

Cayman Islands Exempted Limited Partnerships – when can limited partners bring claims on behalf of the partnership?

An exempted limited partnership ("ELP") is a frequently used entity for Cayman Islands investment funds. An ELP has no separate legal personality and ordinarily only the general partner ("GP") can cause the ELP to bring proceedings (including to protect the investments of a limited partner ("LP") in the ELP).

However, an LP is provided with a statutory right under section 33(3) of the Exempted Limited Partnership Act (As Revised) ("ELP Act") to bring an action on behalf of the ELP (a derivative action) when the GP has "*without cause failed or refused to institute proceedings*". When LPs may be able to exercise this statutory right was recently considered by the Privy Council (the highest Court of Appeal in the Cayman Islands) in *Kuwait Ports Authority and another (Respondents) v Mark Eric Williams and 2 others (Appellants) (Cayman Islands)* ([2024] UKPC 32).

The decision provides helpful guidance for LPs as to when they may be able to take a proactive stance by issuing legal proceedings to protect their investments when the GP has failed or refused to do so.

Background

Two LPs in an ELP brought claims against the GP (and two related parties) for, among other things, conspiracy, breaches of trust and fiduciary duty and knowing receipt. The claims were based upon

alleged wrongdoing by the GP and the two other related parties. It was argued that the claims should be struck out on the basis that the LPs could not bring a derivative claim since the GP had not without cause failed or refused to institute proceedings.

The Court at first instance and on appeal to the Cayman Islands Court of Appeal held that the LPs were able to bring a claim on behalf of the ELP, on the basis that the GP had acted 'without cause' in not bringing proceedings. This was primarily because the GP was itself involved in the alleged wrongdoing and, in being left with a decision of whether to sue itself, meant that the GP was inherently conflicted.

The matter was appealed to the Privy Council.

Decision

The Privy Council agreed that the LPs did have the right to bring the derivative action as the GP had acted without cause. This was on the basis that the GP was subject to an obvious and serious actual conflict of interest which, in this instance, emanated from the GP's alleged wrongdoing.

In reaching this conclusion, the Privy Council considered case law in relation to the bringing of derivative claims in the context of both trusts and limited partnerships. A beneficiary of the trust can bring an action in its own name on behalf of the

trust if there are special circumstances. Such special circumstances can include where it is difficult or inconvenient for the trustees to sue. What must be special about the circumstances is that the derivative action is needed to avoid injustice. Therefore, in the ELP context, where a derivative action is needed to avoid injustice, then the failure or refusal of the GP to institute proceedings may be without cause.

A conflict of interest (of the kind that arose in this case) is a clear example of special circumstances justifying the bringing of a derivative claim. If the GP's decision not to institute proceedings is subject to a conflict of interest, then the decision is inhibited (or in other words without cause) and it is not necessary or appropriate to go on to consider how the conflict in fact affected the decision not to commence proceedings.

Further, the conflict of interest impacting the decision of the GP whether to bring proceedings could not be cured by the identity or independence of its directors (here independent directors, whose appointment post-dated the events giving rise to the claims, had investigated the claims and concluded it was not in the ELPs interests to pursue them). The ELP Act makes it clear that it is the position of the GP and not its directors which must be considered and independent directors could not solve the inherent conflict of whether the GP should sue itself. The GP's directors were seriously inhibited from making impartial decisions regarding the bringing of proceedings because they owe their duties to the GP and it is not in the GP's interests to be sued. If the GP were to act in the interest of the ELP this may include taking action against the GP, but acting in the best interests of the GP may be said to include the avoidance of being sued.

Takeaways

The Privy Council set out 11 principles relating to the right of LPs to bring a claim on behalf of the ELP. The following are likely to be of particular note for LP derivative actions going forward:

- a) There is no requirement for leave (in other words, permission from the Court to bring an action) under section 33(3) but an LP must set out the facts and matters that show the LP is within section 33(3). A defendant who takes issue whether section 33(3) has been complied with can bring an action to strike out the application or apply for a determination on whether the GP has in fact 'acted without cause' as a preliminary issue.
- b) The onus is on the LP to satisfy the Court that the GP has without cause failed or refused to bring proceedings – to determine this, the Court is likely to be assisted by consideration of whether 'special circumstances' exist such as those developed in trusts and limited partnership cases.
- c) The Court should reach its decision by reference to the facts as they appear at the date of the hearing of the strike out or preliminary issue.
- d) The Court should consider, among other things, the strength of the evidence that the GP has failed or refused to institute proceedings without cause, the strength of the alleged derivative claim and the likelihood and nature of injustice that could occur if the claim does not proceed. This allows the Court to consider discretionary considerations, for example whether the LP has an alternative remedy to a derivative action.

The Privy Council also stated that given that ELPs and companies are very different types of legal entities, Courts can take little assistance from case

law concerning derivative actions by shareholders of companies. One of the practical results of the differences is that where there is a conflict in the company context a special committee of independent directors may be sufficient to cure the conflict and avoid a derivative action, whereas in an ELP context the mere fact of the conflict at GP level may allow the LPs to rely on section 33(3) and bring a derivative action assuming it has not otherwise been legislated for in the partnership agreement in a manner contemplated by the ELP Act.

Further Assistance

If you would like further information, please liaise with your usual Maples Group contact of any of the persons listed below.

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