Lending and Taking Security in the United States: Overview

by David Ridley and Graham Silnicki, *White & Case LLP**

Country Q&A | Law stated as at 01-May-2025 | United States

A Q&A guide to lending and taking security in the United States.

This Q&A provides a high-level overview of forms of security over assets, release of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, risk areas for lenders, structuring the priority of debts, debt trading and transfer mechanisms, agent and trust concepts, enforcement of security interests, borrower insolvency, and cross-border issues on loans.

Forms of Security over Assets

Real Estate

1. 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

For the purposes of US secured financing transactions, real estate includes land and any improvements made to the land itself (for example, buildings, roadways, parking, sewers, and so on). Natural resources that are on or in land, such as oil, gas, minerals, and trees, may or may not be considered part of the real estate depending on their nature and processing status. Certain nuances also arise under applicable local law, and so there may be variances across different US jurisdictions as to the precise meaning of real estate.

Common Forms of Security

Generally, the creation of a security interest in or a lien over real estate (or both) requires entry into either:

- A mortgage.
- A deed of trust.

For practical purposes, these two instruments give secured parties equivalent rights and the distinctions are mostly technical, for example:

- A mortgage creates a security interest directly in favour of the secured party and does not involve a transfer of title from the debtor.
- A deed of trust requires the involvement of an independent, third-party trustee, to whom title is conveyed and held for the benefit of the secured party.

The choice between a mortgage and a deed of trust is primarily driven by the laws and customs of the applicable US jurisdiction.

Certain statutory or judgment liens imposed by operation of law (such as those granted in favour of construction contractors or tax authorities) are separate forms of encumbrances, but do not represent an alternative method of securing financing.

A security interest in fixtures is often granted alongside a security interest in or a lien on real estate or both. Security over fixtures is governed by the *Uniform Commercial Code* (UCC) in effect in the applicable US jurisdiction (see also *Practice note, Security: Overview (United States): Security Under the UCC*). 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." This may include, for example, equipment, appliances, machinery or other items attached to the real estate.

Formalities

Real estate. The requirements for the creation, execution, and perfection of security over US real estate are governed by the law of the relevant US jurisdiction in which the property is located.

Regardless of whether a mortgage or deed of trust is used, the instrument creating the security interest must:

- Identify the applicable parties.
- Describe the real estate and related personal property collateral, and the obligations that it secures.
- Clearly state that the property owner grants a lien/security interest in the collateral for the benefit of the secured party.

The agreement must be signed by the property owner. For all jurisdictions in the US, the agreement must be executed before a notary public for the signatures to be notarised. (This is a simple and inexpensive process that verifies the identity of each signatory.)

To perfect the security interest and provide constructive notice of the lien, the agreement must be publicly recorded with the appropriate land records authority in accordance with applicable local law. Typically, the recording must be made with the office of the county clerk in the county where the property is located.

In addition to nominal filing fees, some US jurisdictions impose a mortgage recording tax. In most of these jurisdictions, the mortgage recording tax is calculated based on the amount of debt being secured by the instrument (in which case, the parties may agree, to the extent permitted by and in accordance with applicable law, to cap the secured obligations at an agreed amount, typically the fair market value of the property, to minimise taxes). In addition to the payment of any such fees and taxes, specific technical requirements may need to be satisfied to record the agreement in a given jurisdiction. (These include (among other things) details such as margin and font sizes, the type of legal description for the real estate, county-specific cover pages, "wet ink" signatures, and so on.)

Fixtures. Perfecting a security interest in fixtures requires adherence to certain filing requirements imposed by the UCC. Depending on the applicable US jurisdiction, there may be up to three options for achieving perfection (which can all be carried out simultaneously):

- First, an ordinary financing statement covering fixtures can be filed in the central filing office (such as the secretary of state) of the state/district in which the debtor is "located" for UCC purposes (see *Question 2*). This option is generally not recommended as the sole method of perfection, as it may rank behind any competing security interest perfected by one of the other methods.
- Second, a specific form of financing statement known as a "fixture filing" can be filed, typically with the land records authority in the jurisdiction where the real estate is located (that is, the same office where a mortgage or deed of trust would be filed).
- Third, if the mortgage or deed of trust also covers fixtures and otherwise satisfies the applicable UCC requirements to function as a fixture filing, the recording of that agreement with the land records authority in the jurisdiction where the real estate is located will perfect the security interest in the fixtures (although this method is not available in Louisiana, where a separate fixture filing must be filed in addition to the mortgage).

A transmitting utility financing statement is a special type of filing under the UCC used to perfect security interests in fixtures and other assets of a transmitting utility (that is, companies engaged in telecommunications, railroad operations, electrical transmission, oil and gas pipelines, and so on). Fixtures often represent a significant portion of the assets of a transmitting utility. Given the unique nature of these businesses, the UCC provides for transmitting utility filings to be recorded in the designated central filing office of the state/district in which the assets are located, avoiding the need for numerous county-level fixture filings.

Tangible Movable Property

2.What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible Movable Property

Tangible movable property is defined and governed as "goods" under the UCC (§ 2-105). This category of collateral encompasses "all things that are movable when a security interest attaches" (§ 9-102). This encompasses nearly all tangible property other than real estate. Common types of property that qualify as goods include:

- Equipment.
- Inventory.
- Vehicles.

