



Operational Enhancement: The Cayman Exempted Limited Partnership



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THE CAYMAN EXEMPTED LIMITED PARTNERSHIP (ELP) has, since its creation in 1991, established itself as an effective, enduring and widely used offshore funds vehicle particularly in the closed ended private equity and venture capital space as well as, increasingly, in the open-ended hedge funds space.

The revisions contained in the Exempted Limited Partnership Law (2014 Revision) (the ELP Law) which came into force in July 2014 represent significant changes to this law and have been the subject of an extensive period of consultation between the Cayman government and industry representatives resulting in significant enhancements to the flexibility, practicality and operation of the ELP.

The revisions have already been widely welcomed by both Cayman and onshore fund participants being viewed as offering very much 'something for everyone' with enhancements being delivered for the General Partner (GP), Limited Partners (LPs), lenders and secondary market participants.

The revisions generally reflect the following key principles:

- Promoting primacy of freedom of contract between the partners in the exempted limited partnership agreement (LPA) whilst providing default provisions in key areas;
- Updating the existing ELP Law to accommodate and confirm, on a

statutory basis, certain historic private equity industry practices, clarify (or negate) the impact of certain common law positions and allowing for targeted retroactive effect to provide additional certainty to existing structures;

- Streamlining and simplification of the legal formalities which would otherwise apply in connection with the operation of an ELP including changes of GPs, admission of LPs and transfer of LP interests;
- Enhancement of the security-related regime to facilitate lending into funds; and
- Bringing the Cayman ELP regime closer to its onshore counterparts, particularly in the US (eg, Delaware), to promote consistency where offshore and onshore structures run in parallel.

GP Enhancements

GP duty

Previous absolute requirement of the GP's duty being to 'act at all times in good faith in the interests of the ELP' now amended to retain the good faith element but allow the 'in the interests of the ELP' section to be modified/disapplied by the LPA. This helps address a historically difficult area for Cayman GPs when addressing competing interests (such as conflicts of interest and where a single GP is a GP across various ELPs in a fund structure), bringing the duty more in line with the

Delaware equivalent legislation and providing greater contractual certainty to all partners as to the GP duty and the ability of the LPA to regulate it by appropriate disclosure and informed consent.

GPs are however likely to find that with the increased flexibility, LPs, conscious of the ELP Law change, may also pay more attention to the relevant wording of the LPA.

Use of Foreign Partnership as a GP

- New provisions allowing for the registration of foreign limited partnerships in Cayman to act as qualifying GPs of Cayman ELPs to facilitate fund structuring.

Transfers of GP interests / withdrawal of GP – the impact on ELP property

- Confirmation that on transfer of a GP interest in accordance with the LPA and the ELP Law, all rights/property of the ELP which are held/deemed held by the existing GP vest in the incoming GP without further formalities. (Where non-Cayman assets/rights are held, local law advice should be taken confirming this approach will be respected).
- Confirmation that on a GP withdrawal in accordance with the LPA and the ELP Law, all rights/property of the ELP vest in any remaining GP(s) without further formalities. (Where non-



Cayman assets/rights are held, local law advice should be taken confirming this approach will be respected).

Defaulting partner provisions

- Statutory amendment to the common law position on penalty clauses in an ELP context with the ELP Law now providing that default remedies/provisions in the LPA are no longer unenforceable solely because they would constitute a 'penalty clause' for Cayman law purposes. Historically where the remedies amounted to more than what was termed a 'genuine pre-estimate of loss' they may have amounted to penalty clauses and been unenforceable. This is a provision which most LPs will also welcome giving them comfort that any rogue LPs will be dealt with.
- Confirmation that a GP is not liable for its decision to impose/not impose remedies on any partner subject to its overriding duty of good faith (and, if not excluded in the LPA, its duty to act in the interests of the ELP).

LP Enhancements

LP limited liability

- Additional (non-exclusive) safe harbours for LPs, including those specifically aimed at Limited partner Advisory Committee (LPAC) involvement, which expressly do not constitute taking part in the 'conduct of the business' of the ELP and which might otherwise have led to potential LP liability (LPs being generally prohibited from taking part in the conduct of the business of the ELP or risk liability as if they were a GP).
- Incorporation of an 'actual knowledge' requirement relating to the LP statutory claw-back with respect to returned contributions or released commitment on insolvency of the ELP – the test now requiring a LP to have had actual knowledge of the insolvency of the ELP at the time a return of a contribution/release of commitment was made to it (including if the payment/release causes the insolvency) for the statutory claw-back to take effect and with the applicable time-limit for claw-back

being set at within six months of the date of the applicable return/release.

- Confirmation that the applicable interest rate payable by a LP on statutory LP claw-back may be reduced to zero in a LPA and/or the basis of interest calculation also amended in the LPA (otherwise the statutory rate being 10 per cent simple interest per annum calculated on a daily basis).
- Confirmation that LP limited liability is not lost solely on the basis that an ELP does not (subsequent to its initial registration) have a qualifying general partner – where, for example, a GP withdraws and, for a period of time there is no qualifying GP in place.

LP fiduciary duties

Confirmation that (unless the LPA provides otherwise):

- LPs do not owe fiduciary duties to other partners or the ELP; and
 - LPAC members do not owe fiduciary duties to any partner or the ELP.
- LPs and LPAC members remain advised however that they should continue to act at all times in good faith.

