Article

Winding Up an Exempted Limited Partnership: How Long Will Cayman Islands Law Remain in a Judicial State of Flux?

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In a recent first-instance judgment handed down by Kawaley J on 21 April 2022 in *The Matter of Formation Group (Cayman) Fund I LP*, the Grand Court of the Cayman Islands has held that a winding up petition may be presented directly against an Exempted Limited Partnership (**"**ELP**"**), as opposed to just against its General Partner.

In so doing, Kawaley J has disagreed with the October 2021 first-instance decision of Parker J in *The Matter of Padma Fund, LP*, where the Grand Court had held that the Court does not have the jurisdiction to make a compulsory winding up order against an ELP on a creditor's petition, and that the remedy of the creditor was to commence proceedings against the General Partner only.

As matters currently stand, therefore, there are two divergent first-instance decisions concerning the following key issues under Cayman Islands law:

(i) Who is the proper respondent to a winding up petition in respect of an ELP? and;

(ii) To what extent does the Cayman Court have the jurisdiction to order the winding up of an ELP?

The resolution of these debatable legal issues is not only of legal or academic interest: since these issues also have significant commercial implications.

ELPs are one of the most popular vehicles of choice for investment funds (particularly private equity funds) domiciled in the Cayman Islands. There is also a significant fund finance market, whereby banks and other institutional lenders are willing to lend substantial sums of money to ELPs, often on standard terms providing for limited rights of recourse so far as General Partners are concerned.

The final and binding resolution of these issues, therefore, is of substantial commercial importance both to investors, lenders, creditors, and managers of all Cayman Islands' ELP funds.

Exempted Limited Partnerships: The Statutory Framework

ELPs are governed primarily by the ELP Act (as well as applicable provisions of the Companies Act and the Partnership Act) and possess the following core features:

(a) an ELP must be composed of (i) at least one general partner (GP), who is liable for all debts and obligations of the ELP in the event that the assets of the ELP are inadequate and (ii) at least one limited partner (LP), who shall not be liable for the debts or obligations of the ELP in excess of his or her capital contribution;

(b) an ELP has no separate legal personality and cannot own property in its own right;

(c) all rights and property of the ELP are held by the GP on statutory trust as an asset of the ELP; and

(d) the business of the ELP is conducted by the GP who has authority to enter into contractual arrangements on behalf of the ELP.

Section 33(1) of the ELP Act provides that, *"legal proceedings by or against an exempted limited partnership may be instituted by or against any one or more of the general partners only, and a limited partner shall not be a party to or named in the proceedings"*.

Section 36(3) of the ELP Act provides that the provisions of Part V of the Companies Act and the Companies Winding Up Rules 2018 shall apply to the winding up of an ELP and that for this purpose references in Part V of the Companies Act to a "company" shall include

references to an ELP. However, section 36(3) includes the qualification that the Companies Act applies *"except to the extent that the provisions are not consistent with this Act, and in the event of any inconsistencies, [the ELP Act] shall prevail"*.

The Earlier Decision in *Padma Fund LP*

Prior to the October 2021 decision in *Padma*, the Grand Court routinely ordered the winding up of ELPs in a number of cases and it was generally accepted that the Court possessed jurisdiction to do so (as held by Kawaley J in *The Matter of XIO Diamond* (unreported, 30 April 2020, FSD 256 of 2019)).

However, in *Padma*, Parker J held that the Court did not possess any such jurisdiction for the following reasons:

(a) section 33(1) of the ELP Act states expressly that legal proceedings (which necessarily include winding up petitions) are to be brought against the GP only;

(b) section 36(3) of the ELP Act (which renders Part V of the Companies Act applicable to ELPs) cannot be taken to confer upon the Court the jurisdiction to wind up an ELP given that this would be inconsistent with section 33(1) of the ELP Act;

(c) as provided in section 36(3) of the ELP Act, in the event of any inconsistency with the Companies Act, the ELP Act shall prevail; and

(d) the entities over which the Court has jurisdiction to grant a winding up order are set out in section 91 of the Companies Act, and such entities do not include an ELP, but rather include a foreign company which *"is the general partner of a limited partnership"*.

