

Cayman Islands Limited Liability Companies

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Preface

This publication has been prepared for the assistance of those who are considering the formation of limited liability companies in the Cayman Islands pursuant to the terms of the Limited Liability Companies Act. It deals in broad terms with the requirements of Cayman Islands law for the establishment and operation of such entities. It is not intended to be exhaustive but merely to provide brief details and information which we hope will be of use to our clients. We recommend that our clients and prospective clients seek legal advice in the Cayman Islands on their specific proposals before taking steps to implement them.

Before proceeding with the incorporation of a limited liability company in the Cayman Islands, persons are advised to consult their tax, legal and other professional advisers in their respective jurisdictions.

Persons considering establishing limited liability companies to carry on insurance or mutual fund business should request separate publications prepared by Conyers on these topics.

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1. INTRODUCTION

The principal statute governing the formation and operation of limited liability companies (each an “**LLC**”) in the Cayman Islands is the Limited Liability Companies Act (the “**Act**”).

An LLC is a body corporate with legal personality separate from that of its members, capable of exercising all the functions of a natural person of full capacity irrespective of any question of corporate benefit. An LLC has perpetual succession, the capacity to sue and be sued in its own name and the power to acquire, hold and dispose of property. Any one or more persons may form an LLC for any lawful business, purpose or activity, whether or not for profit, provided that there is always one member.

An LLC is essentially a hybrid entity combining many of the characteristics of existing Cayman Islands exempted companies and exempted limited partnerships. LLCs do not have share capital, member liability is limited and capital accounts are permitted. Similar to exempted limited partnerships, members may set out in the LLC agreement how profits and losses are allocated and how and when distributions are made.

2. PRE-REGISTRATION MATTERS

2.1. Company Name

The proposed name of the LLC can be reserved with the Registrar of Limited Liability Companies (the “**Registrar**”) for up to one hundred and twenty days. No LLC may be registered with a name that is the same as, or substantially similar to, the name of another company on the register. The use of certain words in company names such as “royal”, “chartered” and “bank” is restricted.

The name of an LLC may, but need not, contain the words “Limited Liability Company” or the abbreviation “L.L.C.” or “LLC”. We do, however, recommend that the name includes one such designation to distinguish the LLC from other corporate entities.

An LLC may be registered with a dual name in a foreign script. There is no requirement that the dual name be a translation of the company’s English name.

2.2. Contracts

Where a person purports to enter into a contract in the name of, or on behalf of, an LLC which has not yet been registered, he or she will be personally liable under the contract unless the agreement itself provides otherwise. However, an LLC may ratify the contract and, by doing so, will become bound by and entitled to the benefits set out in the contract from the date of registration of the LLC. Such ratification by the LLC will have the effect of releasing the person who purported to act on the LLC’s behalf from personal liability.

3. FORMATION AND REGISTRATION

3.1. Registration

Registration of an LLC is effected by filing with the Registrar a registration statement signed by or on behalf of any person forming the LLC and the payment of a prescribed fee. The registration statement

is required to state the name of the LLC and, if applicable, the foreign name, the address in the Cayman Islands of the registered office, names and addresses of initial members, the nature of business, the financial year end, the term if not formed for an unlimited duration, together with a declaration that the LLC shall not undertake business with the public in the Cayman Islands other than so far as may be necessary for the carrying on of the business of that LLC outside of the Cayman Islands.

If an LLC carries on any business in the Cayman Islands in contravention of this requirement then, without prejudice to any other proceedings, the LLC and every manager of the LLC who is responsible for the contravention commits an offence and is liable on summary conviction to a fine for every day during which the contravention occurs or continues, and the LLC shall be liable to be immediately dissolved and removed from the Register at the discretion of the Registrar.

The Registrar will make the registration statement available for inspection by any person upon payment of a fee.

If, during the continuance of the LLC, any change is made or occurs in any of the LLC's particulars as set out in the LLC's registration statement, the LLC must file a certificate of amendment to the registration statement with the Registrar specifying the nature of the change and provide such statement to the Registrar within thirty (30) days of the change.

