Decision Summary

States of Jersey

ECONOMIC DEVELOPMENT

Ministerial Decision

Decision Reference:			
Decision Summary Title *(File Name)*:	Amendments to the Companies (Jersey) Law 1991 ("**the Law**")	**Date of Decision Summary:**	December 2008
Decision Summary Author:	James Mews, Finance Industry Development	**Decision Summary: Public or Exempt?** *(State clauses from Code of Practice booklet)*	Public
Type of Report: Oral or Written?	Written	**Person Giving Oral Report:**	n/a
Written Report Title *(File Name)*:	Amendments to the Companies (Jersey) Law 1991 ("**the Law**")	**Date of Written Report:**	December 2008
Written Report Author:	James Mews, Finance Industry Development	**Written Report : Public or Exempt?** *(State clauses from Code of Practice booklet)*	Public

Subject:

Approval of the draft Companies (Amendment No. 10) (Jersey) Law 200- (**"the Amendment"**) and Companies (Amendment No. 3) (Jersey) Regulations 200- ("**the Regulations**").

Decision(s):

The Minister approved the draft Amendment, Regulations, the Report to the Amendment and Regulations, signed the declaration of compatibility with the European Convention on Human Rights and recommended that the documents be lodged *au Greffe* in order that the Amendment can be debated by the States on 3rd February 2009.

Reason(s) for Decision:

The purpose behind the Amendment and Regulations is to clarify aspects of the Law following the introduction of Companies Amendment No. 9. The proposals have undergone consultation with a steering group chaired by Jersey Finance, industry as represented by the Law Society, the Jersey Society of Chartered and Certified Accountants and the Jersey Financial Services Commission.

The Law Officers Department has indicated that the amendments to the Law do not raise any Human Rights issues and that all tariffs for new offences created are commensurate with similar existing offences.

Decision Summary

States of Jersey

Resource Implications:	
There are no measurable financial or manpower costs for the States.	
Action required:	
The documents to be lodged *au Greffe* in order that the Amendment can be debated by the States on 3rd February 2009.	
Signature:	**Position:** Minister for Economic Development
Date Signed:	**Date of Decision** *(If different from Date Signed)*: December 2008

MINISTER FOR ECONOMIC DEVELOPMENT

AMENDMENTS TO THE COMPANIES (JERSEY) LAW 1991 ("the Law")

1 THE ISSUE AND RECOMMENDATION

1.1 It is proposed to amend the Law through the draft Companies (Amendment No. 10) (Jersey) Law 200- (**"the Amendment"**) and the draft Companies (Amendment No. 3) (Jersey) Regulations 200- ("**the Regulations**").

1.2 It is recommended that the Minister approves the Amendment, the Regulations, the Reports to the Amendment and Regulations, signs the statement of Human Rights compliance and that the documents be lodged *au Greffe* in order that the Amendment can be debated by the States on 3rd February 2009.

2 BACKGROUND

2.1 The purpose behind the Amendment and Regulations is to clarify aspects of the Law following the introduction of Companies Amendment No. 9.

2.2 All the proposals have undergone appropriate consultation with a steering group chaired by Jersey Finance, industry as represented by the Law Society, the Jersey Society of Chartered and Certified Accountants and the Jersey Financial Services Commission. Most of the amendments are clarificatory arising from proposals consulted with the public at large in 2007 prior to being placed into Amendment No 9. The remaining proposals, bar one, are limited to the use of companies by the Finance Industry.

2.3 The Law Officers Department has indicated that the amendments to the Law do not raise any Human Rights issues and that all tariffs for new offences created are commensurate with similar existing offences.

3 THE AMENDMENT

3.1 Articles 2 and 3 of the Amendment amend Articles 16 and 17 of the Law to create a right of appeal for a company and/or its members to the Royal Court against certain directions of the Commission, e.g. a direction that the company may become a private company even though it has more than 30 members, or a direction modifying the applicability of Article 17 of the Law to a company. This ensures that these provisions of the Companies Law are human rights compliant.

3.2 Articles 4 and 5 clarifies the position to provide that the share premium account of a par value company and the stated capital account of a no par value company may be applied for the purpose of making a distribution under Part 17 of the Law.

3.3 Article 7 clarifies that for the purposes of Part 12 of the Law, the redemption, purchase or cancellation of its own shares by a company is not to be regarded as a reduction of capital.

3.4 Meanwhile, Article 8 amends Article 61(3) of the Law to clarify that a distribution in accordance with Article 115 is not a reduction in capital to which Part 12 of the Law applies.

3.5 Article 10 replaces Article 67 of the Law, which relates to a company's obligations with regard to its registered office. In particular, the amendment will expressly provide that a company does not satisfy the existing requirement to maintain a registered office in Jersey at all times, unless the occupier of the premises in which the office is situated authorizes their use for that purpose.

3.6 Although a failure by a company to comply with Article 67 will render it (and each of its officers who are in default) criminally liable, the registrar will continue to be entitled to treat its registered office of record as a valid address for the purposes of serving documents on the company. Article 67A provides a defence where a company has breached certain of the obligations in Article 67 in unavoidable circumstances.

3.7 The Law Officers Department has examined the amendments to Articles 67 and 67A of the Law and are content that they are Human Rights compatible and that the maximum penalty for the new offence, i.e. a fine at level 3 on the standard scale, is set at the right level, when compared with other similar regulatory offences in the Law.

3.8 Article 11 amends Article 90 of the Law to enable a company to provide in its articles that the majority required for special resolutions shall be greater than two-thirds of the members or class of members concerned. This amendment has been requested by industry in order to make it easier for Jersey companies to be listed on certain foreign stock exchanges, such as the Hong Kong Stock Exchange, which require companies' special resolutions to be passed by at least a three-quarters majority.

3.9 In addition, greater flexibility will be introduced by allowing the States to amend Parts 8, 12 and 18B of the Law by Regulations. In particular, Part 18B may be extended to mergers between Jersey companies and other bodies corporate (whether incorporated within or outside Jersey) that are not companies.

4 THE REGULATIONS

'OEIC' definition

4.1 Regulation 2 amends Article 1 of the Law to widen the meaning of the expression "open-ended investment company" ("OEIC") to include *inter alia* unregulated funds and COBO only funds. Under the Law, provided certain conditions are met, an OEIC may redeem its shares without the directors being required to make a solvency statement. It is important that OEICs have the benefit of this exemption, because by their nature their shares are subject to frequent redemption each time an investor wishes to call for his money and it would not be practical for the directors to make fresh solvency statements on each occasion for each investor before returning his capital.

4.2 Under the amended definition, a company will be classified as an OEIC if its sole business is to invest in securities or other property and its articles provide that substantially all of its shares are to be redeemed or purchased at the request of the holders at prices not exceeding their net asset value.

4.3 The current requirement that the company is a collective investment fund ("**CIF**") will be dropped, since the argument in favour of affording the exemption to CIFs, i.e. the need to be able to make frequent redemptions, applies equally to COBO-only funds and unregulated funds, which are not CIFs.

4.4 Similarly, the current requirement that the company invests with the aim of spreading investment risk will be dropped, as this excludes so-called feeder funds from being OEICs. Feeder funds collect investments, probably from different classes of investor, and then invest in turn in a master fund. Although they also need to be able to make frequent redemptions, feeder funds cannot be said to spread risk as they invest only in the master fund.

4.5 The amendment to the definition of an OEIC will therefore allow COBO-only, unregulated and feeder funds to benefit from the exemptions afforded to OEICs in order to attract a greater amount of business to Jersey.

Other amendments

4.6 Regulation 3 amends Article 114(2) of the Law. That paragraph at present provides that, for the purposes of Part 17 of the Law (which Part controls distributions by companies), the expression "distribution" does not include reductions of capital by extinguishing or reducing a shareholder's liability on shares that are not paid up. The effect of the amendment is to provide instead that the expression does not include a distribution by a reduction of capital that is made in accordance with Part 12 of the Law.

4.7 Regulation 4 amends Article 181 of the Law relating to the liability of a person to contribute in a creditors' winding up the amount of money paid to him or her in respect of the redemption or purchase by a company of its shares. The liability at present arises if the payment has not been made wholly out of profits available for distribution, or out of a fresh issue of shares for the purpose of the redemption or purchase. The effect of the amendment is to replace references to payments from these specific sources by references to payments made unlawfully.

5 <u>RECOMMENDATION</u>

1.3 It is recommended that the Minister approves the Amendment, the Regulations, the Reports to the Amendment and Regulations, signs the statement of Human Rights compliance and that the documents be lodged *au Greffe* in order that the Amendment can be debated by the States on 3rd February 2009.

