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**Good news for Cayman domiciled private equity funds - Introduction of new ELP Law.**

## IN THIS ISSUE

### Good news for Cayman domiciled private equity funds - Introduction new ELP Law

The Cayman Islands ("**Cayman**") continue to be the leading offshore jurisdiction for the establishment of both hedge funds and private equity funds. Typically, private equity funds are structured in Cayman as exempted limited partnerships ("**ELPs**") and the introduction of the Exempted Limited Partnership Law, 2014 (the "**New ELP Law**"), which has repealed the previous law and came into force on 2<sup>nd</sup> July 2014, is aimed at enhancing the attractiveness of Cayman as the leading offshore jurisdiction for private equity funds.


The New ELP Law aims (i) to confer even greater contractual flexibility on the general partner ("**GP**") and limited partners ("**LPs**") of ELPs in order that they can regulate their affairs within the limited partnership agreement ("**LPA**"), and (ii) to reflect some developing trends in the formation, regulation and operation of private equity funds which bring Cayman, as it relates to ELPs, more closely aligned with Delaware law.

#### **Key Changes Introduced**

##### **Foreign partnerships can act as a GP**

The list of persons who qualify as a GP of an ELP has been extended to include a limited partnership or limited liability partnership established in a recognized jurisdiction (e.g. United States, United Kingdom, Hong Kong, BVI, Singapore, Jersey, Luxembourg) (a "**foreign limited partnership**") provided such foreign limited partnership is registered as a foreign limited partnership in Cayman. Whilst a foreign company has been able to be the GP of an ELP upon registration as a foreign company in Cayman, a partnership established outside Cayman was not previously able to act as a GP of an ELP.

In the context of private equity funds, the extension of entities that can qualify as a GP of an ELP will



improve structuring possibilities for fund managers by allowing a foreign limited partnership to be the GP of both an offshore ELP and an onshore limited partnership.

### **Requirement of a GP to act in the interest of the ELP**

Under the previous ELP law, a GP was under an absolute duty to act in good faith in the interest of the ELP. This duty could not be restricted, limited or varied by the terms of the LPA between the GP and the LPs. The requirement to act in the interest of the ELP often raised the issue of conflicts of interest for the GP, particularly when it acted as GP to more than one ELP. A GP which acted as the sole GP to several private equity funds (structured as ELPs) had to, for example, consider how to discharge its statutory duty to act in good faith in the interest of each fund, in relation to investment opportunities. The New ELP Law retains the absolute duty on the GP to act in good faith and, whilst retaining the duty to act in the interest of the ELP, makes it subject to any express provision in the LPA to the contrary.

Going forward, the LPA may set out in whose interests the GP must act in any particular circumstance. By this change, the New ELP Law has provided additional flexibility to the GP and LPs of an ELP and effectively provided a mechanism for the GP and LPs to remove some of the conflicts of interest issues that a GP had to consider previously (e.g. vis-à-vis dealing with investment opportunities for competing funds). It is important to note, however, that if the LPA has no express provision with regard to whose interest the GP must act in certain given circumstances, then the fallback position is that the GP must act in good faith in the interest of the ELP (i.e. in the collective interest of all LPs of the ELP).

### **Status of LPs when the Partnership ceases to have a qualifying GP**

Under Cayman law, an ELP is required to have at least one qualifying GP who shall, in the event that the assets of the ELP are inadequate, be liable for all debts and obligations of the ELP. If that sole qualifying GP ceases to be the qualifying GP of the ELP (e.g. the GP ceases to be registered as a foreign company in Cayman), it was previously unclear as to whether this fact adversely affected the limited liability status of the LPs in that ELP. The New ELP Law now confirms that even if the ELP ceases to have a qualifying GP, the LPs will not, on that basis, lose the benefit of statutory limited liability.

## **Limited Partners owe no fiduciary duties**

Section 19(2) of the New ELP Law confirms, if confirmation was required, that a limited partner of an ELP owes no fiduciary duty to any other partners of the ELP or to the ELP itself in exercising any of its rights or performing any of its obligations under the LPA, except to the extent that it has expressly agreed to such fiduciary obligations in the LPA.