Any LLC that is in default of the requirement to provide notice of the change in particulars will incur a penalty for each day that the default continues which penalty shall be a debt due to the Registrar.

3.2. Registered Office

An LLC is required to maintain a registered office in the Cayman Islands for the service of process and to which all notices and communications may be addressed. An LLC may, subject to the terms of the LLC Agreement, change the address of its registered office to another permitted address in the Cayman Islands. The LLC is required to notify the Registrar within thirty (30) days of that change and pay the prescribed fee. An LLC that carries on business without having a registered office in the Cayman Islands incurs a penalty of CI\$200/US\$244 for every day during which its business or affairs is so carried on.

4. MEMBERSHIP

In connection with the formation of an LLC, a person that is to be admitted as an initial member of the LLC is admitted upon the registration of the LLC. After the formation of the LLC, a person may be admitted as a member either by being issued with an LLC interest, or upon a transfer of an LLC interest, through a plan of merger or consolidation or in connection with the continuation of a foreign entity as an LLC in the Cayman Islands. Provided that all the requirements for admission contained in the LLC agreement have been met, any such person, howsoever admitted, will, without further actions or formalities, be deemed to have become a member and agreed to be bound by the terms of the LLC agreement from that date as if that person and all existing members and other parties to the LLC agreement had duly executed and delivered the LLC agreement.

A person ceases to be a member of an LLC upon the happening of any event provided for in the LLC agreement.

4.1. Members' Contributions

The liability of a member to contribute to the assets of an LLC is limited to the amount that the member has undertaken to contribute, whether in the LLC agreement or otherwise. Subject to the LLC agreement, no member or manager of an LLC is personally liable for any debt, obligation or liability of the LLC solely by reason of being a member or acting as a manager of the LLC.

Subject to the LLC agreement, a person may receive an LLC interest or be granted other rights in respect of the LLC without making any contribution or being obligated to make a contribution to the LLC.

Subject to the LLC agreement, a member may grant a security interest to a third party in respect of any or all of the LLC interest of that member. Any such security interest has priority according to the time that written notice of the security interest, signed by the secured party and the relevant member, is validly served at the registered office of the LLC.

4.2. Transfer of Membership Interests

An LLC interest is capable of being transferred in whole or in part in accordance with the Act and the provisions of the LLC agreement. An assignee of a member's LLC interest who is not admitted as a member has no right to participate in the management of the business or affairs of the limited liability company except as provided in an LLC agreement or otherwise upon the approval of all of the members and in compliance with the terms of the LLC agreement. Subject to the LLC agreement, unless and until an assignee of an LLC interest becomes a member, the assignee has no liability as a member solely as a result of the assignment.

4.3. Distributions to Members

The profits and losses of an LLC and distributions of cash or in kind by an LLC are allocated or paid among the members in the manner provided in the LLC agreement. Subject to the LLC agreement, the profits and losses and distributions of an LLC are allocated on the basis of the agreed value of the contributions made by each member. An LLC may not declare, make or pay a distribution, or release a member from any obligation to the LLC if, at the time of such distribution or purported release, the LLC is, or would as a result be, unable to pay its debts as they fall due in the ordinary course of business. A member who receives a distribution, or is purportedly released from an obligation in violation of this solvency test and who had actual knowledge of the violation at the relevant time, is liable to the LLC for the amount of such distribution or for the performance of the obligation purportedly released.

5. MANAGEMENT

The LLC agreement, which need not be filed with the Registrar, governs the LLC's business and affairs. Management of the LLC is vested in its members acting by a majority in number unless the LLC agreement provides for all or part of the management to be vested in a manager or managers. Unless the LLC agreement provides otherwise, the members acting by a majority in number or a manager appointed in accordance with the LLC agreement shall have the ability to bind the LLC. The rights and duties of the members and managers in an LLC are, as between themselves, to be determined by the LLC agreement.

