Keeping the Faith: What is the duty of a GP managing a Cayman exempted limited partnership?

Publication - 09/10/2015

This article first appeared in the pfm Fund Domicile Guide October 2015

When it comes to acting in good faith, what is the duty of a GP managing a Cayman exempted limited partnership (ELP)? And does that duty change when the ELP’s partnership agreement excludes the GP’s duty to act in the interests of the ELP? Does Cayman law go as far as Delaware?

Before 1991, partnership law in Cayman was substantially the same as in England. All partnerships were regulated by the rules of common law and equity, which were preserved in the partnership law that was enacted in 1983 (Partnership Law). Under those rules, a partner was a fiduciary who owed a fundamental obligation to display complete good faith towards his copartners, including a duty not to benefit himself at the expense of his partners.

Partners owed such duty of good faith to each other but not to “the partnership,” as it was not a separate legal person.

As Cayman increased in popularity as a jurisdiction for the formation of hedge fund and private equity vehicles, it became clear that the Partnership Law was not fit for purpose; and so in 1991 Cayman introduced The Exempted Limited Partnership Law, 1991 of Cayman (Original ELP Law) to sit alongside the Partnership Law. The Original ELP Law provided for a wholly new form of limited partnership, the exempted limited partnership, a vehicle broadly analogous to an exempted company under the Cayman Companies Law, which would be attractive to international investors. Section 3 of the Original ELP Law preserved, in relation to ELPs, the rules of common law and equity.

The Original ELP Law contained a number of provisions modelled on provisions of the US Uniform Limited partnership Act as adopted in a number of states (including Delaware). Accordingly, it introduced an uncomfortable co-existence of a statute based on that of a jurisdiction where a partnership is a separate legal person (Delaware) with a regime of common law and equity under which a partnership is not a separate legal person. One particular area of discomfort was section 4(3) of the Original ELP Law, which provided that “[a] general partner shall act at all times in good faith in the interests of the exempted limited partnership.” If it was intended that the GP of an ELP would be subject to the same fiduciary duty of good faith to other partners as a partner of any other partnership, section 4(3) would not have been necessary (because that duty would have been preserved by section 3).

This leads to the conclusion that the effect of section 4(3) was to introduce a different duty – the concept of a duty of good faith owed to the ELP rather than to other partners – analogous to the duty of a director of a company to act in good faith in the best interests of that company. On that analogy, the duty of good faith imposed by section 4(3) of the Original ELP Law would be owed to the ELP, taken as a whole, including present and future partners, whether general or limited partners.

In 2014, Cayman introduced a new law governing ELPs, The Exempted Limited Partnership
Law, 2014 (New ELP Law). In the New ELP Law, the GP’s duty of good faith is retained in section 19(1), which now provides as follows: “A general partner shall act at all times in good faith and, subject to any express provisions of the partnership agreement to the contrary, in the interests of the exempted limited partnership.”

Allegiance to the partnership

With this, the New ELP Law has introduced a further area of discomfort. The duty of a GP to act in good faith remains inviolable; but the duty to act in the interests of the ELP can be expressly varied by the partnership agreement. Can it be varied to the point of being excluded?

It is submitted that, having retained the GP’s core duty of good faith and having introduced in 1991 the concept of the duty of good faith of a GP being owed to the ELP rather than to other partners, the legislature cannot be taken now to have permitted the interests of the ELP to be excluded entirely, by agreement, without clear words to that effect. Furthermore, other parts of the New ELP Law support the notion that the GP must retain certain residual fiduciary duties to the ELP. Section 16(1) provides that rights or property of the ELP are deemed to be held by the GP upon trust as an asset of the ELP. The New ELP Law also retains the notion that the management of the ELP is vested in the GP alone, to the exclusion of the limited partners – making the relationship that exists between a GP and the limited partners of an ELP one of absolute trust and confidence.

Finally, as a standalone duty with no identifiable beneficiary, the core duty to act in good faith would be meaningless. Given the foregoing history, this core duty must be taken to be owed to the ELP.

Differences from Delaware

Parallels are sometimes drawn with Delaware; in fact, one rationale for the introduction of the New ELP Law was to promote consistency with the provisions of Delaware law so that Cayman ELPs, which are often used by fund managers in parallel with their Delaware limited partnerships, would have similar concepts and similar principles that would promote greater acceptance of the Cayman financial product.

But such parallels in interpreting section 19(1) offer limited assistance. Under the Delaware Revised Uniform Limited Partnership Act, a partner’s duties, including fiduciary duties, may be expanded or restricted or eliminated by provisions in the partnership agreement; however, the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing. The New ELP Law does not go that far; furthermore, Cayman law does not recognise a universal implied contractual obligation of good faith and fair dealing.

In Delaware the residual duty of good faith is an implied contractual covenant; in Cayman, it continues as a fiduciary duty. When applied to a contract, good faith connotes taking action that conforms to the spirit of the contract, even if a literal interpretation of the contract would allow for a different course of action. By contrast, fiduciary duties are mandatory constraints the existence of which is necessary to curtail the possibility of abuse by the persons owing the fiduciary duties.

Because of this, the conclusion must be that Cayman law does not go as far as Delaware in permitting an ELP’s partnership agreement to exclude entirely the GP’s duty to take into account the interests of the ELP. At a minimum, a GP of an ELP must carry on the business of the ELP honestly and in good faith for the benefit of the ELP; not act fraudulently; not act in bad faith or engage in willful misconduct; and not intercept a partnership opportunity for its own benefit.
About Ogier

Ogier provides practical advice on BVI, Cayman Islands, Guernsey, Jersey and Luxembourg law through its global network of offices. Ours is the only firm to advise on these five laws. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

This client briefing has been prepared for clients and professional associates of Ogier. The information and expressions of opinion which it contains are not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific advice concerning individual situations.

Regulatory information can be found at www.ogier.com

ogier.com
Meet the Author

Giorgio Subiotto
Partner
Cayman Islands
giorgio.subiotto@ogier.com
T+1 345 815 1872
M+1 345 516 9071

Related services

Private Equity
Investment Funds