

# LEGAL DEVELOPMENTS AND RECENT TRENDS FOR THE NEW CAYMAN LLC

GARY SMITH, OF LOEB SMITH ATTORNEYS, DISCUSSES THE RECENT TRENDS, LEGAL DEVELOPMENTS AND ADVANTAGES OF THE NEW CAYMAN LLC

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**HFMWeek (HFM): What impact has the introduction of the new Cayman LLC had since it was introduced in 2016?**

**Gary Smith (GS):** The Limited Liability Companies Law, 2016 (the LLC Law) introduced a new Cayman Islands limited liability company (the Cayman LLC) in June 2016. Since then there has been an increasing number of Cayman LLCs formed and also some that have transferred to the Cayman Islands by way of continuation from other jurisdictions. According to records held by the Cayman Islands Registrar of Companies, between the period 1 July 2016 to 19 May 2017 there were 391 Cayman LLCs formed and another 16 transferred by way of continuation from other jurisdictions. The Cayman LLC has so far been proven attractive for general partner entities and other carried interest distribution vehicles. The Cayman LLC has the benefit of being (like a Cayman Islands exempt company) a separate corporate entity with limited liability, but does not have the maintenance of capital restrictions applicable to exempt companies, and therefore has more flexibility to make distributions of income and capital through the terms of the LLC agreement. For the same reason, Cayman LLCs are also proving attractive for management company entities.

**HFM: What are the key features of a Cayman LLC?**

**GS:** The key features are:

- An LLC formed under the LLC Law is similar in structure to the Delaware LLC as the LLC Law is broadly based on the Limited Liability Company Act in the State of Delaware. However the LLC Law has also preserved the broad legal principles applicable to Cayman Islands companies and the rules of equity and common law.
- A Cayman LLC is a corporate entity which has legal personality separate from that of its members.
- Formation of a Cayman LLC is straightforward. It requires the filing of a registration statement with the Companies Registry and payment of the requisite government fee.
- A Cayman LLC must have at least one member. It can be member managed (by some or all of its members) or the LLC agreement can provide for the appointment of per-

sons (who need not be members) to manage and operate the Cayman LLC.

- Profits and losses of a Cayman LLC are allocated among its members, and among classes of LLC interests or groups of members, in accordance with the terms of the LLC agreement.
- Distributions of cash or in kind are made or paid among the members, and among classes of LLC interests or groups of members, in accordance with the terms of the LLC agreement.
- The liability of an LLC’s members is limited. Members can have capital accounts and can agree among themselves (in the LLC agreement) how the profits and losses of the Cayman LLC are to be allocated and how and when distributions are to be made (similar to a Cayman Islands exempt limited partnership).
- A Cayman LLC may be formed for any lawful business, purpose or activity and it has full power to carry on its business or affairs unless its LLC agreement provides otherwise.
- Access to and the confidentiality of information and records of the Cayman LLC can be governed by the terms of the LLC agreement.
- An LLC agreement may, among other things:
  - o provide for classes or groups of managers having such relative rights, powers and duties as the LLC agreement may provide, and may make provision for the future creation of additional classes or groups of managers having such relative rights, powers and duties as may from time to time be established;
  - o provide for the taking of an action, including the amendment of the LLC agreement, without the vote or approval of any manager or class or group of managers, including an action to create under the provisions of the LLC agreement a class or group of LLC interests that were not previously outstanding;

o may grant to all or certain identified managers or a specified class or group of the managers the right to vote, separately or with all or any class or group of managers or members, on any matter.

- The following statutory registers are required to be maintained for a Cayman LLC but, similarly to the requirement for a Cayman Islands exempted company, only an LLC's register of managers is required to be filed with the Companies Registry:

- a register of members;
- a register of managers; and
- a register of mortgages and charges.

- The register of managers and register of mortgages and charges are required to be maintained in a manner similar to the register of directors and register of mortgages and charges for a Cayman Islands exempt company.

