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## New developments for Cayman exempted limited partnerships

Although the majority of funds established in the Cayman Islands are exempted limited companies, the popularity of the Cayman Islands exempted limited partnership ('ELP') has grown in recent years as the vehicle of choice for many funds. It is within this environment that the legislation governing the formation and operation of ELPs, namely the Exempted Limited Partnership Law (2007 Revision) ('the ELP Law'), has been overhauled by the Exempted Limited Partnership (Amendment) Law ('the Amendment Law') which came into force on 11 May 2009.

The effect of the Amendment Law is to enhance the ELP Law by: 1. Introducing a much greater emphasis on freedom of contract between the participants in an ELP; 2. Providing clarification in a number of key areas which had historically been uncertain; and 3. Implementing recommendations from local financial service industry groups so as to align the ELP Law with other relevant jurisdictions.

Insofar as the Amendment Law introduces changes to the ELP Law which may impact upon corporate rescue and insolvency issues, the relevant provisions are as follows.

### LIABILITY OF LIMITED PARTNERS – 'SAFE HARBOUR PROVISIONS'

The situation arises not infrequently where a limited partner unwittingly undertakes activities whereby he is considered as taking part in the conduct of the business of the ELP. In such cases, s 7(2) of the ELP Law provides that the limited partner will relinquish his limited liability status and be liable as a general partner. A classic example where this may occur is when the limited partner is a member of the ELP's investor advisory committee and, as such, can influence the business undertakings of the ELP. Section 7(3) of the ELP Law has now been modified to extend the so-called 'safe harbour' activities that a limited partner can undertake without risking a loss of his limited liability status. These additional activities are: (a) holding an office or interest in, or having a contractual relationship with, a general partner; (b) consenting or withholding consent to any action proposed, in the manner contemplated by the LPA, with respect to the business of the ELP; (c) calling, requesting, attending or participating in any meeting of the partners; (d) taking any action that results in the winding up or the dissolution of the ELP; (e) taking any action required or permitted by the LPA or by law to bring, pursue, settle or terminate any action or proceedings brought by the limited partner in circumstances where the general partners have refused, without good cause, to institute proceedings; and (f) appointing a person to serve on any board or committee of the ELP, a general partner or a limited partner, or removing a person therefrom.

To keep pace with the changing needs of the financial services and investment fund industries, the Exempted Limited Partnership Law of the Cayman Islands has been recently amended to provide significant enhancement to the framework within which exempted limited partnerships operate.

In the example mentioned, (b) and (f) would likely prevent a limited partner from losing his limited liability status should he elect to participate in an investor advisory committee.

It must be noted that s 7(3) cannot apply to protect a limited partner in circumstances where he undertakes a 'safe harbour' activity whilst holding himself out as a general partner of the ELP.

### CLAWBACK OF CONTRIBUTIONS

Prior to the introduction of the Amendment Law, any payment to a limited partner representing a return of any part of his contribution to the partnership was prohibited unless, at the time of and immediately following such payment, the partnership was solvent.

This absolute prohibition has been removed and s 14 of the ELP Law now extends and qualifies the clawback provision such that any return of contributions made within six months before the insolvency of the ELP is liable to be repaid with simple interest at the rate of 10 per cent per annum (or otherwise as may be specified in the LPA), but only to the extent that such contribution or part thereof is necessary to discharge a debt or obligation of the ELP incurred during the period that the contribution represented an asset of the ELP.

The ability of an ELP to dictate the rate of interest by making relevant provision in the LPA is a sensible and important inclusion in the ELP Law since it allows Sharia-compliant funds to be accommodated.

Slightly different rules apply where the ELP is voluntarily wound up, in which case the six month relation back period commences from the earlier of: (a) the time of the passing of a resolution for winding up; (b) the time or the occurrence of the winding up event specified in the LPA; and (c) the insolvency of the ELP.

### DISSOLUTION ON REMOVAL OF THE GENERAL PARTNER

The Amendment Law clarifies the effect on an ELP where the sole or last remaining general partner is removed.

Previously, s 15(3) of the ELP Law provided that upon the death, insanity, retirement, bankruptcy, commencement of liquidation proceedings, resignation, insolvency or dissolution of the sole or last remaining general partner, the ELP would be immediately dissolved and wound up in accordance with the terms of the LPA or any order made by the court. The limited partners, however, could by unanimous

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vote, within 90 days of the dissolution, appoint a new general partner in which case the ELP would not be required to be wound up.

The difficulty created by s 15(3) was twofold:

- (a) the automatic dissolution of the ELP was inflexible and applied regardless of the provisions of the LPA; and
- (b) if the limited partners elected to appoint a new general partner, the status of the ELP in the hiatus between its statutory dissolution and the new appointment was unclear.

