CAREY OLSEN

Jersey demerger regime

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On 10 July 2018 the States of Jersey enacted regulations to permit the demerger of Jersey companies, which will come into force on 1 September 2018.

Snapshot

- A new process permits the demerger of a Jersey company into two or more Jersey companies (which may or may not include the demerging company)
- Requires shareholder approval (special resolution), a demerger instrument and directors' solvency statements
- Shareholder, creditor and employee protections are built into the process
- No need for court approval provided the directors and prospective directors can make the necessary solvency statements
- Flexibility on how assets, liabilities etc are divided up and the final shareholder structure, including an ability to "cash out" shareholders

Why a demerger?

Demergers are most often used as part of a corporate reorganisation or restructuring. For example, a demerger could be used:

- in preparation for the sale of part of a business, by hiving off assets and liabilities into a separate company, which would then form the target entity;
- to segregate assets held by a fund into multiple separate funds or SPVs (which is particularly useful in an end-of-life scenario); or
- to enable the demerger of a listed entity into two, separately listed entities (or one listed and one unlisted entity).

In addition, because there is flexibility around payments to be made as part of a Jersey demerger, it is possible to use a demerger to effect a take-over by "cashing out" certain shareholders, with others retaining an interest in one or more of the demerged entities.

The new demerger option will be as an alternative to other procedures already available under Jersey law such as a scheme of arrangement, business transfer or distribution of assets within or outside of a standard liquidation or as part of a just and equitable winding up.

Entities capable of demerger

Initially it will only be possible to demerge a Jersey company into two or more Jersey companies (ie not non-Jersey bodies corporate), and demergers will not be available for cell companies or cells, unlimited companies or guarantee companies.

It is hoped that the Jersey demerger regime will be extended to permit demergers into non-Jersey bodies corporate (which is consistent with the current Jersey merger regime).

Whilst government has expressed an intention to extend the demerger regime to local tax-paying companies, until local tax legislation has been developed to deal with demergers, Jersey companies that are subject to Jersey income tax at a rate of more than zero per cent, are Jersey tax resident and have more than 2% Jersey resident shareholders or (broadly) are otherwise required to pay income tax or goods and services tax, or account to the Jersey tax authorities for tax principally payable by employees, contractors etc, will not be permitted to demerge.

The demerger regime is not available for Jersey companies that operate Jersey regulated deposit-taking and insurance businesses, given the availability of banking business and insurance business transfer schemes (similar to FSMA Part VII transfer schemes).

Further, Jersey companies that are under investigation for an offence, or against which there is a criminal prosecution that is ongoing, are prohibited from demerging until the investigation and/or prosecution has concluded.

Documentation and process

The process for demerging Jersey companies is similar to the existing and widely-used merger process, although additional stakeholder protections are built into the process given that demergers are more likely than mergers to have adverse consequences for third parties with a broader interest in the company.

The principal document that gives effect to a demerger is a demerger instrument (equivalent to a merger agreement), which must include prescribed information. The demerger instrument must be approved by shareholders by special resolution on a class-by-class basis. The default special resolution threshold in Jersey is a 2/3 majority, although this can be increased.

Stakeholder protections: shareholders and creditors

Shareholder and creditor protections in a demerger are very similar to those in a merger.

Before notice is given of a meeting to approve a demerger (or, where shareholder approval is given by written resolution, the resolution is circulated to shareholders):

- the directors of the demerging company must pass a resolution that, in the opinion of the directors voting for the resolution, the demerger is in the best interests of the demerging company; and
- the directors of the demerging company who vote for the resolution referred to above, and the proposed directors of each demerged company, must make statutory solvency statements in a prescribed form in connection with the solvency status of the demerging company up to completion of the demerger and the solvency status of the demerged companies for a 12 month period following completion of the demerger, respectively.

If the directors and proposed directors are unable to properly make the required solvency statements, a demerger will require the approval of the court, which has implications on process.

Notice of the shareholder meeting (or the written resolution) must be accompanied by prescribed information and documents.

All creditors known to have a claim of over £5,000 are entitled to at least 21 days' notice of the demerger (which notice must also be published in a prescribed manner in Jersey) and they and shareholders are entitled to inspect the demerger instrument and the proposed memorandum and articles of each demerged company (which, in the case of creditors, may be redacted to remove commercially sensitive information).

Shareholders who did not vote in favour of the demerger and creditors have a statutory right to object to the demerger, and a right to apply to the court on the basis of unfair prejudice to seek relief. That right must be exercised by notice to the company served:

- in the case of shareholders, within 21 days after the date on which all special resolutions approving the demerger are passed; and
- in the case of creditors, within 21 days after the date on which the creditor notice is published, and in both cases the court application must be made within 21 days after the date the relevant shareholder or creditor gives notice to the demerged company.

If the court is satisfied that the demerger would unfairly prejudice the rights of the applicant it has the power to make any order it thinks fit, including:

- in the case of a shareholder applicant, an order regulating the conduct of the demerging company's affairs or ordering the purchase of the applicant's shares by other shareholders or the demerging company; and
- in the case of a creditor applicant, an order to restrain the demerger or modify the demerger instrument, which may be for the benefit of both the applicant and other creditors.

