CAREY OLSEN

Jersey cell companies

Service area / Investment Funds
Location / Jersey
Date / July 2017

Jersey Cell Companies

Jersey introduced Cell Companies into its law in February 2006. 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 Cayman Islands, Ireland, the Isle of Man and Jersey, followed suit with legislation based upon the Guernsey model.

Jersey law recognises two cell company 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 new corporate vehicle that offers an unmatched combination of flexibility and strength.

The purpose and advantages of cell companies

The purpose of a cell company – whether an ICC or a PCC – 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 projects such as collective investment funds, where negotiating transaction documents can 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. General principles of Jersey companies law as to, for example, redemption and re-purchase of shares should also apply to cells, providing the comfort of an established regime.

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. Regulatory consents can be obtained in advance for the structure, and then, as new cells are added, the level of regulatory scrutiny that will be required is much reduced, as the fundamental structure has already been agreed.

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.

As the functionary agreements and regulatory consents have already been agreed with respect to the form of the transaction, a new cell can be added 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. These types of business have long been identified as being particularly suited to the cell company structure, as such vehicles tend to be costly to establish and operate, and so the benefit of replicating a structure through the cell company structure gives a clear commercial advantage.

In addition, such businesses tend to have financially sophisticated creditors that can be expected to understand the principles of ringfencing. Further, in the case of investment funds, investors often want the ability to invest in a range of sub-funds in the same umbrella structure or to switch their investment between sub-funds. Cells can be used with a collective investment fund structure in recognition of the varying risk profiles of different asset portfolios.

Jersey does not limit the uses of cell companies through legislation. While cell companies should not be used for ordinary trading activities (where a group structure remains the most appropriate approach), the flexibility under Jersey law will allow continued innovation in relation to the use of cell companies.

PCCs and ICCs

The Companies (Jersey) Law, 1991 (the "Companies Law") permits the creation of two types of cell company: the Incorporated Cell Company and the Protected Cell Company. The distinction between the two entities 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.

Indeed, at first glance, an ICC structure resembles a group structure, with a company at the top - the ICC or parent - and other companies below - the cells or subsidiaries. There is, however, a crucial difference between an ICC and a standard group structure: while the ICC has significant control over the cells it creates, it is unlikely to own the cells. The cells may be owned by investors, whereas the ICC might be owned by the financial institution structuring the investment product or by a charitable trust so that it is held off balance sheet.

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 the Companies 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, even though a PCC and its cells constitute a single legal entity, members will only be entitled to vote on resolutions of the company or cell of which they are a member.

Regulatory and taxation treatment of cell companies

One significant consequence of the difference between ICCs and PCCs is the regulatory and tax treatment that will be afforded to each structure in Jersey. In the case of a PCC, a ingle regulatory consent will be issued to the PCC itself in respect of all of the cells it creates. As new cells are added or existing cells amended or removed, the regulatory consent will be amended.

In addition, a single tax return will be filed in respect of the entire PCC structure (i.e. the PCC and the cells it creates). In the case of an ICC, as each cell is itself a company, regulatory consents will be issued to each cell and each cell will be assessed for tax separately.

The Island has moved to a taxation system that levies tax at a zero rate on most Jersey companies. Most PCCs and ICCs should fall into this category and will therefore be tax neutral.

Relationship between cell 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, the key point of note is that 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. When considering "ownership", there is no link between the cell company and each of the cells it creates: they each have their own constitution and members and should be considered independent entities.

The Companies Law has taken into account the uses of cell companies and has reflected the reality of their usage: that the cell company is an entity to provide a structure that offers opportunities for investors, and the cells are the vehicles that provide the investment opportunities. The interests of the members of the cell company and the members of each cell are not necessarily the same, and so it makes little sense to treat them as if they were members of a common enterprise.

However, cells are not wholly independent of the cell company that created them, and it is here that a sharp distinction is apparent between cell companies and ordinary group structures. The Companies Law requires cells to have the same secretary and registered office as the cell company. In addition, the cell company is responsible for ensuring that annual returns in respect of each cell are lodged. The directors of a cell company are not required to be the same as the directors of its cells and each cell is responsible for preparing its own accounts.

It is important to emphasise that although the cell company and the cell may 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. It is crucial that directors are aware of which entiiy they are representing and are alive to any possible conflict of interest that could arise.

It is important that accurate records are kept of directors' deliberations and that they clearly state whether the directors are representing an individual cell or the cell company itself at any particular meeting.

Most importantly, unless there is a provision in the constitution of a cell to the contrary, a cell may only change its constitution by special resolution of both the cell members and of the cell company. In this way a cell company retains a degree of control over the cells it creates, without there being any ownership relationship between the company and the cells. This is essential to ensure that the cells all retain a common infrastructure.

Continued

In addition, it reflects the reality that cells are likely to often be branded products created by financial institutions for their investors. For as long as the cell remains within the cell company structure, it is appropriate that ultimate control over the cell remains with the cell company. Investors have a number of options, set out later in this briefing, but they are not permitted to take control of a cell against the wishes of the cell company that administers it.

Company law 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 prohibition has led to cells in other jurisdictions using wholly-owned subsidiaries which in turn acquire shares in other cells.

This approach has not been followed in Jersey. Each cell is a separate investment opportunity, and there is no reason why a cell should not be able to invest in another cell in the same way that a collective investment fund may invest in any other collective investment vehicle. The Companies Law therefore provides that the articles of a cell shall be taken to include a provision that the cell may not own shares in its cell company; and unless a provision to the contrary is included, a provision permitting a cell to own shares in any other cell of the cell company.