JAMES MEWS
Finance Industry Development

EUROPEAN CONVENTION ON HUMAN RIGHTS

Statement of compatibility

Companies (Amendment No. 10) (Jersey) Law 200-

In accordance with the provisions of Article 16 of the Human Rights (Jersey) Law 2000, the Minister for Economic Development has made the following statement –

In the view of the Minister for Economic Development the provisions of the draft Companies (Amendment No. 10) (Jersey) Law 200- are compatible with the Convention Rights.

Signed...

SENATOR ALAN MACLEAN

Dated ....

Draft Speech for the Minister

P185/2008/ - Draft Companies (Amendment No. 10) (Jersey) Law 200- ("the Amending Law")

P186/2008/ - Draft Companies (Amendment No. 3) (Jersey) Regulations 200- ("the Amending Regulations")

Introduction

1. Sir, Members will be aware that there are two Projets to be debated. The purpose behind both the Amending Law and the Amending Regulations is to clarify aspects of the Companies (Jersey) Law 1991 (which I shall refer to as the Principal Law), following the introduction of Companies Amendment No. 9, which came into force in June 2008.

2. The proposed amendments continue to develop the Jersey company law offering, taking into account the needs of both local and international practitioners, to maintain Jersey's international competitiveness. All jurisdictions have found that company law needs reviewing and updating on a regular basis and Jersey is no different in this regard.

3. Both the Amending Law and Regulations have undergone appropriate consultation with a steering group chaired by Jersey Finance, industry as represented by the Law Society, the Jersey Society of Chartered and Certified Accountants and the Jersey Financial Services Commission. Most of the amendments are clarificatory, arising from proposals consulted with the public at large in 2007 prior to being placed into Amendment No. 9.

4. The Law Officers Department has indicated that the proposed amendments to the Principal Law do not raise any Human Rights issues

and that all tariffs for new offences created are commensurate with similar existing offences.

5. No measurable cost or manpower implications arise for the States or the Commission.

P185/2008/ - Draft Companies (Amendment No. 10) (Jersey) Law 200- ("the Amending Law")

Overview

6. The Amending Law will introduce an additional right of appeal to the Royal Court for a company and/or any of its members against certain directions of the Jersey Financial Services Commission ("**the Commission**"), making it easier for companies to gain access to the court and bolstering the human rights compliance of the Companies Law.

7. There is clarification with regard to distributions and reduction of share capital and the Amending Law introduces a new offence where companies do not comply with their obligations regarding the keeping of a registered office in Jersey. In particular, it will be made explicit that a company does not satisfy the existing requirement to maintain a registered office in Jersey at all times, unless the occupier of the premises in which the office is situated authorizes their use for that purpose.

8. Currently, Jersey companies can be listed on various foreign stock exchanges, including the London Stock Exchange, Alterative Investment Market and Plus Markets, NASDAQ, the Dow Jones and Euronext. Jersey company law currently provides for a majority of 2/3rds for the passing of a special resolution, but some common law

jurisdictions, such as Hong Kong, require companies listed on their stock exchanges to maintain a 75% threshold for the passing of a special resolution.

9. In order to facilitate Jersey companies being listed on additional foreign stock exchanges, the Principal Law will be amended to enable companies to specify in their Articles a higher than a two-thirds majority for the passing of special resolutions.

10. Finally, greater flexibility will be introduced by allowing the States to amend Parts 8, 12 and 18B of the Principal Law by Regulations in the future.

SIR, I PROPOSE THE PRINCIPLES
Debate on the Principles>>>

The Articles

11. Article 1 is an interpretative provision.

12. Article 2 amends Article 16 of the Principal Law, which enables a public company to request the Jersey Financial Services Commission to direct that it may become a private company even though it has more than 30 members. The amendment creates a right of appeal to the Royal Court by a member of a company against such a direction, and gives to the company and any member of it a right of appeal to the court against a condition imposed by the direction.

13. The Commission may also direct subsequently that the company shall become subject to the Principal Law as if it were a public

company. The amendment gives the company and any member a right of appeal against such a direction.

14. Article 3 amends Article 17 of the Principal Law, which provides in paragraph (2) that if a private company increases its membership beyond 30 persons, or circulates a prospectus relating to its own securities, the Principal Law is to apply to it as if it were a public company. However, if the Commission is satisfied that the company's affairs may properly be regarded as the domestic concern of its members, it may direct that paragraph (2) shall apply to the company with modifications.

15. The amendment therefore creates a right of appeal by a member of a company against a direction by the Commission modifying the application of Article 17(2) to the company, and gives to the company and any member of it a right of appeal against any term of the direction.

16. Article 4 is clarificatory and provides that the share premium account of a par value company may be applied for the purpose of making of a distribution under Part 17 of the Principal Law.

17. Article 5 is also clarificatory and provides that the stated capital account of a no par value company may be applied for any purpose for which a par value company may apply its share premium account.

18. Article 6 enables the States to amend Part 8 of the Principal Law, relating to the share capital of a company, by Regulations.

19. Article 7 is clarificatory and provides that for the purposes of Part 12 of the Principal Law, (which relates generally to reductions of capital), the redemption, purchase or cancellation of its own shares by a company is not to be regarded as a reduction of capital.

20. Article 8 amends Article 61 of the Principal Law, which deals with the way in which a company may reduce its capital accounts. The amendment makes it clear that a distribution in accordance with Article 115 of the Principal Law is not a reduction in capital to which Part 12 of the Principal Law applies.

21. Article 9 empowers the States to amend Part 12 of the Principal Law, which relates generally to reductions in capital, by Regulations.

22. Article 10 replaces Article 67 of the Law, which relates to the registered office of a company. The amendment introduces the following changes –

(i) Article 67 will explicitly state that a company does not satisfy the existing requirement in the Principal Law to maintain a registered office in Jersey at all times, unless the occupier of the premises in which the office is situated authorizes their use for that purpose. The Registrar will be able to refuse to incorporate a company if he is not satisfied that the occupier of the premises authorizes their use as the registered office of the company.

(ii) Likewise, the Registrar may refuse to register a notice that a company has changed its registered office, if he is not satisfied that the occupier of the premises in which the new office is to be situated authorizes their use for that purpose. If the Registrar ceases to be satisfied that the occupier of premises in which a company's registered office is situated authorizes their use, the Registrar may require the company to change its registered office within 14 days.

(iii) If a company fails to comply with the requirements of Article 67, the company and each of its officers who is in default will be guilty of an offence.

(iv) There will be rights of appeal to the Royal Court against decisions of the Registrar to refuse under Article 67 to incorporate a company, and either to require a company to change its registered office or refuse to register a change of its registered office.

(v) The Minister may make Orders prescribing information that is to be produced to the Registrar to show that an occupier of premises authorizes their use as a company's registered office.

23. It should be noted that although a failure by a company to comply with Article 67 will render it (and each of its officers who are in default) criminally liable, the Registrar and other persons will continue to be entitled, as they are at present, to treat its registered office of record as a valid address for the purposes of serving documents on the company.

24. Article 67A provides a defence where a company has breached certain of the obligations under Article 67 in unavoidable circumstances.

25. The Law Officers Department has examined the amendments to Articles 67 and 67A of the Principal Law and is content that they are Human Rights compatible and that the maximum penalty for the new offence, i.e. a fine at level 3 on the standard scale, is set at the appropriate level when compared with other similar regulatory offences in the Principal Law.

26. Article 11 amends Article 90 of the Principal Law to enable a company to provide in its Articles that the majority required for special

resolutions of the company shall be greater than two-thirds of the members or class of members concerned. This amendment has been requested by industry in order to make it easier for Jersey companies to be listed on certain foreign stock exchanges, such as the Hong Kong Stock Exchange, which require companies' special resolutions to be passed by at least a three-quarters majority.

27. Article 12 is clarificatory and amends Article 115 of the Principal Law to provide that a distribution that is made in accordance with Article 115 is not to be treated as a reduction of capital for the purposes of Part 12 of the Principal Law.

28. Article 13 amends Part 18B of the Principal Law, which relates to mergers between Jersey companies, to enable the States to amend Part 18B by Regulations. In particular, the States may do so by extending the Part (with or without modifications) to mergers between Jersey companies with bodies corporate (whether incorporated within or outside Jersey) that are not companies.

29. Article 15 amends Part 21 of the Principal Law, relating to the winding-up of companies, to enable the States to amend this Part by Regulations. Article 14 is consequential upon Article 15, and on the amendment to Article 220 of the Principal Law by Companies Amendment No. 9.

30. Article 16 amends Schedule 1 of the Principal Law to provide, for a contravention of Article 67, a maximum penalty of Level 3 in the Criminal Justice (Standard Scale of Fines) (Jersey) Law 1993, which equates to a fine of £2,000.

