

Limited Partnerships and Private Equity

Alexander R. Corrie

The concept of the limited partnership is not entirely new to Jamaica, as legislation has provided for the creation of these entities for over 150 years. However, the *Partnerships (Limited) Act, 1853* has been found wanting in a number of key respects, particularly as it relates to the necessities and intricacies of the modern commercial landscape. The newly enacted *Partnership (Limited) Act, 2017* has introduced a new regime, which includes several novel forms of limited partnerships as well as a more defined set of rules which govern their formation and operation. Many of these rules facilitate the effective utilization of the limited partnership as an investment vehicle.

For many years, the limited liability company has been the vehicle of choice for most entrepreneurs seeking to operate businesses, as well as for many investors using that structure to acquire, hold and sell assets. This is due in no small part to liability protection, separate legal personality and other benefits afforded to shareholders under the company law regime. In contrast, the suitability and effectiveness of a traditional partnership as an investment vehicle is limited, as each individual partner potentially faces unlimited personal liability for the debts of the partnership.

Unlike traditional partnerships, which are comprised simply of partners, a limited partnership consists of general partners and limited partners, and there must be at least one person in each category. There is a clear delineation between these roles, whereby general partners are responsible for the firm's management, while limited partners are forbidden from taking part in the management of the partnership business and do not have the power to bind the firm. As a rule, general partners are subject to unlimited liability for the debts and obligations of the partnership. The role of the limited partner is primarily that of a passive investor, providing contributions of capital with a view to eventually reaping returns on his investment. Limited partners, not unlike shareholders in a company, will not face any liability in excess of the amounts they have invested. However, a limited partner will lose his limited liability status if he takes part in the management of the partnership.

The law now provides for the creation of limited partnerships with separate legal personality and perpetual succession, as well as limited partnerships which are one and the same as their partners without perpetual succession. The focus of this article will be on those of the former variety. In Jamaica, these are the Limited Partnership Entity (LPE) and the Limited Liability Limited Partnership (LLLP).

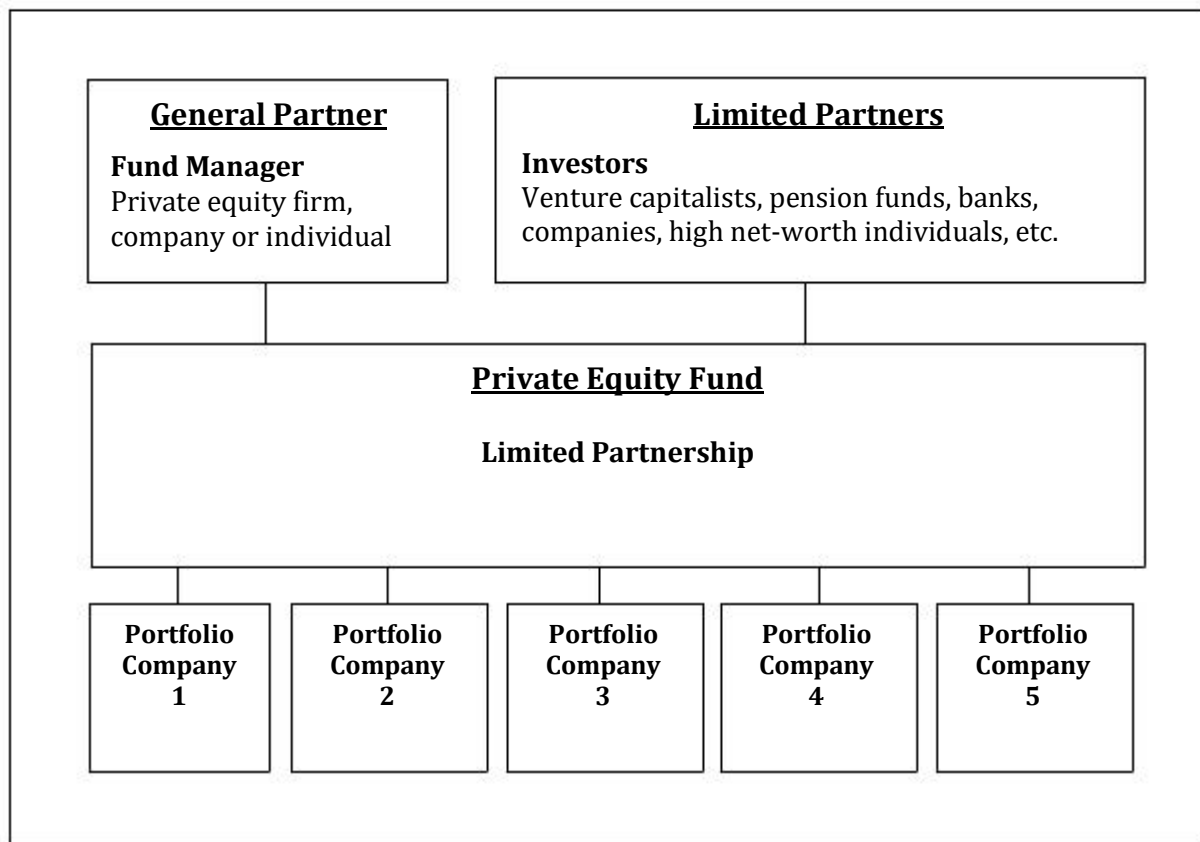
- LPE
The partners' potential exposure to liability for partnership debts under a LPE is as outlined above: general partners will be liable for the debts of the partnership while limited partners have limited liability protection.
- LLLP
This is a relatively new form of limited partnership that is increasingly achieving global recognition. It largely possesses the same characteristics as the LPE, with one critical distinction: its general partners' liability for its debts and obligations is limited to their respective capital contributions. Therefore, the general partners of a LLLP will enjoy the same level of liability protection as the limited partners. Despite this, the general partners still maintain sole responsibility for the management of the partnership to the exclusion of the limited partners.

