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Why so Seri(e)ous? Cayman Series Partnerships in Fund Finance Transactions

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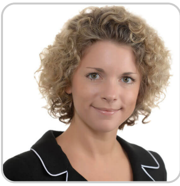

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Funds make use of series partnerships across jurisdictions to allow for segregation of partnership interests, assets, distributions and operations into separate series or classes[1]. A particular quirk of Cayman series partnerships ("CSP"), however, is that they are not statutory entities[2] and instead exist solely as a matter of contract. It is therefore important for lenders to understand how this structure differs from statutory series vehicles and how this might impact a financing.

An overview of Cayman Series Partnerships

The purely contractual arrangement of a CSP means that the segregation of assets and/or liabilities of different series of interests arises solely pursuant to the terms of the limited partnership agreement ("LPA"). As the series structure is contractual, it is effective as between the partners. It is not, however, effective in relation to third parties (such as creditors) in the absence of limited recourse language limiting the recourse of such third parties to the assets relevant to a particular series.

As with all series or segregated portfolio vehicles, the separation of the series interests can be fairly limited (*e.g.,* relating only to how distributions are calculated as between series), or can impact a much wider range of the financials and day-to-day operations of the CSP (*e.g.,* where only certain series are permitted to borrow or grant security) and this will ultimately be dictated by the commercial rationale for establishing the fund as a CSP. It follows that CSPs in finance transactions can be very straightforward and make minimal difference to the usual financing approaches or, at the other extreme, they can be fairly complicated and nuanced, requiring certain bespoke amendments to the facility documentation that needs to be approached on a case-by-case basis.

Lender considerations in relation to CSPs as obligors

A lender will need to confirm the following points when entering into a financing involving a CSP obligor:

- whether the CSP is entering into the transaction (i) for the general account of the CSP, which will usually make the analysis fairly straightforward, or (ii) on behalf of specific series, in which case it can get more complicated;
- where the transaction is being entered into on behalf of individual series, whether every series is participating in the transaction (*i.e.*, borrowing and/or granting security), or only certain series; and
- whether it is anticipated that the CSP will have different third-party creditors at a later date, potentially to other series of the CSP.

If there will be subsequent creditors to different series, secured parties will need to be focused on steps relating to perfection and priority, to minimize any risk of issues arising if a subsequent lender does not have adequate notice of the series structure and ring-fencing of assets. It is worth noting that under Cayman Islands law, a secured creditor can generally enforce security without the need for court involvement (even if the security provider is subject to insolvency proceedings) so assuming that security has been properly taken and perfected, enforcement against the assets of specific series of a CSP should not present an issue for a lender.

Lenders will also need to consider the recourse arrangements outside of the strict security package analysis. In a subscription facility, for example, although the capital commitments are looked to as the primary source of repayment, the loans are generally still fully recourse to the assets of the fund generally, so lenders will need to consider how recourse to a series and general CSP assets is to be dealt with beyond the capital commitments analysis.

Additional lender protections for CSP financings

In connection with documenting a facility with a CSP, secured parties should consider whether series-specific restrictions are appropriate. It is not unusual to include ongoing representations as to various statements of fact relating to the operating of the series to address additional lender risks related to a CSP. We often see a representation confirming that the general partner has taken all actions necessary to create and maintain the applicable series, and that any creditor in respect of liabilities attributable to any other series shall not have recourse in respect of those debts to the assets of the current series.

Additional covenants are often included as well, for example, a requirement for the general partner to ensure that (i) assets and liabilities are not transferred between different series, and (ii) any creditor in respect of liabilities attributable either to any other series or to the general account of the CSP shall be on notice that they do not have recourse in respect of those debts to the assets of the current series. There may also be restrictions in relation to the creation of new series.

LPA diligence involving CSPs

Lenders will need to closely review the LPA to confirm how the CSP's series structure works to ensure that the LPA actually segregates assets and accounts in a way that is consistent with (i) the commercial intention of the parties, and (ii) the proposed financing and security arrangements. Some LPAs may include limitations as to whether a CSP can only borrow on a series-by-series basis, or prohibit borrowing on a joint and several bases as between series, which can impact how the borrowing base is established and how the financing is structured.

Winding up considerations

The LPA for a CSP may include a process for winding up a specific series, and such provisions are often included for consistency with the U.S.-fund documents. As CSPs are not creatures of statute, parties should properly consider the consequences of a proposed winding up of a particular series. Care needs to be taken in drafting and consideration given to whether these provisions would be recognized by Cayman courts, given the lack of statutory segregation, particularly when these terms are to align provisions of a wider fund structure.

Lender considerations in relation to CSPs as pledged entities

Additional considerations arise again when the CSP itself is the pledged entity. Given that there is no statutory segregation of assets for a CSP, in the event of insolvency, the assets of a specific series will not be ring-fenced and will form part of the CSP's general assets. This is an important factor to consider when a lender has taken security over an LP interest that is assigned to a particular series, as ultimately the value assigned to such a series could be significantly adjusted if the contractual series structure collapses.

Conclusion

The use of a CSP can offer benefits to investors, but lenders and secured creditors need to be conscious of the limitations of these structures as a matter of Cayman law, given the lack of statutory recognition.

[1] Referred to as “series” for the purpose of this article.

[2] Unlike, for example, a Delaware series LLC or series partnership, or a Cayman segregated portfolio company.