PROTECTED CELL COMPANIES AND INCORPORATED CELL COMPANIES IN GUERNSEY

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1 Introduction

1.1 The Companies (Guernsey) Law, 2008 ("**Law**") (and references in this article to sections are sections of the Law unless otherwise stated) draws a distinction between:

1.1.1 "Cell" companies being either protected cell companies or incorporated cell companies;

1.1.2 Incorporated cells; and

1.1.3 Non-cellular companies, being companies limited by shares or guarantee, unlimited companies or mixed liability companies. (2)

The purpose of this article is to explain in detail the concept of protected cell companies, incorporated cell companies and incorporated cells and their uses.

2 Protected Cell Companies (PCC)

The PCC is one of the great innovations of Guernsey company law. Since its introduction on 1st January 1998, the protected cell company concept has been adopted by a number of jurisdictions, albeit using different terminology.

2.1 Single Legal Person

A PCC is a single legal person. (441) The significance of the PCC is its ability to have separate and distinct "cells". (442) The assets and liabilities of each cell are

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legally segregated from those of other cells and those assets are not available to creditors of other cells in an insolvency of a cell. (449)

A cell is not a legal person. It is a pool of segregated assets and liabilities. The creation by a PCC of a cell does not create, in respect of that cell, a legal entity or person separate from the PCC itself. (441(2)). This can be contrasted with an incorporated cell which has legal personality.

2.2 Uses of Protected Cell Companies

Companies, which can be established as, or converted into, protected cell companies are:

2.2.1 collective investment schemes authorised under Section 8 of the Protection of Investors (Bailiwick of Guernsey) Law, 1987;

2.2.2 closed-ended investment companies;

2.2.3 insurers licensed under The Insurance Business (Bailiwick of Guernsey) Law, 2002 or those insurers which are exempt from licensing by virtue of Section 5 of it;

2.2.4 any class or description of company other than a licensed person[2] provided that the company and its affairs are administered by a licensed person with a place of business in Guernsey. (437)

2.3 Guernsey Financial Services Commission ("**Commission**") Consent

The written consent of the Commission must be obtained before the incorporation of a protected cell company or the conversion of a company into a protected cell company. The Commission may impose conditions. (438)

The Commission may also from time to time vary, amend or revoke any term or condition subject to which consent was granted or issue a new term or condition. There is provision to appeal against any determination by the Commission including the refusal of consent or the imposition of terms and conditions. (440)

2 A licensed institution under The Banking Supervision (Bailiwick of Guernsey) Law, 1994 as amended, a licensed fiduciary under The Regulation of Fiduciaries, Administration Businesses and Company Directors, etc (Bailiwick of Guernsey) Law, 2000 as amended, a licensee holder under The Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002, a company licensed to carry on controlled investment business under The Protection of Investors (Bailiwick of Guernsey) Law, 1987 as amended, or any other class or description of person prescribed by the Commission

2.4 Creation of Cells and Cellular and Core Assets

2.4.1 The Core

The core is the protected cell company excluding its cells. (443)

2.4.2 Creation of Cells and Cellular Shares

A PCC may, create one or more cells for the purpose of segregating and protecting cellular assets. (442) Subject to the articles of incorporation of the PCC, a cell is established by a board resolution.

A PCC may in respect of its cells, create and issue cell shares. The proceeds of issue will form part of the cellular assets. (444(1)) There is, however, no requirement that a particular cell has to have cell shares. If a cell does not have cell shares there needs to be a mechanism, such as a contract, to enable surplus assets of the cell to be distributed, otherwise a cell transfer order may be required to distribute assets (see paragraph 2.15).

The provisions of the Law apply to cell shares and cell share capital as they would apply to shares and share capital of a non-cellular company. (444(4)) In the case of dividends and distributions regard must be had to the assets and liabilities of the relevant cell, or, as the case may be, the core.

2.4.3 Cellular and Core Assets

The assets of the PCC must be either cellular assets or core assets. (445(1)) It is the duty of the directors to keep cellular assets separate and identifiable from core assets and cellular assets attributable to other cells. (445(2))

2.4.4 Cellular Assets

The cellular assets of a PCC comprise the assets of the company attributable to the cells of the PCC. (445(3))

The assets attributable to a cell of a PCC comprise assets represented by the proceeds of cell share capital and reserves and all other assets attributable to a cell. (445(4))

2.4.5 Core Assets

The core assets of a PCC comprise the assets attributable to the core of the PCC. (445(5)) These assets are represented by the proceeds of core share capital and reserves attributable to the core and all other assets attributable to the core. (445(6))

2.5 Protected Assets

This is a key "ring-fencing" definition. Protected assets are the core assets and any cellular assets attributable to any cell in respect of a liability not attributable to that cell and any core assets in respect of a liability attributable to a cell. (446)

Accordingly, only in limited circumstances may assets of a cell or the core be utilised to satisfy the obligations of another cell or assets of a cell be utilised to satisfy obligations of the core.