The limited partnership structure may be used by entrepreneurs to actively operate businesses, however they are most commonly utilized as vehicles for private equity investments. Private equity funds are typically formed to raise capital for investment in privately held companies,

with an intention for the stakes in those companies to appreciate and eventually be sold for a profit. Private equity funds established in the U.S., the U.K. and other jurisdictions have traditionally utilized the limited partnership as their vehicle of choice, despite the fact that other forms of organizations could be used to structure their operations.

The use of the limited partnership structure may facilitate the investment of capital without dilution of the direction and control of the venture. In many cases, a limited partnership may also be more flexible than a limited company with respect to the allocation of profits, as in a company this is generally dependent on the rights attached to its shares. In a limited partnership, these arrangements are defined by the terms of the limited partnership agreement, which constitutes and governs the limited partnership.

The organizational structure of a basic private equity fund formed as a limited partnership is shown below:



The general partner bears responsibility for controlling the fund and its operations, making decisions regarding its investments and, ultimately, its success. It is normally compensated by way of management fees and other fees and allocations based on the fund's performance. There is typically only one general partner, which in many cases is a private equity firm. It is advisable for the general partners of a limited partnership to take the form of a company or another corporate entity in order to gain liability protection. However, the use of the LLLP structure would negate the necessity for this, due to the limited liability status accorded to its general partners.

As indicated previously, the management of partnership business remains within the authority of the general partner. Notably, however, there are some acts that are explicitly excluded from the scope of 'management of partnership business'. These include participating in decisions regarding the partnership's investments, the transfer of all its assets or the removal of a general partner. These exceptions therefore provide limited partners with an additional safeguard, as

the law permits them to have a say in certain acts and processes of the partnership that could directly and significantly affect the health of their investments, without losing their limited liability status.

The limited partnership agreement will set out provisions such as the term of the partnership, its aims, initial capital contribution or commitment requirements, calls for capital, the rights and restrictions of both types of partners, profit allocations, distributions and the winding up of the partnership. Limited partnerships utilized in this manner will typically continue for a fixed term, with the period being dependent on the investment strategy employed and the assets being targeted. There may be distributions throughout the continuance of the partnership in addition to a final distribution upon the realization of the assets held by it at the end of its life.

Limited partnership interests in a private equity fund are, in many cases, intended to be long-term investments, and are largely illiquid. As such, the capital contributions made by limited partners may be difficult to recover before a major profit distribution or the winding up of the partnership, depending on the terms of the limited partnership agreement. Therefore, the limited partners of most private equity funds tend to be persons and entities that are able to have large amounts of capital invested without receiving returns on their investments for long periods of time, including venture capitalists, high net-worth individuals, pension funds, investment firms, holding companies, insurance companies, banks and other institutional investors, as well as other investment funds.

The limited partnership structure may also be utilized for private investment funds created among families and business associates. When it is used in this manner, a person with the financial nous required for the fund to thrive may be appointed as general partner, as opposed to an external firm or company. The use of an LLLP structure would afford liability protection to that person without the need for the incorporation of a separate entity. Further, although private equity has been highlighted, the structure may be used equally as effectively for investment funds comprised of investments in real estate, publicly traded stock, bonds and alternative assets.

There are additional factors beyond the scope of this article which must be taken into account in determining the most appropriate legal entity to be employed for a given investment plan. However, firms and investors of all types should seriously consider the potential benefits of utilizing the limited partnership structure for a collective investment venture.