These issues have now been clarified by the Amendment Law such that: 1. Subject to any express or implied term of the LPA to the contrary, an ELP will be immediately dissolved on the date falling ninety days after the date that all limited partners are informed of: (a) the death; (b) the commencement of liquidation or bankruptcy proceedings; or (c) the withdrawal, removal or making of a winding up or dissolution order, in relation to the sole or last general partner. 2. The limited partners may by a majority of partners specified in the LPA as being entitled to vote to elect a new general partner (or if no such majority is specified in the partnership agreement, a simple majority), elect a new general partner prior to the automatic dissolution date whereupon the business of the ELP may be resumed and continued.

These new provisions provide a significant relaxation of the previously stringent rules such that: (a) the dissolution of an ELP upon removal of the general partner, and the subsequent appointment of a new general partner, can now be provided for in the LPA; and (b) limited partners are required to be kept informed about the status of the general partner.

**WINDING UP AND DISSOLUTION OF ELPs**

The winding up of an ELP has historically been an area of uncertainty given the lack of statutory guidance in the ELP Law or relevant local caselaw. The former s 15(2) simply provided that on the application of a partner or a creditor, the court may decree dissolution of an ELP, and may make such orders and give such directions for the winding up of its affairs as may be just and equitable.

That position has now been significantly clarified by the Amendment Law which provides that: 1. An ELP will be wound up at the time or upon the occurrence of any event specified in the LPA and dissolved in accordance with the terms thereof; 2. An ELP will continue until wound up and dissolved by resolution of all the general partners and a two-thirds majority of limited partners, unless otherwise specified in the LPA; 3. Except to the extent that such provisions are not consistent with the ELP Law, Part V of the Companies Law (2007 Revision) and the Companies Winding Up Rules 2008 (collectively 'the Companies Legislation') will apply to the winding up and dissolution of an ELP such that: (a) references to companies are taken to be references to ELPs; and (b) references to directors/officers and shareholders of a company are taken to be references the general partner and limited partners respectively; 4. The concept of the court granting a 'decree of dissolution' as an initial step in the liquidation process has been removed, thereby rendering the terminology used in the ELP Law consistent with the Companies

Legislation; 5. As regards the voluntary winding up of an ELP under its LPA, the Companies Legislation will apply in a limited manner whereby the only applicable provisions are: (a) Section 123 (excluding paras (b) and (c)) – Providing notification of the winding up to the relevant authorities; (b) Section 140 – Distribution of the ELP's property; (c) Section 145 – Voidable preferences; and (d) Section 146 – Avoidance of dispositions made at an undervalue.

The most significant aspect of this round of amendments to the ELP Law is in relation contentious winding up applications made by creditors or limited partners. ELPs are now subject to the Companies Legislation which governs the winding up of companies.

In March 2009, Pt V of the Companies Law (2007 Revision) received a significant overhaul which included the introduction of the Companies Winding Up Rules 2008. It is beyond the scope of this article to delve into the operation of the new winding up regime except to say that it provides a very sensible and workable framework within which ELPs may now be wound up.

However, the Amendment Law does not incorporate into the ELP Law those provisions in the Companies Legislation which allow for voluntary liquidations to be brought under the supervision of the court (a process that is mandatory for insolvent companies and is essential for cross-border recognition purposes).

It is to be hoped the court will nonetheless use its general power in s 15(4)(f) to 'make such orders and give such directions for the winding up of an ELP as may be just and equitable' to provide a near approximation to the process of supervising company liquidations.

Appleby is involved in the first piece of litigation under the new ELP Law, concerning the right of limited partners to invoke the court's jurisdiction to appoint an independent liquidator in a voluntary liquidation under ss 7(5) and 15(4)(f). The matter is due to be heard by the Court of Appeal imminently. It is expected to give guidance on the balance to be struck between, on the one hand, the freedom of partners to make and enforce private arrangements concerning the dissolution of an ELP and, on the other hand, the court's overriding jurisdiction to regulate the liquidation of an entity formed under Cayman laws.

**CONCLUSION**

The relaxations and flexibility introduced into the ELP Law by the Amendment Law dictates the need for ELP participants to undertake a review of their LPA in order to take full advantage of the benefits now on offer.

There are still issues which it would be prudent for the Cayman Islands legislature to address in the ELP Law, particularly as regards recognising the rights of third party beneficiaries who are not a party to the LPA. However, it cannot be denied that the introduction of the Amendment Law brings with it a much improved vehicle for pooled investments, with superior clarity for investors and lawyers alike. These attributes should enhance the status of Cayman Islands ELPs as tax efficient vehicles to address the needs of the investment fund industry. This, coupled with the favoured reputation of the Cayman Islands as a stable and well established offshore financial centre, should bode well in a time when global economic contraction is prevalent. ■