

Incorporated Cell and Protected Cell Companies in Jersey

Introduction

The new Part 18D of the Companies (Jersey) Law 1991 (the '**Law**') has introduced the concept of cell companies into Jersey. The legislation was passed by the States on 21 July 2005 and is expected to come into force about the end of 2005. The legislation has been drafted taking into account lessons from other jurisdictions, in particular Guernsey. Two types of cell companies are introduced: the Incorporated Cell Company ("**ICC**") and the Protected Cell Company ("**PCC**").

This briefing is intended to provide a general guide as to when cell companies can be used and the issues to be considered when incorporating a cell company. Specific advice should be sought to ensure that any cell company complies with the Law.

ICCs	PCCs
New concept	Similar to protected cell structures or segregated cell companies elsewhere
Cell is separate company	Cell is required to be treated as though a separate company
Liability limited by structure (separate legal personality)	Liability limited by procedural rules. Provisions preventing cellular creditors claiming non-cellular assets provide enhanced protection compared with non-Jersey structures
Can convert to PCC or to general company	Can convert to IC or general company
Cell has power to contract because of separate legal personality	Special provisions allow the cell to contract
Cell is separate legal entity. Claims limited as matter of law to assets of that cell	Directors obliged to properly separate cellular assets and to notify and record when contracting for cell

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What are cell companies and when are they used?

A cell company is a company which has the ability to create one or more cells within the company which have distinct assets and liabilities. These cells will be used to carry out separate and distinct businesses.

Provision can be made for cells to be dissolved or wound up in certain events. Each cell will have a separate memorandum and articles and its own members, with members of the company not necessarily being members of the cell. Although a cell may not own shares in its cell company, a cell can hold shares in other cells of the same cell company unless the articles specifically provide otherwise. A cell company can be a public or private company, a par value or no par value company, a guarantee company, and can be a limited or an unlimited company.

Historically, the concept of a cell company was formulated for use in relation to umbrella investment funds and to assist in the management of investment pools supporting identified lines of insurance business.

It is expected that the use of Jersey cell companies will be restricted to a wide range of financial service companies and activities.

What is the difference between an ICC and a PCC?

Under the Law, the principal difference between an ICC and a PCC is that an incorporated cell of an ICC is a company whereas a protected cell of a PCC is to be treated as a company but is not a body corporate and has no separate legal identity. The Law provides that, irrespective of the provisions of Article 2 of the Law, a cell is not a subsidiary or wholly owned subsidiary of a cell company. Because a protected cell (“PC”) is not a separate entity, the Law has made special provisions enabling PCs to enter into agreements and to have their assets protected from creditor claims.

Why have ICCs been introduced?

The introduction of the new concept of the incorporated cell (“IC”) reflects concerns which have been voiced in relation to ‘traditional’ protected cell structures established in other jurisdictions. Concerns have been raised that traditional protected cell structures do not provide adequate asset protection where there is a heightened risk of cross default across cells because of a disparity in risk profile between cells or ultimate performance of the business being conducted by the different cells. A second major concern in relation to traditional protected cell structures is that not all jurisdictions will necessarily recognise and enforce provisions in relation to protected cell structures which direct the segregation of the pools of assets attributable to the different cells and provide for the appropriation of those specific pools to satisfy the cellular liabilities because these may be viewed as procedural rules only which a foreign court may be less likely to uphold as a matter of international law.

The incorporated cell company, however, whilst providing the same range of simplified management benefits, also creates each cell as a separately incorporated Jersey company. This is a substantive provision of the Law which will be recognised by foreign courts in the same way as the limited liability of traditional stand-alone companies. In this way an umbrella structure can still offer the full range of limited liability protections available under the Law at the level of the cell.

How do you create a cell company?

Article 3I provides that the memorandum of a company must state if it is an ICC or a PCC and this will be indicated on its certificate of incorporation. The company name must include either the identifying words (or initials) “Incorporated Cell Company” (“ICC”) or “Protected Cell Company” (“PCC”), as applicable.