31. Article 17 gives the name by which this Amending Law may be cited and provides that its provisions shall come into force 7 days after it is registered in the Royal Court.

SIR, I PROPOSE THE ARTICLES
Debate on the Articles >>>

P186/2008/ - Draft Companies (Amendment No. 3) (Jersey) Regulations 200- ("the Amending Regulations")

32. Sir, the Amending Regulations make further amendments to the Principal Law. As with the Amending Law, the purpose behind the Amending Regulations is to clarify aspects of the Law following the introduction of Companies Amendment No. 9.

33. The most significant amendment is a change to the definition of an open-ended investment company ("OEIC") (pronounced "oik"), which will allow other funds whose shares may be subject to frequent redemption (for example, COBO-only, unregulated and feeder funds) to benefit from the exemptions afforded to OEICs.

SIR, I PROPOSE THE PRINCIPLES
Debate on the Principles>>>

The Regulations

34. Regulation 1 is an interpretation clause.

35. Regulation 2 amends Article 1 of the Principal Law to widen the meaning of the expression "open-ended investment company" ("OEIC") to include, *inter alia*, unregulated funds and COBO only funds.

36. Under the Principal Law, provided certain conditions are met, an OEIC may redeem its shares without the directors being required to make a solvency statement. It is important that OEICs have the benefit of this exemption, because by their nature their shares are subject to frequent redemption each time an investor wishes to call for his money and it would not be practical for the directors to make fresh solvency statements on each occasion for each investor before returning his capital.

37. Under the amended definition, a company will be classified as an OEIC if its sole business is to invest in securities or other property and its articles provide that substantially all of its shares are to be redeemed or purchased at the request of the holders at prices not exceeding their net asset value.

38. The current requirement that the company is a collective investment fund will cease, since the argument in favour of affording the exemption to collective investment funds, i.e. the need to be able to make frequent redemptions, applies equally to COBO-only funds and unregulated funds, which are not collective investment funds.

39. Similarly, the current requirement that the company invests with the aim of spreading investment risk will be dropped, as this excludes so-called feeder funds from being OEICs. Feeder funds collect investments from different classes of investor and then invest in turn in a master fund. Although they also need to be able to make frequent redemptions, feeder funds cannot be said to spread risk as they invest only in the master fund. However, their shares are subject to frequent redemption and it is practical that they should also benefit from the exemption.

40. The amendment to the definition of an OEIC will therefore allow COBO-only-, unregulated- and feeder- funds to benefit from the exemptions afforded to OEICs in order to attract a greater amount of business to Jersey.

41. Regulation 3 is clarificatory amends Article 114(2) of the Principal Law. At present, this paragraph provides that the expression "distribution" does not include reductions of capital by extinguishing or reducing a shareholder's liability on shares that are not paid up. The effect of the amendment is to provide instead that the expression does not include a distribution by a reduction of capital that is made in accordance with Part 12 of the Principal Law.

42. Regulation 4 amends Article 181 of the Principal Law relating to the liability of a person to contribute in a creditors' winding-up the amount of money paid to him or her in respect of the redemption or purchase by a company of its shares. The liability at present arises if the payment has not been made wholly out of profits available for distribution, or out of a fresh issue of shares for the purpose of the redemption or purchase. The effect of the amendment is to replace references to payments from these specific sources by references to payments 'made unlawfully'.

43. Regulation 5 provides for the citation of the Regulations and that they will come into force 7 days after they are made.

SIR, I PROPOSE THE REGULATIONS
Debate on the Regulations >>>

END OF SPEECH

Questions:

Why amend the same Principal Law with an Amending Law and separate Amending Regulations?

Under the Principal Law, certain Parts and Articles of the Law may be amended by the States by Regulations, rather than by a new Law. It is thought that where this power exists, it should be exercised. In addition, this approach allows the amendments made by the Amending Regulations to be brought into force sooner than those made by the Amending Law, which will require Privy Council Approval before it is registered and brought into force.

Does the change to the definition of an OEIC constitute a watering down of regulation just to attract funds business to the Island?

The amendment to the definition of an OEIC will permit a greater range of funds to take advantage of this particular regulatory exemption. The extension of the exemption in this way is fully justified given that the basis for affording the exemption to collective investment funds, i.e. to facilitate the making of frequent redemptions, applies equally to COBO-only funds and unregulated funds. The Commission has reviewed the proposed amendment to the OEIC definition and does not object to it.

Is there a real need for the States to be able to amend further Parts of the Principal Law by Regulations in future?

The Amending Law will introduce changes that will allow Parts 8, 12 and 18B of the Principal Law to be amended by Regulations (rather than by a further Amending Law) in the future. These Parts relate to Share Capital, Reduction of Capital and Mergers, respectively. Allowing these Parts to be amended by Regulations in the future will add to the flexibility of Jersey company law, as changes can be introduced quicker, without the need for legislation to go off to the Privy Council for approval – a process that can take 3-4 months.

Although the Amending Law (Article 10(g)) will give the Minister for Economic Development the power to make Orders prescribing information that is to be produced to show that an occupier of premises authorizes their use as a company's registered office, this is a new power relating to a new requirement (i.e. we are not taking power from the States and giving it to the Minister).

December 2008

Jsy/Corp&comm/13768369

Briefing

Changes to the Jersey Companies Law

Client briefing

Introduction

Jersey has long been established as one of the top offshore jurisdictions for international finance transactions. There is a constant process of updating the legal and regulatory framework to ensure that a wide range of structures is available to the client. This briefing note summarises certain changes to the Companies (Jersey) Law 1991 (the "**CJL**").

Effective date

The Companies (Amendment No.2) (Jersey) Regulations 2008 were passed by the States of Jersey on 15 January 2008 and came into force on 22 January 2008.

The Companies (Amendment No. 9) (Jersey) Law was passed by the States of Jersey on 15 January 2008 and, following Privy Council approval, came into force on 27 June 2008.

Distributions

A Jersey company is now permitted to make a distribution from any source other than the capital redemption reserve or the nominal capital account. Therefore, distributions may be made from capital without a need to obtain Court approval for a reduction of capital, as was previously the case, although a special resolution may currently be needed.

A distribution may be debited from any account of the company (including the share premium account and the stated capital account) other than the capital redemption reserve or the nominal capital account. The fact that distributions may be made from the stated capital account of a no par value company but not the nominal share capital of a par value company may lead to an increased use of no par value companies in the future.

A distribution may only be made if the directors authorising the distribution make a statement that they have formed the opinion that:

- immediately following the date of the distribution, the company will be able to discharge its liabilities as they fall due; and
- having regard to the prospects of the company and their intentions with respect to the management of the company's business and the amount and character of the financial resources that, in their view, will be available to the company, the company will be able to continue to carry on business and discharge its liabilities as they fall due for a period of 12 months immediately following the date of distribution (or, if sooner, a solvent winding up of the company).

A director who makes such statement without having reasonable grounds for the opinion may be guilty of a criminal offence.

Financial assistance

The CJL previously prohibited a company giving financial assistance in respect of the acquisition of its own shares. The provisions of Article 58 of the CJL were similar to those in the equivalent United Kingdom statute, so that financial assistance was unlawful, and therefore void, as well as being a criminal offence. That said, financial assistance was historically less of an issue in Jersey given that Article 58 provided for a simplified whitewash procedure.

This prohibition has been removed with effect from 22 January 2008. Importantly, the amendments make it clear that any previous common law prohibition on financial assistance is not revived by virtue of the removal of the statutory prohibition.

Briefing

Changes to the Jersey Companies Law

Redemption and buy back of shares

Monies payable on the redemption of redeemable shares or on the buy back of shares by a Jersey company may be funded from any source, including capital. Previously, in the case of a par value company, the sources available to fund such payments were limited, in general terms, to distributable profits or the proceeds of a fresh issue of shares (although, where such payment included a premium element in excess of the nominal value, the share premium account could also be used). Similar restrictions applied in the case of a no par value company, although stated capital account could also be used.

The directors responsible for authorising the redemption or buy back payment will be required to make a statement that they have formed the opinion that:

- immediately following the date on which the payment is to be made, the company will be able to discharge its liabilities as they fall due; and

- having regard to the prospects of the company and their intentions with respect to the management of the company's business and the amount and character of the financial resources that will, in their view, be available to the company, the company will be able to continue to carry on business and discharge its liabilities as they fall due for a period of 12 months after the date of such payment (or, if sooner, a solvent winding up of the company).

Treasury shares

A Jersey company is now permitted to hold its own shares as treasury shares, where it has purchased or redeemed such shares. The company will not be treated as a member by virtue of holding such shares. Indeed, it will not be allowed to exercise any voting rights in respect of such shares and the number of treasury shares in issue will not be taken into account when calculating, for the purposes of any resolutions or other statutory consents, the total number or any required proportion of shares in issue. The company cannot make or receive any dividend in respect of treasury shares and cannot exercise or enforce any rights or obligations in respect of such shares.

