Powers of attorney supporting the typical security package: a Cayman/Luxembourg comparison

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Powers of Attorney

In this briefing we examine the role that a power of attorney plays in supporting the typical security package held by a secured party. There are notable differences between the Cayman Islands and Luxembourg which should be borne in mind by a secured party when structuring a transaction.

Cayman Islands

In a typical subscription finance transaction, the core assets over which security is taken from a Cayman fund comprise contractual rights held by the Cayman fund and its general partner under the limited partnership agreement and each subscription agreement. This vests an interest in such contractual rights in the secured party, which are exercisable by the secured party should an enforcement scenario arise.

In order to support the secured party's security interests in such contractual rights, an express irrevocable power of attorney is usually granted to the secured party by the Cayman fund and its general partner. This allows the secured party to step into the shoes of the Cayman fund or the general partner and call capital from investors in the name of the Cayman fund or general partner.

It is prudent to have the Cayman fund and its general partner execute the security agreement as a deed where the governing law of the security agreement is not Cayman Islands law. This is aimed at ensuring the power of attorney contained within the security agreement constitutes a power of attorney for the purposes of the Cayman Islands' Powers of Attorney Law. Other than that, there are no formalities that need be observed with respect to execution of the power of

attorney by the Cayman fund or its general partner (assuming the general partner is not an individual person).

Key to a power of attorney granted by a Cayman fund and its general partner is that it is expressed to be irrevocable. Under the Powers of Attorney law a power of attorney granted by or on behalf of a Cayman fund that is expressed to be irrevocable and which is granted to secure the performance of an obligation owed to a secured party: (a) cannot be revoked without the consent of the secured party; and (b) would survive the winding-up or insolvency of the Cayman fund, in each case for as long as the obligation to the secured party remained undischarged.

It should also be noted that failure to constitute a power of attorney as a power of attorney for the purposes of the Powers of Attorney Law would not detract from the power of attorney's validity or enforceability as a matter of the governing law of the document in which the power of attorney is contained. Whilst security interests over Cayman assets would ideally be governed by Cayman Islands law, they are often captured in foreign law documents with little to no detriment to the secured party.

The issues described above remain relevant where the Cayman fund is a limited liability company or an exempted company, adopted to the prevailing structure as necessary.

Luxembourg

Similarly to a Cayman fund, the security granted by a Luxembourg fund involved in a subscription finance transaction is generally over the contractual rights held by the Luxembourg fund and its general partner under the limited partnership agreement and each subscription agreement. In a US context, the security interest granted by the Luxembourg fund over the limited partners' uncalled capital commitments will typically be created pursuant to a first ranking security agreement governed by the same governing law as the loan documents and a second ranking pledge agreement governed by Luxembourg law.

In order to support the secured party's security interests over such contractual rights, an express irrevocable power of attorney is generally granted to the secured party enabling it to serve capital call notices to the limited partners of the Luxembourg fund on its behalf. However, under Luxembourg law certain limitations arise in relation to powers of attorney.

Under Luxembourg law a power of attorney (a) will terminate by operation of law and without further notice on the commencement of any bankruptcy (faillite) or judicial winding-up (liquidation judiciaire) of the grantor of the power; (b) will become ineffective upon the grantor of the power entering controlled management (gestion contrôlée) or suspension of payments (sursis de paiement); and (c) may be revoked voluntarily by the grantor despite being expressed to be irrevocable.

Any such termination, ineffectiveness or voluntary revocation causes the cessation of all power on the part of the attorney to act on behalf of the Luxembourg fund's general partner, although a voluntary revocation of a power expressed to be irrevocable may result in the grantor being liable for damages resulting from the breach of contract. This principle is considered to be a mandatory rule under Luxembourg law. Therefore, as well as applying to Luxembourg law governed powers of attorney, there is also a risk that the Luxembourg courts could consider it a matter of Luxembourg international public policy, which could also lead them to set aside the application of a foreign law governed power of attorney purporting to be irrevocable in all circumstances.

As a result it is common practice for a Luxembourg fund and its general partner to grant a power of attorney to the secured party in the Luxembourg law security agreement collateralising the investors' undrawn commitments and to express it as being irrevocable. In addition, the Luxembourg fund and its general partner will specifically confirm that the power of attorney is granted jointly in their interests as well as in the interest of the secured party for the proper management of the secured collateral and that it constitutes a mandate of mutual interest (mandat d'intérêt commun). Finally, in accordance with the provisions of article 2003 of the Luxembourg civil code, a provision will also be included that provides that the power of attorney granted does not terminate upon the occurrence of bankruptcy (faillite) or similar Luxembourg or foreign law proceedings affecting the rights of creditors generally in respect of the Luxembourg fund and its general partner.

Whilst the above is likely to improve the lender's protection, this would still not be sufficient to make a power of attorney irrevocable in all circumstances. However, Luxembourg market practice generally acknowledges that the right to serve capital call notices is an ancillary right to the secured collateral. Luxembourg security interests survive the insolvency/bankruptcy of the grantor and so upon an enforcement event, a secured party would remain entitled to exercise the right of the fund and its general partner to call and receive the collateralised capital commitments of the limited partners, and so to issue and deliver the related capital call notices to the limited partners, despite the power of attorney having been terminated or having been revoked. This would be done by the secured party acting in its own capacity as secured party under the security agreement and not in its capacity as attorney of the general partner pursuant to the power of attorney.

Ogier’s CAYLUX fund finance team is ideally placed to assist clients and their international transaction counsel on fund finance transactions involving funds domiciled in the Cayman Islands and Luxembourg.

Our multi-jurisdictional team includes Luxembourg legal capability in Cayman and therefore within US timezones and Cayman legal capability from Europe, in addition to their respective home jurisdiction. Our CAYLUX fund finance team provides one port of call for all Cayman and Luxembourg fund finance matters. We provide 'transatlantic standard' client service and

responsiveness regardless of which jurisdiction is used and the timezone in which the deal takes place.

Find out more about our CAYLUX fund finance team.

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