

GUIDANCE NOTE

LIABILITY IN RESPECT OF OFFERING OF
INTERESTS IN A CAYMAN ISLANDS EXEMPTED
LIMITED PARTNERSHIP



World



Class



Responsiveness

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MEMORANDUM CONCERNING LIABILITY IN RESPECT OF OFFERING OF INTERESTS IN A CAYMAN ISLANDS EXEMPTED LIMITED PARTNERSHIP

INTRODUCTION

This memorandum considers the duties and liabilities under Cayman Islands law in respect of an offering of partnership interests ("**Interests**") in a Cayman Islands exempted limited partnership (the "**ELP**"). However, it should be noted that Section 4(1) of the ELP Law (as Revised) (the "**Partnership Law**") prohibits an ELP from undertaking 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 ELP exterior to the Islands. The public of the Cayman Islands does not include Cayman Islands exempted companies, limited partnerships or trusts. While brief mention is made of the applicable disclosure requirements under the Mutual Funds Law (as Revised) (the "**Funds Law**") the reader is also referred to the firm's detailed memorandum on the subject

CLAIMS BY SUBSCRIBERS AGAINST THE EXEMPTED LIMITED PARTNERSHIP AND OTHERS

This memorandum considers the extent to which subscribers for Interests could claim against the ELP, its general partners (the "**General Partners**") and other parties such as its promoters, its general partners' directors, its auditors, its advisers and its agents.

CLAIMS BY THE EXEMPTED LIMITED PARTNERSHIP AGAINST OTHERS

It should also be noted, that if a subscriber were to be unable successfully to claim against a party direct, he might be able to sue the ELP or the General Partners, with the ELP or the General Partners in turn suing to recover its loss from the relevant party involved, the extent to which the ELP or the General Partners could successfully recover in such circumstances would depend on the relationship between the ELP and the relevant party. (So far as the liability of advisers and agents is concerned, this would depend on the relevant contract establishing the relationship between such persons and the ELP).

This memorandum does not consider the extent to which the ELP may be able successfully to claim against its General Partners' directors, promoters, auditors, advisers or agents.

CONFLICTS OF LAWS ASPECTS

This memorandum considers only the position could be obtained in respect of proceedings before a Cayman Islands court applying Cayman Islands law. It should be noted that proceedings might be brought in another jurisdiction, most probably a jurisdiction from which an applicant subscribed for Interests and in which a copy of the relevant offering document was made available to him.

Liability before the courts of any such jurisdiction or under the laws of any such jurisdiction should be separately investigated.

It should further be noted that proceedings might be brought before a Cayman Islands court, but in which the court would be asked to apply, in accordance with



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Cayman Islands conflicts of laws rules, the laws of some other jurisdiction as the appropriate system of law to the relevant action.

CIVIL LIABILITY

Negligent Misstatement

There may be civil liability in tort (under what is usually termed the rule in *Hedley Byrne v Heller*) for misstatements in the offering document. The terms of the offering document place a duty of care on the ELP, and may be argued to place a duty of care on the General Partner and its officers, the promoters and even professional advisers named or referred to in the offering document (or otherwise responsible for its contents), in favour of persons who subscribe or apply for Interests in the ELP on the faith of the contents of the offering document. Breach of this duty would give rise to a claim against such persons for any loss attributable to statements in those parts of the offering document for which responsibility was expressly or impliedly accepted by such person. Reliance on the offering document would have to be proved by the relevant subscriber.

So far as Cayman Islands conflicts of laws aspects are concerned, it may be more likely that an action for misstatement would ensue before the courts of, or under the laws of, the jurisdiction where the misstatement is actually made.

Fraudulent Misrepresentation

Civil liability in tort may also arise in respect of a fraudulent misstatement of fact (although not a promise, forecast or expression of opinion). "Fraudulent" in this context is widely interpreted to mean made either with knowledge that the statement was false or not caring whether the statement is true or false.

As Cayman Islands conflicts of laws aspects are concerned, it may be more likely that action for fraudulent misstatement would ensue before the courts of, or under the laws of, the Jurisdiction where the misstatement is actually made.

Contracts Law (as Revised)

Under the Contracts Law (as Revised), damages may be recovered for any pre-contractual misrepresentation if liability would have arisen had the representation been fraudulently made, unless the person making the representation proved that he had reasonable grounds to believe and did believe up to the time the contract itself was made that the facts represented were true. In general terms this section gives a statutory right to damages in respect of negligent misstatements. Section 14(2) of the same law permits the court to award damages in lieu of rescission where a misrepresentation has been made.

