# IS MORE ALWAYS BETTER? ARE MULTIPLE FORMS OF GENERAL SECURITY AGREEMENT NECESSARY IN EVERY CROSS-BORDER FINANCING?

*Smarter Way to Cross Blog Archives*
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**U.S. and Canadian Forms of General Security Agreement.** It is not uncommon in cross-border financing transactions to have multiple U.S. and Canadian entities as borrowers or guarantors. In these transactions, there are often two forms of general security agreement – one governed by U.S. law (often the law of New York) for the U.S. debtors, and one governed by the law of one of the provinces of Canada for the Canadian debtors. As U.S. counsel, we are frequently brought in on deals that originate in Canada so the deal starts with a Canadian general security agreement form. The next step may not just involve the U.S. lender's counsel pulling an additional U.S. form out of the drawer. Frequently, the Canadian form general security agreement may be "Americanized" by U.S. lender's counsel once the Canadian form has been negotiated by Canadian counsel. The process of turning a Canadian form into a U.S. form can add material cost. Even if a U.S. form is used as the starting point, making it consistent with the Canadian form will also add cost. Once Canadian and U.S. forms of general security agreement are on the table, lender's counsel may require a U.S. debtor or Canadian debtor with assets in both jurisdictions to sign both forms of general security agreement, adding some additional legal work with respect to opinions, resolutions, and the completion of security agreement schedules. Is all this legal documentation just bank lawyers being bank lawyers, or is there no good reason for two different forms and for certain debtors signing both forms?

**Frequent Rationale May Be Based on Questionable Logic.** One argument frequently advanced for requiring a separate U.S. general security agreement for the U.S. debtors, rather than having them the sign the Canadian form goes something like this: A U.S. debtor has assets in the United States, and it will be easier for the secured party to enforce its security interest in the United States if it has a U.S. form of general security agreement. But this generalization involves an assumption that may not be true. It assumes that enforcing a Canadian general security agreement in the United States would be materially more burdensome than enforcing a U.S. general security agreement. A limited search of state and federal cases in New York would indicate that U.S. courts do not have much trouble enforcing Canadian security agreements. See, for example: *Barlow Lane Holdings Ltd. v. Applied Carbon Tech. (Am.), Inc.*, 2004 U.S. Dist. LEXIS 16194 (W.D.N.Y. Aug. 11, 2004) (enforcing a security agreement governed by Ontario law against a U.S. defendant because no evidence was presented that the law of Ontario would differ) and *United States ex rel. Solera Constr. v. J.A. Jones Constr. Group*, 2010 U.S. Dist. LEXIS 34065 (E.D.N.Y. 2010) (Court enforced Quebec hypothec against a Quebec corporation relying on an affidavit of a Quebec lawyer experienced in secured transactions).

Moreover, under the Uniform Commercial Code (the UCC), whether a security agreement creates a valid security interest is governed by the law chosen by the parties in that security agreement (see official comment 2 to the New York UCC §9-301). If a security agreement is governed by the law of one of the provinces of Canada, a U.S. court should not decline to enforce a security interest created under that security agreement so long as such security interest is valid under the law

governing that security agreement, even though such security agreement does not create a valid security interest under the UCC. For example, imagine a security agreement governed by Ontario law which describes the collateral with a supergeneric description ("All assets of the Debtor") and not by type, or does not provide a specific description of any commercial tort claim, as required by the UCC. Such a security agreement would not create a valid security interest under the UCC in the debtor's assets or any commercial tort claim. But if Ontario law governs the security agreement, those deficiencies under the UCC are irrelevant for U.S. law purposes because Ontario substantive law would govern the adequacy of the description of the collateral in the security agreement, not the UCC. A U.S. court should find that the security interest is valid assuming it is valid under Ontario substantive law. This is in contrast to perfection. Perfection is governed by the conflict rules set forth in the UCC. The application of these conflict rules typically results in the secured party having to file a financing statement under the UCC against a U.S. debtor even when the security agreement is governed by the law of Ontario or some other jurisdiction (the law governing the security agreement being irrelevant).

**Doubling Up May Make Sense.** But there still may be good reasons for having a separate U.S. form of general security agreement.