Certain real estate-related property is also captured by the term, such as:

- Fixtures (see *Question 1*).
- Timber to be cut for sale.
- Crops.

However, some types of tangible property are excluded from the UCC definition of "goods." These include, for example, financial instruments, money, and oil, gas, and minerals prior to being extracted.

Common Forms of Security

To create a security interest in goods, a security agreement is required.

The US does not classify security into different forms in the manner seen in the UK and other jurisdictions. One of the primary purposes of Article 9 of the UCC was to eliminate the various historical/common law classifications of security, in favour of a unified "security interest" concept. In the context of personal property collateral for US secured financing transactions, terms such as pledge, lien, encumbrance and so on are therefore used interchangeably, all meaning a "security interest."

See also *Practice note, Security: Overview (United States): Security Under the UCC.*

Formalities

The UCC governs the creation (also known as "attachment") of a security interest in personal property, including tangible movable property. Under the UCC, a security interest will attach to collateral when it becomes enforceable. Establishing enforceability requires all of the following:

- Value to be given in consideration of the security interest.
- The debtor has rights in the collateral.
- The debtor has entered into a security agreement that describes the collateral.

The collateral description must reasonably identify the property being pledged, with references to UCC definitions for applicable types of collateral (for example, "all goods" and "all instruments") being acceptable. Supergeneric descriptions, such as "all assets" are not sufficient.

No specific execution formalities apply to the signing of a security agreement.

Perfection of the security interest is achieved by filing a *UCC-1 financing statement* that identifies the debtor, the secured party, and the collateral. Unlike the collateral description in the security agreement, it is acceptable and customary for the collateral description in the financing statement to generically refer to "all assets" even though there may be certain categories of excluded property. If the collateral consists of a narrower subset of the debtor's assets, it is customary to include a more targeted description of the collateral, often by replicating the collateral description from the security agreement.

The financing statement must be filed in the jurisdiction in which the debtor is "located" for UCC purposes, which is the jurisdiction of organisation of a business entity. Each US state/district has a central filing office (which may be (as applicable) the relevant secretary of state, department of state, or recorder of deeds) where UCC-1 financing statements are recorded.

Financial Instruments

3. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial Instruments

Security is commonly granted over equity interests, debt securities, securities accounts, and negotiable instruments (such as promissory notes) held by a borrower or guarantor. Depending on their specific nature, for the purposes of the UCC these assets may be classified as instruments, investment property, or general intangibles.

Generally, equity interests are classified under the UCC as either:

- Securities, which form part of the broader classification of "investment property."
- General intangibles, which is a catch-all category that includes any personal property other than enumerated exceptions, including investment property.

The most common types of business entities in the US are corporations, limited liability companies, and partnerships. Any equity interest in a corporation is classified as a security. In contrast, an equity interest in a limited liability company or partnership is not considered a security unless any of the following applies:

- It is traded on a securities exchange.
- It is an equity interest in a registered investment company.
- The issuer has elected to have such equity interests treated as "securities" for the purposes of Article 8 of the UCC.

If none of the above exceptions apply, equity interests in limited liability companies and partnerships will be considered general intangibles for UCC purposes.

Debt securities (for example, bonds) fall within the UCC definition of securities (and therefore investment property). Securities accounts are also classified as investment property. Promissory notes and other negotiable instruments are separately classified as "instruments."

Common Forms of Security

See *Question 2, Common Forms of Security*.

Formalities

The formalities for the creation and perfection of security over financial instruments are generally the same as for tangible movable property (see *Question 2, Formalities*).

Security interests in investment property can also be perfected by the secured party gaining "control" of the property, which involves satisfying certain requirements prescribed by the UCC. Perfection by control is preferred by secured parties, since it both:

- Takes priority over any competing security interests perfected only by a UCC filing.
- Forestalls the possibility of the security interest being lost to a third-party purchaser who obtains control.

It is therefore common for a secured party to perfect its security interest in certain types of investment property, such as certificated equity interests and securities accounts, by both filing a UCC-1 financing statement and obtaining control.

Control over certificated equity interests is typically established by delivering the certificates to the secured party, together with an effective endorsement (usually an executed stock power with the date and transferee left blank). For uncertificated equity interests, it is not possible to perfect via control, and perfection can only be achieved with a UCC filing.

Control over a securities account is customarily achieved by having the secured party, the account pledgor, and the securities intermediary (that is, the institution where the account is held) enter into a securities account control agreement that provides that the securities intermediary will comply with instructions from the secured party without further consent of the pledgor.

Claims and Receivables

4.What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and Receivables

US secured financing transactions commonly include a broad grant of security over all types of claims and receivables held by the debtor. If the claim or receivable is evidenced by a financial instrument, it will generally be governed by the UCC as a financial instrument (see *Question 3*). Otherwise, for UCC purposes, most claims and receivables will be classified as either:

- **Accounts.** This classification primarily refers to accounts receivable arising from the sale of property or rendering of services. It does not capture bank or brokerage accounts (see *Question 3* regarding securities accounts and *Question 5* regarding deposit accounts).
- **Payment intangibles.** This is a sub-category of general intangibles (see *Question 3*) and serves as a residual classification for any obligations that are principally monetary but which do not qualify as instruments, accounts, or other specified categories of assets, such as commercial tort claims.

Common Forms of Security

See *Question 2*.

