

Cross-Border Loan Transactions: Supplementing Canadian Law Governed Loan Documents with Collateral and Guaranty Documents Governed by U.S. Law

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by Peter Nelson

Many cross-border loan transactions involve subsidiaries that are organized in the United States and/or U.S. based collateral. To the extent that the underlying loan is made to a Canadian borrower by a Canadian lender, these transactions are typically documented with loan agreements governed by Canadian law (often under the law of the Province where the primary Canadian borrower is organized, but sometimes based on the law of a Province selected by the Canadian lender). In many of these transactions, in addition to the Canadian law governed documents, the Canadian lenders will also require the use of U.S. law governed documents for guarantees provided by U.S. organized subsidiaries and Security Agreements for collateral owned by U.S. subsidiaries or otherwise located in the United States.

Whether or not the requirement to add these additional U.S. law governed documents is prudent and cost effective often depends on several factors, including: 1) the total amount of the loan, 2) the importance of the U.S. subsidiary guarantor to the consolidated balance sheet of the Canadian borrower, 3) the value of any U.S. based collateral, and 4) the nature of the U.S. based collateral. It is also important to understand the reason a Canadian lender would request the additional documentation when the Canadian law governed documents already cover any U.S. based subsidiaries and any U.S. based collateral. Primarily, the additional U.S. law governed documents aid a Canadian lender if and when the lender needs to realize on the U.S. based collateral or otherwise collect against the U.S. organized subsidiary in U.S. courts.

As a general matter, U.S. courts should typically give effect to and recognize Canadian law as a valid choice of law, absent fraud or some other public policy concern. Therefore, Canadian law loan documents should be sufficient regardless of the jurisdiction of the subsidiary or the location of the collateral. Canadian borrowers can therefore argue that adding U.S. law governed documents in addition to the Canadian law documents is unnecessary. While there is merit to this argument, the reality is that while U.S. courts *should* give effect to and recognize Canadian law and they *should* be able to interpret

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and impose Canadian law in any proceeding brought in a U.S. court, many lenders simply don't want to take the risk that a U.S. court would look for an opportunity to negate or invalidate a guaranty or security agreement simply because of the choice of Canadian law when a viable alternative is available. The other argument that is sometimes proffered is that it is better to have a U.S. law governed document if a filing under the Uniform Commercial Code ("UCC") will be made in the United States for U.S. based collateral or for a U.S. organized subsidiary. Fundamentally, the reasonableness of the request hinges on the cost to draft and negotiate the additional documents vs. the likelihood that they would ever be used and if so the value of any U.S. based subsidiaries as guarantors or the value of any U.S. based collateral.

Assuming the borrower is willing to agree to use additional U.S. law governed guarantees and security agreements, lenders will often request that the U.S. law governed documents be "typical" or "market" for similar transactions governed under U.S. law. While this request may be reasonable, in an effort to make the documentation and negotiation as efficient as possible, Canadian borrowers may counter that any U.S. law governed documents simply mirror all of the provisions of their Canadian law counterparts – other than the choice of law provisions and other truly jurisdiction-specific provisions (e.g., referencing the UCC instead of the Personal Property Security Act ("PPSA")). In addition, because most lenders require legal opinions as to the enforceability of loan documents, most borrowers will need to engage separate U.S. counsel to negotiate the documents and provide the necessary legal opinions. Ultimately, the best approach to the form of the documentation and the scope of any opinions will again depend on the cost to draft and negotiate the additional documents vs. the likelihood that they would ever be used and if so the value of any U.S. based subsidiaries as guarantors or the value of any U.S. based collateral.

As with any loan transaction, the costs associated with additional U.S. law governed documents needs to be balanced with the reality that there are some advantages to a lender in having different options in the event they need to enter U.S. courts to enforce their loan documents, while at the same time keeping in mind the value of the guarantees and the U.S. based collateral relative to the total value of the loans.