Subject to the LLC agreement, members, managers and board or committee members do not owe any duty (fiduciary or otherwise) to the LLC or any member or other person in respect of the LLC other than a duty of a manager to act in good faith. A member may in exercising any vote, consent or approval right, act in its own best interests and as it sees fit even though it may not be in the best interests of the LLC or any other member. Board and committee members may, if expressly permitted by the LLC agreement, act in the best interests of a particular member or members, even if not in the best interests of all members or the LLC itself.

A manager of an LLC may also, if permitted by the LLC agreement, be a member.

6. LIMITED LIABILITY COMPANY AGREEMENT

The Act imposes a requirement that the member or members of an LLC enter into an LLC agreement to regulate the business or affairs of the LLC. The LLC agreement must be governed by Cayman Islands law. The LLC will be bound by the terms of the LLC agreement whether or not it is signed by the LLC. An LLC agreement may be entered into at any time before, after or at the time of the filing of a registration statement and, if entered into before such filing, is deemed to be effective on the date of registration of the LLC.

The Act, however, affords flexibility to the members to agree among themselves the internal workings of the LLC, with appropriate minimum safeguards. For example, an LLC agreement may:

- give indemnities to any member or manager or other person from and against any liability;
- provide that a member or manager who fails to perform in accordance with the LLC agreement shall be subject to specified remedies, sanctions or consequences;
- provide for classes of LLC interests;
- provide for the taking of an action, including the amendment of the LLC agreement, without the vote or approval of any member or class of LLC interest or group of members and may provide that any member or class of LLC interests or group of members shall have no voting rights;
- grant to all or certain identified members or a specified class of LLC interest or group of members, the right to vote separately or with all or any class of LLC interest or group of members or managers on any matter;
- provide that voting shall be on a per capita, number, financial interest, class, group or any other basis.

The Act provides considerable flexibility on how approvals or consents of members may be obtained. For example, on a matter to be voted on, consented to or approved by members, unless otherwise provided for in the LLC agreement, the matter may be dealt with without a meeting, without prior notice and without a vote by consent in writing, signed by the members having no less than the minimum number of votes that would be necessary to authorise or take such action at a meeting at which all members entitled to vote thereon were present and voted.

7. ECONOMIC SUBSTANCE

The International Tax Co-Operation (Economic Substance) Act (the “**ES Act**”) applies to a defined class of relevant entities including exempted companies and exempted partnerships, foreign companies and foreign partnerships registered in Cayman, LLCs, general partnerships (other than local partnerships) and limited liability partnerships that are required, subject to what is said below, to maintain economic substance in the Cayman Islands unless they are (i) tax resident outside the Cayman Islands; (ii) an investment fund (including entities through which any such fund invests or operates); or (iii) a not-for-profit company.

The ES Act requires that all Cayman Islands entities notify the Cayman Tax Information Authority (“**TIA**”) of, amongst things, whether or not it is carrying on a “relevant activity” (as defined in the ES Act and as discussed further below) and, if so, whether or not it is a “relevant entity”.

The notification to the TIA is by way of an annual Economic Substance Notification (“**ESN**”) which must be filed prior to an entity filing its annual return with the General Registry’s Corporate Administration Portal (“**CAP**”).

A relevant entity is subject to the ES Act from the date on which it commences a relevant activity. Non-compliance with the ES Act will result in significant financial penalties and continued non-compliance may result in an application by the TIA to the Grand Court for an order that the entity is defunct.

7.1. Relevant Activities

Relevant entities will be required to meet the economic substance test (“**ES Test**”) in respect of their relevant activities in the Cayman Islands. The categories of relevant activities include the following which are further defined in the ES Act:

- (a) Banking business;
- (b) Distribution and service centre business;
- (c) Financing and leasing business;
- (d) Fund management business;
- (e) Headquarters business;
- (f) Holding company business;
- (g) Insurance business;
- (h) Intellectual property business; and
- (i) Shipping business.