Formalities

The formalities are generally the same as those for personal property (see *Question 2*). An exception to the usual rules for creating security interests applies to commercial tort claims of the debtor. As noted in *Question 2,* it is typically sufficient to use UCC-defined collateral types when describing collateral in a security agreement (for example, provisions that encompass "all accounts" or "all general intangibles"). However, for commercial tort claims, the UCC requires a specific description of each pledged claim to create a security interest. This requirement means that any commercial tort claim that may arise post-closing is not automatically captured as after-acquired collateral and must be covered by a supplemental pledge that includes a reasonably specific description of the claim.

Cash Deposits

5. What are the most common forms of security over cash deposits? How are they created and perfected?

Common Forms of Security

See *Question 2*.

A right of recoupment or set-off may arise under applicable law in favour of a depository bank, allowing it to apply funds from a debtor's account against amounts owed by the debtor to the bank in certain circumstances (see *Question 10*).

Security is generally obtained through the pledge of the deposit account in which the cash deposits are held.

Formalities

The formalities for the creation of security interests in cash deposits are generally the same as those for personal property (see *Question 2*). However, the perfection of a security interest in a deposit account is subject to unique requirements. Unlike most other types of collateral (including securities accounts, as described in *Question 3, Formalties*), the filing of a UCC-1 financing statement will not perfect a security interest in deposit accounts. A secured party must obtain control of any pledged deposit account to perfect its security interest. Control of a deposit account for purposes of the UCC is most commonly established either by:

- The account being maintained directly with the secured party as account bank.
- The secured party, the account bank and the pledgor entering into a *Deposit Account Control Agreement* (DACA) under which the account bank agrees that it will comply with instructions from the secured party regarding the

disposition of account funds without further consent by the pledgor. Even where the account is maintained directly with the secured party, it is not uncommon for the parties to also enter into a DACA.

Intellectual Property

6. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual Property

The most common forms of intellectual property (IP) collateral in US secured financing transactions are registered patents, trade marks, and copyrights (and their related applications) and registered domain names. Unregistered IP rights, such as trade secrets, are also typically included.

However, it is customary for trade marks applied for on an intent-to-use (ITU) basis to be excluded from being granted as collateral. This is because the assignment of an ITU trade mark application is prohibited by law prior to the filing of:

- An amendment to allege actual use in commerce.
- A verified statement of use (subject to certain exceptions which are not relevant in this context).

The *Trademark Trial and Appeal Board* has taken the view that certain pledges may fall within the scope of the prohibition if there is language indicative of an assignment in the security agreement, and in those cases has invalidated the resulting trade mark registration.

Common Forms of Security

See *Question 2*.

Formalities

The method for perfecting a security interest in IP differs between:

- Registered copyrights.
- Registered patents, trade marks, and domain names.
- Unregistered IP.

Though all IP rights are classified as general intangibles (see *Question 3*) by the UCC, the UCC is pre-empted by the *Copyright Act of 1976 (17 U.S.C. §§ 101–122)* regarding perfection of a security interest in registered copyrights. As a result, security interests in registered copyrights must be perfected by the filing of a copyright security agreement with the *US Copyright Office* (USCO). Meanwhile, security interests in unregistered IP and registered patents, trade marks, and domain names are perfected in the ordinary manner for other personal property (see *Question 2, Formalities*). Security interests in unregistered copyrights are also generally thought to be perfected by filing a UCC-1 financing statement, although the law is not settled on this point.

Although not specifically required for perfection purposes, it is customary to also file patent and trade mark security agreements with the *US Patent and Trademark Office* (USPTO). This filing provides protection against, and serves as notice to, subsequent bona fide purchasers or creditors who search the USPTO records and take the IP subject to the existing security interest.

Problem Assets

7. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future Assets

The UCC permits security agreements to create a security interest in future assets (often referred to as "after-acquired" property) and this security is commonly granted in commercial loan transactions. In these cases, the security interest is automatically established as soon as the debtor acquires or otherwise has rights in the new property.

An exception applies to commercial tort claims. Since these claims must be specifically described for a security interest to be created in relation to them, they will not be subject to a security interest unless the appropriate steps are taken (see *Question 4, Formalities*).

To perfect a security interest in after-acquired property, the same actions that apply to the relevant original property must be taken (see above). If perfection is achieved by filing a UCC-1 financing statement, the security interest will be automatically perfected by a pre-existing financing statement that remains valid, provided the after-acquired property falls within the collateral description in that filing.

For after-acquired real estate, the mortgage or deed of trust should be amended to cover the additional land. If a corresponding fixture filing exists, it should be amended to cover the additional after-acquired land and any corresponding fixtures.

The UCC also provides for a security interest to automatically extend to any identifiable proceeds of any sale of collateral. If the security interest in the collateral has been perfected, the security interest in the proceeds will also automatically be perfected, although automatic perfection will expire after 20 days unless any of the following applies:

- A filed financing statement covered the original collateral and the proceeds are collateral in which a security interest may be perfected by filing at the same office (and were not acquired with cash proceeds).
- The proceeds are identifiable cash proceeds.

- The proceeds are captured as after-acquired collateral that is subject to an existing perfected security interest (see *Question 7*), or a security interest in the proceeds has otherwise been perfected separately within the 20-day period.

