

Key features of Cayman LLCs

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Primacy of freedom of contract

Overall the drafting of the LLC Law adopts a similar approach as adopted with respect to exempted limited partnerships (**ELPs**) under the Cayman Exempted Limited Partnership Law (the **ELP Law**) in that many of its default provisions remain subject to the relevant LLC Agreement.

Reflection/Improvement on ELP and Exempted Companies Provisions

Many of the provisions of the LLC Law combine the flexibility of certain provisions of the ELP Law while also reflecting the corresponding provisions for Cayman Islands exempted companies under the Companies Law but with enhancements made generally to increase the flexibility of LLCs as compared to exempted companies and certainty/ease of use for members/managers of LLCs.

Preservation of the Rules of Equity and Common Law

The LLC Law expressly states that the rules of equity and common law applicable to companies registered in the Cayman Islands, as modified by the Cayman Companies Law and other laws in the Cayman Islands, shall apply to LLCs except in so far as such rules and law are inconsistent with the express provisions of the LLC Law or the nature of LLCs. Specific differences noted in the LLC Law are with respect to the LLC:

- Not being a company limited by shares or guarantee but with the liability of its members limited pursuant to the provisions of the LLC Law
- Having certain characteristics of, and the flexibility to allocate profits and losses to its members in a manner akin to partners in an exempted limited partnership
- Being managed by its members or by one or more managers that are not members

As the LLC entity is a new form of entity and is not a form of entity in for example England & Wales, whose common law decisions are of persuasive authority in Cayman, this provision is expected to prove useful guidance with respect to the interpretation of provisions in the LLC Law.

Ease of Registration and Confidentiality of Commercial Agreement

A LLC is registered with a short-form registration statement pursuant to Section 5 of the LLC Law (the **Registration Statement**) (similar to a ELP, section 9 Statement). Any changes to the Registration Statement must be filed with the Registrar of Limited Liability Companies (the **Registrar**) within thirty days of the change.

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A LLC's name may (but is not required to) use the suffixes LLC, L.L.C. or Limited Liability Company and it may be preceded or followed with a dual foreign name.

The governing document for an LLC regulating its business and internal operations (equivalent to the memorandum and articles of association of an exempted company or the exempted limited partnership agreement of an ELP), is the LLC Agreement (which may be referred to on its face as a LLC Agreement, an operating agreement or any other name).

The LLC Agreement can be entered into at any time before, after, or at the time of, the filing of the Registration Statement (if entered into before such filing it is deemed effective on the date of registration of the LLC).

There is no requirement to file the LLC Agreement with the Registrar - unlike an exempted company which does have to file its articles of association with the Registrar of Companies.

Separate Legal Personality

As a body corporate a LLC has separate legal personality (unlike ELPs), it is therefore able to contract in its own name.

Limited Liability

No manager or member of a LLC is personally liable for debts/obligations/liabilities of the LLC except to the extent provided for in the LLC Agreement.

Members' liability to contribute assets is generally limited to what the member has agreed to contribute within the provisions of the LLC Agreement and potential clawback of distributions made where a LLC was insolvent.

Unless the LLC Agreement provides otherwise, the obligation of a member to make a contribution or return money or other property paid or distributed in violation of the LLC Law may be compromised only by consent of all the members and **only if** the LLC is able to pay its debts and will remain so immediately following the compromise. A creditor though who extends credit to an LLC may enforce the original obligation of the member, to the extent that the creditor reasonably relied on the obligation of a member when extending the credit (provided the creditor has not consented to the compromise).

Capacity, Corporate benefit; *Ultra Vires*

An LLC is capable of exercising all the functions of a natural person of full capacity irrespective of corporate benefit.

Unless restricted in its LLC Agreement, an LLC has the power to do all things necessary or convenient to carry on its business or affairs – the LLC Law includes (without limiting this general power) various specific and wide-ranging powers which will undoubtedly prove useful in the context of issuing legal opinions on LLC actions.

As with Cayman exempted companies, no act of an LLC shall be invalid by reason only of the LLC lacking capacity or power to perform the act. In other words, the *ultra vires* doctrine does not apply to render an act invalid if legal obligations have already been incurred. This does not however prevent the lack of capacity/power being asserted in the following circumstances:

- In proceedings by a member or manager against the LLC to prohibit the performance of an act or the disposition of property by or to the LLC

- In proceedings by the LLC, whether acting directly or through a liquidator or other legal representative or through members or managers in a representative capacity, against the former members or managers of the LLC for loss or damage through their unauthorised act(s)

Admission of Members/Transfer of LLC Interests

Any initial member(s) are admitted upon registration of the LLC.

