

# Introduction of the New ELP Law and the Contracts (Rights of Third Parties) Law 2014: good news for Cayman Islands domiciled private equity funds

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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 (New ELP Law), which came into force on 2 July 2014, will enhance the attractiveness of Cayman as the leading offshore jurisdiction for private equity funds. The New ELP Law aims 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).
- 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.

The first section of this article discusses the key changes introduced under the New ELP Law (*see below, Key changes introduced under the New ELP Law*).

The second section of this article discusses the application and enforcement of the Contracts (Rights of Third Parties) Law 2014 of the Cayman Islands, which was enacted in May 2014 to modify contract law in the Cayman Islands (*see below, Contracts (Rights of Third Parties) Law 2014*). It grants to one or more persons who are not parties to a contract (third parties) the ability to enforce rights and benefits expressly granted to the third party/ies in the contract. The Contracts (Rights of Third Parties) Law applies to contractual rights and benefits capable of being enforced by a third party, including limitation of liability provisions, indemnities and exculpation clauses. In the investment funds context, this law is expected to be particularly beneficial in dealing with indemnity and exculpation provisions of LPAs, subscription agreements, and shareholders' agreements, which commonly seek to benefit a wider class of persons than the parties to the agreement itself (for example, investment managers, each of the investment manager's affiliates, and each officer, director, employee, agent, stockholder, partner or member of the investment manager).

## KEY CHANGES INTRODUCED UNDER THE NEW ELP LAW

### 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 recognised jurisdiction (for example, United States, United Kingdom, Hong Kong, BVI, Singapore, Jersey and Luxembourg) (foreign limited partnership). This is provided the foreign limited partnership is registered as a foreign limited

partnership in Cayman. While a foreign company has been able to be the GP of an ELP on 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 that 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, while 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 can set out in whose interests the GP must act in any particular circumstance. By this change, the New ELP Law has both:

- Provided additional flexibility to the GP and LPs of an ELP.
- 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 (for example, in relation to dealing with investment opportunities for competing funds).

However, if the LPA has no express provision with regard to whose interest the GP must act in certain given circumstances, then the fall-back position is that the GP must act in good faith in the interest of the ELP (that is, in the collective interest of all LPs of the ELP).

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

An ELP must have at least one qualifying GP who is, 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 (for example, 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 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 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 fiduciary obligations in the LPA).

Similarly, 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 (*section 24(2), New ELP Law*):

- Exercising any of its rights or authorities.
- Otherwise performing any of its obligations as a member of any board or committee of the ELP.

However, partners may agree to set out certain fiduciary obligations in the LPA. They may, 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.
- Partnership interest (or part of the partnership interest) over which the security interest has been granted.
- 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 of the partnership interest) must be given to the ELP at its registered office by the grantor or grantee in order for the notice to be deemed validly served.

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

### Register of partners

The register of limited partners need only record the following in respect of each ELP (and therefore need no longer contain financial information such as LP contributions and details of return of contributions to LPs) (*section 29, New ELP Law*):

- The name and address of each LP.
- The date on which a person became an LP.
- The date on which the LP ceased to be an LP.

The register of LPs can be inspected by:

- All LPs, subject to any express or implied term of the LPA.
- 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. The GP must maintain a separate record of contributions with the following information (*section 30, New ELP Law*):

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

Any person can access the register of contributions with the GP's consent.

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 relating to:

- Other LPs' capital contribution.
- 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 ELP's registered office, the GP must 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 is possible to admit a new LP to the ELP without first requiring the LP to agree to become bound by the terms of the LPA by either:

- Executing counterpart agreements.
- Entering into a deed of adherence to those terms.

The conditions and process for admission of LPs to the ELP and for the transfer of LP interests have been simplified.

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

### Expansion of safe harbours for LPs' service 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:

- Serving on advisory boards or committees of the ELP.
- Serving on the board of directors or a committee of a company in which the ELP has an interest (such as investment portfolio companies).
- Consulting with, 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

The LPA may contain 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.
- The rights of members and former members of boards or committees to exculpation or to be indemnified out of the assets of the ELP.

If these provisions exist, then, subject to the LPA's express terms, any person duly appointed to be a member of any board or committee of the ELP in accordance with those provisions both (*New ELP Law*):

- Is deemed to have notice of those provisions.
- Have the benefit of those provisions.

Further, those provisions are not unenforceable by a board or committee appointee solely on the basis that such person is not a party to the LPA (*New ELP Law*).

This provision provides 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 (for example, 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. An LPA may provide that, where an LP fails to perform any of its obligations under, or otherwise breaches, the LPA (for example, where an LP fails to commit additional capital when called upon to do so), that LP may be liable to remedy or suffer consequences of, the failure or breach specified in the LPA (for example, by reducing, eliminating or forfeiting the defaulting LP's partnership interest in the ELP). These provisions are not unenforceable solely on the basis that they are penal in nature.