7.2. Economic Substance Requirements

For relevant entities carrying on relevant activities, the ES Act requires that they:

- (a) conduct core income generating activities (“CIGAs”) (see further below) in relation to the relevant activity;
- (b) be directed and managed appropriately in the Cayman Islands related to the relevant activity; and
- (c) with regard to the level of relevant income from the relevant activity carried out in the Cayman Islands, have an adequate –
 - (i) amount of operating expenditure incurred in the Cayman Islands;
 - (ii) physical presence (including maintaining a place of business or plant, property and equipment) in the Cayman Islands; and
 - (iii) number of full-time employees or other personnel with appropriate qualifications in the Cayman Islands.

Relevant entities carrying on the business of a pure equity holding company (one that only holds equity participations in other entities and only earns dividends and capital gains) will have reduced requirements such that they will need to comply with all filing requirements under the Act and have adequate human resources and premises in the Cayman Islands for holding and managing equity participations in other entities.

Each relevant entity that is carrying on a relevant activity and is required to satisfy the ES Test will be required to file an annual return with the TIA in respect of their status under the ES Act.

7.3. Core Income Generating Activities

CIGAs are defined in the ES Act to mean activities that are of central importance to a relevant entity in terms of generating income and that are being carried out in the Cayman Islands. CIGAs may be outsourced provided that the relevant entity is able to monitor and control the carrying out of the CIGA. The TIA will only accept the relevant entity’s claim to have satisfied the ES Test by means of domestic outsourcing if the information is verified by the service provider. Such verification must be made within thirty days of the relevant entity providing the same information to the TIA.

Service providers undertaking outsourcing functions are required to register with the DITC so that the DITC can independently verify the engagement and nature of the services provided.

8. CONTINUANCE AND DISCONTINUANCE

8.1. Continuance into Cayman

A foreign entity may apply to the Registrar for permission to continue into the Cayman Islands as an LLC. A number of prescribed matters regarding the applicant’s status must be satisfied before the LLC can be registered, although the Act provides that some of these points can be satisfactorily confirmed by a declaration or affidavit signed by an authorised person of the applicant.

8.2. Discontinuance from Cayman

The Act contains provisions whereby an LLC may be de-registered as an LLC in the Cayman Islands and continued as a foreign entity under the laws of any other jurisdiction by application to the Registrar. A number of prescribed matters must be satisfied before de-registration is permitted many of which can be confirmed by a voluntary declaration or affidavit of a manager or member.

9. ARRANGEMENTS, MERGERS AND CONSOLIDATIONS

9.1. Arrangements

The Act provides a mechanism for court approved schemes of arrangement. If a majority in number representing seventy five percent vote in value of the creditors or class of creditors, or members or class of members agree to any compromise or arrangement, the compromise or arrangement will, if sanctioned by the court be binding on all creditors or members, as the case may be, and also on the LLC or, if the LLC is being wound up, on the liquidator and contributors of the LLC.

9.2. Mergers and Consolidations

An efficient and cost-effective mechanism exists for mergers and consolidations between either two LLCs, one or more LLCs and one or more Cayman Islands exempted companies or one or more LLCs and one or more foreign companies.

Generally “merger” means the merging of two or more constituent companies and the vesting of their undertaking, property and liabilities in one of such companies as the surviving company whereas “consolidation” means the combination of two or more constituent companies into a consolidated company and the vesting or the undertaking, property and liabilities of such companies in the consolidated company. The essential difference is that a consolidation produces a new company different from either of its constituent companies, while in a merger one of the constituent companies will continue to exist as the other is merged into it. The surviving company may be an LLC, Cayman exempted company (but no constituent company can be a segregated portfolio company) or a foreign company.

The procedure to effect a merger or consolidation involves the approval by both managers (if any) and members of a written plan, which must include certain prescribed information. A plan of merger or consolidation, except between a parent and its subsidiary, is required to be authorised by two thirds majority in number of the members of each constituent LLC or, in the case of a particular constituent LLC, such threshold as set out in the LLC Agreement and such other approvals as required in accordance with the LLC Agreement. The consent of each holder of a fixed or floating security interest of a constituent company in a proposed merger or consolidation is required unless the court waives the requirement for consent.

