

# THE BENEFITS OF USING CAYMAN EXEMPTED LIMITED PARTNERSHIPS

MATT MULRY, OF DILLON EUSTACE, REFLECTS ON THE BENEFITS OF USING CAYMAN EXEMPTED LIMITED PARTNERSHIPS IN PRIVATE EQUITY

**T**he Cayman exempted limited partnership is a flexible structure ideally suited for use as a closed-ended investment vehicle permitting investment during a limited capital raising period and drawing down capital commitments in order to fund investment opportunities and operating costs as they arise. Whether a private equity manager is looking to establish a venture capital fund, real estate fund, infrastructure fund, technology fund, energy fund, healthcare fund, art fund, pre-IPO fund, buy-out fund or distressed assets fund the Cayman exempted limited partnership is an ideal choice. The key terms of private equity vehicles including investor allocations and distributions, carried interest waterfalls, preferred returns, catch up provisions, hurdles, other fee provisions, default provisions, clawbacks, key man provisions and advisory committee terms can all be addressed within the Cayman legal and regulatory framework.

This article looks at the formation, structuring, management, liability provisions, default provisions, distribution provisions, tax treatment and requirements for service providers in private equity structures established as Cayman exempted limited partnerships.

The exempted limited partnership is established as a contractual arrangement between its passive investor limited partners and one or more managing general partners. The general partner is established as a special purpose vehicle to insulate the promoter from the general partner's liability for the fund's debts and obligations. Cayman limited partnerships are contractual arrangements created under a limited partnership agreement made between the general partner and any number of limited partners. Limited partnerships do not have their own legal personality – generally

affording them a 'look-through' status for domestic tax purposes. Cayman limited partnerships are subject to the Partnership Law (Revised) and the Exempted Limited Partnership Law (Revised). Generally these laws are permissive and the contractual arrangements within a Cayman limited partnership are flexible enough to accommodate all the provisions commonly negotiated between its manager and its key investors.



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Partnership interests can be issued in different classes to apply different fee terms, liquidity terms, redemption or other terms to the investors in each of those classes. In order to form a Cayman Islands partnership a relationship needs to be established between persons carrying on a business in common with a view to profit. Limited partners will generally invest in an exempted limited partnership with a view to profit through their holding of participating interests, but it is also important to consider the position of the general partner and to provide for a form of profit whether by way of the payment of a fee for the general partner's services, by way of a carried interest or other participation interest. A Cayman exempted limited partnership may be formed for any lawful purpose provided that it shall not undertake

business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of its business exterior to the Cayman Islands.

A Cayman exempted limited partnership is not an entity distinct from its partners and it has no separate legal personality. The property of an exempted limited partnership is held by its general partner on trust as an asset of the exempted limited partnership in accordance with the terms of its partnership agreement. The general partner will conduct the management of the business of the exempted limited partnership and enter its transactions on its behalf. If the assets of the exempted limited partnership are inadequate to cover its debts and obligations, its general partners will be liable for all of those debts and obligations. In managing the business of the exempted limited partnership, the general partner is obliged to act at all times in good faith and in accordance with any additional duties provided for in the limited partnership agreement.

Under the Exempted Limited Partnership Law (Revised), limited partners are not, as such, liable for the debts or obligations of their exempted limited partnership. However if a limited partner takes part in the conduct of the business of their exempted limited partnership in its dealings with persons who are not partners, that limited partner may be liable, in the event of the insolvency of the exempted limited partnership, for all of its debts and obligations incurred during the period such limited partner took part in the conduct of that business.

In all cases, such liability is restricted only to persons who transact business with the exempted limited partnership during the relevant period with actual knowledge of such participation and who reasonably believed the limited partner to be a general partner of the



exempted limited partnership. The Exempted Limited Partnership Law (Revised) provides for a non-exclusive list of activities which a limited partner can undertake and which are not considered to be taking part in the conduct of the business of an exempted limited partnership. Importantly, these include acting as a director of the general partner or serving on a committee of the exempted limited partnership and consenting to or withholding consent to actions proposed by the general partner.

The Exempted Limited Partnership Law (Revised) law provides wide flexibility to impose sanctions on limited partners that default on their commitments to contribute capital to an exempted limited partnership and provides a non-exclusive list of common sanctions seen in private equity structures which are expressly permitted in limited partnership agreements. The development of the law in this area has been informed by the private equity market and facilitates the use of common default provisions employed in private equity structures.

Distributions can be made to limited partners of a Cayman exempted limited partnership in accordance with the terms of the limited partnership agreement, and clawback terms can be incorporated to ensure that the fund can meet its own clawback obligations to its underlying funds. Under the Exempted Limited Partnership Law (Revised) law, if a limited partner of an exempted limited partnership receives a payment representing a return of any part of its contribution to the partnership, or if a limited partner is released from any outstanding obligations in respect of its commitment when the exempted limited partnership is insolvent, and that limited partner has actual knowledge of the insolvency, they may be liable to return the amount of such payment or

the due performance of that released obligation within six months from the date the payment was made. A limited partner's liability in this instance will be limited to the extent that such amount or performance is required to discharge a debt or obligation of the exempted limited partnership, together with any interest provided for in the limited partnership agreement.

There is currently no income or capital gains tax imposed by the Cayman Islands government which will apply to distributions to investors in a Cayman exempted limited partnership. In order to ensure that this tax neutrality applies to a private equity fund for the duration of its term, the exempted limited partnership may apply to the Cayman Islands governor in cabinet for an undertaking that no law enacted in Cayman imposing any tax on profits, gains or appreciation, or which is in the nature of estate duty or inheritance tax, shall apply to the structure for a period of 50 years.

There is no requirement for a Cayman domiciled limited partnership fund to appoint a Cayman domiciled general partner, although tax advice provided to the fund or its promoters may be that the appointment of a Cayman resident general partner would be beneficial to the exempted limited partnership. At least one general partner must be a corporate entity, partnership or an individual resident in Cayman. Where a corporate entity or partnership is used, this must be a Cayman-domiciled company or partnership, or a non-Cayman company or partnership which has been registered under the Companies Law (Revised) as a foreign registered company or under the Exempted Limited Partnership Law (Revised) as a foreign registered partnership. Cayman resident directors are not required to be appointed to the general partner, but this may be

beneficial depending on tax advice.

A Cayman-domiciled company and a Cayman law governed limited partnership are required to maintain a registered office in Cayman. A general partner to a Cayman law governed limited partnership which is registered as a foreign company under the Companies Law (Revised) is required to appoint an agent for the service of process in Cayman. While it can be helpful to appoint a third-party administrator to assist with compliance burdens imposed on a private equity fund under anti-money laundering, counter-terrorism financing, non-proliferation and tax compliance legislation, it is not necessary for a closed-ended Cayman exempted limited partnership to appoint an administrator. Similarly, a Cayman exempted limited partnership is not required to appoint an auditor or custodian. Where the appointment of third-party service providers are preferred for these services, the Cayman Islands offers a wide range of highly qualified professional organisations who are available to assist.

The Cayman Islands has long been renowned as the leading domicile for hedge fund structures and with its low-cost, business friendly approach to private equity structures, and with the increasing use of private equity funds by assets managers across the globe, Cayman is fast becoming the preferred jurisdiction for a private equity fund. ↓



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Matt Mulry has extensive experience in the Cayman Islands where he has advised on investment funds, compliance and regulatory issues, general corporate and commercial work and has been involved a number of major transactions for leading onshore law firms and investment managers.