Previously, default remedies routinely included in LPAs (for example, 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) both:

- Ran the real risk of being subject to legal challenge on the basis that they were penalties (that is, remedies which go well beyond a reasonable assessment and measure of the loss suffered as a consequence of the default).
- May be unenforceable as a matter of Cayman Islands law generally.

The New ELP Law has now clarified that these default provisions, which are routinely included in LPAs, are not 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 on 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.

The Registrar can strike the ELP off the Register of ELPs where either:

- The Registrar has reasonable cause to believe that the ELP is not carrying on business or is not in operation.
- The GP makes an application to the Registrar.

The GP, any LP or any creditor of the ELP can:

- Object 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.
- Apply on the above grounds to the Cayman court to have the ELP 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 can 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 of Cayman

ELPs can now formally de-register 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

An LPA no longer needs to be executed as a deed and witnessed to make a power of attorney granted in it valid (*New ELP Law*). The New ELP Law 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. This change will have retroactive effect and therefore validates any power of attorney contained in any LPA which was executed before 2 July 2014.

Section 27 of the New ELP Law has the effect of removing the application of the decision in the English case *R (on the application of Mercury Tax Group & Anor) v HMRC & Ors (Mercury)* [2008] EWHC 2721 in Cayman. Section 27 of the New ELP Law confirms that an LPA (or any agreement under which any person agrees to make any commitment or contribution to an ELP (for example, a subscription agreement)) is validly executed where either:

- The complete agreement is executed.
- 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 can now use a dual foreign name. This can be particularly useful for ELPs carrying on business in non-English-speaking jurisdictions (for example, China and Russia).

## KEY CHANGES INTRODUCED BY THE CONTRACTS (RIGHTS OF THIRD PARTIES) LAW 2014

The Contracts (Rights of Third Parties) Law 2014 of the Cayman Islands (Law) was passed to modify contract law in the Cayman Islands. It grants to one or more persons who are not parties to a contract (third parties) the ability to enforce rights and benefits expressly granted to the third party/ies in the contract.

### Why is the Law significant?

Before the Law, under the common law applicable to the Cayman Islands, a person had to be party to a Cayman law-governed contract to be able to enforce the provisions of that contract. This applied even where the parties to the contract clearly intended that a third party should have rights under the contract. Under the Law, a third party will be able to enforce a contractual term granting rights to that third party, provided that the contract specifically provides in writing that the third party can enforce the relevant contractual term (that is, the opt-in condition). A term of a contract purporting to confer a benefit on a third party is not in itself sufficient to enable the third party to enforce the term. The opt-in condition must be met. Only terms which are expressed in writing in the contract to be capable of enforcement by the third party are enforceable.

The Law applies to contractual rights and benefits capable of being enforced by a third party, including limitation of liability provisions, indemnities and exculpation clauses. In the investment funds context, the new Law is expected to be particularly beneficial in dealing with indemnity and exculpation provisions of subscription agreements, LPAs, and shareholders' agreements, which commonly seek to benefit a wider class of persons than the parties to the agreement itself (for example, investment managers, each of the investment manager's affiliates, and each officer, director,

employee, agent, stockholder, partner or member of the investment manager).

The new Law should remove the need for separate agreements to deal with indemnity and exculpation provisions.

### Identifying the third party

For a third party to personally enforce a term of the contract, the third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description. This includes a person nominated or otherwise identified under the terms of the contract. However, the third party need not be in existence when the contract is entered into.

### Application

The Law will apply to any contract which seeks to confer benefits or rights capable of being enforced by a third party. However, the Law will not apply to certain contracts, including:

- Contract on a bill of exchange.
- Promissory note.
- Other negotiable instruments.
- Claims against employees under employment contracts.
- Contracts for carriage of goods by sea, road, or air.

- Letters of credit.

Similarly, the Law will not apply in respect of either the Memorandum of Association of a Cayman company or the Articles of Association of a Cayman company (which are statutory contracts binding on a Cayman company and its shareholders).

Contracts made before the Law came into force can be amended to:

- Confer benefits on a third party.
- Include the opt-in condition.

However, a third party will only be able to enforce a right that accrues on or after the date on which the contract is amended.

### Enforcement

Where the third party seeks to enforce rights under the contract, any remedy that would have been available to the third party in an action for breach of contract if the third party had been a party to the contract will be available. The rules of contract law relating to damages, injunctions, specific performance, and other relief will also apply. Therefore, the third party will have no greater rights in respect of enforcing the contract than a party to the contract.

The Law also contains provisions relating to double recovery and the contracting parties varying the contract subject to the third party's assent.

## Practical Law Contributor profile

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### Publications

- "Investment Funds: Cayman Islands", published in the Practical Law Investment Funds Multi-jurisdictional Guide 2012.
- "Introduction of Non-Petition... Covenants", published in International Corporate Rescue Vol. 10 (2013) Issue 4.
- "Cayman Islands' Court of Appeal Re-affirms Status of Segregated Portfolio Companies", published in International Corporate Rescue Vol. 9 (2012) Issue 6.