After formation of an LLC, admission of members is essentially governed by the LLC Agreement with specific provisions in the LLC Law dealing with mergers/consolidation/continuation of foreign entities into Cayman as LLCs and conversion of exempted companies to LLCs.

Unless the LLC Agreement provides otherwise, a person can be admitted as a member of the LLC and receive an LLC interest/be granted other rights in respect of the LLC without making a contribution or being obligated to make a contribution to the LLC.

Transfers of LLC interests are also essentially governed by the LLC Agreement with the LLC Law providing fall back provisions – as an LLC interest is in the nature of contractual rights under the LLC Agreement (similar to limited partnership interests) the transfer of LLC interests (or part thereof) will generally be effected by way of assignment of rights and assumption of obligations.

Provided the relevant LLC Agreement provisions have been complied with, any person (however admitted) is deemed to have become a member and adhered to and agreed to be bound by the terms and conditions of the LLC Agreement from that date as if that person and all existing members and any other parties to the LLC Agreement had together duly executed and delivered the LLC Agreement.

Members have no statutory rights of preemption in connection with the issue of LLC interests although an LLC Agreement can provide for these.

The LLC Law provides no statutory right of withdrawal for members other than in accordance with the LLC Agreement or with the consent of all members or otherwise as provided for in the LLC Law.

Security over LLC Interests

Subject to the LLC Agreement, members can grant security over their LLC interest (or any part thereof).

Any security interest over the whole or part of an LLC interest properly granted has priority according to the time that that the written notice of such security interest, signed by each of the secured party and the relevant member, is validly served at the registered office of the LLC. Such notice must specify the relevant security agreement and other prescribed details of such agreement.

Flexible Classes; Voting and Meeting Provisions

The LLC Agreement can provide for the creation of different classes of LLC interests, managers or groups of members or managers, the voting rights of members and managers and meetings provisions relating to members/classes of interests/managers.

The default members' voting position (subject to the LLC Agreement or where the LLC law provides for a different level) is that any vote/consent/approval required of members shall be passed by simple majority in number of the members entitled to vote on the

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matter.

Written members' and managers' consents on a less than unanimous basis (i.e. signed by members/managers having not less than the minimum number of votes that would be necessary to authorise the relevant action at a members or managers meeting, as applicable, at which all the members/managers entitled to vote on the matter were present and voted) are permitted (subject to the LLC Agreement).

The LLC Law specifically recognizes the ability of the LLC Agreement to provide for negative/deemed consent provisions i.e. where a notice provides that a member will be deemed to have consented to a matter if it does not confirm its opposition to such matter within a time specified.

The LLC Law also contains a provision stating that consent/approval of members may be either express or inferred from a course of dealing.

While the LLC Agreement can provide for separate classes of interests, there is no provision within the current LLC Law allowing for the assets and liabilities of classes or series of interests to be segregated in the way for example that Cayman Islands segregated portfolio companies allow for the statutory segregation of assets and liabilities between different portfolios or that Delaware law allows for series segregation.

Amendments to the LLC Agreement

The LLC Agreement can include provision for the taking of any action including, specifically, the amendments of the LLC Agreement without the vote or approval of any member or class of interest or group of members or of any manager or class or group of managers – accordingly it can also determine if a particular threshold is required.

Indemnification

Under the LLC Law, the LLC is able to indemnify members and managers or other persons against any liability/actions/claims (including legal expenses) and the LLC Agreement should set these out expressly.

Certainty of Remedies for Breach of LLC Agreement

Similar to ELPs, the LLC Agreement can set out remedies for breach by members/managers of the LLC Agreement and the common law rule against penalty clauses will not apply.

The LLC law gives specific (non-exhaustive) examples of certain typical remedies.

Clawback from members on Cash Flow Insolvency

A member who receives a distribution or is released from any obligation to the LLC at a time when the LLC is unable to pay its debts as they fall due in the ordinary course of business (**Cash Flow Insolvent**) (including where such distribution/release causes the LLC to be Cash Flow Insolvent) and who has actual knowledge at the time of the distribution/release of this, will be liable to repay the distribution/performance of the relevant obligation which was purportedly released (similar to ELPs).

Unlike in an ELP context, the LLC Agreement may also require a member even without knowledge of the Cash Flow Insolvency at the relevant time to repay the distribution/performance of the obligation.