This is subject to any recourse agreement. (see paragraph 2.10)

2.6 Attribution of Assets and Liabilities

The Law adopts the concept of "attributing" assets and liabilities to cells. This is the method of identifying the segregated pool of assets and liabilities within a cell. Accordingly, it is important that any transaction in respect of a cell is correctly identified as referable to the relevant cell in the contractual documentation. The directors are under an obligation to ensure this is done. (see paragraphs 2.13 and 2.14).

2.7 Position of Creditors of a PCC

2.7.1 Implied Terms and Conditions

To reinforce the cellular nature of liabilities, there is implied (unless expressly excluded in writing) in every transaction entered into by a PCC the following terms:

2.7.1.1 that no party shall seek to make liable any protected assets;

2.7.1.2 that if any party succeeds in making liable any protected assets, that party must pay to the company a sum equal to the value of the benefit obtained; and

2.7.1.3 that if any party succeeds in seizing, attaching or levying execution against any protected assets, that party must hold those assets or their proceeds on trust for the company and must keep those assets or proceeds separate and identifiable as such trust property. The implied terms are subject to any recourse agreement (see paragraph 2.10). (448(3))

2.7.2 Express Terms

To reinforce the implied terms, one would normally expect to see express non-recourse wording included in any contractual documentation.

2.7.3 Recovery of Assets in Breach of Implied Terms

If any asset or sum is recovered by the company it must, after deducting or paying any costs of recovery, be applied by the company so as to compensate the cell affected or the core, as the case may be. (448(5)) All sums recovered on account of property held on trust as a result of an implied term, will be credited against any concurrent liability against any protected assets. (448(4))

If protected assets have been improperly taken in execution of a liability and cannot be restored to the cell affected or the core, as the case may be, the company must appoint an independent expert to certify the value of the assets lost. The company must then transfer or pay from the cellular assets or core assets to which the liability was attributable, assets or sums sufficient to restore to the cell effected or the core, the values of the assets lost. (448(6)) This obviously depends on there being sufficient assets available to do this.

2.8 Recourse to Cellular Assets and Core Assets

Subject to the terms of any recourse agreement, cellular assets of a cell are only available to creditors of the company in respect of that cell and no further recourse may be had to the core assets. (449)

Similarly, and again subject to the terms of any recourse agreement, core assets are only available to creditors in respect of the core. (450)

2.9 Liability and Disputes

2.9.1 Generally

Subject to the terms of any recourse agreement, where any liability arises which is attributable to a particular cell, the cellular assets attributable to that cell are liable and it is not a liability of the protected assets. (451(1)) Similarly, where any liability arises which is attributable to the core, the core assets are liable and it is not a liability of the cellular assets. (452)

Any liability not attributable to a cell is a liability of the core. (454(1)) Therefore, it is important to identify the cell to which the liability is referable.

2.9.2 Criminal Penalties

Where a PCC is liable to any criminal penalty, due to the act or default of a cell or an officer acting in relation to a cell then the penalty must only be met from the cellular assets attributable to that cell. (465(1)) It is not clear what an “act” or “default” of a cell means in this context since a cell has no separate legal personality. Similarly, where a PCC is liable to any criminal penalty due to an act or default of the core or any office of the core, then the penalty may only be met from the core assets. (465(2))

2.9.3 Fraud

In the case of loss or damage which is suffered by a particular cell and which is caused by fraud perpetrated by or upon the core or another cell, the loss or damage is the liability solely of the company’s core assets or that other cell’s assets, as the case may be. (451(2))

2.9.4 Disputes

If there is a dispute as to whether any right is in respect of a particular cell, whether any creditor is a creditor in respect of a particular cell or whether any liability is attributable to a particular cell or the amount to which any liability is limited, the PCC may refer the matter in dispute to the court which will make a declaration on the matter. (453)

2.10 Recourse Agreements

Where a recourse agreement has been entered into, it is possible for a creditor to have recourse to assets to which he would otherwise not be entitled to under the Law. A recourse agreement is a written agreement between a PCC and a third party which provides that pursuant to an arrangement effected by the PCC, protected assets may be subject to a liability owed to that third party.