Fungible Assets

Fungible assets generally do not create issues in US secured financing transactions, as it is customary for a lender to take security over all (rather than a portion) of such assets.

Where security is being taken over only a portion of fungible assets, a secured party could require the borrower to segregate or label the specific assets subject to its security interest to reduce the risk of:

- Not being able to identify the collateral assets at the time of enforcement.
- Having to share collateral proceeds with creditors who have competing claims over other portions of those assets.

If competing, equal-ranking security interests have been granted over separate portions of fungible assets that have been indistinguishably combined, the UCC rules on "commingled goods" will apply to provide the secured parties with equal-ranking security interests in the combined assets in proportion to the value of their respective original portions.

Other Assets

Assets over which security cannot be granted, either because such a grant is directly disallowed by law or is effectively disallowed due to prohibitions on assignment, include:

- Government licences in certain regulated industries (for example, gaming, broadcasting, and wireless communications).
- ITU trade mark applications (see *Question 6*).

Other assets that are subject to relatively onerous and costly procedures for granting or perfecting security include:

- Aircraft and related assets (engines and propellers).
- Ships and other vessels.
- Motor vehicles and other assets subject to certificate-of-title laws (unless the assets qualify as "inventory" under the UCC, which requires that the debtor be in the business of selling these assets).
- Railcars and other railroad assets.

This second group of assets is often excluded from collateral in corporate financing transactions, unless the assets are the subject of the financing or otherwise represent an important source of collateral value.

Release of Security over Assets

8. How are common forms of security released? Are any formalities required?

Credit and security documents customarily provide for the release of security interests on the occurrence of certain events, for example:

- The repayment of the secured debt.
- The permitted sale of the encumbered asset.

In some cases, release occurs automatically on the occurrence of the relevant event, and in others the secured party may be required to execute some form of release acknowledgment. These acknowledgment documents usually also provide that the secured parties will take the necessary actions to evidence the release by (as applicable):

- Amending or terminating UCC-1 financing statements and other relevant filings.
- Terminating any control agreement in place.
- Returning possessory collateral.

For real estate, the mortgage or deed of trust release must be executed, notarised, and recorded with the appropriate land records authority where the existing instrument was recorded before the instrument can be discharged.

Special Purpose Vehicles (SPVs) in Secured Lending

9. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It is not common to take security over the shares of an SPV for this purpose for secured corporate lending transactions. Such a structure could potentially be used to provide indirect security over assets that are subject to transfer or pledge restrictions (for example, government licences or non-wholly owned equity investments), but this is rarely relevant.

SPVs are most commonly seen in the US in structured finance transactions, such as in receivables financings and in certain project and commercial real estate financings.

Quasi-Security

10. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

Sale and Leaseback

Sale and leaseback transactions involve the sale of property to a buyer that immediately leases the property back to the seller, typically on a long-term basis. In the US, these types of structures are most common in commercial real estate transactions but may also be arranged for aircraft, ships, vehicles, and industrial equipment (among others).

There is a risk, however, that sale leaseback arrangements could be recharacterised as secured financings by the US bankruptcy courts. This could mean that the buyer of the property is deemed to have only a security interest in the property, rather than ownership rights (which remain with the seller), with the purchase price deemed to have been a loan from the buyer to the seller. If the buyer did not take steps to obtain a perfected security interest in the property as a precaution, the deemed security interest would be unperfected and therefore subject to avoidance in bankruptcy. In that case, the buyer may be exposed to losses, as their claim for repayment of the "loan" would be relegated to the pool of unsecured claims. Further, if it is deemed a secured financing, even in the case of a perfected security interest, the transaction could be subject to potential non-consensual restructuring under a bankruptcy plan of reorganisation when certain requirements are met. A lease, on the other hand, must generally be either completely rejected or completely assumed (in the latter case, with all defaults cured) in bankruptcy, unless the non-bankrupt party otherwise agrees.

To mitigate the risk of recharacterisation, the buyer/lessor in a sale and leaseback transaction could seek the grant of a precautionary security interest from the seller and take steps to perfect the security interest.

Factoring

Factoring transactions involve the sale of accounts receivable by a business to a third party finance company, known as the "factor," at a discount. There are numerous varieties of factoring arrangements available, but all basically provide the business with certainty of payment in exchange for selling the receivable at a discount. The factor may be able to charge fees and interest, depending on the arrangement. A factoring arrangement can be either:

- Non-recourse, where the factor assumes the credit risk of non-payment by the payor of the receivable.
- Recourse, where the risk of non-payment remains with the business. The business may be required to repurchase a receivable if payment cannot be collected.

The amount of fees charged by the factor is generally higher for non-recourse arrangements, given the additional risk.

As with sale and leaseback transactions, there is a risk that a factoring transaction could be recharacterised by a bankruptcy court as a secured financing, with similar implications for the factor (see above, *Sale and Leaseback*). To mitigate the risk of recharacterisation, the parties could take steps to structure the factoring transaction as a "true sale." In general, non-recourse arrangements have a higher likelihood of being upheld by the courts as being a true sale.

Factoring agreements may also include a precautionary grant of security in favour of the factor, which the factor may take steps to perfect.

Hire Purchase

Hire purchase (also known as "rent to own" or an instalment sale) involves the lease of an asset on terms where ownership will be transferred from the lessor to the lessee on the final lease payment being made. These arrangements share many characteristics with capital/finance leases, which can also ultimately result in a transfer of ownership to the lessee at the end of the lease period.