Stakeholder protections: employees

Unlike mergers, the demerger process deals expressly with employee rights.

Employees must be given notice of the demerger within a prescribed period, and a copy of the demerger instrument and the proposed memorandum and articles of each demerged company must be made available to employees for inspection (which may be redacted to remove commercially sensitive information).

All employee rights etc must continue with one of the demerged companies (ie a demerger cannot be used to avoid redundancy etc costs), although it is possible to terminate employment contracts as part of the demerger by including express provision to that effect in the demerger instrument. Where a contract of employment is terminated in these circumstances, relevant employees' rights as against the demerging company would be dealt with along with any other liabilities (discussed further below).

Employees have a right to object to a demerger by notice to the demerging company before completion of the demerger, the effect of which (if not withdrawn by completion) is that the rights and liabilities of the employee are not transferred by the demerger and the employee's employment by the demerging company is terminated on completion of the demerger.

In this case, the obligation to compensate the employee for the termination of the employee's employment (save for any payment in lieu of notice paid by the demerging company)

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falls on the demerged companies in the manner set out in the demerger agreement (or otherwise jointly or severally), although as a matter of law the employee never becomes an employee of any of the demerged companies.

Other procedural requirements

Certain other procedural steps must be followed, including:

- making a declaration to the Jersey tax authorities, who must then issue a tax certificate if the demerging company is eligible to demerge; and
- applying to the Registrar of Companies in Jersey to complete the demerger which, unless agreed to by all shareholders and creditors, cannot be done until all shareholder applications objecting to the demerger have been disposed of (other than by an order restraining the demerger) and all creditor objection and objection application periods have expired and, if any creditor objection application has been made, it has been disposed of (again, other than by an order restraining the demerger).

The demerger takes effect when all necessary registrations have been made on the public register by the Registrar of Companies.

Splitting assets and liabilities amongst the demerging companies

The demerger instrument must identify the undertaking, property, rights and liabilities of the demerging company and must state in respect of each demerged company which of such undertaking, property, rights and liabilities are to become that company's (provided that a liability attached to particular property must pass to the same demerged company as the property).

A key point in drafting demerger instruments will be to ensure that all assets and liabilities are adequately provided for. Assets and liabilities not ascribed to a particular demerging company pass to the demerged companies on completion of the demerger (in the case of assets, jointly in common equal parts and, in relation to liabilities etc, jointly and severally), which is likely to be undesirable in the majority of cases.

The effect of a demerger

General

The corporate effect of a demerger is dependent on whether the demerging company continues as a survivor company. If it does, the demerging company continues as a separate, demerged company along with one or more new demerged companies. If it does not, the demerged company ceases to be incorporated as a separate legal entity and continues as two or more demerged companies.

However the demerger is structured, by operation of law all property, rights and civil liabilities of the demerging company in existence immediately before completion of the demerger become the property, rights and civil liabilities of the demerged companies in the manner set out in the demerger instrument (noting the position as set out above where the demerger instrument does not specify how particular property, rights or liabilities are to be dealt with).

Further, subject to an order of the court, the demerged companies become jointly and severally liable for any financial penalties of the demerging company, and all actions and legal proceedings pending by or against the demerging company may be continued by or against all or any of the demerged companies.

Effect on licences etc

The exception to the general statement above as to the effect of a demerger is in relation to any licence, authorisation, certificate, consent, permit, registration or other permission held by the demerging company immediately before the demerger effective date issued by any licensing or regulatory authority.

These only transfer to a demerged company if the relevant licensing or regulatory authority has given its permission to the transfer. This reflects the fact that licences etc are generally granted based on a particular set of circumstances, and the demerged entities may no longer meet the licencing requirements as a consequence of the demerger.

Effect on contracts etc

By operation of law, completion of the demerger expressly does not cause a breach of contract or confidence or a civil wrong, or give rise to any remedy by a party to a contract or other instrument (including by way of an event of default or termination event), although where the assets and liabilities of a demerging company are outside Jersey consideration should be given to whether the laws (including contract laws) of relevant foreign jurisdiction(s) would recognise this provision.

Effect on employment agreements and employee-related matters

Optionality exists in terms of the manner in which contracts of employment are dealt with: the default position is that contracts of employment are not terminated and continue with the relevant demerged company, but is it possible to expressly terminate contracts of employment (although it is not possible to sever continuity of employment, rights that an employee had against the demerging company pre-completion, collective agreements or obligations to contribute to retirement schemes, which continue against the relevant demerged company or (if not allocated by the demerger instrument) the demerged companies jointly and severally post-completion).

Where contracts of employment are not terminated, there is also a requirement to maintain the same terms of employment for 12 months following the completion of the demerger to avoid the risk of any changes to terms being declared void.

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Key contacts

For further information or professional advice please contact our lawyers below:

Robert Milner
Partner

D +44 (0)1534 822336
E robert.milner@careyolsen.com

James Willmott
Partner

D +44 (0)1534 822307
E james.willmott@careyolsen.com

FIND US

Carey Olsen Jersey LLP
47 Esplanade
St Helier
Jersey JE1 0BD
Channel Islands

T +44 (0)1534 888900
E jerseyco@careyolsen.com

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