This amendment will be of particular value to investment funds where the fund manager may want to have shares of the fund available for investors on short notice.

Corporate directors

Prior to 22 January 2008, the CJL required Jersey companies to have directors who are individuals. Jersey companies are now permitted to have corporate directors provided that the body corporate acting as a director (a) is registered to provide such services pursuant to the Financial Services (Jersey) Law 1998 and (b) does not itself have any corporate directors.

Accounts

Previously, the CJL required that all Jersey companies prepared accounts in accordance with generally accepted accounting principles (GAAP) and show a "true and fair view" of the profit and loss and the state of the affairs of the company. This provision has been relaxed so that, while all companies must still prepare accounts in accordance with GAAP, any company that is required to appoint an auditor (essentially all public companies or companies the articles of which so require) can prepare accounts which either "show a true and fair view" of or "present fairly on all material respects" the financial position of the company.

Other changes

- A cell company and each of its cells are no longer required to have the same directors.

- Public companies are permitted to dispense with annual general meetings, provided that all members agree in writing. (This relaxation of the statutory requirement for annual general meetings to be held was previously available only to private companies).

- A public company that is a limited company is allowed to end its name with "Public Limited Company", "PLC" or "plc".

- The notice period for calling an annual general meeting or a general meeting to consider a special resolution has been reduced from 21 days to 14 days.

- The statements of solvency required in respect of a re-domiciliation in or out of Jersey have

Briefing

Changes to the Jersey Companies Law

been amended to be consistent with those required for redemption/buyback and distribution, as set out above.

Summary

The changes to the CJL underline Jersey's commitment to remain in the top tier of offshore jurisdictions. The increased flexibility in respect of the sources of funds available to fund redemptions and buybacks of shares, the removal of the prohibition on unlawful financial assistance and the greater flexibility in terms of distributions mean that Jersey companies will be increasingly attractive for vehicles in cross-border transactions. Indeed, given the recent amendments to the UK Companies Acts, it may be that the greater flexibility of Jersey corporate law may make Jersey vehicles attractive for domestic UK transactions, as well as cross-border tax-driven structures.

About Ogier

Ogier is one of the world's leading providers of offshore legal and fiduciary services employing over 800 professional and support staff. The group has a presence in nine jurisdictions around the world, namely Bahrain, the British Virgin Islands, the Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, London, Montevideo, New Zealand and Tokyo.

Ogier provides advice on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets including the rapidly growing Asian and Chinese markets.

Ogier continues to be recognised as a leading law firm by the leading legal directories, including Legal 500 and Chambers.

Client briefing

Briefing

Changes to the Jersey Companies Law

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OGIER

Jersey: Changes To The Jersey Companies Law

15 July 2008

Introduction

Jersey has long been established as one of the top offshore jurisdictions for international finance transactions. There is a constant process of updating the legal and regulatory framework to ensure that a wide range of structures is available to the client. This briefing note summarises certain changes to the Companies (Jersey) Law 1991 (the "CJL").

Proposed amendments

The Companies (Amendment No.2) (Jersey) Regulations 2008 were passed by the States of Jersey on 15 January 2008 and came into force on 22 January 2008.

The Companies (Amendment No. 9) (Jersey) Law was passed by the States of Jersey on 15 January 2008 and awaits Privy Council approval; it is anticipated that it will come into force in mid-2008.

Distributions

A Jersey company will be permitted to make a distribution from any source, not merely from distributable profits. Therefore, distributions may be made from capital without a need to obtain either shareholder or Court approval for a reduction of capital, as is currently the case.

A distribution may be debited from any account of the company (including the share premium account and the stated capital account) other than the capital redemption reserve or the nominal capital account. The fact that distributions may be made from the stated capital account of a no par value company but not the nominal share capital of a par value company may lead to an increased use of no par value companies in the future.

A distribution may only be made if the directors authorising the distribution make a statement that they have formed the opinion that:

Client briefing

- immediately following the date of the distribution, the company will be able to discharge its liabilities as they fall due; and
- having regard to the prospects of the company and their intentions with respect to the management of the company's business and the amount and character of the financial resources that, in their view, will be available to the company, the company will be able to continue to carry

on business and discharge its liabilities as they fall due for a period of 12 months immediately following the date of distribution (or, if sooner, a solvent winding up of the company).

A director who makes such statement without having reasonable grounds for the opinion may be guilty of a criminal offence.

This amendment is expected to come into effect in mid-2008.

Financial assistance

The CJL previously prohibited a company giving financial assistance in respect of the acquisition of its own shares. The provisions of Article 58 of the CJL were similar to those in the equivalent United Kingdom statute, so that financial assistance was unlawful, and therefore void, as well as being a criminal offence. That said, financial assistance was historically less of an issue in Jersey given that Article 58 provided for a simplified whitewash procedure.

This prohibition has been removed with effect from 22 January 2008. Importantly, the amendments make it clear that any previous common law prohibition on financial assistance isnot revived by virtue of the removal of the statutory prohibition.

There are transitional provisions addressing the concern that, prior to the amendments relating to distributions coming into force in mid-2008, any acts that would previously have constituted financial assistance might be an unlawful distribution.

Redemption and buy back of shares

With effect from mid-2008, it is proposed that the monies payable on the redemption of redeemable shares or on the buy back of shares by a Jersey company may be funded from any source, including capital. Currently, in the case of a par value company, the sources available to fund such payments are limited, in general terms, to distributable profits or the proceeds of a fresh issue of shares (although, where such payment includes a premium element in excess of the nominal value, the share premium account may also be used). Similar restrictions apply in the case of a no par value company, although stated capital account can also be used. In all cases, the shares to be redeemed or bought back must be fully paid.

The directors responsible for authorising the redemption or buy back payment will be required to make a statement that they have formed the opinion that:

- immediately following the date on which the payment is to be made, the company will be able to discharge its liabilities as they fall due; and

- having regard to the prospects of the company and their intentions with respect to the management of the company's business and the amount and character of the financial resources that will, in their view, be available to the company, the company will be able to continue to carry on business and discharge its liabilities as they fall due for a period of 12 months after the date of such payment (or, if sooner, a solvent winding up of the company).

Treasury shares

A Jersey company is now permitted to hold its own shares as treasury shares. The company will not be treated as a member by virtue of holding such shares. Indeed, it will not be allowed to exercise any voting rights in respect of such shares and the number of treasury shares in issue will not be taken into account when calculating, for the purposes of any resolutions or other statutory consents, the total number or any required proportion of shares in issue. The company cannot make or receive any dividend in respect of treasury shares and cannot exercise or enforce any rights or obligations in respect of such shares.

This amendment will be of particular value to investment funds where the fund manager may want to have shares of the fund available for investors on short notice.

Corporate directors

Prior to 22 January 2008, the CJL required Jersey companies to have directors who are individuals. Jersey companies are now permitted to have corporate directors provided that the body corporate acting as a director (a) is registered to provide such services pursuant to the Financial Services (Jersey) Law 1998 and (b) does not itself have any corporate directors.

Accounts

Currently, the CJL requires that all Jersey companies must prepare accounts in accordance with generally accepted accounting principles (GAAP) and show a "true and fair view" of the profit and loss and the state of the affairs of the company. This provision is to be relaxed so that, while all companies must still prepare accounts in accordance with GAAP, any company that is required to appoint an auditor (essentially all public companies or companies the articles of which so require) can prepare accounts which either "show a true and fair view" of or "present fairly on all material respects" the financial position of the company. This proposed amendment is due to come into force in mid-2008.

Other changes

With effect from 22 January 2008

- A cell company and each of its cells are no longer required to have the same directors. With effect from mid-2008
- Public companies will be permitted to dispense with annual general meetings, provided that all members agree in writing. (This relaxation of the statutory requirement for annual general meetings to be held is currently available only to private companies).
- A public company that is a limited company will be allowed to end its name with "Public Limited Company", "PLC" or "plc".
- The notice period for calling an annual general meeting or a general meeting to consider a special resolution will be reduced from 21 days to 14 days.
- The statements of solvency required in respect of a re-domiciliation in or out of Jersey will be amended to be consistent with those required for redemption/buyback and distribution, as set out above.

Summary

The proposed changes to the CJL underline Jersey's commitment to remain in the top tier of offshore jurisdictions. The increased flexibility in respect of the sources of funds available to fund redemptions and buybacks of shares, the removal of the prohibition on unlawful financial assistance and the greater flexibility in terms of distributions mean that Jersey companies will be increasingly attractive for vehicles in cross-border transactions. Indeed, given the recent amendments to the UK Companies Acts, it may be that the greater flexibility of Jersey corporate law may make Jersey vehicles attractive for domestic UK transactions, as well as cross-border tax-driven structures.