Cells are created by special resolutions which must assign a distinctive name to the cell distinguishing it from other cells and which must include the words (or initials) “Incorporated Cell” (“IC”) or “Protected Cell” (“PC”), as appropriate.

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What has to be included in a special resolution creating a cell?

The special resolution must specify the terms of the memorandum and articles of the cell and may provide for the dissolution or winding up of the cell in various events such as bankruptcy, resignation of members, the expiry of a fixed period of time or for other specified reasons.

The cell company must file the special resolution and the cell is created under the Law when the registrar issues a certificate of incorporation (for an IC) or a certificate of recognition (for a PC). The cell must have the same directors, secretary and registered office as the cell company.

The special resolution creating the cell must include the information required in relation to a memorandum of non-cellular companies. Article 127YB provides that when filed the special resolution has effect as if it were a memorandum of association.

Control of cell company boards

When PCCs or ICCs are to be used to structure a public fund, it should be noted that, as a result of the requirement that all cells will share the same board as the cell company, the investors will not have the ability to change the composition of the board. An appropriate level of investor control will, however, remain available either through a resolution directing the board to deal with the business of the cell in a particular way or, ultimately, through the ability to resolve to move the cell either to an independent existence with a board appointed freely by the investors or to move the cell to be dependent upon another cell company under the control of a selected replacement management group.

Accounting and annual return requirements

Articles 127YD – 127YG make provisions in respect of registers of members, annual returns, accounting records for cells and accounts of cell companies. These impose obligations on the cell company to keep separate records of members of cells and to include information required for an annual return of a company in respect of each cell in the cell company's annual return.

Critically, these Articles also impose obligations to keep accounting records in relation to each cell sufficient to show the cell's transactions and to disclose the financial position of the cell and to enable the directors to ensure that the cell company's accounts comply with the Law. The cell company's and the cells' accounts must show the position in respect of each cell. As will be seen below, the ability to separately identify cellular assets is critical to the concept of creditor protection in PCCs and the accounting records will clearly be of some importance in this process.

Transfers of cells

Article 127YI provides for the transfer of a cell of a cell company to another cell company. Cells of ICCs can be transferred to PCCs and vice versa. To transfer a cell there must be a written transfer agreement between the cell companies and the transfer must be approved by the directors of both cell companies and approved by special resolution of the cell company receiving the cell.

In addition, the transfer agreement must be:

- authorised by a special resolution of the cell company transferring the cell and sanctioned by the Court as an arrangement under Article 125; or
- consented to by all the members and creditors of the cell or, if agreement of all creditors is not possible, authorised by special resolution of the cell and sanctioned by the Court which must be satisfied that no creditor of the cell will be materially prejudiced by the transfer.

The cell company receiving the cell must file its special resolution approving the transfer within 21 days of approval of the transfer agreement together with copies of the transfer agreement, any new articles of the cell being transferred and a declaration by each of the directors of the cell company transferring the cell of the belief on reasonable grounds that the cell is able to discharge its liabilities as they fall due, that no creditors of the cell company transferring the cell will be unfairly prejudiced by the merger and that the transfer agreement has been approved as required by Article

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127YI. Failure to file the documents or making the declaration without grounds to do so is an offence.

Following receipt of the documents in proper form, the Registrar will register the transfer of the cell, issue a new certificate of incorporation (for ICs) or recognition (for PCs) and record that it has ceased to be a cell of the transferring company. Provision is made for any required transfer of property and rights and liabilities and obligations of the cell to become effective on the issue of the new certificate of incorporation or certificate of recognition. Provision is also made to enable legal proceedings by or against the cell to be continued against the cell as transferred.

All cells of a cell company must be of the same type

A cell company can have either protected cells or incorporated cells. On transfer, therefore, the cell will have to adopt the form applicable to the cell company on which it becomes dependent.