Provision is made for a dissenting member of a Cayman Islands constituent LLC or company to be entitled to payment of the fair value of his shares or interests upon dissenting to the merger or consolidation. Where the parties cannot agree on the price to be paid to the dissenting member, either party may file a petition to the court to determine fair value of the shares or interests. These rights are not generally available where an open market exists on a recognised stock exchange for the shares of the class held by the dissenting member.

10. MAINTENANCE OF REGISTERS AND UPKEEP OF RECORDS

10.1. Register of Members

An LLC must maintain a register of members containing the name and address of each person who is a member of the LLC, the date on which such person became a member and the date on which such person ceased to be a member either at its registered office or, provided a record of the address at which such register is maintained is kept at its registered office, at any other place, information on each group or class of LLC interest and whether such member interests confer voting rights (and whether such rights are conditional). The register of members and the record of the address at which it is maintained is only open to inspection as provided for in the LLC Agreement or as permitted by the manager. However, if the Register of Members is not kept at the registered office of the LLC in the Cayman Islands, it will need to be made available there in electronic or other form on service of an order or notice for production by the TIA pursuant to the Tax Information Authority Act. The Register of Members must be updated within twenty-one (21) days of any change in the particulars therein.

An LLC in default of the maintenance of register of member requirements set out in the Act shall incur a penalty of CI\$5,000/US\$6,098. A failure to comply with an order or notice of the Tax Information Authority without reasonable excuse will result in a penalty of CI\$500/US\$610 and a further penalty of CI\$100/US\$122 for every day during which the non-compliance continues.

10.2. Record of Members' Contributions

The LLC must maintain or cause to be maintained, in any country or territory, a record of the amount and date of the contribution(s) of each member and the amount and date of any payment representing a distribution or, otherwise, a return of the whole or any part of the contribution of any member. The LLC must update such record within twenty-one (21) days of the date of any change in the particulars therein.

Where the records of members' contributions or books and records are kept at a place other than the registered office of the LLC, the LLC must, upon service of an order or notice by the TIA, make available, in electronic form or any other medium, at its registered office, such records.

10.3. Register of Managers

An LLC must maintain a register of managers containing the name and address of each manager and a copy of the register managers must be sent to the Registrar within 30 days of the first appointment of any manager. Notice of any change must be filed with the Registrar within 30 days of any such change taking place.

The Registrar will maintain a list of the names of the current managers of each registered LLC and make the same available for inspection by any person upon payment of an inspection fee and subject to such conditions as the Registrar may impose.

An LLC in default of complying with the above requirements shall incur a penalty of CI\$500/US\$610. In addition, if the Registrar is satisfied that a breach has been knowingly and wilfully authorised or permitted, an LLC shall incur a CI\$1,000/US\$1,220 penalty and every manager of the company to which the breach

relates shall incur a penalty of CI\$1,000/US\$1,220 as well as a further penalty of CI\$100/US\$122 for every day during which the default continues.

10.4. Register of Mortgages and Charges

An LLC must maintain at its registered office a register of mortgages and charges over the assets of the LLC and such register must be open to inspection by members and creditors at all reasonable times. If such inspection is refused, any authorised person of the LLC refusing the same, and every manager of the LLC authorising or knowingly and wilfully permitting such refusal, shall incur a penalty of (CI\$4/US\$5 for every day during which such refusal continues and a Judge sitting in chambers may compel an immediate inspection of the register.

This register does not need to be filed with the Registrar. Any manager of the LLC who knowingly and wilfully authorises or permits the omission of an entry in the register of mortgages and charges shall incur a penalty of CI\$100/US\$122.

10.5. Register of Security Interests

An LLC must maintain at its registered office a register of security interests over member interests in the LLC notified to the registered office in accordance with the Act and such register shall contain the time and date of receipt of any notices validly served at the registered office in accordance with the Act. The register is required to be updated within twenty one (21) days of receipt of a validly served notice and the register, or an extract thereof, shall be open to inspection by a person who is either expressly provided for in the LLC agreement or permitted by the manager.