It was further held, *obiter*, that in respect of a limited partner's petition to wind up an ELP on just and equitable grounds, this jurisdiction was already provided for pursuant to section 35(e) of the Partnership Act, which provided for broader bases for a partner to apply for winding up than section 92 of the Companies Act.

The Court accepted the Respondent's submission that it could not have been the intention of the legislature to narrow the Court's jurisdiction by replacing section 35 of the Partnership Act with section 92 of the Companies Act.

The Later Decision in *Formation Group (Cayman) Fund I LP*

In *Formation*, a winding up petition was brought by limited partners directly against the ELP, who was named as the respondent, on the ground that it was just and equitable for the ELP to be wound up.

The GP applied to have the petition struck out on the basis that (relying on *Padma*) it was incorrectly brought against the ELP as opposed to the GP.

Kawaley J dismissed the GP's strike out application and held that it was permissible for an ELP to be named as respondent to a winding up petition for the following reasons:

(a) Section 33(1) of ELP Act does not provide that legal proceedings cannot be brought against an ELP. Rather, it creates a general rule immunizing limited partners from being sued and for that reason emphasizes that legal proceedings are generally to be brought against the GP only, rather than the LPs.

(b) Section 36(3) of the ELP Act expressly provides that Part V of the Companies Act applies to ELPs and that reference to "company" in the Companies Act include ELPs. Therefore, it is of no significance that section 91 of the Companies Act does not refer to ELPs expressly.

(c) The available evidence of the legislative history preceding section 36(3) of the ELP Act supports the view that it was intended to provide that an ELP may be wound up in the same manner as a company under Part V of the Companies Act. This legislative history was not before Parker J in *Padma* and was not considered by him.

(d) Section 36(3) is a specific provision which applies expressly to the winding up of ELPs and cannot be said to be overridden by the more general provision in section 33(1) which refers to legal proceedings against GPs.

(e) It is entirely logical for the business of an ELP to be wound up separate and apart from its general partner which may have other entirely separate business concerns.

(f) The fact that an ELP has no separate legal personality does not prevent it from being a party to legal proceedings given that a traditional partnership can sue and be sued under the firm name under Grand Court Rules, Order 81, rule 1.

Comment

As matters stand, two equally respected and experienced judges of the Grand Court have taken opposing views on the legal framework for the winding up of ELPs.

Until this difference of judicial opinion at first-instance is settled by the Court of Appeal or by the Privy Council, or by legislative reform, Cayman Islands law continues to be in a state of uncertainty given that first-instance decisions are not binding on other first-instance judges, and may be departed from if considered by another first-instance judge to be wrong.

In the meantime, it remains to be seen which position will be considered to be, or become, the prevailing first-instance view by other Justices of the Grand Court. Indeed, it also remains to be seen whether Parker J may decide to depart from his own decision in *Padma* in similar such cases in the future, in light of the legislative history which was subsequently considered in *Formation*.

Notably, the Court in *Formation* did not deal with the issue raised in *Padma* regarding the broader provisions in section 35 of the Partnership Act for the winding up of an ELP.

It is unclear whether those provisions will still be considered applicable as alternative bases upon which a partner may apply to wind up an ELP, or whether a partner is limited to the bases set out at section 92 of the Companies Act.

Some of the bases set out in section 35 of the Partnership Act, which are not included in the Companies Act include (i) a fellow partner being permanently incapable of performing his part of the partnership contract (ii) a fellow partner being guilty of conduct calculated to prejudicially affect the partnership business; and (iii) a fellow partner wilfully or persistently committing a breach of the partnership agreement.

In potential defence of the judicial approach in *Padma*, it might be argued that in some cases, depending on their precise facts, it might be preferable or appropriate for creditors to seek the winding up of the GP (as opposed to the ELP) given that the GP is ultimately liable for the ELP's debts if the ELP's assets are inadequate to meet those debts. However, there may be other instances in which the ELP is solvent and there is no need to have recourse to the GP's assets at all. In such circumstances, it may prove expedient to be able to proceed against the ELP directly (particularly if winding up the GP practically proves more challenging on account of the fact that it may administer a number of different funds or may be incorporated in another jurisdiction).

Given the importance of these issues, and the residual uncertainty that exists in light of two conflicting first-instance judgments, clarity from the Court of Appeal or the Privy Council is now necessary and welcome, pending legislative reform of the ELP Act.

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