The conflict of laws rules under the Personal Property Security Act (the PPSA) for the validity of a security interest are not the same as under the UCC. Under the PPSA, validity is treated like perfection and priority – the parties' choice of law doesn't control (See Ontario PPSA§§5.(1) and 7.(1)). For example, if the assets subject to a security agreement governed by Ontario law are located in New York, under the PPSA, the law of New York (the UCC) governs the validity of a security interest in such assets located in New York, notwithstanding the parties' choice of Ontario law in the security agreement. Similarly, if the debtor has its sole place of business or chief executive office in New York, under the PPSA, the law of New York would govern the validity of a security interest in certain intangibles and mobile goods of the debtor. ("U.S. assets" will be used to refer to those assets of a debtor as to which the validity of a security interest is governed by U.S. law under the PPSA conflict rules.)

The PPSA conflict rules applicable to the validity of a security interest create a rather surprising possibility—a U.S. court could find a security agreement governed by Ontario law creates a valid security interest for purposes of enforcement in the United States even though it includes a defective collateral description applying the UCC requirements. But a Canadian court could find that this same security agreement does not create a valid security interest in the U.S. assets on the basis that the UCC, rather than the PPSA, governs the validity of such security interest. We don't know if this bizarre result would in fact ensue. But the PPSA conflict rules applicable to the validity of a security interest may justify having a separate U.S. form of security agreement and certain debtors being required to sign both the Canadian and U.S. forms of security agreement, so as to assure the creation of a valid security interest in their respective U.S. assets for purposes of enforcement in Canada, not the United States!

However, before using the PPSA conflict rules applicable to the validity of a security interest as the basis for requiring a separate U.S. form of security agreement whenever a debtor has U.S. assets (and not just using a Canadian form), consider the following: Not all security agreements governed by the law of Ontario or one of the other provinces contain collateral descriptions that are defective under the UCC. If there is a deficiency in the collateral description in such a security agreement applying the UCC requirements to such description, the deficiency can be remedied by modifying the description of collateral, rather than creating a separate US form security agreement. Finally, it is important to remember a

security interest created under such a security agreement, if valid under the law of the province governing such security agreement, should still be fully enforceable in the United States, even if not enforceable in Canada against the U.S. assets.

In my view, the more compelling reason for requiring a separate U.S. form of security is that the debtor representations and covenants in a U.S. form tie more closely into the UCC perfection requirements, which are different than the Canadian requirements for certain types of collateral. It is these UCC perfection requirements that are likely to apply to a U.S. debtor or a Canadian debtor with a U.S. location or assets. For example, the perfection of a security interest in a U.S. deposit account (as original collateral, but not as proceeds of other collateral) cannot be accomplished by the filing of a financing statement (in contrast to the rules under the PPSA). Perfection under the UCC requires a control agreement among the depositary bank, the secured party and the debtor. Many U.S. general security agreements require the debtor to disclose the details relating to its deposit accounts and include a specific covenant that requires the debtor to provide a control agreement for each of its existing and future deposit accounts. Similarly, there may be special provisions in a U.S. general security agreement for, among other things, vehicles that are covered by certificates of title, timber, and as-extracted collateral (minerals and oil and gas) for which there are special perfection requirements that require the secured party to obtain additional information.

**It Is a Judgment Call.** In an asset based deal, the lender may have the objective of having a perfected security interest in every material asset of the debtor, with cost being very much a secondary concern. Using a separate U.S. general security agreement form with detailed representations and covenants addressing UCC requirements will be consistent with this objective. In some cases, having a Canadian or U.S. debtor sign both forms may indeed make sense. But there do remain situations where requiring a separate form of U.S. security agreement may not add enough value to justify the cost, and using the same Canadian form for all debtors (with perhaps some modifications) may be an appropriate solution. The right choice will largely depend on the nature of the debtor's present and expected future assets and the level of lender's reliance on those assets. For example, if a U.S. debtor only has receivables and inventory and has no other assets, or is a holding company, using the same form for such debtor as the Canadian debtors could make sense. U.S. counsel and Canadian counsel experienced in cross-border matters should work together to make this assessment rather than falling back on the proverbial "more is better."