Conversion to a cell company

Article 127YM deals with the conversion of non-cell companies into cell companies. An existing non-cell company may only alter its memorandum and articles to provide for it to be a cell company if:

- the alteration is authorised by special resolution of the company and sanctioned by the Court in accordance with Article 125; or
- the alteration is consented to by all the members of the company and all the creditors of the company, or, if the consent of all the creditors of the company cannot be obtained, the alteration is authorised by a special resolution of the company and sanctioned by the Court which must be satisfied that no creditor will be materially prejudiced by the alteration.

The special resolution must include any change of name necessary (for example, changing the company's name from limited to ICC or PCC, as appropriate).

The same requirements apply where a cell company wants to convert to being a non-cell company or an ICC wants to convert to being a PCC or vice versa.

Once the Registrar has received a copy of the special resolution altering the memorandum and the name of the company and appropriate evidence to show the requirements set out above have been complied with, a new certificate of incorporation will be issued and the change of status takes effect from the issue of the new certificate of incorporation.

When a PCC is to convert to an ICC or vice versa, it is important to keep in mind that every cell must be converted by this process as all cells must have the same status.

Migrating cell structures into Jersey from other jurisdictions

A body incorporated outside Jersey can, with the approval of the Jersey Financial Services Commission, change its status to a PCC or an ICC by following the conversion process described above as part of the re-domiciliation process.

Transactions with PCs of PCCs

Article 127YP provides that a cell of a PCC may enter into an agreement with its cell company or with another cell of the cell company and the agreement shall be enforceable as if each cell of the PCC were a body corporate with separate legal identity.

Directors' obligations

Article 127YC(2) provides that the provisions of the Law apply to cells of a cell company. This means that directors of cell companies have all the duties of non-cell company directors.

Directors' additional duties for PCCs

Article 127YR provides for additional duties of directors of a PCC.

Directors of a PCC must discharge their duties to best ensure that:

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Keeping cellular and non-cellular assets separate

- cellular assets are kept separate and are separately identifiable from the non-cellular assets of the company; and
- the cellular assets attributable to each cell of the company are kept separate and are separately identifiable from the cellular assets attributable to other cells of the company.

Notifying other parties and recording transactions in relation to cells

Directors must ensure that, when the company enters into an agreement in respect of a cell of a company:

- the other party to the transaction knows or ought reasonably to know that the cell company is acting in respect of a particular cell;
- the minutes of any meeting of directors held in relation to the agreement clearly record that the company was entering into the agreement in respect of the cell and that the other party knows this or will be advised of this.

Failure to comply with these duties is an offence. Whilst there is no directly applicable personal liability upon directors in these circumstances, the general provisions of the Law to protect against fraudulent or wrongful trading could in appropriate cases be brought into play, so potentially making directors in default personally liable for the cell's liabilities.

Protection of cellular assets and isolation of liabilities

The assets and liabilities of a cell of an ICC are protected and isolated because, under the Law, the incorporated cell is a separately incorporated company.

The position with PCCs, which are not separate legal entities, is different and various provisions have been included to provide protection for the assets and isolation of the liabilities of a protected cell.

Article 127YT differentiates between 'Cellular Transactions' and 'Cellular Liabilities' which are transactions in relation to, or liabilities incurred in respect of, the activity or assets of a particular cell of the PCC and 'Non-Cellular Transactions' and 'Non-Cellular Liabilities' which relate to the PCC in its own right.

Claims in relation to cellular transactions and cellular liabilities extend only to cellular assets. Claims in relation to non-cellular transactions and non-cellular liabilities extend only to non-cellular assets.

When can a PCC's non-cellular assets be used to meet cellular liabilities?

A PCC may not meet cellular liabilities from non-cellular assets or another cell's cellular assets or non-cellular liabilities from cellular assets except where certain strict requirements have been met. In particular, the PCC or the relevant PC must be permitted to do this under its articles, and the directors must make a statement that, having made full enquiry into the affairs and prospects of the PCC (or the particular PC), they have formed the opinion that:

- immediately after meeting the liability, the PCC or the PC will be able to discharge its liabilities as they fall due; and
- taking into account the future intentions of the directors with respect to the PCC (or the PC) and the amount and character of the financial resources in their opinion available to the PCC (or the PC), the PCC (or the PC) will be able to continue to carry on business and be able to discharge its liabilities as they fall due for one year following the date on which the liability is to be met.