As a general matter, since the relevant contract is with the ELP itself, the relevant person against whom the subscriber would claim would be the ELP, although the ELP might be able in turn to claim against its General Partners, the promoters or advisers.

So far as Cayman Islands conflicts of laws aspects are concerned, in general questions arising concerning a contract are governed by its proper or governing law. However, it is possible that a different system of law could be applied to questions of damages for representations made to induce someone to enter into a contract. In this regard, it is possible that a Cayman Islands court would seek to apply the same system of law to damages for contractual misrepresentations as to damages for negligent misstatements, given the similarities between the two types of claim.



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Action for Deceit

An aggrieved investor may, by bringing an action for deceit (a civil claim in tort rather than contract), obtain damages for deceit if it can be shown that:

- (a) a material misstatement was made fraudulently; and
- (b) he was induced to subscribe for Interests as a result of such a misstatement.

"Fraudulently" means made either with knowledge that the statement was false or not caring whether the statement was true or false. It is not necessary to show either an intent to defraud or that the fraudulent statement was the sole cause which induced the investor to take up the Interests.

The omission of information can amount to a false statement if there is some active misstatement of fact or such a partial and fragmentary statement of fact as to render what is stated false or misleading by reason of the failure to include the omitted information.

If a statement is true at the time it is made, but becomes untrue before the acceptance of the application for Interests becomes unconditional, it may still give rise to an action for deceit, as it would be fraudulent to permit applications for Interests without clearly pointing out the mistake.

Although expressions of opinion and expectation, as opposed to statements of fact, would not give rise to liability under this particular head, language may be used in such a way as to become a representation of existing fact which, if erroneous, would amount to a misrepresentation.

So far as Cayman Islands conflicts of laws aspects are concerned, it would seem that the same rules apply as for fraudulent misstatement (see above).

Contractual Liability

The offering document will also form the basis of a contract between the ELP and the successful applicants for Interests. If it is inaccurate or misleading, applicants may be able to rescind the contract and/or sue the ELP and/or the General Partners and/or the promoters for damages.

As a general matter, since the relevant contract is with the ELP itself, the relevant person against whom the subscriber would claim would be the ELP, although the ELP might be able in turn to claim against its directors, promoters or advisers.

So far as Cayman Islands conflicts of laws aspects are concerned, these questions would be determined according to the governing law of the contract for subscription. Where there is an express choice of Cayman Islands law as the governing law this is likely to be conclusive to determine the governing law. Where the documentation makes no express choice of governing law at all, it is likely that a Cayman Islands court would still consider Cayman Islands law as the governing law, since the offer or is established in the Cayman Islands and the subject matter of the contract is Interests in a Cayman Islands ELP.

Secret Profits and Conflict of Interest

It is a cardinal principle of Cayman Islands law and equity that no one representing an ELP may profit from any transaction between the ELP and a



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third party except insofar as the same has been specifically authorised by the ELP. Any profit so made but not so authorised will belong to the ELP.

Accordingly, it is essential that all fees and profits to be made by General Partners, agents, managers etc. be specifically disclosed to and authorised by the ELP. (Normally, provision for such authorisation is expressly made in the limited partnership agreement.) Having been disclosed to the ELP, and clearly being relevant to its business, all such fees and profits should be disclosed in the offering document to prevent any allegation of misrepresentation.

This is particularly important where directors and officers of the General Partners are also directors, officers and/or shareholders of a party contracting with the ELP (usually the manager or investment adviser). In such a case, if fees and profits are not properly disclosed, a limited partner may have a right of action against the ELP, with the ELP counterclaiming against the General Partners personally for breaching their duties to administer the ELP and perform its obligations in good faith and with reasonable care and skill.

The right to rescission may be lost where the ELP is wound up or is insolvent or on equitable grounds, e.g. delay or where the shareholder has taken action which is inconsistent with rescission, such as accepting dividends or attempting to sell the Interests.

CRIMINAL LIABILITY

There may also be a risk of criminal liability:

Section 249 of The Penal Code (as Revised)

Where an officer of an ELP (or person purporting to act as such) with intent to deceive members or creditors (which may include subscribers) of the ELP about its affairs, publishes or concurs in publishing a written statement or account which to his knowledge is or may be misleading, false or deceptive in a material particular, he is guilty of an offence and is liable to imprisonment for seven years.