About Ogier

Ogier is one of the world's leading providers of offshore legal and fiduciary services employing over 700 professional and support staff. The group has a presence in nine jurisdictions around the world, namely the British Virgin Islands, the Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, London, Montevideo and New Zealand.

Ogier provides advice on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets including the rapidly growing Asian and Chinese markets.

Ogier continues to be recognised as a leading law firm by the leading legal directories, including Legal 500 and Chambers.

- In Legal 500 Ogier has more lawyers recommended and more tier 1 rankings for individual practice areas than any other Jersey firm.
- In Chambers the firm has more lawyers recommended than any other Jersey firm.
- In PLC Which Lawyer - Ogier received tier 1 rankings for all four categories in Jersey.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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Private Companies In Jersey (Ogier)
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Private Trust Companies In Guernsey (GuernseyFinance)
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APPLEBY

Jersey: Jersey Company Law: Capital Maintenance Requirements Relaxed

02 July 2008

Article by Wendy Benjamin

Jersey companies will no longer be tied to profits when making distributions to shareholders. A significant relaxation of Jersey's capital maintenance regime will come into force on 27 June 2008 under Companies (Amendment No.9) (Jersey) Law 2008 (the 'Law') which was registered in the Royal Court of Jersey on Friday 20 June 2008.

Under the Law, distributions to shareholders may be made from any source of funds not just distributable profits, apart from nominal capital or capital redemption reserve in the case of par value companies. So Jersey companies may, for example, use their share premium account or (in the case of no-par value companies) stated capital accounts to make distributions.

The directors approving the distribution must make a specified solvency statement when making a distribution. In general the directors approving the distribution must state that in effect, they believe the company will still be solvent 12 months after the distribution. It is not necessary for all the directors of a company to approve the distribution or for all of the directors to sign a solvency statement.

Those directors signing a solvency statement are not now required to make 'full enquiry into the affairs and prospects of the company' before doing so. However, a director making such a statement without having reasonable grounds may be guilty of a criminal offence.

A solvency statement is not a public document. It is a private statement to be kept with the company's books and does not need to be filed with the Registrar of Companies in Jersey.

The Law also brings into force a number of other changes that may be useful for companies wishing to return funds to investors. Reductions of share capital will no longer require court sanction in Jersey provided the reduction in question can be classified as a distribution as referred to above. They will still require special resolutions of the shareholders.

Redemptions simplified

Similarly, redemptions and purchases of own fully paid shares by both par value and no par value Jersey companies will be permitted from any source provided the directors make the necessary solvency statement. A redemption or share buy back will not now necessitate an equivalent transfer to a capital redemption reserve.

There are other helpful changes in the law including:

- Public limited companies will be allowed but not compelled to have a name ending with 'PLC', 'plc' or 'public limited company';

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name ending with 'PLC', 'plc' or 'public limited company';

- Public companies may, like private companies, waive the holding of annual general meetings subject to obtaining the consent of all their members;

- The notice period for annual general meetings, or any other general meeting at which a special resolution is to be proposed, is reduced from 21 to 14 days; and

- In the course of a creditors winding up, liquidators may make interim distributions to the company's members, before settling all claims of creditors, if satisfied that the company's assets are sufficient to cover all creditors' claims and the expenses of the winding up, taking into consideration the interim distribution.

Some further changes to the requirements for accounts and auditors will be brought into force under the Law at a later date, probably in August. Those changes include permitting audited accounts to either 'show a true and fair view' of or to be 'presented fairly in all material respects' to show the company's financial position. The latter alternative offers greater flexibility to international investors using Jersey companies.

Conclusions

These amendments to Jersey company law follow changes earlier this year including those to permit the use of treasury shares by Jersey companies and the removal of the prohibition on financial assistance for the acquisition of shares. They should ensure that Jersey retains its position as a leading offshore jurisdiction providing flexible corporate structures, responsive to market developments.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Specific Questions relating to this article should be addressed directly to the author.

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Companies (Amendment No.9) (Jersey) Law 200* Position Paper provided by David Singleton

RESPONSES

The Minister for Economic Development invites comments on the matters set out in this Position Paper. The closing date for responses is 12 May 2006.

Responses should be sent to

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It is the policy of Jersey Finance to make individual responses it receives available to the Economic Development Department upon request, unless a respondent specifically requests otherwise.

The contents of any response may form the subject of discussions with industry bodies and other interested parties.

1. INTRODUCTION

In 2003, a consultation paper was issued by the Jersey Financial Services Commission (the "Commission") in relation to proposed amendments to the Companies (Jersey) Law (the "Law").

As a result of the response to that consultation, a number of the proposals made by the Commission were refined. In addition, since the Companies (Amendment No.8) (Jersey) Law was approved by the States in June 2005, a number of suggestions have been made by industry practitioners to the Economic Development Department in relation to potential improvements to the Law.

This position paper sets out a number of proposed amendments to the Law. Where possible, changes to the Law will be implemented through Regulations, as they can be brought into force in an expedited timescale. Where this is not possible, changes will be made by Amendment to the Law. It is hoped that this Amendment would be in a position to be approved by the States early in the autumn of 2006.

It should be noted that the proposed changes set out in this paper are not comprehensive. There will be a small number of changes aimed primarily at clarifying the existing provisions of the Law, which are unlikely to be contentious and upon which it would not be sensible to consult.

This position paper differs from a consultation paper. The majority of matters set out in this paper have already been the subject of consultation, a number arise directly from further consideration of Amendment No.8, with the remainder responding to developments in other jurisdictions and which are expected to be widely welcomed by those affected by the Law.

The purpose of this paper therefore is to inform the wider community of the results of previous consultations and of the proposed amendments to the Law. It is anticipated that this paper will form the basis of law drafting instructions, and that the proposals set out in this paper are only likely to be materially altered in the face of compelling argument.

2. THE PROPOSED CHANGES

Solvency Tests (Articles 55(9), 115)

Amendment No.8 introduced a new form of "solvency test" for Jersey companies considering making a distribution of assets (in whatever manner) to its members. The test requires the directors of the company who authorise the corporate action to make a statement in a prescribed form:

> The statement shall state that the directors of the company authorising the redemption, having made full enquiry into the affairs and prospects of the company, have formed the opinion –
>
> (a) that, immediately following the date on which the payment is proposed to be made, the company will be able to discharge its liabilities as they fall due; and
>
> (b) that, having regard to the prospects of the company and to the intentions of the directors with respect to the management of the company's business and to the amount and character of the financial resources that will in their view be available to the company, the company will be able to continue to carry on business and will be able to discharge its liabilities as they fall due until the expiry of the period of one year immediately following the date on which the payment is proposed to be made or until the company is dissolved under Article 150, whichever first occurs.

Two problems have been identified with this test. Firstly, the new test was designed to avoid the need to have accounts prepared prior to making a decision as to whether assets existed sufficient to justify making a distribution. However, "having made full enquiry" is unclear and in most cases legal advice would recommend that directors prepare accounts in order to satisfy that requirement. Secondly, as it is an absolute requirement that the directors make full enquiry prior to making the statement, if it subsequently comes to light that full enquiry was not made, an argument could be made that the distribution itself was not validly made, and therefore those who received a distribution in good faith could be compelled to repay it.

It is proposed that a better way of incorporating this type of solvency test into the Law is to remove the words "having made full enquiry into the affairs and prospects of the company" from Articles 55 and 115 and to introduce into Article 115 an offence the equivalent of Article 55(10):

> A director who makes a statement [under paragraph (8)] without having reasonable grounds for the opinion expressed in the statement is guilty of an offence.

The end position would then be that it is a question of fact whether the solvency statement has been made and the distribution is valid, but it would then be a question for the court to decide whether the director had reasonable grounds for making that statement and therefore whether the director committed an offence. In determining whether the director had reasonable grounds it is likely that the court would consider the degree of enquiry that the directors made into the company's affairs and prospects.

Financial Assistance (Article 58)

It is proposed that this article should be deleted. Financial assistance provisions have become a complex set of requirements that have to be satisfied in a wide range of circumstances for little clear end. Practically, this has caused a significant burden to those contemplating takeovers of Jersey companies for many years.

In transactions involving groups of companies, preparing the various resolutions that are required to "whitewash" assistance can be a voluminous task. This adds to the costs and risks of doing business in Jersey without bringing any clear benefit to the Island. Australia and New Zealand have already abolished their provisions relating to financial assistance and the UK is expected to do the same.