Before entering into a recourse agreement, each director of the PCC who authorises it must make a declaration that he believes that:

2.10.1 no creditor of the company will be unfairly prejudiced by the recourse agreement; and

2.10.2 unless the memorandum or articles provide to the contrary, the members of the cell or core to which the protected assets are attributable must pass a resolution by simple majority approving the recourse agreement.

A director who makes a declaration without having the grounds to do so is guilty of a criminal offence.

Therefore, if there is any doubt whether creditors could be prejudiced then their consent should be obtained.

Subject to any reasonable restrictions the PCC may impose, any member and creditor of the PCC may inspect or request a copy of the director's declaration. (447)

2.11 Extra-Territorial Effect

The provisions referred to above in respect of the liability of cellular and core assets, are expressed to have extra-territorial application.

In insolvency proceedings in two jurisdictions, this raises issues of conflicts of law and whether another jurisdiction would accept the extra-territorial effect. The usual approach in the case of double insolvency is to treat the insolvency proceedings in the place of incorporation as the principal insolvency and to treat the additional insolvency proceedings as being ancillary. This would suggest that in any double insolvency affecting a PCC the protected cell structure would be respected i.e. the place of incorporation will ultimately determine the attribution of assets and liabilities.

However, where either significant assets of a cell are held in a jurisdiction other than Guernsey or liabilities are incurred under foreign laws, foreign legal opinion should be obtained on whether a foreign court would accept the cellular integrity of the PCC in that jurisdiction.

2.12 Protecting Third Parties

There are a number of sections of the Law designed to ensure that third parties dealing with a PCC are put on notice of that fact.

2.12.1 Name

The name of a PCC must include the expression "Protected Cell Company", "PCC" or any other cognate expression approved in writing by the Commission. (21(2))

2.12.2 Memorandum

The memorandum of a PCC must state that it is a protected cell company. (15(2)(c))

2.12.3 Cell Name

Each cell of a PCC must have its own distinct name or designation. (23)

2.12.4 Notification

A PCC must:

2.12.4.1 inform any person with whom it transacts that it is a PCC; and

2.12.4.2 for the purpose of the relevant transaction, identify or specify the cell in respect of which that person is transacting, unless that transaction is in respect of the core. If the transaction is with the core, then the transaction must be specified to be with the core. (455)

In practice, this will involve contractual documentation making it clear that the PCC is transacting in respect of a particular cell or the core.

2.13 Directors' Liabilities

If a PCC:

2.13.1 fails to inform a person that he is transacting with a PCC, and that person is otherwise unaware and has no reasonable grounds to believe that he is transacting with a PCC; or

2.13.2 fails to identify or specify the cell in respect of which a person is transacting, and that person is otherwise unaware of, and has no reasonable basis of knowing, which cell he is transacting with,

the directors of the PCC incur personal liability to that person in respect of the transaction. This is regardless of any provision in the articles or any other contract or otherwise. Nevertheless, the directors have a right of indemnity against the core assets of the PCC in respect of their personal liability unless they were fraudulent, reckless or negligent or had acted in bad faith.

The Royal Court of Guernsey may relieve a director of all or part of his personal liability.

If the Court relieves the director of all or part of his personal liability, the Court may order that the liability in question must instead be met from such of the cellular or non-cellular assets of the PCC as may be specified in the order. (455)

2.14 Directors' Duties

It is the duty of the directors of a PCC:

2.14.1 to keep cellular assets separate and separately identifiable from core assets; and

2.14.2 to keep cellular assets attributable to each cell separate and separately identifiable from cellular assets attributable to other cells. (445(2))

2.14.3 However, the directors of a PCC may cause or permit cellular assets and core assets to be held by or through a nominee or by a company the shares and capital interests of which may be cellular assets or core assets or a combination of both. (445(8))

In addition, the directors may cause or permit cellular assets or core assets to be collectively invested or collectively managed by an investment manager provided the relevant assets are separately identifiable. (445(9))

2.15 Transfer of Cellular Assets

It is not possible to transfer a cell (which has no legal personality) but it is possible, in certain cases, to transfer cellular assets.

Generally the consent of the court is required for the transfer of the cellular assets attributable to any cell of a PCC. The court will be required to grant a cell transfer order. It should be noted that it is not possible to transfer the core assets of a PCC. However, a cell transfer order is not required to invest, and change investment of, cellular assets or otherwise to make payments or transfers from cellular assets in the ordinary course of the PCC's business.