Sections 241 and 242 of The Penal Code (as Revised)

Any person who by any deception dishonestly obtains for himself or another any pecuniary advantage is guilty of an offence and is liable to imprisonment for five years.

Any person who dishonestly obtains property belonging to another, with intention of permanently depriving the other of it is guilty of an offence and is liable to imprisonment for ten years. For these purposes a person is treated as obtaining property if he obtains ownership, possession or control of it, and "obtain" includes obtaining for another or enabling another to obtain or retain.

For the purposes of both sections "deception" means any deception (whether reckless or deliberate) by words or conduct as to fact or as to law, including a deception as to the present intentions of the person using the deception or any other person.



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THE MUTUAL FUNDS LAW

The definition of a mutual fund excludes an ELP issuing only Interests that are not liable to redemption or repurchase at the investor's option. The Funds Law therefore does not apply to what are usually termed "closed-end" funds.

Filing of Offering Document

Under Section 4(1) of the Funds Law a mutual fund must not carry on or attempt to carry on business in or from the Islands unless, inter alia, it is the holder of a mutual fund licence and it has a registered office in the Cayman Islands (or if a unit trust, a licenced trust company as its trustee) and a licensed mutual fund administrator is providing its principal office in the Cayman Islands; and

The statutory definition of "offering document" is:

"a document or series of documents on the basis of which:

- (a) equity interests in the mutual fund are offered for sale; or*
- (b) persons are invited to subscribe for or purchase equity interests in the mutual fund, but does not include any other notice, circular, advertisement, letter or other communication used in connection with the offer for sale of any equity interest in the mutual fund or the invitation to any person to subscribe for or purchase any equity interest in the mutual fund if before the offer, or invitation is taken up or accepted the prospective investor is given the opportunity to consider an offering document containing the information prescribed by Section 4(6) of the Funds Law (i.e. A discription of equity interests and such other information as is necessary to enable prospective investors to make an informed decision as to whether or not to subscribe for or purchase the equity Investment)".*

Exceptions

This filing requirement (under Section 4(1)) does not apply where:

- an exemption from the requirement has been granted by CIMA; or
- the mutual fund is one in which the equity interests are held by not more than 15 investors the majority of whom are capable of appointing or removing the "operator" of the fund; or

the mutual fund is one in which:

- (a) the minimum aggregate equity interest purchaseable by a prospective investor is US\$100,000 (or equivalent in any other currency); or
- (b) the equity interests are listed on a stock exchange (including an over-the-counter market) specified by CIMA by notice in the Gazette, and it is registered with CIMA, and the annual registration fee has been complied with, and there is filed with CIMA the "prescribed details" in respect of the mutual fund's



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current offering document (unless an exemption from this requirement has itself been granted by CIMA.

Continuous Offering

If there is a continuing offering of Interests, the filing requirement under Section 4(l) of the Funds Law has not been complied with if "any promoter or operator of the mutual fund:

is aware of any change that materially affects any information in the offering document filed with CIMA or in the prescribed details of the offering document filed with CIMA; and

has not, within 21 days of becoming so aware, filed with CIMA an amended offering document or amended prescribed details, as the case may be, incorporating that change."

Penalty

The operator (which in the case of an ELP, means the General Partner) of a mutual fund operating in breach of Section 4(1) of the Funds Law is liable to a fine.

Meaning of Promoter

The statutory definition of "promoter" is "*any person whether within or without the Cayman Islands who causes the preparation or distribution of an offering document in respect of the mutual fund or proposed mutual fund but does not include a professional adviser acting for or on behalf of such a person*".

Misrepresentation as a mutual fund

Any person, other than a mutual fund falling within the exceptions (b) and (c) above and a mutual fund duly licensed and administered in accordance with Section 4(1) of the Funds Law, who represents that he is carrying on or attempting to carry on business in or from the Islands as a mutual fund is liable to a fine.

Powers of the CIMA

The Funds Law confers various statutory powers on CIMA to obtain information from promoters or operators relating to mutual funds, to seek certain court orders, and to take certain other actions. (For more detail, the reader is referred to the Funds Law itself and to the firm's separate memorandum on it.)



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This publication is for general guidance and is not intended to be a substitute for specific legal advice. Specialist advice should be sought about specific circumstances. If you would like further information please contact:

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