The emphasis of the Law is moving to provide as much flexibility as possible, provided that the company remains solvent and there is no fraud on minority shareholders. Sufficient remedies already exist if financial assistance results in insolvency or a fraud on a minority of shareholders and, this being the case, it is felt that the protection that the article purports to provide is no longer necessary.

Registered Office Provisions (Articles 67, 71 & 205)

Under the current Law, every Jersey company must have a registered office in Jersey. There is, however, no penalty for a breach of this requirement, though a penalty does exist, under Article 44, if the Registrar of Companies is not told of any change to the location of the register of members, which would usually, though not necessarily, be the registered office.

The current requirement is simply that the company has a registered office. There is, however, no requirement for the person who provides the registered office to agree to this: in other words, a company can give any address in Jersey as its registered office and there is no mechanism for ensuring that the registered office has any relationship with the company in question.

This poses significant risks to the Island. To provide a registered office is a regulated activity, and the Commission relies upon regulated corporate service providers to carry out ongoing due diligence against the owners of Jersey companies. It is therefore vital that a mechanism exists which ensures that the address given as the registered office address is bona fide: in other words, that the owner of a registered office address is willing to accept communications addressed to the company. The best practical way of achieving this is requiring all formal correspondence from the Registry to be sent to the company's registered office address: if the person providing the address does not wish to provide the registered office for the company he will then be put on notice that his address is being used and will be able to inform the Registrar that this should not be the case. The Registrar will then be able to take steps to wind up the company.

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Capital maintenance - the Companies Act 2006

September 2008

Summary

The doctrine of capital maintenance - i.e. that a company must receive proper consideration for shares that it issues and that having received such capital it must not repay it to members except in certain circumstances - is a fundamental principle of English company law. The Companies Act 2006 makes a number of important changes to the rules relating to capital maintenance and, in line with the deregulatory objectives of the Act, a number of the statutory requirements in this regard have been relaxed. This briefing discusses some of the key areas of law which have developed in relation to capital maintenance and explains the recent deregulatory measures which have been introduced.

Maintenance of capital

English law has developed the doctrine of capital maintenance with the aim of ensuring that a company with a share capital must obtain proper consideration for the shares that it issues and must not return funds so received to its members, except in certain circumstances.

The general principles were originally developed by the courts and since then have been increasingly superseded by statute, most notably Part V of the Companies Act 1985 (CA 1985) and, from the applicable dates of implementation, Parts 17, 18 and 23 of the Companies Act 2006 (CA 2006).

The doctrine of maintenance of capital underpins the legal rules in the following important areas:

- payment of dividends or other distributions to shareholders;
- reduction of a company's share capital and/or reserves;
- prohibition on the provision by a company of financial assistance for the purchase of its own shares; and
- a company's redemption or purchase of its own shares.

The CA 2006 makes a number of important changes to the rules relating to capital maintenance and, in line with its deregulatory objectives, a number of the statutory requirements have been relaxed. In particular, with effect from 1 October 2008, the rules on unlawful financial assistance will no longer apply to private companies (in most circumstances) and private companies will also be allowed to reduce their share capital without the need to go to court. Amongst other things, the reforms present a good opportunity for groups of companies to rationalise the capital structure of group members to remove dividend blocks which may prevent subsidiaries paying up dividends to their parent company.

Distributions

The provisions relating to distributions in the CA 1985 have broadly been restated in Part 23 CA 2006 which came into force on 6 April 2008 and applies to distributions made on or after that date. It continues to be the case that a dividend or distribution to members cannot be made except out of profits available for the purpose by reference to "relevant accounts" and Part 23 sets out the rules relating to permissible distributions.

In addition, in relation to distributions in kind (arising for example, on the transfer of an asset intra-group from a subsidiary to its parent or a sister subsidiary at less than market value), the existing City market practice that arose after the decision in *Aveling Barford Ltd v Perion Ltd [1989] BCLC 626*, has been confirmed in section 845 CA 2006 so that:

- if a company is transferring an asset where the amount or value of the consideration is not less than (i.e. is equal to or more than) its book value and the company has profits available for distribution, the transfer can proceed. The transfer will be treated as a distribution but the amount of the distribution is taken to be zero. For the purposes of section 845, the company's distributable profits will be treated as being increased by the amount, if any, by which the actual consideration for the asset exceeds its book value; and
- if a company is transferring an asset for less than book value, the amount of the distribution is calculated by reference to the asset's book value. The distribution will be deemed to be the difference between the book value of the asset and the amount or value of actual consideration given for it. Provided that the company's distributable profits are equal to or exceed the amount of the difference, the distribution will be lawful.

Other points to note in relation to distributions:

- A further restriction applies to distributions by public companies which does not apply to distributions by private companies. A public company may only make a distribution if, following the distribution, the amount of its net assets is not less than the aggregate of its called-up share capital and undistributable reserves (section 831(1) CA 2006). The effect of this is that a public company must, when calculating the amount available for distribution, reduce the amount of its net realised profit available for distribution by the amount of its net unrealised losses (see section 2.31 of The Institute of Chartered Accountants in England and Wales' Technical Release TECH 01/08).
- The statutory rules on distributions, with a couple of stated exceptions, are subject to the common law. Under the common law, a company cannot lawfully make a distribution out of capital. Accordingly, even if the "relevant accounts" show sufficient profits available for distribution, the directors must consider whether, subsequent to the relevant balance sheet date, the company has suffered losses which might affect the company's ability to make a distribution.
- When deciding whether to make a distribution, the directors must consider their general duties, including their duty to promote the success of the company under section 172 CA 2006.

Reduction of share capital

Companies reduce share capital for a number of reasons. One example is where a company wants to make a distribution to shareholders and needs to create sufficient distributable profits to do so. Reserves to enable a distribution to be made can be created by a reduction or cancellation of the company's share capital or certain reserves, such as share premium.

From 1 October 2008, the CA 2006 introduces a new procedure for private companies to be able to reduce their share capital by a special resolution supported by a solvency statement given by all the directors. This new procedure does not require court approval of the reduction and introduces an ability for the private company concerned to reduce its capital in any way which was previously only possible if the company was an unlimited company. Whilst the solvency statement required is similar to the CA 1985 "whitewash" statutory declaration for financial assistance, unlike the "whitewash" procedure and the continuing requirements in connection with a private company purchase of own shares out of capital, no auditors' report is required and creditors have no right to object to the reduction.

The solvency statement is a written statement signed by every director stating that they are of the opinion that:

- at the date of the statement, there are no grounds on which the company could be found to be unable to pay its debts; and
- the company will be able to pay or discharge its debts as they fall due for the next 12 months or, if the company is to be wound up in the next 12 months, in full within 12 months of commencing the winding up.

It will not be permissible to qualify a solvency statement in any way and directors will commit a criminal offence if they make a solvency statement without having reasonable grounds for the opinions expressed in it.

The nature and extent of the work which will have to be done to ensure that directors have reasonable grounds for giving a solvency statement will depend on the circumstances. The directors will need sufficient information before them to enable them to identify the company's current liabilities (including contingent and prospective liabilities) as well as those which have to be discharged over the next 12 months. Precisely what the directors need to consider is likely to depend on the circumstances of the company. In the case of a trading company, the directors may consider it appropriate to prepare a memorandum as to the company's working capital over the next 12-18 months on the basis of certain reasonable assumptions and "stress-test" this model by varying certain of the assumptions within a reasonable range.

Whilst there is no requirement in the CA 2006 for an auditors' report to support a solvency statement, in certain situations the directors might consider it prudent to seek advice or comfort from the company's auditors to be able to demonstrate that they have reasonable grounds for the opinions expressed in the solvency statement and that they have adopted sensible processes to reach their conclusions.

Subject to anything to the contrary in the shareholder resolution relating to the reduction or anything in the company's articles, if a private company reduces its share capital using the new route, then the reserve will be treated as a realised profit and so be distributable. In the case of a court-approved reduction, the reserve will be treated as a realised profit unless the court orders otherwise.

In relation to reductions of capital confirmed by the court, the CA 2006 broadly restates the procedure contained in the CA 1985, subject to certain minor amendments which come into effect on 1 October 2009. The court-approved route is available to both public and private companies, unlike the new out of court procedure referred to above which only applies to private companies.

If a company follows the court-approved reduction process, then, once a shareholder resolution has been passed reducing the company's share capital, the company may seek confirmation of that resolution from the court. Unless the court directs otherwise, all creditors of the company as at a date fixed by the court are entitled to object to the reduction. In such cases, the court process requires a list of creditors, but, in practice, will usually dispense with this requirement if the company can show that all of its creditors have consented to the reduction or that, to the extent that such consent has not been obtained, an adequate form of creditor protection is in place. Commonly accepted methods of creditor protection include:

- setting aside cash funds in a blocked account;
- providing a bank guarantee; and
- providing an undertaking to the effect that the amounts arising from the reduction of capital will be paid into a reserve and will not be repaid to shareholders to the extent that creditors have not been paid off or consented.

