

# Commencement of the Limited Liability Companies Law, 2016

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The Cayman Islands Government published the Limited Liability Companies Law, 2016 (the “**LLC Law**”) by way of Extraordinary Gazette on 8 June 2016 and it is expected to be brought into effect toward the end of June. As readers will be aware from our previous briefings on this topic, the LLC Law allows for the introduction and establishment of limited liability companies (“**LLC’s**”) similar in structure to that of the Delaware LLC.

The LLC Law has been developed as a joint effort between the Cayman Islands Government and the Cayman Islands Monetary Authority in consultation with representatives from industry bodies (including Campbells). Campbells is proud to have been integrally involved in the development of the LLC Law through its membership of the legislative sub-committee tasked with reviewing the LLC Law on behalf of industry and accordingly is already in a position to provide clients with detailed insight into the provisions of the LLC Law.

This introduction of the LLC has been eagerly anticipated, particularly by the investment funds and venture capital industry. It will be of interest to fund managers by offering a level of commonality in Cayman Islands structures to those which they see in the US investment funds market (such as Delaware LLCs). The LLC Law and LLC concept have been well received by our clients, most notably those in the hedge, private equity and venture capital funds sectors in North America. It is also of interest to those wishing to use Cayman Islands vehicles in corporate transactions, special purpose vehicles and joint venture arrangements due to the differences in duties owed by managers (the LLC equivalent of company directors) and the ability for a written operating agreement (the “**LLC Agreement**”) to allow for provisions such as weighted voting rights of managers. Fiduciary risk for those managing an LLC can be curtailed when compared to the risks of acting as a director of a Cayman Islands company.

The passing of this new law demonstrates the continued ability of the Cayman Islands to work with market participants in order that it remains the world’s leading offshore jurisdiction; flexible and responsive to the needs of clients.

## Summary

An LLC is similar in key respects to a Delaware limited liability company and the LLC Law is based, in part, on the corresponding Delaware LLC law (the “**Delaware LLC Law**”). While the Cayman Islands has sought to broadly follow the Delaware LLC Law, it has adapted the LLC Law for consistency with Cayman Islands legal principles by preserving the broad legal principles applicable to companies and the rules of equity and common law.

The LLC is a versatile entity with a hybrid of the benefits of the main two structures used in fund formation being

an exempted limited company and the exempted limited partnership. An LLC, in common with an exempted company (and unlike an exempted limited partnership) will be a body corporate with a separate legal personality to its members but will maintain the internal accounting and record keeping flexibility of an exempted limited partnership. Further, unlike an exempted limited partnership, an LLC will not need to have a separate general partner entity in order to maintain the limited liability of its members and may either be managed by its members in accordance with its LLC Agreement or by 'managers' (who may or may not be members) appointed by the members.

The LLC must have at least one member. Its members benefit from limited liability to the amount of each member's agreed maximum contributions with substantial contractual freedom to agree the internal workings of the LLC vehicle set out in an LLC Agreement within the framework of the LLC Law.

## Advantages and Disadvantages

### ADVANTAGES

- Ability to vary fiduciary risk of those managing the LLC;
- Avoid technical issues of par value and share capital of a company;
- Ability to more closely mirror the terms of a US LLC vehicle; and
- Lower fees than for an exempted limited partnership, or foreign corporation registered in the jurisdiction, may in certain circumstances replace an exempted limited partnership, thereby avoiding the need for a separate general partner.

The Cayman Islands is the leading offshore fund jurisdiction and as such, the LLC will complement the current fund structuring offerings and will allow for: (1) more straightforward and flexible administration of the tracking and calculation of a member's investment in a fund, without the need to reference shares and the rigidity of share capital; (2) flexibility in corporate governance concepts; and (3) a closer synergy between the legal frameworks for onshore vehicles and offshore vehicles, which will be particularly useful in a master/feeder structure where a parallel Delaware onshore feeder is established.

It will be possible for the LLC to be operated / controlled by a majority of members or managers (who need not be members) and who owe no fiduciary duties to the LLC, its members or any other person save that managers will still retain a duty of good faith (unless varied in the LLC Agreement). This will certainly suit those looking for structures where stakeholders can promote and contract for their own interests, without traditional issues of fiduciary responsibilities and associated liabilities of directors of corporate entities, such as those engaged with venture capital, private wealth and family offices or in private equity.

### DISADVANTAGES

- Untested in Cayman Islands courts as to how judicial precedent will be applied (for example in evaluating the fiduciary risks for managers); and
- Unfamiliar conceptually to non-US groups.