As with sale and leaseback and factoring, a bankruptcy court may weigh various considerations in determining whether a hire purchase or similar transaction is a lease (where ownership of the asset remains with the seller, who can seek repossession at the end of the lease term) or a secured financing (where ownership of the asset transfers to the buyer but seller retains a security interest).

Retention of Title

The concept of retention of title (also known as a conditional sale) refers to a sale of goods in which the buyer takes possession of the property, but the agreement provides for the seller to retain title until payment or other conditions are satisfied. Under the UCC, retention of title provisions are deemed to be limited in effect to the reservation by the seller of a security interest in the goods (§ 2-401(1)).

Other Structures

Other types of quasi-security structures in the US include:

- **Set-off.** Various set-off rights may arise by law or contract in the US. The most common example is a bank set-off, where a financial institution has the right to apply funds from a customer's deposit account to satisfy debts owed by the customer to the institution.

  The UCC generally provides that any set-off rights held by an institution with respect to a deposit account have priority over any security interest in the relevant account.

  Set-off rights under non-bankruptcy law are recognised under the *US Bankruptcy Code (11 U.S.C. §§ 101-1532)*, but any exercise of set-off rights is generally stayed during the bankruptcy, and the amount subject to set-off is treated similarly to a secured claim. A distinction exists for rights of recoupment, where the respective amounts owed by the parties to one another arose from a single transaction, in which case setting off payments is not stayed.
- **Invoice discounting.** This arrangement (also known as "invoice or accounts receivable financing") is similar to factoring, but the receivables are used as collateral for a loan, instead of being sold to the financing provider. Receivables financing customarily involves an express grant of a security interest in the relevant receivables. Special considerations may apply for assignment-restricted receivables, such as certain health care receivables to be paid by government bodies or agencies.
- **Purchase money.** This is a transaction in which financing is provided to acquire goods that are pledged as collateral security for the financing. Subject to satisfaction of certain requirements under the UCC, the financing provider may obtain a *Purchase-Money Security Interest* (PMSI) in the financed goods. The primary advantage of a PMSI is that it is generally given priority over competing security interests in the same property, including any pre-existing security interests that automatically capture after-acquired property of the debtor.

Guarantees

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

Guarantees are common in US financing transactions. In a corporate financing, the guarantors typically include the borrower's direct parent company, some or all of its subsidiaries and, as to the obligations of the other loan parties, the borrower itself.

A guarantee is created when the guarantors enter into a contract with the secured parties (or their agents) that includes appropriate guarantee provisions. Although it is most common for parties to use a standalone guarantee agreement, it is also possible for the guarantee provisions to be included in the loan or security agreement.

Typically, guarantees in corporate loan transactions are guarantees of payment rather than guarantees of collection. Therefore, the guarantor is responsible for any unpaid amounts regardless of whether the lenders have tried to collect from the borrower. However, in some cases, the guarantor's liability will be subject to a capped amount, or the lender's recourse against the guarantor will be limited to specific pledged assets.

Risk Areas for Lenders

12. Do any laws affect the validity of a loan, security, or guarantee (or the terms on which they are made or agreed)?

Financial Assistance

US law does not restrict a company from providing financial assistance (such as security and guarantees) to support the financing of a purchase of its own equity (that is, shares, membership interests or partnership interests, as applicable), or the equity of its parent company.

Corporate Benefit

Except in cases of avoidable transactions (see *Question 20*), US law does not require that a company receive any specific corporate benefit in exchange for pledging security or providing guarantees in support of another entity's debt obligations.

Generally under applicable local law, directors and managers owe fiduciary duties to their company and its equityholders (that is, the holders of the shares, membership interests or partnership interests, as applicable), including the duty to act with care and in the best interests of the company and its equityholders. If the actions of a director or manager are challenged, the US courts typically apply a standard of review that presumes the directors had acted appropriately, unless it can be shown that (as applicable):

- The directors had failed to duly inform themselves of all relevant considerations.
- The directors had acted in bad faith or otherwise in a conflicted manner.

Loans to Directors

Publicly-traded companies are generally prohibited under US federal securities laws from providing personal loans to directors, unless certain exceptions apply (for example, if the company is engaged in the business of consumer lending and provides the loan in the ordinary course on standard market terms).

For private companies (and public companies relying on an exception to the general prohibition), applicable local US law may require approval from the company's board of directors (board) or equityholders before money can be loaned to a director.

Usury

Local US laws may limit the maximum interest rate that can be charged by a lender. Most commercial loans are effectively carved out from these limits through various exemptions. For example, under New York law, interest rate restrictions do not apply to loans of USD2.5 million or more.

Others

A pledge of government licences that involves certain regulated industries may be prohibited or subject to restrictions (see *Question 7*).

Lenders may also be subject to margin lending restrictions. For US banks and other non-broker dealer lenders in the US, regulations limit the amount of credit that such institutions can extend to finance the purchase or carrying of "margin stock" (primarily, equity securities registered or traded on a US national securities exchange) when the credit is directly or indirectly secured by margin stock. More extensive securities credit regulations apply to US broker dealers. Generally, these regulations are not applicable to foreign lenders, subject to certain exceptions (such as when the bank has branches located in the US), although any margin financing obtained by a US borrower from a foreign lender to purchase or carry margin stock issued by a US issuer is generally required to conform to the margin regulations applicable to US lenders.

