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Features of Cayman Fund Vehicles and the Curious Case of Padma Fund LP

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Most people who have had a reasonable degree of interaction with Cayman funds and fund finance transactions will be well aware that different Cayman vehicles have distinct constructions and legal characteristics (in particular, Cayman exempted limited partnerships and their general partners). A recent decision of the Cayman Courts in a case named *In the matter of Padma Fund LP* ("Padma") has, for now at least, added an extra factor to consider when engaging with such funds. While Padma provides no reason for immediate alarm from the perspective of lenders in fund finance transactions, it does merit mentioning so that lenders and their advisors can be aware of the prospective issues it could create in practice.

Before giving a very high-level (we promise!) summary of the Padma decision and its implications, it is helpful by way of background to run through the most commonly seen Cayman vehicles and highlight some of their notable features.

Exempted Limited Partnerships ("ELPs"). Long regarded as the Rolls Royce of offshore private equity fund vehicles, the ELP is the most commonly seen Cayman fund vehicle in fund finance transactions.

- *Separate Legal Personality*: A Cayman ELP does not have separate legal personality and, while it is registered as an ELP in the Cayman Islands (and can obtain certificates of good standing in respect of itself, etc.), it must act at all times by its general partner which, together with acting for the ELP in executing contracts, etc., holds the property of the ELP (including the rights to make capital calls) in trust for the ELP.

- *Source of Secured Capital Call Rights*: As a result of the legal construction of the ELP and the fact that the general partner technically holds the rights under the limited partnership agreement ("LPA") to call on LPs to fund commitments, it is typical for both the general partner and ELP to be separate independent parties to the security agreement, and both parties grant a security interest over their respective rights under the LPA.

Limited Liability Companies ("LLCs"). LLCs are a relatively new addition to the Cayman stable of fund vehicles. The structure and form of a Cayman LLC is very similar to that of its Delaware cousin and so its features are familiar to most U.S. market participants.

- *Separate Legal Personality*: A Cayman LLC does have separate legal personality, and so when it enters into security agreements, it does so independently and on its own behalf. Cayman LLCs can be either member-managed or manager-managed, and the applicable member or manager executes documents on behalf of the LLC.
- *Source of Secured Capital Call Rights*: The rights to call on members of an LLC (the equivalent of LPs of an ELP) are those of the LLC itself and are generally contained in the LLC operating agreement. Accordingly, the security is granted over these rights by the LLC itself.

Exempted Companies. More commonly seen as a general partner to Cayman ELPs, Cayman exempted companies are also sometimes seen as the fund vehicle (although more often than not they are only relevant as a borrower or grantor of security in the hedge fund and asset-based lending space).

- *Separate Legal Personality*: A Cayman exempted company does have separate legal personality, and so when it enters into security agreements, it does so independently and on its own behalf. An exempted company is managed by its directors, and a director or authorized signatory executes documents on behalf of the company.
- *Source of Secured Capital Call Rights*: In contrast to ELPs and LLCs, the rights to call on shareholders of a Cayman exempted company (the equivalent of LPs of an ELP) are generally not contained in the constitutional document (memorandum and articles of association) of the exempted company but are instead contained in the subscription agreement(s) executed by shareholders. Accordingly, in these circumstances, the security interest is granted over the rights contained in such subscription agreements.

The Padma Decision

The Padma decision has raised some eyebrows amongst Cayman Islands attorneys as it contradicts existing case law concerning the procedural aspects of how certain actions can be taken against ELPs. Padma concerned the ability of a creditor to seek the winding-up of a Cayman ELP. A long list of existing decisions of the Cayman Courts provide that such a petition can be presented against the ELP itself (notwithstanding that it does not have separate legal personality) without needing to take action against the general partner. The decision of the Cayman Court in Padma directly contradicted this position in holding that the Exempted Limited

Partnership Act in fact required that such a petition must be presented against the general partner of the ELP (and a petition against the ELP alone could not proceed).

The relevance of all of the above to fund finance is that many credit agreements will specify that no action may be taken against a general partner except in certain circumstances (for example, in respect of the pledged rights under the security agreement and/or as a result of any fraud by the general partner). If the Padma decision was to be followed in subsequent case law (requiring an action against an ELP to be taken against the general partner) and the above referenced limited-recourse wording was present in a credit agreement, it could give rise to a scenario whereby a lender wished to take an action against an ELP but was prevented from doing so by its inability to initiate the action against the general partner of the ELP under the terms of the limited recourse provisions of the credit agreement.

As a result of this and the doubt cast by Padma on the common law position regarding how certain actions may be taken against ELPs, until such time as Padma is reversed by the Courts or clarified by legislative changes, we expect to see wording added more frequently to credit agreements clarifying that when taking an action against an ELP such legal proceedings may be taken against the general partner of that ELP for the purposes of complying with the Exempted Limited Partnership Act. It is hoped that in time this uncertainty in the law will be clarified, but until then we remain stuck with the curious case of Padma!