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Investment Funds

CorporateLiveWire

January/February 2013

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The Cases for Change: Is it time to amend the Limited Partnerships Act 1907?

By Jeremy Elmore

The United Kingdom limited partnership remains the market standard structure for on-shore private equity and venture capital funds, as well as on-shore funds investing in many other sectors. However, the simple fact it that the legislation governing UK limited partnerships, the Limited Partnerships Act 1907 (the "Act"), is over 100 years old and lacks the degree of sophistication required to comprehensively address certain of the issues which are faced by modern investment vehicles. The Department of Business, Enterprise and Regulatory Reform consulted in 2008 on proposed developments to the Act and, whilst certain helpful changes were subsequently made regarding certainty of registration, many of the more challenging proposals unfortunately found their way into the long grass.

This issue is brought sharply into focus by the fact that many other jurisdictions, including Guernsey, Jersey and, most recently, Luxembourg have enacted laws which provide many of the features contemplated by the DBERR consultation and enhance the suitability of the limited partnership in those jurisdictions as a vehicle for the structuring of alternative investment funds. It is therefore arguable that the UK is at a competitive disadvantage in this regard.

Two cases over the last 12 months provide clear examples of circumstances in which certain features of the UK limited partnership were considered by the courts and the inherent uncertainties in the legislation exposed. The findings of the court are likely to have come as something of a surprise to both the GP and LP communities and, on balance, both sides may feel that their position has been somewhat prejudiced.

The Inversiones case (Inversiones Frieira SL and another v. Colyzeo Investors II LP and another – May 2012) considered the level of information an LP is entitled to obtain in relation to a partnership and its underlying investments. The judgment reveals that the potential scope of the information open to inspection as the "partnership books and records" can extend significantly beyond the standard contractual financial reporting obligations (as set out in the LPA and the standards the GP would expect to apply) to operational documents of the limited partnership and, potentially, its investment holding vehicles.

The Inversiones case was brought by two affiliated investors in a European private equity real estate fund who were seeking an order for the GP to make available a vast amount of documentation relating to under-performing investments and their financing structures. The GP contested this went well beyond the scope of what an LP was entitled to review.

In addition to any contractual rights granted to LPs under the terms of the LPA, the court considered an LP's statutory right "to inspect the books of the firm and examine into the state and prospects of the partnership business" under the Act. This right is specifically framed by what is necessary for the purpose of allowing an LP to examine the state and prospects of the partnership in which they have invested. However, historically neither GPs nor LPs extensively considered the statutory entitlement on the basis that reporting obligations are generally contained in the LPA and it has been assumed that these are the standards with which a GP needs to comply.

While the extent of the "books of the Partnership" which are open to this right of inspection will vary on a case to case basis, the judge in the Inversiones case stated that: "if it would be necessary or advantageous for the GP or its delegate to rely on a document to establish rights as against a third party or to determine rights as between the members of the partnership themselves, then the document should be available for inspection by the LPs".

This could potentially mean that, as well as the internal records of the partnership, a wide range of documents such as valuation reports and funding documents of a partnership will in principle be open for inspection. In addition, the judge indicated that if the GP or its delegate had obtained and held documents between third parties and such documents were significant for the partnership, they may also be regarded as part of the partnership books and records. This would mean funding, operational and other transactional documents of underlying investment-level SPVs examined by the GP may also form part of the partnership books.

Whilst an LP's right to inspect partnership books will always have to be balanced alongside the fiduciary duties of the GP and the contractual confidentiality provisions by which the partnership may be bound, the Inversiones decision does indicate a willingness on the part of the court to extend a GP's disclosure obligation well beyond that which it has contractually negotiated. Transparency is something which should be applauded and something which has been central to recent regulatory change and developments in operating practice – however, the Inversiones case does serve as a timely reminder to GPs of the importance of agreeing appropriate investor reporting and confidentiality provisions with limited partners and determining the extent to which certain documentation should be retained at the SPV level.

A more difficult case for the limited partner community was the Henderson case (Certain Limited Partners in Henderson PFI Secondary Fund II LLP (A Firm) v. (1) Henderson PFI Secondary Fund II LLP (A Firm) (2) Henderson Equity Partners Limited (3) Henderson Equity Partners (GP) Ltd – November 2012).

In the case, a number of investors in an infrastructure fund claimed that the manager had used fund commitments to acquire a project management company which included substantial assets falling outside the scope of the fund's investment policy. LPs claimed that the allocation of assets and liabilities to the fund was therefore unauthorised.

The key lesson in the context of the interpretation of the Act was the consideration by the court as to whether LPs could bring an action against both the GP and the manager for breach of contract or misrepresentation. The court determined that while a general partner can be sued by any limited partner in respect of liabilities under its governing LPA (without such actions constituting management of the partnership business), any claim against a separate manager is a 'partnership asset' and therefore must be brought by the GP, in the name of the partnership.

If LPs pursued a claim against the manager, they would be standing in place of the GP, and would forfeit their limited liability for the period during which such claims were pursued, as this would constitute taking part in the management of the partnership business.

In terms of general principles, the judgment indicates that as soon as there is participation in the decision-making process by requiring notice of individual decisions and commenting upon operational business decisions taken by the general partner, a limited partner will be 'involved in management'. Legislation in many other jurisdictions provides a number of (non-exhaustive) safe-harbours for activities which may be taken by LPs without prejudicing their limited liability and thus potentially avoids the issue which arose in the Henderson case.

There is no doubt that the Act is ripe for review to ensure the UK maintains a suite of competitive and balanced limited partnership legislation. It can only be hoped that these recent cases highlight the importance of this issue and serve to raise it up the agenda of the UK government, as well as both the GP and LP communities.

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