

Cayman Islands Exempted Limited Partnerships

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This Briefing Note provides a summary of the main legal requirements and general principles applicable to the formation, registration, operation and termination of exempted limited partnerships in the Cayman Islands.

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Introduction

Cayman law provides five basic forms that may be suitable for commercial and financial enterprises: a company, a limited liability company, a foundation company, a partnership and a trust. Each of these forms has certain features and variants that may be particularly appropriate for the activity in question.

Partnership form

The Partnership Act (Revised) (**Partnership Act**) defines a partnership as the relation which subsists between persons carrying on a business in common with a view to profit. This definition is taken from a corresponding English law from the late 19th century, and there is consequently a body of case law and commentary that gives a firm grounding to the partnership concept under English law and, therefore, Cayman law.

Exempted limited partnerships

An exempted limited partnership (**ELP**) is a Cayman partnership that is registered under the Exempted Limited Partnership Act (Revised) (**ELP Act**). The ELP Act specifically preserves relevant provisions of the Partnership Act and provides that the principles of common law and equity applicable to partnerships shall apply to ELPs.

The ELP Act takes these partnership concepts and provides a modern framework that makes an ELP the vehicle of choice for particular types of international business, including for all types of private equity, real estate and other closed-ended funds; as tax transparent master funds in onshore/offshore hedge fund structures; and as single-investor vehicles replicating managed accounts.

Key features of an exempted limited partnership

An ELP has the following key features, certain of which are described in greater detail below:

- no separate legal personality;
- neither the ELP nor the partners subject to taxation in the Cayman Islands;
- a minimum of one general partner and a minimum of one limited partner;
- all management responsibility vested in the general partner(s);
- limited liability for the limited partners, except in narrow circumstances;

- unlimited liability for the general partner in the event that the assets of the ELP are inadequate; and
- inviolable duty of the general partner to act in good faith.

Formation and registration

Name

The proposed name must include the words 'Limited Partnership' or the letters 'L.P.' or 'LP'. There are certain restricted words that, in some cases, may not be included in the name of the ELP at all and, in other cases, require the prior consent of the Registrar of Exempted Limited Partnerships (**Registrar**): for example, 'bank', 'insurance', 'trust', 'royal'.

Qualifying general partner

At least one general partner must be a 'qualifying general partner': typically a Cayman exempted company; a non-Cayman company (or LLC) registered in Cayman as a foreign company; or a non-Cayman limited partnership registered in Cayman as a foreign limited partnership.

A Cayman ELP may itself serve as a qualifying general partner provided that it in turn has a qualifying general partner.

Registered office

The ELP must have a registered office in the Cayman Islands, provided by a service provider licensed by the Cayman Islands Monetary Authority (**CIMA**) for such purpose.

Number of partners

At all times, an ELP requires at least two separate persons or entities as partners (the 'two-party rule'), including a minimum of one general partner and a minimum of one limited partner.

Three common issues arise in this context:

- it is sometimes proposed that a limited partner be a 'parent' ELP of which the general partner of the 'subsidiary' ELP is itself general partner. Where there is no other limited partner of the subsidiary ELP this arrangement does not satisfy the two-party rule noted above, because the proposed limited partner ELP is not a separate legal entity and so the contract forming the subsidiary ELP is purportedly between the general partner and itself (albeit as general partner of the parent ELP). Certain structuring solutions have been developed to address this. We note that the same issue does not arise where the parent partnership is a Delaware LP treated as a separate legal entity;
- there is some debate as to whether all partners need to share in the profits of the business, given the phrasing of the definition in the Partnership Act ('persons carrying on a business in common with a view to profit'). The prudent approach is to provide the ability for the general partner to receive a share of the profits, even if that share is minimal. This can be accomplished through an allocation of profits based on contribution or a fixed or variable fee; and
- subject to satisfying the above requirements, one person or entity may hold both a general

partner interest and a limited partner interest. Some care needs to be taken to ensure that the general partner does not jeopardise the limited liability status of its limited partner interest.

Process

An ELP is established by:

- ensuring that at least one of the proposed general partners (generally there is only one general partner) is a 'qualifying general partner' under the ELP Act – see above;
- one or more general partners and one or more limited partners agreeing to form an ELP with the relevant name, typically by signing a short-form limited partnership agreement (LPA); and
- the general partner registering details of the ELP with the Registrar by way of a Section 9(1) Statement, and paying the registration fee.

Upon submission of the ELP registration documents, it takes approximately five business days for the Certificate of Registration to be issued. Upon payment of an express registration fee it is possible to obtain the Certificate of Registration within one business day.

