

YOU GOTTA HAVE (GOOD) FAITH

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OF WALKERS, PROVIDE THEIR VIEW ON ALL ASPECTS OF ACTING IN GOOD
FAITH UNDER THE CAYMAN ISLANDS LLC LAW

The Limited Liability Company (LLC) in the Cayman Islands has proven to be a popular vehicle from the outset. One of the key selling points of the LLC is the ability for clients to mirror the terms of their onshore vehicles and structures; and for that reason, the Limited Liability Companies Law (the Cayman LLC Law) has been closely modelled on the Delaware vehicle of the same name. However, in response to our discussions with users of the Delaware product, the Cayman model has one key departure: it offers contracting parties a greater degree of flexibility and certainty when considering the duties owed by members to one another.

The Cayman Islands legislation did not import the implied covenant of good faith and fair dealing, which we understand is the only duty that cannot be waived, modified or eliminated in a Delaware LLC agreement. The resulting ability to expressly define the duties applicable to the parties to an LLC agreement entirely within that document affords the contracting parties, who are typically sophisticated and experienced, the flexibility to negotiate their agreement with the certainty that its terms will be considered entirely within the four corners of the contract. The uncertainty inherent in the implied covenant of good faith and fair dealing, with the potential that exists under Delaware law for an exercise of judicial discretion in a way that may run counter to the true intention of the parties, is avoided.

Under the Cayman LLC Law, the duty to act in good faith in respect of the rights, authorities or obligations which are exercised or performed, may be expressly expanded or restricted by the provisions of the LLC

agreement. Ultimately, this means that the parties to the contract can decide for themselves what standard of duty will apply. This freedom of contract in relation to good faith departs not only from the LLC's Delaware counterpart, but also from its Cayman Islands statutory siblings: primarily the exempted company and the exempted limited partnership. Directors of exempted companies must

to avoid a patchwork of differing applicable fiduciary duties. In a joint venture context, it may mean that by agreeing to eliminate any fiduciary duties that co-investors might owe to each other, they are agreeing simply to limit their remedies to contractual breaches. Where a joint venture vehicle is downstream in a fund structure, this may be helpful in ensuring that a manager is able to discharge the duties it has to act in the best interests of its own investors without also being a fiduciary for third-party co-investors.

What does it mean to expand or restrict the duty of good faith? In terms of expansion, the standard can be raised to whatever level the parties desire by inserting additional duties into the LLC agreement, or by importing law or regulation from other jurisdictions, all of which is relatively straightforward. More complex is understanding how the duty to act in good faith might be restricted. In order to do this, we must first understand what the duty comprises.

Given the recent introduction of the law, there is not yet any specific judicial precedent on the subject. However, case law in relation to the duty of good faith in the context of company directors provides a useful indicator of its meaning. Such case law suggests that, in addition to honesty, which is at the core of good faith, there is also an element of "rationality" or "reasonableness" (being an act which is not perverse and irrational or an honest belief that is, to some degree, founded). There are a number of possibilities when regarding what it might mean to restrict this duty: in particular, it may be possible to restrict the duty of good faith completely, or restrict it in part (e.g. just the 'rationality' limb). It is also possible, given the relatively



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act in good faith in what they consider to be in the best interests of the company. General partners of Cayman Islands exempted limited partnerships must act in good faith and, subject to any express provisions of the partnership agreement to the contrary, in the interests of the partnership. This difference has real consequences for those wanting to utilise the LLC as a joint venture vehicle, general partner entity or as any of the many other solutions it offers. For some, it may simply be that they want, contractually, to adopt the Delaware standard of good faith and fair dealing for both consistency and familiarity.

For others, it may be setting another standard with which they wish to comply – perhaps where a party is already subject to a specific standard by a regulatory body and wishes



binary nature of the good faith obligation, that “reduce or restrict” may simply mean the same as “eliminate”: not to be permissive of bad faith, but in order to limit disputes to questions of contractual breach.

It is possible that the Cayman courts might determine that honesty is an “irreducible core” at the heart of good faith that cannot be eliminated. If that were to be the case, then the restriction on the duty of good faith might only apply to the ability to limit the rationality or reasonableness component of the duty. It is also possible that the Cayman courts might determine that the restriction relates to the scope of the obligations to which the duty applies – obligations which the parties actually contract to have, and to those people the obligations are actually owed to, rather than any reduction in the standard of the duty itself. Whatever the interpretation, it would no doubt be prudent to expressly set out in the agreement any specific actions or rights which are intended to be available to the parties, on the basis that where the agreement gives the parties clear rights, the other parties to the agreement might be more likely to be stopped from claiming that the right-holder has breached their duty of good

faith, simply because they exercised a right they are granted under the agreement. Until the position has been determined, it may be wise to state that any significant restriction on the default duty of good faith be made subject to “the maximum extent permitted by the Cayman LLC Law.”

While these are still early days – in terms of practical application and judicial interpretation – it is clear that the issues surrounding where to draw the boundaries in respect of the parties’ obligations to each other are critical. The subject will be at the forefront of the minds of those contracting, whether they are in an investor/manager relationship or joint venture partnership relationship. The drafting of the Cayman LLC Law strikes a balance between providing a default standard applicable where the agreement is silent, and providing the parties to an LLC agreement with the full power to agree between them the duties by which they will be bound and the remedies that will be afforded for purported breach. Where the circumstances call for it, the freedom to set out unambiguously the obligations of the parties within the four corners of the agreement has already proven invaluable. +



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