Similarly, section 24(2) of the New ELP Law states that a member of any board or committee of the ELP does not, in the absence of express provisions in the LPA to the contrary, owe any fiduciary duty in exercising any of its rights or authorities, or otherwise in performing any of its obligations as a member of any board or committee of the ELP.

Partners may nevertheless agree to set out certain fiduciary obligations in the LPA. They might, for example, agree to impose fiduciary duties on members of advisory boards or committees of the ELP.

## **Register of Security Interests**

The New ELP Law requires the GP to maintain a register of security interests over any partnership interest at the registered office of the ELP. The register of security interests must contain the identity of the grantor and grantee, the partnership interest or part thereof over which the security interest has been granted, and the date on which notice of the security interest was validly served. Written notice of the grant of a security interest over the partnership interest or part thereof must be given to the ELP at its registered office by the grantor or grantee in order for such notice to be deemed validly served.

The register of security interests of the ELP may be inspected by any person during usual business hours.

## **Register of Partners**

Section 29 of the New ELP Law provides that the register of limited partners need only record the following in respect of each ELP (and therefore need no longer contain financial information, e.g. LP contributions and details of return of contributions to LPs):

- i. the name and address of each LP;
- ii. the date on which a person became an LP;
- iii. the date on which the LP ceased to be an LP.

The register of limited partners may be inspected by all LPs subject to any express or implied term of the LPA, and may also be inspected by any other person with the consent of the GP.

### **Register of Contributions**

Details of capital contributions by LPs to the ELP and details of payments representing a return of contribution by the ELP to LPs are no longer required to be kept in the register of limited partners. Section 30 of the New ELP Law requires the GP to maintain a separate record of contributions with the following information:

- i. the amount and date of the capital contribution(s) of each LP; and
- ii. the amount and date of any payment representing a return of the whole or any part of the contribution of any LP.


Any person may have access to the register of contributions with the consent of the GP.

The changes introduced in respect of the register of limited partners and register of contributions provide the GP with the ability to prevent or restrict an LP from accessing financial information pertaining to other LPs' capital contribution and/or return of contributions by the ELP.

Where the register of limited partners and the register of contributions are maintained at a place other than the registered office of the ELP, the GP is required to maintain at the registered office a record of the address where these registers are maintained.

### **Admission formalities simplified**

The New ELP Law has clarified previous concerns regarding whether or not it was possible to admit a new LP to the ELP without having the LP execute counterpart agreements or enter into a deed of adherence to agree to become bound by the terms of the LPA. The conditions and process for admission of LPs to the ELP and for the transfer of LP interests, have been simplified.



The conditions and process for admissions and the transfer of LP interests can be set out in the LPA. Provided those conditions and procedures have been complied with or waived in accordance with the terms of the LPA, the admission will be valid. This change will allow investment managers to determine their own conditions and procedures for admitting LPs.

### **Expansion of safe harbours for LPs serving on advisory boards**

A limited partner of an ELP can lose its limited liability status if it takes part in the conduct or management of the business of an ELP. The New ELP Law has expanded the non-exhaustive list of safe harbours for activities that an LP can do in respect of the ELP in which it holds an interest without losing its limited liability status. The list has been extended to include:

- (i) serving on advisory boards or committees of the ELP, or
- (ii) serving on the board of directors or a committee of, consulting with or advising or being an officer, director, shareholder, partner, member, manager, trustee, agent or employee of, a company in which the ELP has an interest (such as investment portfolio companies).

### **Ability of Advisory Board/Committee members to enforce terms**

Where the LPA contains provisions governing the establishment and regulation of any boards or committees of the ELP (including, the manner and terms of appointment; powers, rights and obligations; and the rights of members and former members of boards or committees to exculpation or to be indemnified out of the assets of the ELP), then subject to the express terms of the LPA, any person duly appointed to be a member of any board or committee of the ELP in accordance with those provisions will be deemed to have notice of and shall have the benefit of those provisions in the LPA. Moreover, those provisions in the LPA will not be unenforceable by a board or committee appointee solely on the basis that such person is not a party to the LPA.