## Jurisprudence

The LLC is a new vehicle with no current equivalent legal concept in the Cayman Islands and as such there is no Cayman Islands jurisprudence / court decisions on LLCs. Therefore the LLC Law expressly states the key features of an LLC to provide clear guidance to promoters and their service providers alike.

To the extent that they are relevant to an LLC, the LLC Law seeks to preserve the rules of equity and common law which are applicable to exempted limited companies. In simpler terms, the current court decisions and judicial precedents which apply to companies will apply to LLCs, but there remains residual uncertainty as to how practically it will apply – for example, will fiduciary good faith obligations be identical for LLC managers as for company directors? It is expected that the understood current principles of contractual interpretation will apply to the provisions of any LLC Agreement.

## Applicability

The LLC Law provides that the LLC will automatically be incorporated into the following current Cayman Islands laws such that it may also act in the following capacities pursuant to the provisions of such laws:

- The Mutual Funds Law – such that the LLC can be structured as a mutual fund;
- The Exempted Limited Partnership Law – such that the LLC can be structured as a general partner of an exempted limited partnership; and
- The Securities Investment Business Law – such that the LLC can be formed to act as an investment manager or adviser to a mutual fund.

## Formation

An LLC will be registered with the Registrar of Limited Liability Companies (the “**Registrar**”), formed in a similar manner to an exempted partnership by submission of a registration statement which contains initial details such as the name (and, if applicable, any foreign translation), registered office and term of the LLC. Note the LLC must have a registered office in the Cayman Islands. In common with an exempted company or an exempted limited partnership, an LLC will receive a certificate of registration.

The Registrar will record the name of the LLC, the date of registration and any change of name or foreign name. The LLC Law contains rules on the naming convention of an LLC. Of principal interest to readers will be that an LLC may, but need not, have “Limited Liability Company”, “LLC” or “L.L.C.” as part of the name of the LLC. No other company or entity registered in the Cayman Islands may now use “Limited Liability Company”, “LLC” or “L.L.C.” in their name, unless they are already registered in the Cayman Islands or will be registered as a foreign company.

## Separate Legal Personality

An LLC is a corporate entity which has separate legal personality to its members, so the members have no risk for the LLC’s liabilities save to the extent of any agreed unpaid contributions to the LLC. The separate legal personality continues until the LLC’s certificate is cancelled by the Registrar deregistering or striking off the LLC.

The LLC Law gives an LLC full power to carry on its business or affairs unless its LLC Agreement provides otherwise.

It may be formed for any lawful business, purpose or activity.

An LLC has the power to indemnify a member or manager and may advance expenses.

## **Membership**

The LLC must always have at least one member and there are no Cayman residency requirements for members. The initial member is admitted upon registration of the LLC. Members are issued interests, which although akin to a partnership interest also has attributes of shares of a company. The LLC Law then sets out the manner in which members may be admitted or interests transferred and allows interests to be issued without a contribution and allows for an LLC to acquire, purchase, redeem or otherwise any LLC interest.

The LLC Law allows the LLC Agreement to divide the LLC's interests into classes and/or allow for voting or non-voting interests and allow for meetings or otherwise.

The LLC Law also allows the LLC Agreement to alter most of the provisions in the LLC Law regarding the manner in which such members are admitted or interests issued, allowing substantial contractual freedom.

## **LLC Agreement**

The LLC and its members must enter into an LLC Agreement which governs and regulates its business or affairs. The LLC Agreement must be governed by Cayman Islands law (regardless of any expression otherwise in the LLC Agreement). The LLC Agreement may, but need not be, executed and is binding regardless of signature.

The LLC Agreement may: (a) provide specific remedies or sanctions or consequences against any member or manager failing to comply with its terms and/or (b) specify the happening of an event which would subject members or managers to specific remedies or sanctions or consequences.

The LLC Law provides that any specific remedies or sanctions or consequences shall not be unenforceable on the basis that they are a penalty or forfeiture in nature, so forfeiture of an interest for defaulting members is in principal enforceable.

The LLC Law also provides that no act nor disposition of real or personal property of or to an LLC shall be invalid because the LLC lacked capacity or power but that the same may be asserted in proceedings by a member or manager against the LLC or by the LLC (through a liquidator or member or managers or other representative) in proceedings against the member or manager (or former member or manager) to prevent the same.

The LLC Agreement need not be filed or registered with the Registrar in line with the Cayman Islands Exempted Partnership Law and the Delaware LLC Law.

