory public sale of the secured asset through the courts)?

Personal property and fixtures

If an event of default occurs, there are a number of contractual remedies available. A secured party also has rights under the UCC and can reduce a claim to judgment, foreclose, or otherwise enforce the security interest by any available judicial procedure (*Article 9, Part 6, UCC*).

If every aspect of the disposition of the secured assets (including the method, manner, time, place and notice) is commercially reasonable, a lender can dispose of the asset by public or private proceedings, and apply the proceeds of sale to repay the debt.

The automatic stay provisions under the Bankruptcy Code (*see Question 22*) and state law impose additional limitations on a lender's exercise of remedies in relation to the secured asset.

Real property

Enforcement is also not limited to a public sale of the secured assets through the courts. If an event of default occurs, available remedies include:

- **Action to pay debt.** Most mortgages contain an acceleration clause that permits the lender to declare the entire debt due. Assuming it is a recourse loan, the lender can institute an action against the borrower to collect the debt. However, in some states, if the mortgage lender sues the borrower for a personal judgment without first foreclosing its mortgage on the real estate, it loses its lien on the real estate.
- **Power of sale.** In certain states, a power of sale is available. Without need for court action and after certain statutory notice requirements are met, the property can be sold at a public sale, either by a public official, the lender, or, in the case of a deed of trust, the trustee.
- **Possession.** Most commercial mortgages grant the lender the right to take possession of the property on an event of default. The lender can operate the property and apply the revenues to payment of the debt. However, in many states this remedy is unenforceable without first obtaining a judicial order awarding possession or appointing a receiver. In addition, this remedy can subject the lender to possible tort and other liability as a mortgagee-in-possession of the real estate.



- **Receivership.** Most commercial mortgages grant the lender the right to a court-appointed receiver on an event of default. The receiver has the right to possess and operate the property and apply the rents and other revenues to the payment of the debt. Each state has its own requirements for appointing a receiver and certain states prohibit the appointment of a receiver unless the:

- lender has inadequate security for the debt; or
- borrower is committing waste (impairing the value of the real estate by, for example, failing to maintain the property or pay real estate taxes).

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? If yes, please give brief details, including voting requirements to approve such procedures. How do they affect a creditor's rights to enforce its loan, guarantees or security?

Other than in connection with private consensual restructurings of debt (for which the voting requirements are set out in the documents for that debt), there are no company rescue or reorganisation procedures outside of insolvency proceedings.

22. How does the start of insolvency procedures affect a creditor's rights to enforce its loan, guarantees or security?

Once a bankruptcy petition is filed, an automatic stay of creditor actions comes into effect (*Bankruptcy Code § 362*). Subject to a few limitations, the automatic stay provides a period of time in which all litigation, collection activities, foreclosures and repossessions of property are suspended. A secured lender cannot pursue any enforcement action on any debt or claim that arose before the filing of the bankruptcy petition.

Under specific circumstances, a secured lender can obtain relief from the automatic stay. For example, under a Chapter 11 bankruptcy, if the borrower does not have equity in certain property and the property is not necessary to an effective reorganisation, the secured lender can seek an order of the court to modify or terminate the stay.

State law imposes other limitations on a secured lender's exercise of remedies in relation to its security.

23. What transactions involving loans, guarantees, or security interests can be made void if the entity that received the loan or granted the guarantee or security becomes insolvent? Please briefly state the time limits that apply and the conditions that must be met for the transaction to be made void.

Preferences

A borrower's bankruptcy trustee may be able to invalidate a lender's properly perfected security interest if the grant or perfection of the security interest was made on account of pre-existing indebtedness while the borrower was insolvent and within 90 days before the borrower's bankruptcy filing. If the lender is an insider of the borrower (for example, someone who is a director or officer of the company or is in control of the company), this time period

is one year. The situations in which a preference attack are most likely to be relevant are:

- **Delayed perfection of initial security interests.** If perfection occurs more than 30 days after the date of transfer (that is, the creation of the lien), then it arguably constitutes a transfer on account of pre-existing indebtedness. In that case, if the borrower files for bankruptcy protection within 90 days after the date of perfection, the lender's security interest is vulnerable to a preference attack.
- **After-acquired property.** A transfer in property is not made until the borrower acquires rights in that property. Therefore, even if the lender's security interest was perfected more than 90 days (or one year) before the borrower's bankruptcy filing, the lender's security interest in relation to assets acquired by the borrower within 90 days (or one year) before the filing can be vulnerable to preference attack. There are special exceptions to this rule for acquisitions of inventory and accounts receivable, and for proceeds of property that is already subject to the lender's security interest.
- **Future grants of security interests.** If a borrower subsequently grants a security interest over assets that were not subject to the security interest initially granted to the lenders, a new 90-day (or one-year) preference period begins (to the extent the new security interest secures the lender's existing indebtedness).

Fraudulent conveyances

State and federal law recognise two types of fraudulent transfer:

- **Actual fraud.** This occurs when the transfer is made with the actual intent to hinder, delay or defraud creditors.
- **Constructive fraud.** This occurs when both:
 - the borrower did not receive fair consideration or reasonably equivalent value for the transfer; and
 - at the time of the transfer, or as a result of the transfer:
 - the borrower was or became insolvent;
 - the borrower had or was left with unreasonably small capital with which to conduct its business; or
 - the borrower believed it would incur debts beyond its ability to pay as they matured.