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Flexible Distribution, Allocation, Contribution and Redemption Provisions

An LLC does not have share capital but issues LLC interests (which can be likened to limited partnership interests in a ELP context) – historic corporate maintenance of capital issues are therefore avoided.

The LLC Agreement is able to contractually set out profit/loss allocation provisions and set out distribution provisions with the LLC being able to adopt partnership-style capital accounts and capital commitments/contractual distribution mechanisms subject only to a cash-flow solvency test (i.e. the LLC being able to pay debts as they fall due in the ordinary course of business).

If the LLC Agreement does not set out the basis for allocation of profits and losses and distributions these will be allocated/made on the basis of the agreed value (as stated in the records of the LLC) of the contributions made by each member to the extent they have been received by the LLC and not returned.

Unless the LLC Agreement provides otherwise, an LLC can acquire by purchase/redemption or otherwise (and for consideration or no consideration) an LLC interest provided that immediately following the acquisition, the LLC is able to pay its debts as they fall due in the ordinary course of business.

Flexible Management

The default provision is that management of the LLC is vested in the members, acting by majority in number.

The LLC Agreement may provide for management in whole or in part by one or more managers and where a person has agreed to become a manager they will have the rights, powers, responsibilities and obligations specified in the LLC Agreement whether or not they are actually a party to the LLC Agreement.

Unless otherwise provided in an LLC Agreement, the members acting by a majority in number or an appointed manager has the authority to bind the LLC.

Managers have a statutory power of delegation - subject to the LLC Agreement providing otherwise.

The LLC Agreement determines the rights and duties of managers/members with respect to the LLC and between themselves.

The LLC Agreement will contain provisions governing the resignation and removal of managers.

Limited Duties for Members/Managers/Board & Committee Members

Managers/members/board & committee members are subject to a statutory duty of good faith (which duty of good faith may be expanded or restricted by the LLC Agreement) – with the LLC Law specifying that no separate duties (including fiduciary duties) shall be owed to the LLC, any member or other person in respect of the LLC unless the LLC Agreement provides expressly to the contrary.

The LLC Law specifically provides (i) a member may act in its own best interests even if it is not in the interests of other member(s) or the LLC (subject to provisions of the LLC Agreement to the contrary) and (ii) a person on a board/committee of an LLC may (if expressly permitted by the LLC Agreement) act in the best interests of a particular member(s) – even if it is not in the best interests of all members or the LLC.

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Managers are fully protected on relying in good faith on the records of the LLC and on opinions/reports/statements/other information prepared or supplied and presented to the LLC by any of its managers/members/officers/employees/committees/professional advisers/any other person, provided the manager reasonably believes such matters are within such persons knowledge/professional or expert competence and the person has been selected with reasonable care by or on behalf of the LLC.

Members/Managers Information Rights

The default member/manager information rights indicated below are subject to limitation pursuant to the LLC Agreement.

Members have the right for any purpose reasonably related to the member's interest as a member of the LLC to:

- True and full information regarding the state of the business and financial condition of the LLC
- The name and address details of each manager
- A copy of the LLC Agreement, Registration Statement, Certificate of Registration and all amendments
- True and full information regarding the amount of cash and a description and statement of the agreed value of any other property/services contributed by such member and which such member has agreed to contribute in the future, and the date on which such member became a member

Each manager also has the right to inspect all the above information for a purpose reasonably related to the position of manager.

Winding-up

An LLC can be wound up:

- Voluntarily
- Compulsory by the Cayman court
- Under court supervision

Voluntary winding up can be commenced in accordance with the LLC Agreement (including following specified events or the expiration of a fixed term) or on the vote or written consent of at least two-thirds of the LLC members (subject to the LLC Agreement providing otherwise).

The Provisions of Part V of the Cayman Companies Law and the Companies Winding Up Rules as applicable to voluntary liquidation apply *mutatis mutandis* (except where inconsistent with the LLC Law).

The LLC Law also contains provisions relating to voluntary winding up where an LLC has no members.

The compulsory liquidations provision closely follow those for exempted companies.

Non-petition clauses, where a petitioner is contractually bound not to present a winding up petition, are statutorily recognized and a Cayman court is bound to dismiss a winding up petition or adjourn a hearing on these grounds.

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Schemes of Arrangement

Schemes of arrangement with members/creditors requiring court approval can be implemented where a majority in number representing seventy-five per cent in value of the creditors or class of creditors, or members or class of members, present and voting at the meeting agree to the relevant scheme, in which case, if sanctioned by the Cayman court, it will be binding on all the creditors/class of creditors/ members/class of members, as applicable, or where an LLC is in the course of being wound up, on the liquidator and contributories of the LLC.