13. Can a lender be liable under environmental laws for the actions of a borrower, security provider, or guarantor?

In general, the lending of money, or holding or enforcing of a security interest or guarantee, will not per se lead to lender liability under US federal environmental laws for the actions of a borrower, pledgor, or guarantor.

However, a secured lender could face liability for environmental contamination at a pledged property if the lender participates in the management of the property. The types of activities that constitute "participation" in the property's management are not entirely settled at law, but may include the exercise of decision-making control over:

- The environmental compliance measures for the property.

- The day-to-day operations of the property.

Merely monitoring or inspecting a facility, or requiring a response action to address contamination, would not alone qualify as participation in management.

If a secured lender takes ownership of a property through foreclosure, it is permitted take certain actions as owner (such as maintaining business activities, winding-up operations, or taking other actions to preserve, protect, or prepare the property for sale) without exposing itself to liability for existing contamination, provided it seeks to dispose of the property at the earliest practicable, commercially reasonable time, on commercially reasonable terms.

State environmental laws are, however, beyond the scope of this Q&A.

Structuring the Priority of Debts

14. What methods of subordination are there?

Contractual Subordination

Contractual subordination is common where a borrower incurs debt with different priority profiles, such as first lien and second lien loan facilities, term loan and asset-based loan facilities, senior and mezzanine facilities, and unitranche facilities that involve hybrid structures combining senior and subordinated debt into one instrument.

Contractual subordination is possible in relation to both the priority of payments (payment subordination) and priority of security interests in shared collateral (lien subordination). In lien subordination, the proceeds of shared collateral are applied to satisfy the senior obligations prior to the junior obligations, while the proceeds of any non-collateral assets are shared pro-rata among both the senior and junior obligations (subject to competing claims of other secured and unsecured creditors). In payment subordination (typically seen in mezzanine facilities), all recoveries from the shared obligors are applied to satisfy the senior obligations prior to the junior obligations.

To achieve contractual subordination, the secured parties typically enter into an intercreditor agreement (or, for a unitranche facility involving "first-out" and "last-out" components, an Agreement Among Lenders (AAL)). Subordination terms can vary but, in the case of lien subordination, it is customary for the junior lender to confirm that:

- Its security interests in the shared collateral are subordinate to those of the senior lender.
- It will turn over any proceeds of shared collateral that it may receive to the senior lender.
- It will not take enforcement action against the shared collateral (usually for an agreed standstill period following a triggering event, to provide the senior lender with an opportunity to commence and control the enforcement process).

Intercreditor agreements may also restrict the junior creditor from taking certain actions in a bankruptcy proceeding, such as objecting to a debtor-in-possession financing that includes certain pre-agreed terms for the benefit of the junior creditor and is supported by the senior creditor.

Structural Subordination

Structural subordination is often seen in the form of holdco facilities (that is, where loans are provided to a parent entity above the operating company, which may have its own separate debt facilities) or in fund financing.

Generally, structural subordination arises when:

- A first lender lends to an entity and receives guarantees or collateral or both from that entity.
- A second lender lends to a subsidiary of the first entity and receives guarantees or collateral or both from the subsidiary.

The first lender is structurally subordinated in respect of the assets of the subsidiary, since the proceeds of those assets will be applied to repay the debt of the subsidiary before any residual value can be directed to the first entity to repay its debt.

In addition, certain types of liability management transactions (that is, transactions undertaken by a borrower to refinance or restructure its obligations outside of bankruptcy) involve structural subordination, with the borrower relying on flexibility in its debt documents to move valuable assets into a new or existing non-guarantor entity, which in turn incurs debt secured by those assets.

Intercreditor Arrangements

Intercreditor agreements are commonly used to document the terms of competing security interests over shared collateral, of either equal or differing priority. The parties are normally the applicable secured parties (or institutions acting on their behalf as agents), with the debtor providing their acknowledgment of, or consent to, the agreement. The equivalent agreement for a unitranche facility consisting of first-out and last-out components is an AAL and is typically signed by the debtor (although historically that was often not the case).

For details of the key intercreditor agreement terms in an arrangement involving a lien subordination, see above, *Contractual Subordination*. For equal priority arrangements, the key terms are similar, however, in some cases, one group of secured parties (or their agent) will be appointed to serve as the effectively senior party for purposes of controlling any exercise of remedies and distributing collateral proceeds (but with all secured parties being equally entitled to the related benefits), subject to a "control flip" mechanism in certain circumstances.

In unitranche financings consisting of first-out and last-out components, the AAL will additionally include detailed provisions governing the allocation of payments between the parties for both ordinary-course amounts (interest, amortisation and prepayments) and collateral proceeds from enforcement actions, in accordance with the negotiated distribution of economic risk.

Debt Trading and Transfer Mechanisms

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

Debt is commonly traded in the US, especially in the syndicated lending market.

Debt transfers are typically conducted by way of assignment in accordance with the terms set out in the loan documents and standardised market forms. Lenders may also sell participations in their loans to another investor, transferring the economic interests in their loan (along with certain limited voting rights) while remaining the lender of record.

Since security and guarantees for commercial loans are typically granted in favour of an institution appointed to act as agent for all lenders, assignees automatically obtain the benefit of the security and guarantees on joining the lender group.