Where a creditor list is required, it is for a creditor bringing an objection to the reduction to show that there is a real likelihood that the proposed reduction will put at risk the due discharge of its claim or debt.

Unlimited liability companies can continue to reduce their capital in any way and thereby create distributable reserves without the need for a court sanction or to follow the solvency statement procedure introduced by the CA 2006. However, the relative unattractiveness of introducing companies with unlimited liability into corporate groups may mean that their use becomes less frequent.

The table attached to this briefing summarises the relative merits of the different routes which a company may follow to reduce its share capital.

Financial assistance

The prohibition on the giving of financial assistance by private companies in most circumstances will be repealed with effect from 1 October 2008. As a result of this repeal, from 1 October 2008, there will no longer be any statutory whitewash procedure. However, the prohibition on the giving of financial assistance by public companies contained in the CA 1985 will be retained until 1 October 2009, when it will be replaced by similar provisions in Chapter 2 of Part 18 CA 2006. In addition, a private company will continue to be unable to give financial assistance for the acquisition of shares in its (direct or indirect) public holding company.

Notwithstanding the repeal of the statutory rules, a transaction which might once have constituted unlawful financial assistance still needs to be considered in the light of the following general company law principles which must continue to be taken into account:

- the transaction must be in the best interests of the company ("likely to promote the success of the company for the benefit of its members" in accordance with section 172 of the CA 2006); and
- the transaction must not breach the rules on distributions or otherwise constitute an illegal reduction in the capital of the company.

In addition, the validity of the transaction must not be vulnerable to challenge as a transaction at an undervalue for the purposes of section 238 of the Insolvency Act 1986.

As far as the first point is concerned, the board minutes recording the directors' approval of the transaction concerned should identify the commercial benefit which the transaction confers and which enables the directors to conclude that the transaction promotes the company's success. If this conclusion is reinforced by an approval of the transaction by the company's shareholders, then this should reduce or eliminate the risk of a challenge by the company or shareholders based on a breach of duty by the directors. However, the risk of such a challenge will remain if the company is insolvent, or is threatened by insolvency in consequence of the transaction concerned.

The board also needs to give detailed consideration as to whether the transaction might amount to an unlawful reduction of capital. If the transaction involves an outright transfer of assets to or for the benefit of the shareholders of the company, then it may constitute a distribution. The statutory rules on distributions referred to above will have to be complied with if the transaction is gratuitous, or it involves a transfer at less than book value (if the company has distributable reserves) or less than fair market value (if the company does not have distributable reserves). If the transaction, being one which is with or for the benefit of shareholders, involves a gift, a loan, a guarantee, an indemnity or the creation of security, then it might constitute an unlawful reduction in the company's capital if it reduces the company's net assets. This will be the case if a provision needs to be made in the company's books when the transaction is entered into and the company has insufficient distributable reserves to cover that provision.

Whether or not a provision has to be made is primarily a decision for the directors, acting in accordance with their general duties to the company. They will have to assess the likelihood of the guarantee being called, the security being enforced or the loan not being repaid (as applicable). There will be no effect on net assets if no immediate accounting provision needs to be made. The amount of detailed information needed by the directors to enable them to assess the situation will depend on factors such as the degree of uncertainty about the likelihood of the event occurring and the potential size of any resulting payment or loss. However, in all cases the directors, in making an informed decision, will need to be satisfied that they have sufficient information about the overall financial situation. In deciding whether or not a provision must be made (and, if they conclude that it must be made, in determining the amount of that provision and the amount of any distributable reserves that may be available to cover it), the directors may, in some circumstances, wish to consult the company's auditors. The board minutes of the meeting at which the directors consider these issues should record the fact that the directors have considered whether the transaction will result in a reduction of net assets and, if so, the amount of the company's distributable profits.

Purchase of own shares

The general rule is that a limited company may not acquire its own shares by purchase, subscription or otherwise, except as permitted. Part 18 CA 2006, which comes into effect on 1 October 2009, brings together the current methods by which a limited company can acquire its own shares and section 658 CA 2006 prohibits the acquisition by a limited company of its own shares except in accordance with the provisions of that Part. One advantage of a company reducing its share capital by purchasing its own shares is that the purchase price for the shares concerned may exceed the amount of capital that those shares represent.

The provisions of Part 18 will simplify some restrictions, including in the following ways:

- a company will have the power to purchase its own shares unless there is a specific prohibition or restriction contained in its articles of association. Currently a company (public or private) wishing to purchase its own shares must have authority in its articles to do so; and

- a private company wishing to purchase its shares out of capital will no longer need specific authorisation in its articles. In addition, the directors will no longer have to make a statutory declaration before a solicitor or commissioner for oaths in connection with the purchase out of capital. A private company will be able to make a purchase out of capital if it complies with the requirements of Chapter 5 of Part 18 which include that the directors have given a solvency statement (similar to the statutory declaration currently required under the CA 1985) supported by an auditors' report as to the reasonableness of such a statement. A shareholder resolution will also still be required.

A new requirement will be that where the shares are cancelled following their purchase (which they must be unless they are held as treasury shares), the company must notify the registrar of companies of the cancellation and provide a statement of capital.

Conclusion

The key changes to the capital maintenance rules introduced by the CA 2006, being the repeal of the statutory prohibition on the giving of financial assistance by private companies and the new out of court reduction of capital procedure for private companies, are to be welcomed. Whilst it will be interesting to see how market practice develops in relation to the new out of court reduction procedure available to private companies, the changes should simplify many transactions, shorten transaction timetables and reduce costs.

Relative merits of the different routes for returning share capital to shareholders

Reduction of share capital supported by a solvency statement	Reduction of share capital approved by the court	Reduction of share capital by reregistration as an unlimited company	Purchase of own shares out of capital

• Only available to private companies.
• Procedural requirements more straightforward (special resolution of shareholders and a solvency statement) making this route quicker and less costly.
• Possibility of criminal sanctions for making a solvency statement without reasonable grounds may mean that directors seek additional comfort before giving such a statement or simply prefer to adopt the court approval route.
• No requirement for the company to obtain creditor consent or to put in place creditor protection measures. Accordingly, this route might be preferred in the following circumstances:
  ◦ where a company has a very large number of creditors and it would be complex and costly to put in place creditor protection measures; or
  ◦ where the number or size of any creditors are unpredictable (eg because of litigation or a large pension deficit) .
• The reserve arising is treated as a realised profit and is therefore
	• Procedural requirements more onerous therefore may take longer (typically not less than 8 weeks) and be more costly.
	• No requirement for the directors to opine on the ability of the company to pay its debts. Accordingly, this route might be preferred in the following circumstances:
	  ◦ the company is highly leveraged;
	  ◦ the company's business is undergoing difficulties or has recently suffered a set-back;
	  ◦ there are material risks or uncertainties connected with the company's business; or
	  ◦ one or more of the directors is less involved in the running of the business than the others (making him reluctant to give the solvency statement) and the other directors want him to remain on the board rather than resign.
	• The distributability of the reserve arising may be wholly or partly restricted pursuant to the court
		• Procedural requirements less onerous than the out of court route and the court approved route.
		• No criminal sanctions and no requirement to opine on the ability of the company to pay its debts.
		• No issues as to distributability of resulting reserves.
			• Only available to private companies.
			• Procedural requirements more straightforward than a reduction approved by the court but slightly more onerous than a reduction supported by a solvency statement.
			• Possibility of criminal sanctions for making a solvency statement without reasonable grounds.
			• No requirement for the company to obtain creditor consent or to put in place creditor protection measures but creditors (or members who have not supported the special resolution) can apply to the court to block the purchase.
			• No issues as to distributability of resulting reserves.
			• Useful in circumstances where none of the reduction of capital routes are possible because the company has insufficient share capital and share premium to cover the amount of capital to be returned.

distributable immediately (to the extent not needed to eliminate existing losses).	order.

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THE NEW SOLVENCY TEST

AIC Seminar, Tuesday 16 September 2008

[AQ1]

1 In the executive summary prepared by the Commerce and Employment Department of the States of Guernsey addressed to the Chief Minister dated 26 January 2007 regarding the revisions of the Companies Law in Guernsey (the "Policy Letter"), one of the most significant proposals was a recommendation that the concept of capital maintenance be discarded in favour of a solvency model as the measure of the ability of a company to make distributions. These revisions came into effect on 1 July 2008 with the introduction of the Companies (Guernsey) Law 2008.