Squeeze-out

Where, within four months of an offer for LLC interests, not less than ninety per cent (or such other threshold as specified in the LLC Agreement) of holders of the affected LLC interests have approved the offer, then the transferee (offeror) can, within two months of the four month period, compulsory purchase the remaining LLC interests (unless a dissenting holder makes an application to the Cayman court within one month of receiving notice of the compulsory acquisition from the transferee and the court determines otherwise).

These statutory squeeze-out provisions may be expressly disapplied in the LLC Agreement – at this point it not entirely clear, based on the current drafting of the LLC Agreement, whether all the provisions must be disapplied or whether partial disapplication is permissible.

These squeeze-out provisions are more flexible than for exempted companies where, for example, the 90% threshold cannot be lowered or raised in the Articles and the statutory squeeze-out provisions cannot be disapplied – potentially making the LLC an interesting vehicle in the context of take-overs.

Mergers and Consolidations

Statutory mergers and consolidations can be effected (subject to the LLC Agreement providing otherwise) between:

- Two or more Cayman LLCs
- LLC with a Cayman exempted company (not being a segregated portfolio company)
- LLC and a foreign entity (provided the foreign entity has separate legal personality)

With the approval of two-thirds majority in number of the members of each constituent LLC (or such lower or higher threshold provided in a particular LLC Agreement); a special resolution of the members of any Cayman exempted company involved (as determined by its articles of association) and any other authorisations required by the LLC Agreement of the LLC/articles of association of the exempted company (together with the requisite authorisations for any foreign entity to comply with its relevant laws).

Parent/Subsidiary mergers of LLCs do not require member approval provided a copy of the plan of merger is given to every member of each subsidiary entity (unless the parent entity agrees otherwise).

[Note – with respect to the wording in parentheses with respect to parent/subsidiary mergers referring to 'parent entity', the corresponding provision for exempted companies in the Companies Law has the term 'member' substituted for 'parent entity' and

appears to indicate that the member can waive the right to receive a copy of the plan of merger (which makes sense) – accordingly the reference to 'parent entity' in the LLC Law may be a drafting error.]

Fixed and floating security interest holder consent is required (may be waived by Cayman court on terms considered appropriate).

Dissenter Rights - A member of a constituent LLC is entitled to such payment in respect of the member dissenting from the merger/consolidation as may be provided for in the constituent LLC's LLC Agreement. If no payment is provided for in the LLC Agreement then the member is entitled to an amount equal to fair value of the member's LLC interest as of the date of the member's dissention, based on a good faith determination of such member's right to share in distributions from the constituent LLC.

The dissenter rights are more specific than their equivalent for exempted companies in the Companies Law which do not provide equivalent provisions for the articles of association to determine payment and do not give details as to the fair value (just stating that a dissenting member shall be entitled to payment of the fair value for his shares).

Continuation In and Out

A foreign entity can apply to be registered/continued in as a LLC.

An LLC can be deregistered as an LLC and registered by way of continuation out as a foreign entity.

Conversion from Exempted Company to LLC

An exempted company may be re-registered as a LLC. Conversion requires a special resolution of the members of the exempted company.

Re-registration as an LLC does not create a new legal entity.

Statutory Records and Registers

An LLC must keep the following LLC registers/records with only the register of managers having to be provided to the Registrar but with specified time limits for changes to be recorded:

- Register of members
- Register of managers
- Register of mortgages and charges (over the LLC's assets)
- Record of Member Distributions and Contributions
- Register of Security Interests (over members' LLC interests)

Accounts

An LLC must keep books of account for a minimum of five years from the date they are prepared and as are necessary to give a true and fair view of the business and financial of the LLC and to explain its transactions.

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This will include the LLC being required to keep material underlying documentation including contracts and invoices with respect to:

- All sums of money received and expended by the LLC and matters in respect of which the receipt and expenditure takes place
- All sales and purchases of goods by the LLC
- The assets and liabilities of the LLC

Tax Undertaking

An LLC is able to apply for a tax undertaking from the government for 50 years which essentially provides certainty for promoters that the current Cayman tax free position (save with respect to applicable, generally nominal stamp duty) will continue with respect to the entity notwithstanding any later changes to Cayman laws.

This note is intended as a high-level review of key features of Cayman LLCs as at the date hereof. Specific legal advice should be sought with respect to any matter.

Collas Crill, July 2016