- Subject to any express provisions of an LLC agreement to the contrary, a manager of the LLC will not owe any duty (fiduciary or otherwise) to the LLC or any member or other person in respect of the LLC other than a duty to act in good faith in respect of the rights, authorities or obligations which are exercised or performed or to which such manager is subject in connection with the management of the LLC provided that such duty of good faith may be expanded or restricted by the express provisions of the LLC agreement.

**HFM: How, if at all, will Delaware law influence the development of the law governing the Cayman LLC?**

**GS:** While the Cayman LLC is loosely based on the Delaware LLC, it is worth noting that the legal traditions in both jurisdictions are different. Section 3 of the LLC law states that: "The rules of equity and of common law applicable to companies registered in the islands, as modified by the Companies Law and any other laws in force in the islands applicable to such companies, shall apply to a limited liability company, except in so far as such rules and law or modifications thereto are inconsistent with the express provisions of this law or the nature of a limited liability company..."

The development of the jurisprudence for Cayman LLCs is likely to be different in a number of respects from Delaware law because the rules of equity and of English common law, as is applicable in the Cayman Islands will be applied rather than Delaware law. By way of example, section 26(4) of the LLC law states that:

"Subject to any express provisions of an LLC agreement to the contrary, a manager shall not owe any duty (fiduciary or otherwise) to the limited liability company or any member or other person in respect of the limited liability company other than a duty to act in good faith in respect of the rights, authorities or obligations which are exercised or performed or to which such manager is subject in connec-

tion with the management of the limited liability company provided that such duty of good faith may be expanded or restricted by the express provisions of the LLC agreement."

The duty to act in "good faith" in section 26(4) of the LLC law is a new statutory duty rather than an existing common law duty. The concept of "good faith and fair dealing" in Delaware law is an implied contractual duty. Delaware law allows for an LLC agreement to restrict, limit or exclude liabilities for breach of contract and breach of duties to the extent such breach does not constitute a bad faith violation of the implied contractual covenant of good faith and fair dealing. However, English common law applicable in the Cayman Islands does not recognise a general implied duty of good faith in contracts, and therefore the concept of "good faith" under section 26(4) is likely to be construed differently by the Cayman courts.

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WE EXPECT THAT OVER THE NEXT FEW YEARS CAYMAN LLCs MIGHT ALSO PROVE ATTRACTIVE AS A STRUCTURE FOR OFFSHORE INVESTMENT FUNDS – ESPECIALLY PRIVATE EQUITY FUNDS AND REAL ESTATE

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**HFM: What are the possible uses of a Cayman LLC?**

**GS:** Owing to the additional flexibility that clients will have in using Cayman LLCs, going forward we see it being used for holding companies, joint venture entities and other special purpose vehicle (SPV) entities.

**Investment feeder fund:** The Cayman LLC has a number of features which lends itself to being a good fit for offshore investment funds. It is a corporate entity which has separate legal personality from that of its members, it has capacity to sue and to be sued in its own name, and it has the power and ability to acquire, hold and dispose of assets in its own right (as contrasted with a Cayman LP). The LLC Law has created a framework for Cayman LLCs to maximise the flexibility of operating through the terms of the LLC agreement. For example, pass-through treatment of profits and losses for tax purposes; and more flexibility to make distributions of income and capital through the terms of the LLC agreement by removing the maintenance of capital restrictions applicable to exempt companies. By way of contrast with LLCs formed in Delaware, which have traditionally been used as a general partner for Delaware limited partnerships, for carried interest distribution vehicles, and as management companies, but not as investment funds, we expect that over the next few years Cayman LLCs might also prove attractive as a structure for offshore investment funds (especially private equity funds and real estate funds, where we have already advised clients on funds structured as Cayman LLCs). There are a number of reasons for this: (i) using the Cayman LLC means having one entity rather than two entities when a limited partnership with its GP is used; (ii) using a Cayman LLC will be just as flexible as a limited partnership structure and therefore allow clients to align the rights of investors between onshore and offshore investment funds in master/feeder structures.

**General Partners and Management Companies:** the Cayman LLCs that have been formed to date have been predominantly general partners of limited partnerships and management companies and we expect this trend to continue for the reasons outlined above. ■