No transfer of the cellular assets attributable to a cell of a PCC may be made except under the authority of and in accordance with the terms and conditions of the cell transfer order.

The court must not make a cell transfer order unless it is satisfied that the creditors of the PCC entitled to have recourse to the cellular assets attributable to that cell consent to the transfer or that those creditors would not be unfairly prejudiced by the transfer and the court must hear any representations of the Commission. (457)

It will clearly be easier to facilitate the granting of a cell transfer order if the creditors' consent is obtained. The court may attach conditions to any cell transfer order, particularly with regard to discharging claims of creditors. (457(6))

A cell transfer order is not required for the PCC to lawfully make payments or transfers from the cellular assets attributable to any cell of the company to a person entitled to have recourse to cellular assets. (457(8))

2.16 Arrangements between Cells

A PCC is a single legal person. A cell is not a legal person. A cell cannot contract with another cell since this would mean that the PCC would be contracting with itself. Neither can a cell hold shares in another cell directly since the PCC would then own shares in itself. A PCC could, however, establish a subsidiary attributable to a cell which could hold cell shares in another cell.

The Law permits, however, "arrangements" to be made between any of the company's cells, the PCC and the core. (458(1)) It is not clear how the company could be distinguished from the core in these circumstances.

An arrangement is any dealing with, or transfer, disposition or attribution of, the cellular or core assets of a PCC. (458(2))

An arrangement does not include a transaction with any third party. It relates only to transactions within the PCC itself.

The arrangement must be effected in the ordinary course of the PCC's business or the business attributable to any of its cells. For example, an investment company could effectively sell assets by transferring them from one cell in return for cash received from another cell. If the arrangement is not in the ordinary course of business then a cell transfer order will be required.

A PCC must, in respect of the arrangement, make such adjustments to its accounting records and of its cells as are necessary or expedient. The adjustments may include the transfer or disposition of assets, rights and liabilities as between cells, the core and any of its cells, as between the company and the core and as between the company and any of its cells.

On the application of any of the PCC, a director, liquidator or administrator of the PCC, the receiver or administrator of any cell affected by the arrangement, a manager of the business of the PCC or of any cell affected by the arrangement or, with leave of the court, any other person directly or indirectly affected by the arrangement, the court may make and subsequently vary, rescind, replace or confirm, an order in respect of the execution, administration or enforcement of an arrangement or any cellular or core assets subject to or affected by the arrangement. (458)

This could include an order as to the attribution, transfer, disposition, tracing, vesting, preservation, application, recovery or delivery of relevant assets.

2.17 Winding up of a Protected Cell Company

The liquidator of a protected cell company is bound to deal with the company's assets in accordance with the provisions of the Law relating to protected cell companies and in discharging the claims of creditors he must apply the company's assets to those entitled to have recourse to them. (456)

Accordingly, he must apply assets attributable to a cell only in respect of claims of creditors in respect of that cell and must not utilise assets of any other cell of the company to satisfy such claims, subject to the terms of any recourse agreement.

2.18 Administration Orders in respect of a PCC or Cells

An administration order may be made in respect of a protected cell company or a cell of a protected cell company.

2.19 Receivership Orders of Cells

The Law provides a mechanism to wind up a cell of a protected cell company by the making of what is termed a “receivership order”. Although the person appointed is expressed to be a “receiver”, his role is more akin to that of a liquidator in that he is appointed for the purposes of the orderly winding up of the business of the cell and the distribution of its assets. The reason for the distinction between the “winding up” of a company (or PCC or an IC of an ICC) and the “receivership” of a cell of a PCC is due to the fact that a cell of a PCC is not a separate legal entity.

3 Incorporated Cell Companies (ICC)

3.1 General

An ICC is an extension of the principle of the PCC but with a number of significant differences.

The significance of the incorporated cell company concept is that it permits the existence of separate legal entities (incorporated cells) within another legal entity (the incorporated cell company). (474)

An incorporated cell company is a single legal person. (473) It is the mothership of the incorporated cells within it. ICCs and ICs are companies and, accordingly, are subject to all the requirements of the Law unless otherwise stated.

Unlike a PCC, an ICC houses one or more incorporated cells within it, each ring-fenced by virtue of their separate legal existence from other incorporated cells and the ICC itself.