Formation of cell companies and cells

A cell company is created in the same way as any other company – by application to the Registrar of Companies. The application must be in prescribed form and stipulate whether the company is to be an ICC or a PCC. Where the cell company is to be used for a regulated activity the Registrar will expect to see a consent issued by the Jersey Financial Services Commission (the "Commission"). In practice, it is likely to be prudent to contact the Commission prior to the formation of any cell company to ensure that any regulatory issues are addressed at an early stage.

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 special resolution is then filed with the Registrar of Companies like any other special resolution, though the cell will not be created until the Registrar of Companies 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 in Jersey maintained by the Commission and discover how many cells a cell company has created and the constitution of each cell. In practice, cells are not required on the spur of the moment. Therefore, the requirement to lodge the special resolution creating the cell prior to the cell coming into existence is something that can easily be accommodated within the normal timescale for a transaction.

The advantages, however, 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. The overall effect is to create a structure that is extremely robust and in keeping with Jersey's reputation as a transparent, well-regulated jurisdiction.

Another significant advantage of this approach lies in the freedom it gives to establish cells with different share structures. In other jurisdictions, cells issue shares out of the share capital of the PCC. This is not the case in Jersey. Each time a cell is created - whether by an ICC or a PCC - the resolution creating the cell shall 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 PCC. The overall effect is simple and stark: if a cell becomes insolvent then, as the creditors can pursue the noncellular assets of the PCC, it is almost certain that the PCC itself becomes insolvent.

The end result is an insolvent PCC with solvent cells and no clear guidance as to how the solvent cells can be placed within a solvent framework. Other jurisdictions allow the court to appoint an administrator (which is not possible in Jersey), and he 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 sufficient to meaningfully satisfy any creditor.

Continued

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 (each having separate legal identity).

In the case of PCCs, the position is not so clear. The PCC itself will hold assets in respect of the cells it creates and will enter into contracts in respect of individual cells. It is therefore incumbent upon the directors of a PCC to ensure that the assets of individual cells are identified as such and kept segregated from each other at all times. When the company enters into a contract in respect of a cell it is important that the other party knows that this is the case and that this is recorded in the company's minutes. A director who fails in this regard will be guilty of an offence.

However, even if the fact that the PCC is acting on behalf of an individual cell is not disclosed, the creditor will still only be able to bring an action against the (undisclosed) cell in respect of which the company was acting. The reason for this is simply that the oompany itself is almost certain to have significantly less assets than the cell, and so here is little benefit in allowing the cell company to be made bankrupt as a result of a failure of the directors to disclose that they were representing a particular cell.

Constitution of cells

The constitution of a cell is largely a matter for the cell company to determine when passing a resolution to create the cell. The key issue is that a cell may be structured in any way that a stand alone company could be structured.

In this way, maximum flexibility is maintained. In addition, as each cell is either a separate company or is treated as if it was, a single cell company may create cells without reference to the share structure of the cell company or of other cells.

Conversion to or from a cell company

An ordinary company can convert to a cell company or vice versa and a PCC can convert to an ICC (and vice versa) in the manner set out in the Companies Law.

In general, many of the options open to ordinary companies under the Companies Law apply to cell companies, and so, for example, a non- Jersey PCC could migrate to Jersey and be incorporated in Jersey as an ICC.

Prior to such a change taking place, it is likely that regulatory consent will be required. In addition, the change must not prejudice creditors, so must be either approved by all of the members and creditors of the cell or by an order of the Royal Court of Jersey.

In practice, the Royal Court will regard applications to change status as being akin to schemes of arrangement and will wish to be satisfied that no party is unfairly prejudiced by the change.

A cell of a cell company may become a cell of another cell company by being transferred from the former to the latter. This provides flexibility in the structuring of collective investment schemes over time.

Options open to investors

Cell members can either sell or redeem their shareholding (if redeemable). They can also, however, apply by special resolution to have the cell incorporated as a new company, independent from the cell structure.

Cell members can seek to have the cell transferred to another cell company or even migrated to another jurisdiction. The basic principle, however, is that while a cell is within a cell company structure, the cellular members must accept the terms upon which the cell company created the cell.

Summary of key advantages of Jersey cell companies

Prior to introducing cell companies into Jersey, exhaustive research was undertaken into the strengths and weaknesses of existing PCC regimes. Jersey is not the first jurisdiction to introduce cell companies, and 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 considerable and include:

- stronger ring-fencing of assets and liabilities;
- reduced risk of the 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 protected (unincorporated) cells;
- ability to have cells which create shares without reference to the shares of the cell company;
- ability to have different directors for different cells and the cell company;
- right of cells to invest directly in each other;
- no statutory limitation upon uses of cell companies; and
- greater certainty and flexibility in numerous areas through subjecting cells to the Companies Law as if they were companies.

On a practical level, these advantages are significant, both in terms of the additional security that the Jersey cell company has, and the administrative flexibility that applies to the operation of cell companies.

Continued

FIND US

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

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

FOLLOW US

Visit our corporate team at
careyolsen.com

PLEASE NOTE

Carey Olsen Jersey LLP is registered as a limited liability partnership in Jersey with registered number 80.

This briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such. © Carey Olsen Jersey LLP 2019