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Private equity funds eye Cayman ahead of rule change

A proposal for amendments to Cayman law could align their legislation with that of Delaware in order to facilitate private equity structures adopting the master/feeder structure, potentially attracting more funds domiciling in the offshore jurisdiction.

Cayman is expected to pass a new Exempted Limited Partnership Law in March or April 2014. The bill, which sets out the terms of the proposed new law, provides for increased drafting flexibility for exempted limited partnership agreements, writes Matt Mulry, partner – financial services, Dillon Eustace.

It also introduces a number of changes including provisions relating to the replacement of general partners, execution of documents, taking of security over partnership interests, admission of partners, transfer of partnership interests and winding up of exempted limited partnership. The Bill also provides for the redomiciliation of Partnerships to and from Cayman. This article seeks to set out a summary of the proposed changes and how they might impact those using or considering the use of Partnerships.

Drafting Flexibility

The most notable proposed change to the existing law is: that a Partnership agreement will be able to provide that a general partner need not act in the interests of the Partnership. This could be desirable where a general partner is obliged to deal with the competing interests of investors and service providers, particularly with regards to remuneration arrangements.

The existing list of activities a limited partner can undertake without taking part in the business of a Partnership (thereby risking loss of their limited liability) is expanded by the Bill. The new law will allow a limited partner to: -

- (i) act as a member of any committee of the Partnership or any of its general partners or limited partners including giving advice or consenting to any action proposed by a general partner; and
- (ii) to act for, advise, consult or have an interest in any entity in which the Partnership has an interest or which provides services to the Partnership or its general partner.

The Bill also provides that, subject to the Partnership agreement, members of a committee are deemed to have notice of and the benefit of provisions of the agreement relating to the committee regardless of whether they are a party to it. Members of such committees will also only have those fiduciary duties provided for in the Partnership agreement. A person executing the Partnership agreement, or identified in it, will not thereby be deemed to be a partner under the new law.

Additionally, the Bill allows a Partnership agreement to include votes of persons who are not limited partners in decisions on the winding up of the Partnership or the appointment of a new general partner. It also clarifies that a limited partner only owes fiduciary duties if they are

provided for in the Partnership agreement. These provisions refine the existing law regarding the use of committees and provide greater flexibility to regulate the operations of committees which can be an important part of the Partnership structuring for investors.

The new law expressly states that remedies against defaulting limited partners of a Partnership will not be unenforceable solely on the basis that those remedies are penal in nature. This will remove a long held doubt over the enforceability of forfeiture and other provisions of Partnership agreements and give comfort to investors and managers that common default provisions will be effective once the new law is passed.

The Bill also allows for registration of a Partnership with a dual foreign name including names in non-Roman scripts which may be attractive to Partnerships with, or which target, investors in the CIS, Asia, the Middle East or North Africa.

Appointment and Replacement of General Partner

The Bill clarifies that the Partnership does not lose its limited liability on the departure of its Cayman domiciled or registered general partner. The Bill also provides that any new general partner will have all rights and property of the Partnership vested in them and any continuing general partners without the need for further formality. Similarly on the retirement of any general partner such rights and property will vest in the remaining general partners without further formality. These provisions will give additional comfort when making changes to the general partners of a Partnership.

The Bill also provides for the registration in Cayman of foreign limited partnerships or limited liability partnerships where they are established in an approved jurisdiction. Once registered the foreign limited partnership or limited liability partnership will be able to act as the general partner to a Partnership. This will expand the possibilities for multi-jurisdictional Partnership structures.

Execution of Documents

The Bill provides for a Cayman statutory departure from English case law relating to the formalities for execution of documents and also provides for a statutory departure from the Cayman law formalities for the execution of a power of attorney. Any Partnership agreement, deed of accession and any document entered into by the general partner on behalf of its Partnership will be validly executed where it is signed as contemplated by the parties and in conformity with Cayman law, including where signature pages are executed before the document is in final form and attached to the document with the relevant party's authority. Where a Partnership agreement contains a power of attorney, the power will be deemed validly executed on the execution of the Partnership agreement or on adherence thereto by the donor limited partner without further formality.

These provisions will, in the specified circumstances, remove the risk of agreements being challenged on technical grounds of failure to observe formalities and allow a more practical approach to be taken at completion. These provisions are also expressed to have retroactive effect.

Security

The new law clarifies that Partnership property includes any right to make capital calls and receive the proceeds thereof and that the Partnership agreement may allow a general partner to transfer or grant a security interest in his Partnership interest with the prior written consent of any other general partner.

It also expressly permits a Partnership agreement to provide that a disposition of rights under the agreement shall confer economic rights only. Notwithstanding the winding up of the Partnership the Bill confirms that a secured creditor is entitled to enforce their security without leave of the court.

The Bill also states the assets of a Partnership may be subject to a floating charge whether or not the partners are companies, overseas companies or bodies corporate. The provisions bring clarity to a number of areas regarding the taking and enforcement of security over Partnership interests.

Admissions and Transfers

The Bill contains provisions confirming that a partner may be admitted by execution and delivery of the Partnership agreement (or any supplement or counterpart) with the general partner and without the consent of the limited partners. Where the requirements for admission of a partner as set out in the Partnership agreement are complied with, the Bill provides that the person admitted is deemed to have adhered to and agreed to be bound by the Partnership agreement as if they and all existing partners had executed and delivered the Partnership agreement. This provision is also expressed to have retrospective effect. These provisions will allow for additional drafting flexibility for partnership structures.

Winding Up

The Bill amends the current provisions for filing of notices on a winding up and introduces a new strike off procedure for Partnerships. Generally the strike off procedure is likely to be used only where a Partnership has not traded because it will not affect the liabilities of any partner which may be enforced as if the Partnership had continued. The strike off process does not therefore afford the finality of a winding up.

Transfers by way of Continuation

The Bill allows a Partnership to redomicile to another jurisdiction which permits, or does not prohibit, that redomiciliation on satisfaction of certain conditions including prescribed notices and solvency/financial requirements. A partnership established other than under Cayman law will also be allowed to register under the new law without creating a new entity or affecting any property of the Partnership. These provisions may provide an attractive route to restructure a Partnership to a new jurisdiction without the negative tax implications of a realization for investors.

Application

The Bill includes saving provisions, so no action will be required by existing Partnerships in order to fall within the new law. The drafting flexibility brought in by the new law may, however, prompt a review of existing Partnership agreements where increased flexibility might be attractive to investors.

<http://www.altassets.net/knowledge-bank/private-equity-funds-eye-caymans-ahead-of-rule-change.html>