24. Please list the order in which creditors are paid on the borrower's insolvency, assuming the security interests have been validly perfected. Consider:

- The secured creditors considered in *Questions 2 to 6*.
 - Statutory claims.
 - Unsecured creditors.
 - Subordinated creditors.
-

Generally, the secured lender's claims have priority over all unsecured claims of the other creditors (including trade creditors, employees, landlords and senior unsecured noteholders) to the extent that the relevant secured assets have realisable value.



Although perfection of a security interest is necessary for a lender to obtain priority, it does not assure priority over all third parties. The UCC, state law and federal law contain extensive rules that determine when a lender's security interest in a secured asset has priority over competing interests in that asset. These rules are complex and beyond the scope of this chapter.

Generally, in corporate insolvency, property is distributed in the following order:

- Secured creditors (see *Question 25* for general rule on priority among secured creditors).
- Expenses of insolvency proceedings.
- Certain employee claims, tax claims and government claims.
- Unsecured creditors (subject to priority rules under the Bankruptcy Code).
- Subordinated creditors.
- Shareholders.

Under certain circumstances, however, this order can be altered by a bankruptcy court, which can:

- Subordinate one claim to another claim.
- Recharacterise certain debt as equity.
- Confirm a reorganisation plan that varies the distribution rules.

25. If more than one creditor holds the same security interest over the same asset, how is priority between them determined? Please briefly set out any specific ranking rules that apply.

In general, when two creditors hold perfected security interests in the same asset, the creditor that is first either to perfect its security interest or file its financing statement covering that asset has priority (see *Question 24*).

26. If a security interest has not been validly perfected, where does the security holder rank on the borrower's insolvency?

Generally, in a bankruptcy case, any lender that has failed to perfect its security interest before bankruptcy will be in the position of an unsecured creditor. Outside of bankruptcy, in some circumstances, a secured lender that has failed to perfect its security interest still may be able to enforce its security interest.

CROSS-BORDER ISSUES ON LOANS

27. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders? If yes, please give brief details, for example registration requirements.

In general, there are no restrictions on granting security interests to foreign lenders. However, it may be necessary for a foreign lender to meet certain state requirements (for example, qualify to do business in the state) if it wants to exercise rights and remedies as a secured creditor.

28. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls in force that would prevent the repatriation of proceeds realised in the US through the enforcement of security or other payments to a foreign lender under the security document or loan agreement.

29. Is a foreign choice of law clause in a security, guarantee or loan document recognised and applied by the courts in your jurisdiction? Does local law always apply in certain circumstances?

State law governs recognition of choice of law clauses. In New York, the parties to a secured transaction generally have freedom to select the law that governs the creation of a security interest. When a transaction bears a reasonable relation to New York and to another jurisdiction, the parties to the transaction can choose the law that will govern their rights and duties. The UCC generally imposes certain limitations on the ability of the parties to select the law that governs (among other things):

- Perfection.
- The effects of perfection or non-perfection.
- The priority of the lender's security interests (including certain aspects of the attachment and perfection of security interests in securities).
- The enforcement of the security interest.

However, it does not limit the law governing the creation and attachment of the lender's security interests.

TAX AND FEES ON LOANS, GUARANTEES OR SECURITY INTERESTS

30. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security? Consider the following and state the tax rates and fee amounts, if they are more than a nominal amount:

- Documentary taxes (for example, stamp duty).
- Registration fees.
- Notaries' fees.

Generally, state and local, not federal, taxing authorities impose any documentary, filing and other taxes payable in connection with the granting, taking or enforcement of security.

Taking security

The expenses associated with the filing of financing statements are:

- **State filing fees and filing service charges.** These are generally modest in amount, unless there is a very large number of debtors or a large number of local filings (for example, relating to fixtures).



- **Filing taxes.** Some states impose a mortgage recording tax or documentary stamp tax on filings of financing statements, although not all types of assets are subject to the tax. The tax is measured by the amount of indebtedness being secured. In a multi-state transaction where only part of the secured assets is located in the state that levies the tax, the tax can often be paid according to the ratio that the value of the secured asset located in the state bears to the total value of all the secured assets. In certain cases, the mortgage recording tax in relation to real property can be material. In New York, for example, a mortgage of US\$500,000 (as at 1 November 2010, US\$1 was about EURO.7) or more securing commercial real property can be taxed at a combined city and state rate of 2.8%.

Enforcing security

Expenses may be payable in connection with the disposing of secured assets in the commercially reasonable manner required under the UCC or in connection with real property foreclosure actions. Court costs and professional fees may also be payable.

31. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security?

Generally, taxes and fees payable in connection with the granting or taking of security are not sufficiently expensive to require those strategies. In certain instances, however, New York state and local mortgage recording taxes may require consideration of tax minimising strategies, but these are usually designed on a case-by-case basis.

REFORM

32. Please summarise any proposals for reform and state whether they are likely to come into force and, if so, when.

Article 9 of the UCC underwent substantial reorganisation in 2001, and major reform is not expected in the near future.

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