3.1.1 Uses of an Incorporated Cell Company

These are the same as for protected cell companies. (see paragraph 2.2) (468)

3.1.2 Commission Consent

The written consent of the Commission must be obtained before the incorporation of an incorporated cell company or the conversion of a company into an incorporated cell company. The Commission may impose terms and conditions. (469)

The Commission may from time to time vary, amend or revoke any term or condition subject to which consent was granted or issue a new term or condition. There is provision for appeal against any determination of the Commission including the refusal of consent or the imposition of terms and conditions. (471)

3.2 Incorporated Cells ("**IC**")

An IC is a single legal person separate from other IC's and its ICC, although it must have common officers and the same registered office as its ICC. It is effectively a "company within a company". It is not a subsidiary of the ICC and may not be a member of its ICC. (474) As a distinct legal entity, an ICC has no power by virtue of its position to transact on behalf of its ICs, nor can an IC transact on behalf of its ICC or any other incorporated cell within the ICC. (476)

An IC cannot be incorporated unless its ICC has passed a special resolution authorising an application for the IC's incorporation. (472)

3.3 Commonality between ICCs and ICs

An IC must have the same directors (136) and secretary (169) (if any) and registered office as its ICC. (474(6))

3.4 Notice to Third Parties

There are a number of sections of the Law designed to ensure that third parties dealing with an ICC or an IC are put on notice of that fact.

3.4.1 Name

The name of an ICC or IC must make it clear that it is an incorporated cell company or incorporated cell, as the case may be. (21(2)(b) and (c))

3.4.2 Memorandum

The memorandum of an ICC or an IC must state that it is an incorporated cell company, or incorporated cell, as the case may be. (15(1))

3.4.3 Notification

The directors must inform any person with whom the ICC or IC transacts whether the transaction is being entered into by the ICC or by an IC, and, in the case of an IC, identify the relevant IC which is transacting. (476(3))

3.5 Directors' Duties

It is the duty of the directors of an ICC and its ICs:

3.5.1 to keep the assets and liabilities of the ICC separate and separately identifiable from those of each IC; and

3.5.2 to keep assets and liabilities of each IC separate and separately identifiable from those of other ICs. (475(1))

The provisions are not dissimilar to the obligations imposed on directors of PCCs.

As with PCCs, the Law makes it clear that the pooling of assets for the purpose of collective investment or management by a third party is permitted provided that the assets remain separately identifiable assets. (475(2))

3.6 Transactions by ICCs or ICs

An ICC has no power by virtue of being an ICC to enter into any transactions on behalf of its ICs (476(1)) nor has an IC, by virtue of being an IC, the power to enter into any transactions on behalf of its ICC or any other ICs of its ICC. (476(2)) There is, however, no reason in principle why an ICC could not be appointed agent of its IC or, indeed, an IC for its ICC or another IC since they are separate legal entities.

The directors and officers of an ICC and its ICs must ensure that in respect of every transaction, it is stated whether the transaction is being entered into by the ICC itself or if an IC is transacting, which IC. (476(3))

3.7 Transfer of Incorporated Cells between Incorporated Cell Companies

An incorporated cell may be transferred to another incorporated cell company, subject to certain procedural requirements. (50(1)) The effect of the transfer is that the incorporated cell ceases to be an incorporated cell of the transferor incorporated cell company and becomes an incorporated cell of the transferee incorporated cell company.

All property, rights and liabilities of the incorporated cell are unaffected. (50(11))

3.8 Winding up of Incorporated Cell Company

The winding up of an incorporated cell company must be carried out in such a way as not to prejudice the affairs, business and property of any of its incorporated cells. The incorporated cell company must continue to carry on business to the extent necessary for the continuance of the business of its incorporated cells. (477)

Subject to any direction to the contrary by the liquidator, a resolution of the incorporated cell or the court, the appointment of a liquidator in respect of an incorporated cell company does not affect the position of the directors of its incorporated cells. (478(1))

An incorporated cell company which is being wound up may not be dissolved until each of its incorporated cells has ceased to exist. In practice, this means that they have been wound up and dissolved or transferred to another incorporated cell company. (479)

3.9 Administration of Incorporated Cell Company

The administration of an incorporated cell company must be carried on in such a way as not to prejudice the affairs, business and property of any of its incorporated cells. During the administration, the incorporated cell company must carry on business to the extent necessary for the continuation of business of its incorporated cells. (389)

4. Conclusion

The cell company concept is now well established and internationally recognised. It is now 12 years since the first PCC was registered.

The ICC, the PCC's younger sibling, passed its fourth birthday on 1st May 2010. Both PCCs and ICCs enable assets and liabilities to be successfully ring-fenced. Their flexibility of use has enabled Guernsey to offer two innovative corporate structures to its offering.