This provision will give comfort to persons who sit on ELP advisory boards and committees that they can benefit from terms in the LPA relating to their committee or board (e.g. rights to exculpation and indemnification) even if they are not a party to the LPA.

## **Remedies for default given statutory recognition**

The New ELP Law provides more certainty with respect to the enforceability of remedies for LP default contained in the LPA. If the LPA provides that where an LP fails to perform any of its obligations under, or otherwise breaches the LPA (e.g. where LP fails to commit additional capital when called upon to do so), that LP may be subject to or suffer remedies for, or consequences of, the failure or breach specified in the LPA (e.g. reducing, eliminating or forfeiting the defaulting LP's partnership interest in the ELP), then those remedies or consequences in the LPA will not be unenforceable solely on the basis that they are penal in nature.

Previously, default remedies which are routinely included in LPAs (e.g. reducing, eliminating or forfeiting the defaulting LP's partnership interest in the ELP where it fails to contribute committed capital or failed to commit additional capital when called upon to do so) ran the real risk of being subject to legal challenge on the basis that they were penalties (i.e. remedies which go well beyond a reasonable assessment and measure of the loss suffered as a consequence of the default) and may be unenforceable as a matter of Cayman law generally. The New ELP Law has now clarified that these default provisions, which are routinely included in LPAs, will not be unenforceable solely by virtue of being deemed a penalty.

Additionally, the GP has been given flexibility in determining whether or not to trigger the default provisions in the LPA upon a default by an LP. The GP will not be liable for its decision to impose any remedies or consequences or for its decision not to do so, provided that the GP's decision is made in good faith.

## **Strike Off regime for ELPs**

A strike off regime has been introduced for ELPs which is very similar to that which applies to Cayman companies. The regime allows ELPs to effect a soft termination by being struck off the Register of ELPs without being required to fully wind up and dissolve.

Where the Registrar has reasonable cause to believe that the ELP is not carrying on business or is not in operation, or if the GP makes an application to the Registrar, the Registrar may strike the ELP off the Register of ELPs. The GP, any LP or creditor of the ELP who objects to the ELP being struck off, on grounds that the ELP was in fact carrying on business, in operation or otherwise at the time that it was

struck off , may apply to the Cayman court to have it restored to the Register of ELPs.

The application to restore the ELP to the Register must be made within two years of the strike off date. If the two year period has elapsed, approval may be sought from the Cayman Government to allow the restoration as long as this is sought within a ten year period from the date the ELP was struck off the Register.

### **Transfer out by ELPs by way of continuation permitted**

ELPs may now formally deregister in Cayman and re-domicile to another jurisdiction. Previously, there was no formal process for an ELP to transfer from Cayman to another jurisdiction with ease.

### **Execution Formalities**

Under the New ELP Law, the LPA no longer needs to be executed as a deed and witnessed in order to make valid a power of attorney granted in it. It also allows for the grant of powers of attorney to be irrevocable without the need to satisfy the requirements that would otherwise apply under Cayman law. The New ELP Law states that this change will have retroactive effect and so validates any power of attorney contained in any LPA which was executed prior to 2<sup>nd</sup> July 2014.

Another significant change which has the effect of removing the application of the English caselaw decision in the Mercury case [2008] EWHC 2721 from applying in Cayman is in section 27 of the New ELP Law. Section 27 confirms that an LPA, or any agreement pursuant to which any person agrees to make any commitment or contribution to an ELP (e.g. subscription agreement) will be validly executed where the complete agreement is executed or where any signature or execution page to the agreement is attached with the relevant party's express or implied authority. This validates the normal practice of collating signature pages in advance of closing and then attaching them to the final form documents.

### **Dual foreign names**

Similar to the position for Cayman exempted companies, ELPs will now have the ability to use a dual foreign name which can be particularly useful for ELPs carrying on business non-English-speaking jurisdictions (e.g. China and Russia).



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