When can cellular creditors obtain non-cellular assets?

Article 127YU includes specific provisions to protect cellular assets from creditors' claims. In particular, creditors with claims arising from cellular transactions are only entitled to claim against the cellular assets of that cell and, if their claim does not arise from a cellular transaction, they will not be entitled to claim against cellular assets.

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Article 127YU(3) specifically provides that creditors have no right either in Jersey or elsewhere to make claims against cellular assets (if their claim arises from a non-cellular transaction) or against non-cellular assets or the cellular assets of another cell if their claim arises from a cellular transaction.

Other provisions make a creditor who succeeds in obtaining cellular or non-cellular assets to which he or she is not entitled liable to repay to the cell or PCC as applicable an amount equal to the benefit improperly obtained. Where the creditor successfully sells, realises or obtains title to cellular or non-cellular assets to which they are not entitled, the creditor must hold those assets or the proceeds on trust separated and identifiable as trust property. The creditor must pay or return them to the PCC on demand and if he or she fails to do so he or she will be guilty of an offence.

Insolvency of cells

In the event of the insolvency of a cell, this will not (in the absence of any special provisions in the Articles of Association subjecting the non-cellular assets to the liabilities of an insolvent cell) lead to the insolvency of the cell company, whether an ICC or a PCC. This results, in the case of an ICC, from the separate incorporation of each IC and, in the case of a PCC, from the express provisions of the Law restricting creditor claims to the relevant cellular assets and denying access to non-cellular assets. This is likely to reduce administrative inconvenience and cost arising for cells not otherwise affected by the insolvency of another cell of the cell company.

A PCC can apply to court to determine whether liability is to be met by cellular or non-cellular assets

Article 127YW enables a PCC to apply to the Court to determine whether a liability is to be met by cellular or non-cellular assets, by cellular assets of a specific cell or by a combination. This may be a practical solution to enable directors to ensure that they have complied with the Law.

Summary

The Jersey legislation has taken a strong approach to protection of cellular assets and separation of cellular liabilities, taking on board problems identified with protected cell structures and legislation in other jurisdictions. In addition to strengthening the asset protection provisions in relation to its PCCs, it has introduced the concept of ICCs which avoid many of the problems identified with protected cell structures in other jurisdictions whilst providing the simplified management benefits associated with cell companies.

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Contact Details

Cayman

Peter Cockhill
+1 345 949 9876
peter.cockhill@ogier.com

James Bergstrom
+1 345 949 9876
james.bergstrom@ogier.com

James Bagnall
+1 345 949 9876
james.bagnall@ogier.com

Jersey

Richard Thomas
+44 (0) 1534 504231
richard.thomas@ogier.com

Clive Chaplin
+44 (0) 1534 504251
clive.chaplin@ogier.com

Nick Ward
+44 (0) 1534 504244
nick.ward@ogier.com

Guernsey

Roger Le Tissier
+44 (0) 1481 737150
roger.le.tissier@ogier.com

William Simpson
+44 (0) 1481 737163
william.simpson@ogier.com

Marcus Leese
+44 (0) 1481 737152
marcus.leese@ogier.com

Locations

Cayman Islands

PO Box 1234, GT Queensgate House,
South Church Street, Grand Cayman,
Cayman Islands
Tel: +1 345 949 9876
Fax: +1 345 949 9877

Guernsey

Coutts House, Le Truchot, St Peter Port,
Guernsey GY1 1WD
Tel: +44 (0) 1481 721672
Fax: +44 (0) 1481 721575

Jersey

Whiteley Chambers, Don Street, St Helier,
Jersey JE4 9WG
Tel: +44 (0) 1534 504000
Fax: +44 (0) 1534 504444

London

2 Royal Exchange Buildings,
London EC3V 3LF
Tel: +44 (0) 20 7220 1170
Fax: +44 (0) 20 7220 1199

www.ogier.com

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