Contractual Guide on Secured Transactions

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Outline

• Introduction
• Pre-contractual matters
• Importance of Clear Contract Drafting and Drafting Techniques
• General Principles from Model Law Applicable to Security Agreements
• Sample Security Agreement
• Closing the Deal
• Conclusion
Introduction

• Purpose of panel – practical advice
• Focus on contract issues
• Best practices
• Standard asset-based-loan transaction
• Link to Model Law and Guide to Enactment
Assume Model Law in effect in all relevant jurisdictions

• Possible application of different property laws
• Generally will not discuss private international law issues, except for a brief description of the issues below
• Implementation of the law
• Possibility of “smart” contracts
Pre-contractual matters

• Discuss with client understanding client's goals (whether grantor or secured creditor)
• Initial documents
• Secured creditor to issue non-binding “Indication of Interest” or “Proposal Letter” (sample forms to be attached)
Diligence

• Secured creditor to send Diligence Letter or Perfection Certificate to grantor

• Gather essential information concerning the grantor and the proposed collateral (sample forms attached)
Secured creditor to conduct searches

- Secured transactions registry
- Intellectual property registry
- Judgments
- Tax Liens
- Other searches (depending on jurisdiction)
- Determine locations of collateral
Determine whether grantor’s locations are owned or leased

- Secured creditor to obtain and review copies of leases
- Secured creditor to consider obtaining agreement with each landlord providing for (i) waiver of any security interest landlord may have and (ii) secured creditor’s access to premises in the event of default
- Secured creditor to determine if any tangible movables are held by a processor or other third party and to consider obtaining a “bailee letter” from such third party (sample form of bailee letter to be attached)
Cash Dominion + insurance

- Secured creditor to determine location of grantor’s bank accounts for implementation of cash dominion system
- Secured creditor to determine what bank account control agreements will be required
- Secured creditor to conduct field examination of collateral (tangible and intangible) using secured creditor’s staff or third party service provider
- Determine if grantor has appropriate insurance for its collateral
Issue binding commitment letter

- Amount of loan
- Interest rate
- Fees
- Timing
- Collateral
General benefits of clear drafting

• Avoid disputes
• See to make sure that all parties understand the terms of the deal
• Use terms that correspond to terms in Model Law
• Take into account experience and sophistication of parties when drafting agreement
Simple drafting

• If these kinds of transactions are new to the business community, simple documents will be easier to explain and work with
• Avoid:
  o Use of legalistic words
  o Long sentences
  o Long paragraphs
• Use easy-to-read fonts
• Examples of ineffective drafting
General Principles from Model Law

- Party autonomy
- Mandatory provisions
• Article 3.1 Model Law
  o Enables parties to adapt their agreement to their needs
• Examples:
  o Definition of default (Article 2 para. j and 52 para. 1 Model Law)
  o Negative pledge clause
  o Additional security / partial repayment clauses
  o Post-default rights (Article 72 para 1 b and Article 72.3 Model Law)
Mandatory provisions

- Article 3.1 Model Law
  - ‘Ensuring fairness and protecting the legitimate interests of third parties’
  - (Legislative Guide Secured Transactions p. 25)

- Examples:
  - Good faith
  - Commercial reasonableness
Sample Security Agreement

• See sample form provided

• Key provisions:
  o Parties
  o Creation of security right
  o Description of encumbered assets
Sample Security Agreement

• Key provisions (con’t):
  o Reference to secured obligation
  o Representations and warranties concerning the grantor and the encumbered assets
  o Covenants relating to the encumbered assets
  o Events of default
  o Remedies
Closing the Deal

- Registry filings
- Pre-filing
- Post-closing confirmatory search
- Certificates
- Delivery of funds
Post-closing monitoring

- Change in identifier
- Change in State of grantor
- Change in location of tangible encumbered assets
Conclusion

• Wrap up how pieces fit together and each is important
• Invite questions
• Transition to next panel
  o Post-closing
  o Types of transactions
  o Monitoring
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General Principles from Model Law

- Party autonomy (Art. 3.1 ML)
  - Enables parties to adapt their agreement to their needs

- Examples:
  - Definition of default (Art. 2 para. j and 52 para. 1 ML)
  - Negative pledge clause
  - Additional security / partial repayment clauses
  - Post-default rights (Art. 72 para 1 b and Art. 72.3 ML)
  - Method to be applied for the sale of the encumbered asset (Art. 78 para 3 ML)
Mandatory provisions (Art. 3.1 ML)