Agent and Trust Concepts

16. Is the trust or agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

Agent Concept

The concept of agency is recognised and is commonly used in institutional loan markets where credit facilities are syndicated to multiple lenders. It is customary for an institution to be appointed as agent to hold the collateral and administer the credit facility on behalf of the lender group.

Trust Concept

The concept of a trust is recognised in the US but generally does not play a role in secured financing transactions (other than in the context of high-yield notes, where a trustee is typically appointed by noteholders).

The collateral agent role in the US is the equivalent of the "security trustee" role common in other jurisdictions. However, a collateral agency arrangement does not involve the creation of a trust as that concept is understood under US law.

Enforcement of Security Interests

17. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? How are the main types of security interest usually enforced? What requirements must the lender comply with?

Enforcement

Typically, a lender (or an agent acting on behalf of a lender) can take enforcement action when an event of default occurs under the loan documents. The loan documents will specify the events and circumstances that would constitute an event of default, including any applicable notice requirements, grace periods, or cure rights (that is, rights a borrower may have under the terms of the loan agreement to "cure" certain events of default).

Methods of Enforcement

Under the UCC, following an event of default (and generally in addition to remedies under other law) a secured party can apply the following enforcement methods:

- The secured party can, subject to certain conditions (including consent of the debtor after default), take possession of the collateral, either in full or in partial satisfaction of the secured obligations (strict foreclosure).
- The secured party can cause the disposition of the collateral in a public or private sale. If this route is chosen, the two main requirements imposed by the UCC on the secured party in relation to its disposition of collateral are that:
    - every aspect of the disposition is commercially reasonable (including the "method, manner, time, place, and other terms"); and
    - the secured party provides notice of its proposed sale to the debtor, any secondary obligors, and certain other secured parties. This must be in a form that complies with applicable UCC requirements, and must be provided within a reasonable timeframe prior to any sale (with a notice period of at least ten days being deemed reasonable in non-consumer transactions).

  The UCC also imposes a general obligation of good faith in the performance and enforcement of every contract within the scope of the UCC. If a secured party fails to follow the UCC's requirements in connection with a collateral disposition, a court may enjoin the disposition or, if already completed, may award damages.

(UCC Article 9, Part 6.)

The UCC and the security documents may also support other enforcement actions that do not require judicial intervention, for example:

- The UCC permits secured parties to redirect payments on accounts receivable or instruct an account bank to transfer the balance from a deposit account subject to a DACA, in each case, to the secured party's own account.
- For pledged equity, the security documents may allow for a secured party to step into the shoes of the equityholder and exercise certain voting rights.

Depending on the type of collateral involved, enforcement actions may also be subject to rights and requirements stipulated in the relevant security documents or other applicable law (for example, regulatory requirements resulting from a change in ownership).

Borrower Insolvency

Rescue, Reorganisation, and Insolvency

18. Are company rescue or reorganisation procedures (other than insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee, or security?

In the US, there are no formal company rescue or reorganisation procedures other than insolvency proceedings.

19. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee, or security?

The commencement of a bankruptcy case under the US Bankruptcy Code triggers an automatic stay (moratorium) of proceedings and remedies, which prevents creditors from foreclosing on collateral or taking any enforcement actions (unless these are specifically permitted under the US Bankruptcy Code or have been ordered by the bankruptcy court). Guarantees from guarantors who are not themselves subject to a bankruptcy case are generally not subject to the stay.

Once a bankruptcy case has been opened, security interests will no longer automatically attach to after-acquired property of any obligor that is subject to the bankruptcy proceeding, even if they normally would under applicable non-bankruptcy law (although, subject to some exceptions, security interests would generally still attach to the proceeds of any collateral acquired by the obligor prior to the commencement of the case).

20. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor, or security provider becomes insolvent?

Certain transactions may be made void by a bankruptcy court if they are found to constitute a preferential transfer or fraudulent transfer of assets, or a fraudulent incurrence of a debt. A "transfer" is defined broadly in the US Bankruptcy Code and includes the grant of a security interest.

Preferential Transfers

A transfer may be subject to avoidance as preferential (commonly known as a preference) pursuant to Section 547 of the US Bankruptcy Code if all of the following are applicable:

- The transfer was made by an insolvent debtor in favour of a creditor in relation to a pre-existing debt.
- The transfer was made during the 90-day period prior to the filing of the bankruptcy petition (or if the creditor is an insider of the debtor (generally a controlling party, an affiliate, or an insider of an affiliate): during the one-year period prior to the petition).
- The transfer enabled the creditor to receive more than it would have otherwise been entitled to receive in a hypothetical case concerning the debtor under Chapter 7 of the US Bankruptcy Code (liquidation).

Most US jurisdictions also have insider preference statutes that may apply to void transfers made by an insolvent debtor to a pre-existing insider creditor for an antecedent debt, if the insider had reasonable cause to believe that the debtor was insolvent (see, for example, *N.Y. Debt. & Cred. Law § 274*).

