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Using Powers Of Attorney In Fund Financing Transactions

By **Zachary Barnett, Mark Dempsey, Michael Gaffney and Anastasia Kaup**
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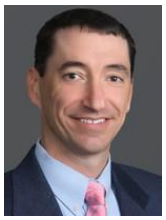
Zachary Barnett


Mark Dempsey


Michael Gaffney


Anastasia Kaup

A power of attorney (POA) is a written agreement wherein an individual or organizational person (the "principal") provides advance authority to another party (the "agent") to make certain decisions, to execute certain documents or to act on the principal's behalf, generally or in certain circumstances. POAs can take the form of stand-alone documents or can be included within other documents (e.g., within a security agreement for a secured lending transaction). Grants of POAs are commonly included in security documents for secured lending transactions to enable the agent to take actions (e.g., direct the disposition of proceeds within the principal's account, execute and deposit checks) on behalf of the principal and usually spring into effect upon the occurrence of an agreed triggering event, such as an event of default under the related credit documents. While POAs are likely to be found in almost all secured lending transactions, there can be nuances related to how such POAs are used in a given transaction and/or jurisdiction. This article discusses some of the issues, considerations and concerns with the use of POAs in subscription credit facility transactions in the United States.

A subscription credit facility, also frequently referred to as a capital call facility, is a loan made by a bank or other credit institution (the "lender") to a private equity or other type of investment vehicle (the "fund"). The defining characteristic of such facilities is the collateral package, which is composed of the rights to make capital calls on the unfunded commitments of the limited partners in the fund (the "investors"), to receive capital contributions when called from time to time by the fund's general partner or manager (the "general partner") and to enforce the same, pursuant to a limited partnership agreement executed by the investor and the general partner.

Powers of Attorney in Subscription Credit Facilities

Generally

POAs are widely used in facilities in the United States and are most commonly included as grants of authority within standard collateral documents, as opposed to stand-alone documents. For example, a POA provision within a security agreement might read as follows:

The Lender is hereby granted an irrevocable power of attorney, which is coupled with an interest, to, during the existence and continuance of any Event of Default, (a) execute, deliver and perfect all documents and do all things that the Lender considers to be required or desirable to carry out the acts and exercise the powers set forth in this Security Agreement, and (b) execute all checks, drafts, receipts, instruments, instructions or other documents, agreements or items on behalf of any Pledgor, as shall be deemed by the Lender to be necessary or advisable to protect the security interests and liens herein granted or the repayment of the secured obligations, and the Lender shall not incur any liability in connection with or arising from the exercise of such power of attorney, except as a result of its own gross negligence or willful misconduct.

Under such a POA, upon the occurrence of an "event of default", the lender could take any of the specifically aforementioned actions or other unspecified actions that the lender deems necessary or advisable to protect its security interests and the liens granted under the security agreement, without the requirement to provide prior written notice or obtain written or other consent from the pledgor/principal granting the power of attorney. It is generally understood that a lender could utilize the POA to, among other things, issue capital call notices, initiate litigation against an investor in connection with the enforcement of remedies available under the limited partnership agreement, or establish a new bank account of the fund, in each case in the name of the general partner. Any such actions would be taken in the name of and on behalf of the general partner and not in the name of the lender.

It is generally understood that to be enforceable under New York law, a POA must generally, at a minimum: (a) be clearly stated in writing and (b) be signed and dated by a principal with the capacity to grant the POA. If the power of attorney states that it takes effect upon the occurrence of a contingency (e.g., the occurrence of an event of default under a loan agreement), the power of attorney takes effect only at the time of that occurrence and is not in effect before the occurrence. Depending on the jurisdiction for applicable governing law, and/or the purpose of the POA or other factors, there may be additional requirements that may be dictated by statute, case law or otherwise. Such other requirements could include execution by a witness, the inclusion of specific statutory language or otherwise take a specific form.

It is also important that any granted POA is irrevocable, such that the granting party cannot freely revoke the authority or powers provided in the POA. Generally, a POA coupled with an interest or given as security will be irrevocable unless the parties add express language to preserve the revocability of the POA.[1] New York courts have held that a POA will only be irrevocable to the extent that (a) the POA affects the legal relations of its creator, (b) the authority under the POA is held by the creator for the benefit of the creator or another third party, (c) the POA was given for consideration and (d) the POA was given to secure the performance of a duty (other than any duty to the creator by reasons of agency).[2]

Other Uses of Powers of Attorney in Facilities

While POAs have always been an important component of the security package in a facility, there are also some uses of a POA outside of inclusion in a broader collateral package. First, a lender could rely on a power of attorney where a pledge of typical facility collateral is not available. Such a scenario could arise where the limited partnership agreements or other constituent documents, other contracts or local applicable laws may prohibit the direct grant of security over the right to call capital contributions from investors. This could also arise where the fund has already granted security over the right to call capital contributions from investors to another creditor. Lastly, we have seen such a POA in the context

of equity commitment enhancements where a full grant of security over the right to call capital contributions from investors was not otherwise contemplated. In such scenarios, it is common for the POA to take a more detailed form than the example set forth above that is typically included in a security agreement. Such a POA would typically be expected to contain fairly detailed descriptions of the specific actions that are able to be taken thereunder by the lender. In such scenarios, funds and lenders should take care that the POA does not contravene or conflict with any applicable restrictions on an outright draft of security over the right to call for capital contributions from investors.

Another scenario where a lender may rely more heavily on a POA is where the fund's limited partnership agreement leaves uncertainty over which entity has the rights or the ability to call for capital contributions from investors and the related authority to pledge such rights as security for a facility. This could arise where a general partner of a fund has delegated certain categories of rights to an investment manager for the fund pursuant to an investment management agreement, where the fund is organized as a corporation or a limited liability company with a board of directors, or in jurisdictions where the rights to call capital belong to the fund alone, notwithstanding that the general partner may issue capital call notices. In these situations, it is typical not only to take a standard grant of security over the right to call capital contributions from investors but also to supplement such grant with a POA from any applicable parties that may have rights to call capital.

Conclusion

POAs are one more tool that can provide a lender with rights in connection with a fund's ability to call capital contributions from investors. Drafted properly, POAs can provide a lender with the ability to take immediate action after an agreed triggering event, such as the occurrence of an event of default under the facility documentation, without the need to provide prior written notice to or obtain the consent or cooperation of the fund or an order of a court.

Zachary K. Barnett is a partner and Mark C. Dempsey is a counsel in the Chicago office of Mayer Brown LLP. Michael P. Gaffney is an associate in the firm's Charlotte, North Carolina, office. Anastasia N. Kaup is an associate in Chicago.

[1] See Rest.3d Agen §3.12; see also NY General Obligations Law Sec. 5-1511(3)(a).

[2] See Ravalla v. Refrigerated Holdings Inc., No. 08-cv-8207 (CM), 2009 U.S. Dist. LEXIS 23353, at *10-11 (S.D.N.Y. Feb. 25, 2009).