• “Ensuring fairness and protecting the legitimate interests of third parties” (Legislative Guide ST, p. 25)

• Examples:
  o Art. 4:
    ▪ Commercial reasonableness
    ▪ Good faith
    ▪ Art. 53 (reasonable care to preserve the asset)
Law applicable to the security agreement

- Choice of law clause (art. 84)
- Applies to liability for breach of agreement, error, etc.
Sample Security Agreement

- See sample form provided
- Key provisions:
  - Parties
  - Creation of security right
  - Description of encumbered assets
Sample Security Agreement

• Key provisions (continued)
  o Reference to secured obligation
  o Representations and warranties concerning the grantor and the encumbered assets
  o Covenants relating to the encumbered assets
  o Events of default
  o Remedies
2. Grant of the security right and secured obligations

2.1 Grant of the security right

The Grantor grants to the Creditor a security right in all of the Grantor’s present and future movable assets within each of the following categories (the “Encumbered Assets”):

(a) Inventory;
(b) Receivables;
(c) Equipment;
(d) Funds credited to a bank account;
(e) Documents of title (whether negotiable or not), including without limitation bills of lading and warehouse receipts;
(f) Negotiable instruments, including without limitation bills of exchange, cheques and promissory notes;
(g) To the extent not listed above, all proceeds and products of all of the foregoing.
Sample Security Agreement

2. Grant of the security right and secured obligations

... 

2.2 Secured Obligations

The security right hereby granted secures all Obligations.
3. Representations and warranties

The Grantor represents and warrants to the Creditor that:

3.1 Location of certain Encumbered Assets

(a) The inventory and the equipment of the Grantor are and will be held by the Grantor at all times in the provinces of New Brunswick and Quebec and, unless the Grantor notifies the Creditor of a change, at the addresses listed in the Annex to this agreement.

(b) The billing addresses of the debtors of the receivables owed or to be owed to the Grantor are and will be at all times in Canada and the United States and, unless the Grantor notifies the Creditor of a change, in the jurisdictions listed in the Annex to this agreement.

(c) The bank accounts of the Grantor are and will be held at all times at branches of banks in the provinces of New-Brunswick and Quebec, and, unless the Grantor notifies the Creditor of a change, at the addresses listed in the Annex to this agreement. The account agreements relating to these bank accounts are and will be governed by the law of the province in which the applicable branch is located and do not and will not refer to another law for matters relevant to this agreement.
3. Representations and warranties

The Grantor represents and warrants to the Creditor that:

... 

3.2 Location and name of the Grantor

(a) The registered office and the place of central administration of the Grantor are and will be located at all times at the addresses specified on the first page of this agreement.

(b) The Grantor’s exact name and jurisdiction of incorporation are as specified on the first page of this agreement. The Grantor will not change its jurisdiction of incorporation without the prior written consent of the Creditor and will not change its name without giving to Creditor a 30-day prior notice of the change.
4. Authorizations relating to the Encumbered Assets

... 

4.3 Dealings with Encumbered Assets

(a) Until the Creditor notifies the Grantor that an Event of Default has occurred, the Grantor may sell, lease or otherwise dispose of its inventory and documents of title, collect its receivables and negotiable instruments and dispose of worn-out or obsolete equipment, in each case, in the ordinary course of its business.

(b) Except as permitted by paragraph (a), the Grantor will not sell, lease or otherwise dispose of the Encumbered Assets.

(c) The Creditor may at any time notify the debtors of the Grantor’s receivables of the existence of its security right. However, a notification given prior to the occurrence of an Event of Default will authorize the debtors to make their payments to the Grantor until otherwise instructed by the Creditor.
6. Enforcement

6.1 Rights after an Event of Default

After the occurrence of an Event of Default and to the extent same is continuing:

(a) the Creditor may enforce its security right and exercise all rights of a secured creditor under the Model Law and any other applicable law;

(b) the Creditor may also, subject to any mandatory provision of applicable law,

(i) take possession, use, operate, administer and sell, lease or otherwise dispose of any of the Encumbered Assets, in each case, on terms and conditions it deems appropriate;

(ii) collect the Grantor’s receivables and negotiable instruments, compromise or transact with the obligors of these receivables and instruments, and grant discharges to them; and

(iii) take all other actions necessary or useful for the purpose of realizing on the Encumbered Assets, including without limitation completing the manufacture of inventory and purchasing raw materials.
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