10.6. Books of Account

Every LLC is required to keep proper books of account including, where applicable, material underlying documentation including contracts and invoices, with respect to:

- (a) all sums of money received and expended by the LLC and matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods by the LLC; and
- (c) the assets and liabilities of the LLC.

Proper books of account shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the business and financial condition of the LLC and to explain its transactions. Such records shall be retained for a minimum period of five years from the date on which they are prepared. Where the LLC fails to keep proper books of account for the retention period, the LLC is subject to a penalty of CI\$5,000/US\$6,098.

The records need not be kept in the Cayman Islands, but will need to be made available at the registered office if an order or notice for production under the Tax Information Authority Act is made.

10.7. Beneficial Ownership Register

Unless an alternative route to compliance is available by, for example, being listed or licensed under a Cayman regulatory law, each LLC's corporate service provider ("CSP") has an obligation to establish and maintain a register of its beneficial owners to be kept at its registered office. Each LLC is required to take reasonable steps to identify any registrable beneficial owners which include individual beneficial owners of the LLC and all Cayman incorporated, formed or registered legal entities that would be beneficial owners if they were individuals ("reportable legal entities").

Beneficial owner details are uploaded to the General Registry via Corporate Administration Platform ("CAP") system. The information is encrypted upon submission and further encrypted upon receipt. The data is then deleted from CAP and goes to a non-internet facing, offline server only accessible by a Government authorised competent authority.

There are significant financial penalties for failure to establish or maintain a beneficial ownership register. Administrative fines apply to 'in-scope' entities that fail to take reasonable steps to identify beneficial owners and reportable legal entities, fail to ensure their beneficial ownership register remains up to date and/or fail to provide particulars of registrable beneficial owners to their CSPs or certain notices to their registrable beneficial owners. Entities that rely upon an alternative route to compliance are not required to maintain a beneficial ownership register but may still be in breach if they fail to provide written confirmation of their alternative route to compliance and instructions to file the information required to satisfy the alternative route to compliance, or if they incorrectly seek to rely upon an alternative route to compliance that is not available to the entity. Of particular note, Cayman Islands LLCs whose beneficial ownership register indicates a status of 'Enquiries pending' for three uninterrupted months will be presumed to be in breach and liable to administrative fines. There are a number of other technical breaches for which LLCs and/ or their CSPs may be fined. The Registrar may strike an LLC from the register if a fine remains unpaid for ninety days.

11. ONGOING OBLIGATIONS

11.1. Filing Requirements

On the occurrence of certain events, a notice is required to be filed with the Registrar within certain prescribed time periods. These are indicated in brackets below.

- (a) Change in managers or managers' details (30 days);
- (b) Change to the registration statement (30 days);
- (c) Change of location of the registered office (30 days).

Significant penalties apply in the event of failure to file an update with the Registrar on time.

An annual return must be submitted to the Cayman Islands Government in January of every year together with the prescribed fee. A current listing of the annual government fees is available upon request. Significant penalties apply for failure to file the annual return on or before 31 March in any year. Where an LLC fails to file an annual return in accordance with the Act, the LLC shall be deemed to be a defunct

company and can, subject to a six months' notice period, be treated as a defunct company and struck off by the Registrar.

12. WINDING-UP

An LLC may be wound up voluntarily, compulsorily by the court or under the supervision of the court. An LLC shall be wound up voluntarily when: (i) the term, if any, for the duration of the LLC expires; (ii) an event specified in the LLC agreement, following which the LLC is to be wound up, occurs; (iii) the LLC has no members; (iv) subject to the LLC agreement, upon the affirmative vote or written consent of at least two thirds in number of the members of the LLC. Unless inconsistent with the Act, the provisions of Part V of the Companies Act and the Companies Winding up Rules, as applicable, apply *mutatis mutandis* to the winding up of an LLC.

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

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