LP recovery of expenses for action taken on behalf of an ELP

Where a LP brings an action on behalf of an ELP (being allowed to do so only where a GP has failed, without cause to do so) and the action is successful (wholly or partly), there is now specific provision for the court to award the LP reasonable expenses including attorney's fees from any recovery or the ELP.

Admission of LPs/transfer of LP interests

The ELP law aims to facilitate transfers of LP interests and admission of LPs to ensure that, provided the LPA is complied with, there should be no privity of contract concerns including providing confirmation that the relevant person will be deemed to have adhered to/agreed to be bound by the LPA; and have the rights and obligations contained in the LPA, in each case as if the relevant person and all existing partners had together duly executed and delivered the LPA. This provision also has retroactive effect.

General Enhancements

Enforcement of third party rights

- LPAC members are extended (subject to express provision to the contrary in the LPA) third party rights including, specifically, with respect to exculpation and indemnification provisions in the relevant LPA. This, together with the new Cayman Contracts (Rights of Third Parties) Law (CRTPL), which came into force in June 2014, addresses the historic Cayman issue of having no general legislation allowing for direct enforcement of third party rights. Previous workarounds have included the GP being specifically authorised in the LPA to execute separate non - Cayman law governed indemnity agreements (subject to a law which does allow for enforcement of third party rights), the GP holding such rights on a trust concept or the use of Cayman 'deed polls'.
- Additional third parties typically intended to be caught by exculpation and indemnity provisions within, for example, definitions in the LPA such as 'Covered Persons' or 'Indemnified Parties' can now make use of the CRTPL which provides third party benefit and enforcement rights on an opt-in basis (ie it does not automatically apply but the contract must state the intention that the relevant third parties are intended to be able to enforce directly).
- Confirmation that a third party can be named in/execute a LPA to, for example, take the benefit or assume the liability of a provision under the LPA without being deemed to be a partner.

Privacy

- Changes to the requirements of the Register of LP Interests (LP Register) - with the main LP Register which (subject to the LPA) is open to all partners (and only to others with GP consent) now not containing financial details of contributions/commitments but with the introduction of a new requirement for a separate record of contributions which is only open to inspection by GP consent. Confirmation that both registers can be held outside of Cayman.



Confirmation of validity of remote closings

- Confirmation effectively that English case law (the Mercury case) does not apply in the case of LPAs – confirming the validity of the practice of execution of LPAs/other partnership documents executed as deeds by execution of counterpart signature pages in advance of final form documents and which are then attached with authority to the relevant final agreements such as is typical on a remote closing (works also retroactively).

Security Enhancements

- **GP grant of security over capital calls:** Clarification that contractual rights including the right to make capital calls and receive the proceeds thereof are rights/property of the ELP meaning that historic concerns over the authority/capacity of a GP to grant such security where the GP was not specifically authorised to do so in the LPA (on the basis these were considered personal rights of the GP) are alleviated.
- **Floating Charges:** Confirmation that an ELP can grant floating charges over its assets (the previous position being uncertain given that, as a matter of common law, partnerships are generally unable to do so).
- **Continuing security on withdrawal of GP:** Confirmation that on a withdrawal of a GP, ELP property vests in remaining GP(s) and remains subject to any mortgages/charges/security interests.
- **Enforcement of security:** confirmation that, in an ELP specific context, a secured creditor is entitled to enforce its security

without the leave of the court and without reference to the general partner or liquidator appointed to wind-up the ELP.

- **Introduction of a 'Register of Security Interests':** essentially the same as the prior requirement for a register of mortgages of limited partnership interests and having to show all security interests over LP interests for which notice has been given to the ELP, however, in terms of the notice requirements there is no longer a requirement to provide the Cayman registered office of the fund with an executed copy of the complete charge agreement, just the prescribed particulars.
- GP consent for LP transfer/grant of security: Clarification that, subject to the LPA, no LP may transfer/grant a security over its interest without prior/simultaneous GP consent.

Additional changes

- Allowing dual foreign names (eg, with Chinese characters) to be used (and not having to be translations of the English).
- Additional provisions expressly allowing GP agents and delegates to enter into documents on behalf of the ELP.
- Clarification with respect to certain winding-up and dissolution provisions:
- Clarification that changes to the make-up of the partners do not cause the LPA to terminate (previously the ELP Law just confirmed that this did not cause a dissolution of the partnership).
- Clarification that where there are multiple GPs in a partnership, the LPA can delegate authority to one GP where the ELP Law provides for certain GP authorities/powers as the previous law was unclear

as to whether all GPs had to perform the relevant matters.

- Introduction of a short form strike-off process for ELPs (comparable to that available for exempted companies under the Cayman Companies Law and with corresponding reinstatement provisions so likely only of practical use where a fund has not traded).
- Introduction of migration provision for ELPs out of Cayman (previously only migration in provided for).
- Provisions deeming powers of attorneys (POAs) contained in LPAs (including irrevocable POAs) to have been validly executed for Cayman formalities where the donor has executed or adhered to the LPA even where not executed as a deed (works also retroactively).

Looking Forward

The ELP Law in its current form highlights Cayman's commitment to listen to the concerns and suggestions for improvement from the stakeholders who use this structure and address them in a balanced and practical manner. Further enhancements to the regime remain under constant discussion amongst industry participants with a view to ensuring the Cayman ELP structure remains at the forefront of offshore fund structuring. ■

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