Limited partnership agreement

The LPA sets out the respective rights and obligations of the general partners and the limited partners. Typically, these include the following matters:

- The general partner's powers and obligations in relation to the ELP, including, in particular, the general partner's obligations in respect of the management of the ELP and any limitations on the general partner's authority.
- The method and procedure for the admission of additional partners, the retirement and withdrawal of existing partners and the transfer of interests in the ELP.
- Procedures for requiring the limited partners to contribute additional funding to the ELP, if applicable, and consequences of any default in doing so.
- The allocation and distribution of net profits of the ELP amongst the partners, and arrangements in relation to fees and expenses.
- Provisions relating to non-Cayman taxation (for example to address US tax treatment), if applicable.
- Indemnification of the general partner by the ELP.
- Provisions governing advisory boards or other committees.
- A power of attorney authorising the general partner to perform various agreed functions on behalf of the limited partners.
- The process to amend the LPA.
- Events of termination of the ELP and procedures upon such termination.

As these provisions may be very detailed, it is common practice for an ELP to be formed and registered with a short-form LPA and for this to be amended and restated once the full terms have been settled.

The ELP Act provides that various statutory powers or prohibitions are subject to the express or

implied provisions of the LPA and, further, that the LPA may not exclude certain statutory rights or obligations. It is, therefore, essential that, prior to its execution, the LPA be reviewed against the ELP Act to ensure that the rights, powers and obligations provided for in the LPA are not restricted by the terms of the ELP Act.

It may be necessary to make a subsequent filing with the Registrar upon execution of an amended LPA, in the form of a Section 10(1) Statement. This is generally a post-event notification except where there is a change of general partner, when such filing is a prerequisite.

Neither the formation LPA nor any amended version of the LPA is required to be filed with the Registrar.

Rights and obligations of a general partner

Conduct of the ELP's business

An ELP does not have a separate legal personality and it is a requirement of the ELP Act that all letters, contracts, deeds, instruments or documents of whatever nature shall be entered into by or on behalf of the general partner on behalf of the ELP. It is the general partner who undertakes the conduct of the ELP's business, while the limited partners are, in effect, passive investors who contribute capital in order that the business may be carried on with a view to profits being generated.

Standard of care; unlimited liability

With the general partner's powers comes a higher level of responsibility and liability. The general partner must act at all times in good faith. The LPA may demand a higher standard of care but it is not permissible to dilute this good faith requirement. The ELP Act also requires that the general partner act in the interests of the ELP. However, this is subject to any express provisions to the contrary in the LPA and therefore it is permissible to provide that the general partner may take into account the interests of other partnerships it advises, its affiliates or other persons.

The general partner has unlimited liability such that, in the event that the assets of the ELP are inadequate, the general partner is liable for all of the debts and obligations of the ELP.

Vesting of property

The property and assets of an ELP are held in the name of the general partner for the benefit of the ELP and all actions, claims, demands or proceedings raised in respect of or against the assets of the ELP are to be raised by, and in the name of, the general partner on behalf of the ELP. Any debt or obligation incurred by the general partner in the conduct of the business of an ELP shall be a debt or obligation of the ELP.

Clear identification of the capacity in which a general partner is acting is of particular importance where a general partner acts as such in relation to more than one ELP. In such circumstances, it is important that the acquisition of assets by the general partner or the undertaking by it of debts or obligations, in each case on behalf of a particular ELP, is clearly documented and made apparent to the third party involved in order that the assets held by it as general partner of one ELP are not adversely affected by the debts or obligations incurred by it on behalf of another ELP.

Rights and obligations of a limited partner

Contributions

Generally, a limited partner is required to contribute to the ELP the amount agreed to be contributed by it under the terms of the LPA or accompanying subscription agreement. Such amount may be contributed in a single payment or may be committed for contribution over a period or in instalments as provided for in the LPA.

There is no statutory requirement for contributions to be made in the form of money so, unless the LPA provides otherwise, contributions of property, investments or other assets are permitted.

Where limited partners commit to contribute capital, the LPA will invariably provide remedies for default. These may include forfeiture, forced sale or subordination. The ELP Act expressly provides that such remedies or consequences shall not be unenforceable solely on the basis that they are penal in nature.

Allocation of profits and return of contributions

Typically, the LPA contains detailed provisions regarding the allocation and distribution of profits amongst the partners and the withdrawal of partners.

Limitation of liability

The ELP Act provides that limited partners shall not be liable for the debts or obligations of the ELP save:

- as provided for in the LPA;
- to the extent a limited partner takes part in the conduct of the business of the ELP. In such circumstances, that limited partner may be liable to any person who transacts business with the ELP during that period with actual knowledge of his participation and who then reasonably believed the limited partner to be a general partner. The ELP Act provides certain “safe harbours” that do not amount to taking part in the conduct of the business of the ELP, such as approving or disapproving an amendment to the LPA, or consulting with and advising the general partner with respect to the business of the ELP. Therefore, participation by a limited partner on an advisory board or investment committee is permissible, even where the recommendation of that advisory committee is binding on the general partner; or
- where a limited partner receives a payment representing a return of any part of his contribution or is released from a commitment to pay into the ELP, and at the time of that payment or release the ELP was insolvent and the limited partner had actual knowledge of that insolvency. The liability of the limited partner in these circumstances is limited to a period of six months following the date of the payment or release.

