JERSEY CELL COMPANIES

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On 1st February 2006 an amendment to Jersey's Companies Law (the "Amendment") came into force which introduced cell companies into Jersey law.

Protected cell companies (PCCs) were first developed in Guernsey in the late 1990s. Originally to attract captive insurance work to Guernsey, they proved popular and versatile, and were soon found to be a useful vehicle in collective investment fund structures. Other jurisdictions, including the Isle of Man, Cayman Islands and Dublin, have followed suit with legislation based upon the Guernsey model.

The Amendment builds upon the legislation in these other jurisdictions to introduce two new vehicles: the Jersey PCC, a "second generation" PCC that represents the first significant advance from the PCC model developed in other jurisdictions; and the Incorporated Cell Company (ICC), a truly innovative corporate vehicle that offers an unmatched combination of flexibility and strength.

The Purpose and Advantages of Cell Companies

The purpose of a cell company is to provide a vehicle which can create cells, separate parts within which assets and liabilities can be segregated. This concept of ring-fencing is fundamental to cell companies. The key principle is that the assets of a cell should only be available to the creditors and shareholders of that cell.

The administrative benefits of a cell company are significant. Once a cell company structure is in place, repeat transactions can be established in a much reduced timescale. This is particularly attractive in products such as collective investment funds and securitisations, where negotiating transaction documents can

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be a complex and lengthy process, and where a successful initial structure will often lead to a demand for further, similar structures using the same key participants. A framework can be established which includes all of the participants in the structure – such as administrators, managers, investment managers and custodians – and model agreements entered into governing the contractual roles of those participants.

When particular transactions are envisaged – for example, adding a fund to invest in a specific country or sector, or a new vehicle to acquire receivables in the course of a securitisation – a cell can be created specifically to act in that defined role at a fraction of the cost and time that would be required were the structure to be established from scratch.

The Uses of Cell Companies

Most jurisdictions limit the use of cell companies by statute. Typically, they may only be used in collective investment fund, insurance and securitisation structures.

Jersey does not intend to limit the uses of cell companies through legislation. Although a policy note is in the course of being drawn up to provide guidance in relation to the use of cell companies, flexibility will be maintained and it is both hoped and anticipated that new and innovative uses will be found for cell companies following their introduction.

ICCs and PCCs

The distinction between ICCs and PCCs is straightforward, but significant. An ICC creates incorporated cells: these cells are separate companies with their own legal identity. They may hold assets, sue and be sued in their own name, and do anything that an ordinary Jersey company could do. As a result, there can be no doubt that ring-fencing is effective within an ICC structure: assets and liabilities are apportioned as effectively as they would be among subsidiaries in a group structure.

A PCC, on the other hand, creates protected cells. Protected cells do not have their own legal personality, though they are treated for the purposes of Jersey company law as if they were Jersey companies. Thus a PCC and the cells it creates together form a single legal entity, in contrast to ICCs. However, in a departure from the approach taken in other jurisdictions, members will only be entitled to vote on resolutions of the company or cell of which they are a member.

Relationship between Cells and Cell Companies

The relationship between a cell company and the cell it creates is unlike any other corporate relationship. Whether the cell company is an ICC or a PCC, a person is not a shareholder in the cell company merely by virtue of being a shareholder in a cell created by that cell company. The cell company and each of the cells it creates have their own constitution and members and should be considered independent entities.

However, cells are not wholly independent of the cell company that created them. Cells must have the same directors, secretary and registered office as the cell company. In addition, the cell company is responsible for the upkeep of the cells it creates: ensuring that annual returns in respect of each cell are lodged and that accounts of each cell are prepared as required by law. Although the cell company and the cell will have common directors, the duties of the directors will vary according to whether they are acting for the cell company or in respect of an individual cell. Directors must be aware of which entity they are representing and of any possible conflict of interest.

Company law generally prohibits a company from owning shares in itself. This has caused difficulties in other jurisdictions with PCC legislation, where the approach has been to treat members of cells and members of the cell company as being members of the same single corporate entity. As a result, cells have not been able to directly hold shares in other cells issued by the same company.