Fraudulent Transfers

A transfer or obligation may be voidable as fraudulent pursuant to Section 548 of the US Bankruptcy Code if either:

- The transfer was carried out or obligation incurred with the intention of hindering, delaying, or defrauding creditors ("actual" or "intentional" fraudulent transfer).
- The transfer was made or obligation incurred for an amount that was for less than the reasonably equivalent value of the asset transferred or proceeds received by the debtor of the obligation incurred at a time when the debtor:
    - was or became insolvent;
    - had, or would be left with, unreasonably small capital; or
    - intended to, or believed they would, incur debts beyond their ability to make payment when they reached their maturity (constructive fraudulent transfer).

If the transfer was made to an insider of the debtor, a higher level of scrutiny is likely to be applied by the bankruptcy court.

Under the US Bankruptcy Code, transfers that occurred during the two year-period prior to the debtor's bankruptcy filing can be subject to challenge as fraudulent. However, certain non-bankruptcy laws may provide for a longer effective period, which may be applied by the bankruptcy court if they are applicable to the transaction. For example, the *Uniform Fraudulent Transfer Act (1984)* (known as the *Uniform Voidable Transactions Act* in its updated form) (UVTA) permits avoidance challenges for up to four years after a transfer (or, in the case of actual fraud, the longer of four years after a transfer and one year after the transfer was, or could reasonably have been, discovered by the challenger). The UVTA has been enacted (with sundry variations) in most US jurisdictions, including New York and Delaware.

21. In what order are creditors paid on the borrower's insolvency?

Generally, bankruptcy claims are satisfied in the following order:

- Secured claims (to the extent of the creditor's interest in the applicable collateral).
- Certain unsecured claims that have been granted priority status. These include:
    - administrative expenses associated with the bankruptcy proceedings;
    - certain amounts owed to the insolvent company's employees; and
    - claims for various unpaid taxes (among which there are also different priorities).
- General unsecured claims (and any amounts of secured claims that exceed the value of the creditor's interest in the applicable collateral).
- The insolvent company's equityholders.

US bankruptcy laws also provide the US bankruptcy courts with powers to elevate certain claims over others, including the power to grant certain claims a super-priority status that can put them ahead of other secured claims or priority unsecured claims.

If more than one creditor holds the same security interest over the same asset, the creditor with the earlier security interest is generally given priority, subject to any intercreditor or subordination arrangements between parties. Subject to certain exceptions relating to claims arising from the purchase or sale of securities in the debtor or inequitable conduct by a creditor in connection with its claim, the US Bankruptcy Code and other applicable US federal statutes and judicial precedent generally give effect in bankruptcy proceedings to the priority of security interests and payments established by non-bankruptcy laws and contractual subordination agreements.

However, if a creditor has a security interest that has not been validly perfected, the security interest is subject to avoidance in bankruptcy, which will leave the creditor with an unsecured claim.

Cross-Border Issues on Loans

22. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

A small number of US states require out-of-state lenders to obtain a licence to engage in lending activities in that state. Depending on the particular state, these requirements may arise if the borrower or any real estate collateral is located in that state. Various exceptions may apply, however, including for:

- Lenders who do not exceed a certain threshold of lending activity in the applicable jurisdiction.
- Loans that are below a certain threshold amount.
- Lenders who are separately regulated as banks under US law.

Other than the above rules in relation to certain US states, there are generally no restrictions that apply specifically to foreign lenders.

Certain prohibitions or other restrictions may apply to a foreign lender that seeks to foreclose on collateral such that it would become the owner of US assets, or that seeks to bring legal action in the courts of a jurisdiction without having satisfied qualification requirements if applicable in that jurisdiction.

23. What regulatory requirements does a UK lender have to comply with to purchase a loan made to a borrower in your jurisdiction?

See *Question 22*.

**The authors wish to thank Amy Bagdasarian, Adam Cieply, Glen Cuccinello, Amy Delsack, Elizabeth Feld, Richard Graham, Laura Mulry, Julia Rubin, and David Thatch for their contributions to certain sections of this Q&A.*

Contributor Profiles

David Ridley, Partner

White & Case LLP
Phone +1 212 819 8771
david.ridley@whitecase.com
www.whitecase.com

Professional qualifications. New York, US, Attorney, 2012

Areas of practice. Partner in debt finance practice and co-head of US private credit and direct lending. Practice focuses on leveraged and corporate finance, representing major commercial and investment banks, private credit funds, and corporate borrowers.

Specialist in corporate finance transactions with an emphasis on domestic and cross-border acquisition finance. Significant experience with broadly syndicated facilities, unitranche facilities, pro rata facilities, investment grade facilities, second lien facilities, mezzanine finance, venture debt, ABL facilities, DIP financing, preferred equity, warrants, and equity co-invests. Experience also includes distressed lending, workouts, and restructurings.

Non-professional qualifications. LLB, University of Technology, Sydney, 2005; BA, University of Technology, Sydney, 2005

Graham Silnicki, Associate

White & Case LLP
Phone +1 212 819 8251
graham.silnicki@whitecase.com
www.whitecase.com

Professional qualifications. New York, US, Attorney, 2013

Areas of practice. Practice focuses primarily on the representation of major commercial banks, investment banks, private equity sponsors, funds and corporate borrowers in connection with a variety of domestic and global finance transactions, including secured and unsecured syndicated credit facilities, investment-grade financings, asset-based loans, and leveraged acquisition financings.

Non-professional qualifications. JD, University of Toronto Faculty of Law, 2012; Bachelor of Journalism, Toronto Metropolitan University (formerly Ryerson University), 2007

END OF DOCUMENT