Cayman Islands tax treatment

Neither an ELP nor any partner is subject to any form of direct taxation in the Cayman Islands. An ELP is entitled to apply for an undertaking to be granted on behalf of the Cayman Islands Government that, for a period not exceeding 50 years from the date of the undertaking, no law which is enacted in the Cayman Islands imposing any tax to be levied on profits, income, gains or appreciations shall apply to the ELP or to any partner in respect of the operations of the ELP, the assets of the ELP or the interest of a partner in the ELP.

Partnership records

The LPA normally establishes procedures for the maintenance of accounting records in relation to the contributions made by partners to the ELP, the allocation of profits amongst the partners and the scope of the limited partners' powers to inspect such records. In the absence of a provision to the contrary in the LPA, the ELP Act provides that a limited partner may demand and receive from the general partner true and full information regarding the state of the business and financial condition of the ELP.

The general partner must also maintain:

- a register of limited partners containing the name and address of each partner, their date of admission and date of withdrawal. Subject to the LPA, this is open to inspection by any partner and any other person with the consent of the general partner;
- a record of the amount and date of each partner's contribution and the amount and date of the return of all or any part of a limited partner's contribution. This record is only open to inspection with the consent of the general partner; and
- a register of security interests recording details of any security granted by a limited partner over its limited partner interest. The register of security interests may be inspected by any person.

Ongoing obligations

In addition to compliance with the elements of the ELP Act highlighted in this note and adherence to the terms of its LPA, an ELP has the following ongoing obligations:

- in the event of a change to any of the particulars contained in the Section 9(1) Statement filed upon registration of the ELP, a general partner must file with the Registrar an updated statement within certain specified periods depending on the nature of the proposed amendment;
- an ELP must pay an annual registration fee to the Registrar in January of each year (which varies depending upon whether the ELP is registered with CIMA or not); and
- the general partner must retain all books of account for a minimum period of five years from the date on which they are prepared.

Depending on the nature of the ELP's activities, the ELP and its general partner may have additional obligations beyond the scope of this note, for example to be registered as a mutual fund or a private fund or otherwise to be licensed to carry on its business; to perform anti-money laundering procedures on its limited partners and counterparties; and to comply with the notification and reporting requirements under FATCA and CRS.

Termination of an ELP

Upon termination, an ELP may be liquidated or it may apply to be struck off. A formal liquidation is the method typically used for any ELP that has taken in investors or actively traded.

Liquidation

The liquidation of an ELP consists of two distinct steps: its winding up and its subsequent dissolution.

Grounds for winding up

An ELP may be wound up in the following circumstances:

- at the time or upon the occurrence of any event specified in the LPA;
- by resolution of all the general partners and a two-thirds' majority of partners (unless otherwise specified in the LPA);
- automatically, following the liquidation or withdrawal of the last qualifying general partner. In the event of the death, commencement of liquidation or bankruptcy proceedings, or the withdrawal, removal or making of a winding up or dissolution order in relation to the sole or last remaining qualifying general partner, the ELP will, subject to any express or implied term in the LPA, be wound up on the date (the automatic wind up date) falling 90 days after the date of the service of a notice on all the limited partners informing them of that event. However, the business of the ELP may be resumed and continue if, before the automatic wind up date, the requisite majority of partners elect a new qualifying general partner. The necessary majority is such majority specified in the LPA as being entitled to vote to elect a new general partner, or if no such majority is specified in the LPA, a simple majority of the partners (determined by reference to capital contributions); or
- by court order.

Winding up procedure

The procedure for winding up an ELP is substantially the same as that for winding up a company under the Companies Act (Revised). For instance, the ELP Act incorporates express provisions relating to the application and distribution of ELP property on winding up. It also imports clawback provisions in the Companies Act for the recovery of undue preferences and dispositions at an undervalue.

Any surplus remaining after satisfaction in full of all ELP liabilities is distributed to the partners in accordance with their rights under the LPA.

On completion of the winding up, the general partner or other liquidator must sign and file a notice of dissolution with the Registrar, following which the ELP is dissolved.

Strike off

Where an ELP is not carrying on business or is not in operation, the general partner may request that it be struck off the register by the Registrar and dissolved.

A partner or creditor who objects to an ELP being struck off the register may, for a period of up to ten years following the date the ELP was struck off, apply to court for the ELP to be reinstated. The striking off the register of an ELP does not affect the liability, if any, of any general partner or limited partner of the ELP, and the liability continues and may be enforced as if the ELP had at all times continued to be in existence.

The strike-off provisions therefore provide a convenient, simpler alternative to formal dissolution which will be suitable for some ELPs; but the reinstatement provisions mean that strike-off is a less final method of terminating an ELP.

Transfer by way of continuation

An ELP may apply to deregister in the Cayman Islands and transfer by way of continuation to another jurisdiction as a partnership, body corporate or any other form of entity under the laws

of that jurisdiction.

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