This approach has not been followed in Jersey where the articles of a cell are taken to include, unless otherwise specified, a provision permitting a cell to own shares in any other cell of the cell company.

Formation of Cell Companies and Cells

Once established, a cell company can create cells. The process of creating a cell begins when the cell company passes a special resolution to this effect. The resolution must give the cell a name and a constitution which includes all of the information that one would expect to find in the memorandum and articles of association of any company. The resolution is then filed with the Registrar and the cell is created when the Registrar issues a certificate of incorporation (in the case of an incorporated cell) or a certificate of recognition (in the case of a protected cell).

This is a marked difference from the approach taken in other jurisdictions, where a cell is created with less formality, without a constitution and without the requirement for public notification. The Jersey approach emphasises that the distinction between a cell company and the cells of such a company is a matter of public record, and not simply an accounting treatment within a company. Any interested party can search the Companies Registry and discover how many cells a cell company has created and the constitution of each cell.

The advantages of this are significant: there is transparency, certainty and a level of information available to third parties that would significantly weaken any attempt by a creditor to challenge the principle of cellular liability. The position of each cell and the rights of cellular members are a matter of public record and therefore indisputable.

Jersey cell companies also have the freedom to establish cells with different share structures. In other jurisdictions, cells issue shares out of the share capital of the PCC. In Jersey, each time a cell is created – whether by an ICC or a PCC – the resolution creating the cell must include details of the cell's share structure.

As each cell is regarded as being distinct from the cell company and from other cells, each cell may have any share structure that an ordinary company could have. So a cell company can have some cells with par value shares, others with no par value shares, and others with unlimited shares, and so on.

Insolvency of Cells and Cell Companies

In other jurisdictions, the creditors of a cell are entitled to the assets of that cell and to the non-cellular assets of the cell company: the assets of the cell company that are not attributable to any particular cell. Typically, these non-cellular assets are fairly limited in value: little more than the paid up share capital of the cell company. However, if a cell becomes insolvent then, as the creditors can pursue the non-cellular assets of the cell company, it is almost certain that the cell company itself becomes insolvent.

The end result is an insolvent cell company with some solvent cells and no clear guidance as to how those cells can be placed within a solvent framework. Other jurisdictions allow the court to appoint an administrator (which is not possible in Jersey), who will be tasked with establishing a new structure within which the solvent cells can operate. This is undeniably complex, costly and uncertain.

The Jersey legislation minimises the risk of the cell company becoming insolvent by providing that creditors of a cell are only entitled to have their debt met from the assets of that cell. There is no right of recourse to the cell company's non-cellular assets, which are, in any event, unlikely to be significant. Individual cells can be made insolvent in the same manner as individual companies, but this will not affect the position of solvent cells or of the cell company itself.

In addition, the Jersey legislation takes further steps to minimise the risk that the cell company itself is left with unintended obligations. In the case of ICCs, creditors will clearly be creditors of the individual cell or the cell company with which they contract. In the case of PCCs, creditors will only be able to bring an action against the cell in respect of which the company was acting and the directors must keep the assets of individual cells segregated from each other.

The Advantages of Jersey Cell Companies

Prior to introducing the Amendment, exhaustive research was undertaken into the strengths and weaknesses of existing cell company regimes. Jersey is not the first jurisdiction to introduce cell companies, so it was important to ensure that the product Jersey offered was a clear improvement upon that available elsewhere.

The advantages of Jersey cell companies over those available in other jurisdictions are significant and include:

- Stronger ring-fencing of assets and liabilities
- Reduced risk of a cell company itself becoming insolvent
- Clear distinction between the cell company and the cells it creates (and, as a result, clarification of the duties of the directors of cell companies)
- Choice of incorporated or unincorporated cells
- Ability to have cells which create shares without reference to the shares of the cell company
- Rights of cells to invest directly in each other
- No statutory limitation upon uses of cell companies
- Greater certainty and flexibility in numerous areas through treating cells under Jersey law as if they were companies.

Given the advantages, we believe that Jersey cell companies will be a significant addition to the range of products available in the financial markets.