## **Liability to Third Parties**

The LLC Law states that no member or manager is to be personally liable for any debt, obligation or liability of the LLC solely by reason for being a member or manager of the LLC. However, through the LLC Agreement or otherwise a member or manager may agree to be personally liable for the debts, obligations or liabilities.

The liability of a member is limited to the amounts contributed or as set out in the LLC Agreement or as otherwise agreed between the member and the LLC. Subject to the LLC Agreement the contribution by a member to an LLC may be in cash, property, other assets including services rendered or any other obligation.

The LLC Law contains the same provisions to protect creditors as are set out in the Companies Law. Any compromise agreement to waive a contribution or return money or other property paid or distributed may only be made where the LLC is able to pay its debts and will remain so immediately following the compromise.

Subject to the LLC Agreement, members may grant security over the whole or part thereof of any LLC interest. The security interest will have priority from the date that written notice signed by each of the secured party and the relevant member, is validly executed and served on the registered office and such notice shall not be validly given unless it specifies the agreement pursuant to which the security interest is granted including the date thereof and the parties thereto, the identity of the grantor and the grantee of the security interests and the LLC interest or part thereof that is subject to that security interest.

## **Allocations and Distributions**

Except for when an LLC is unable to pay its debts as they fall due in the ordinary course of business, the LLC Law allows the LLC Agreement to govern the manner in which distributions are made and profits and losses are allocated among members or classes of interests. If the LLC Agreement is silent as to this the LLC Law allows for distributions of profits and losses to be allocated on the basis of contributions made.

The LLC Law does not allow an LLC to declare, make or pay a distribution to a member or release any obligation where it is unable to pay its debts as they fall due in the ordinary course of business and the LLC Law contains the same provisions as the Companies Law and the Exempted Partnership Law as to limitations on distributions and liabilities of those paid or released from obligation in an insolvency situation.

Subject to the terms of the LLC Agreement, LLC interests are capable of withdrawal on demand of notice by any member(s).

## **Management**

The LLC Law allows the LLC Agreement to appoint any person, with their agreement, to be named or designated as a manager of the LLC to govern the management of the LLC including the rights and duties of the members and managers. A manager may or may not be a member or a party to the LLC Agreement. An LLC may have more than one manager. The LLC Agreement may allow for classes or groups of managers (which could for example manage different assets) and set out their relative rights, powers and duties.

If the LLC Agreement is silent, then the management of an LLC vests in its members acting by a majority.

The LLC Law allows the LLC the flexibility to expand or restrict the duties owed by members or managers or persons on any committee acting for the LLC in its LLC Agreement, subject to the minimal duty that any manager must act in good faith in respect of the rights, authorities or obligations to which the manager is subject or exercises or performs, although even this duty is capable of restriction in the LLC Agreement.

Unless otherwise set out in the LLC Agreement or unless acting in a manager capacity (in which case they are subject to the above minimal duty), the LLC Law states that a member does not owe any duty (fiduciary or otherwise) to the LLC or any member in exercising their rights or authorities in respect of the LLC or in performing their obligations under the LLC Agreement.

The LLC Law allows the LLC Agreement to protect the confidentiality of the LLC and restrict access to the books and records of the same, but if the LLC Agreement is silent as to the point, the members of an LLC may have access to inspect the LLC books and records.

Unless otherwise provided in the LLC Agreement, a manager has the power and authority to delegate the rights and powers to manage and control the business.

## **Winding Up**

The LLC agreement may contain details of how the LLC is terminated. Otherwise the LLC Law sets out termination provisions and an LLC may be wound up voluntarily, compulsorily by the Court or under Court supervision. An LLC may be wound up in the same manner as an exempted company and certain provisions of the Companies Law and Companies Winding Up Rules as applicable to a voluntary liquidation will apply.

## **Maintenance of Registers**

LLCs will be required to maintain registers of members, managers and mortgages and charges. The register of managers is the only register that requires to be filed with the Cayman Islands authorities.

## **Additional Miscellaneous Elements of the LLC Law**

The LLC Law allows for the conversion of exempted companies into LLCs, reconstructions, amalgamations and mergers and consolidations. Additionally the LLC Law allows for the transfer in of foreign entities to be registered as LLCs and vice versa.

It is envisaged that future iterations of the LLC Law will allow for conversion of exempted limited partnerships to LLCs and additional flexibility requirements.

## **Summary**

The LLC will be a valuable measure to provide flexibility for clients.

Specific legal advice should always be sought whether an LLC is helpful in a particular situation.

View the new Limited Liability Companies Law, 2016 [here](#).



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