2 The term "capital maintenance" was misleading: a company was not required to keep its capital intact and if the capital of a company was lost (for example in the course of the company's trading) the company was under no legal obligation either to make it good or (on that ground only) to wind up its affairs. The rule was not that a company must maintain the capital it raises but that it must raise the capital which it purports to raise and, broadly, a limited company could not return capital to its shareholders other than in compliance with and as authorised by explicit statutory provisions in respect of such returns. Any unauthorised returns were illegal at common law.

3 These rules were primarily intended for the protection of the creditors. Experience has shown that the extent to which the capital maintenance rules provided such protection is questionable, especially since the previous company law did not prescribe a minimum capital for a company and there were various wide ranging common law and statutory exceptions. The Commerce and Employment Department recognised this in the Policy Letter stating—

> "The Department proposes to move from capital maintenance as the touchstone of certain corporate action and decision making to a solvency test. Capital maintenance is seen as too unwieldy and artificial. The proceeds of an issue of shares may be spent immediately after receipt, whereas a solvency test at the time action is prepared or a decision is made is much more relevant to the demands of business and the legitimate expectations of those doing business with, or affected by, corporate affairs. Solvency has been increasingly used in Guernsey legislation as the criterion for various decisions. It is proposed to assimilate all

these tests into one, to be used for everything from dividend distribution to reduction of capital."

4 The solvency test is now set in s 527 of the Company Law. It is required to be met in a variety of corporate procedures: it is used in the conversion process either of non-cellular companies or protected cell companies into incorporated cell companies; the transfer of incorporated cells between incorporated cell companies; conversions of non-cellular companies into incorporated cells; conversions of protected cell companies into non-cellular companies; it is referred to in amalgamations and migrations (both in and out of the Island); it is also considered by the Registrar in relation to restorations to the Company Register and also is a consideration that the Royal Court must take into account in making an administration order. Perhaps, though, the greatest attention needs to be paid to the solvency test and the reference which is made to it in relation to the procedures for making distributions and dividends.

5 The solvency test and its related sections in the Company Law borrow heavily from New Zealand's Companies Act 1993 (the "NZ Law"). This in turn follows a formula similar to the solvency test as employed in the United States (particularly the Model Business Corporations Act).

Distributions and dividends

6 A "distribution" for the purpose of the Companies (Guernsey) Law, 2008, s 301, "in relation to a distribution by a company to a member, means—

"(a) the direct or indirect transfer of money or property, other than the company's own shares, to or for the benefit of a member, or

(b) the incurring of a debt to or for the benefit of a member,

in respect of a member's interests, and whether by means of a purchase of property, the redemption or other acquisition of shares, a reduction of indebtedness, or by some other means."

7 The definition of "distribution" in the NZ Law is similar although it uses "shareholder" rather than "member". There is no definition of "member" in the Company Law. Presumably the change in terminology is to include reference to guarantee members and members with unlimited liability as well as shareholders.

8 It appears that (under s 301(a)) an allotment of a company's shares as a bonus issue is not a distribution (but see s 302(1)(a) which adds uncertainty). The transfer of money or property or the incurring of a debt must be linked to the member's interests as is stated it must be

"in respect of a member's interests". The question remains as to whether any transaction between a company and a member would be caught by the definition of "distribution". Whilst there does not appear to be any relevant case law on the issue it seems unlikely it would be caught if it could be demonstrated that the debt arose out of a genuine, arm's- length transaction in which the member was involved solely as a creditor or employee. This question is likely to arise in practice, particularly in relation to shareholder loans and the terms on which these may be entered into.

9 Section 302(1) defines "dividend" as meaning—

> "every distribution of a company's assets to its members, except distributions by way of—
>
> (a) an issue of shares as fully or partly paid bonus shares;
>
> (b) a redemption or acquisition of any of the company's own shares or financial assistance for an acquisition of the company's own shares;
>
> (c) a reduction of share capital;
>
> (d) a distribution of assets to members during and for the purposes of its winding up;
>
> (e) a distribution of assets to members during and for the purposes of an administration order;
>
> (f) a distribution of assets to members of a cell of a protected cell company during and for the purposes of a receivership order; or
>
> (g) a distribution of assets to members of a cell of a protected cell company during and for the purposes of the termination of the cell."

Dividends may be in the form of money or other property.

10 The declaration of a dividend is treated at common law as the creation of debt recoverable by a shareholder. It is considered that the Company Law may have altered that position. This view is supported by a number of terms within the Company Law. In applying the solvency test the dividend/distribution which is being authorised is not considered a debt under the expanded definition of debts (see below) and a distinction is made between the authorisation of a dividend and its payment. Furthermore, the board can also rescind the resolution authorising the distribution (see below) which would not be possible if a debt recoverable by the shareholder had arisen at the time of the declaration of the dividend.

11 It is to be noted that the definition of distributions is wide and that certain activities that may not obviously be regarded as distributions fall within the definition such as financial assistance as well as a purchase of the company's own shares, including a redemption of shares.

12 It should be noted however the procedure for distributions does not apply to open-ended investment companies (as defined in the Company Law). An open-ended investment company must not, however, redeem its shares unless it satisfies the solvency test (s 321(2)).

13 It is to be noted that the abandonment of the capital maintenance doctrine will no longer require court sanctioned reductions of share capital which now will only require sanction in accordance with the company's constitutional documents.

14 With both a distribution and a dividend the Company Law has separate sections dealing with procedures; in each case the board of the directors may authorise the activity if—

(a) the board of directors is satisfied on reasonable grounds that the company will, immediately after payment, satisfy the solvency test; and

(b) it satisfies any other requirement in its memorandum and articles.

15 The test requires the board to make a future assessment by making reference to the solvency test being satisfied immediately after the distribution or dividend is made. This must be an informed decision, not only to satisfy the reasonable grounds criteria but also to comply with the directors' fiduciary responsibilities to the company.

16 The board of directors must approve a certificate (implicitly prior to the distribution/dividend and practically usually at the same board meeting on giving its approval) stating—

> "(a) that in their opinion the company will, immediately after the distribution, satisfy the solvency test, and
>
> (b) the grounds for that opinion,
>
> and the certificate must be signed on their behalf by at least one of them."

17 It is also possible for the company's constitutional documents to prohibit or restrict distributions or dividends in certain instances, for example, distributions or dividends out of capital or non-realised profits. It may be that prohibitions of this nature are contained in existing constitutional documents because they were drafted before 1

July 2008 or at the request of investors or financiers. For ease of references in this article "distributions" will from this point include dividends as the two concepts are treated very similarly.

18 If, after a distribution is authorised but is not paid, the board ceases to be satisfied on reasonable grounds that the company will, immediately after the distribution is made, satisfy that the solvency test, any distribution made by the company is deemed not to have been authorised (ss 303(3) and 304(3)).

19 There appears to be an inference from the drafting of the law (although not expressly stated) that the board must monitor the company's financial position to ensure the solvency test continues to be met following an authorisation. This interacts (but rather awkwardly) with s 309(3) and recovery of distributions (see below).

Recovery of distributions

20 Recovery of distributions from directors and members is the corollary for the flexibility of the distribution regime.

21 A distribution (which definition includes a dividend) made to a member at a time when the company did not, immediately after the distribution, satisfy the solvency test may be recovered by the company from the member except to the extent that (these requirements are conjunctive)—

(a) the member received the distribution in good faith and without knowledge of the company's failure to satisfy the solvency test;

(b) the member has altered his position in reliance on the validity of the distribution; and

(c) it would be unfair to require payment in full or at all.

22 If, in relation to a distribution made to members—

(a) the procedure set out for distributions (which may include dividends, redemptions or acquisition of shares giving financial assistance for the purpose of the company's own shares) has not been followed; or

(b) reasonable grounds for believing that the company would satisfy the solvency test did not exist at the time the certificate was signed,

then a director who—

(i) failed to take reasonable steps to ensure the procedure was followed, or

(ii) voted to approve the certificate (as the case may be), is personally liable to the company to repay to the company so much of the distribution as is not able to be recovered from members.

23 If a distribution is deemed not to have been authorised (i.e. if after the distribution is approved by the board the board ceases to be satisfied on reasonable grounds that the company will, immediately after the distribution is made, satisfy the solvency test) a director who—

(a) ceased after authorisation but before the making of the distribution to be satisfied on reasonable grounds for believing that the company would satisfy the solvency test immediately after the distribution is made; and

(b) failed to take reasonable steps to prevent the distribution being made,

is personally liable to the company to repay to the company so much of the distribution as is not able to be recovered from members.

The statutory solvency test

24 Section 527 reads—

> "… the company satisfies the solvency test if:
>
> (a) the company is able to pay its debts as they become due [NZ Law continues 'in the normal course of its business'];
>
> (b) the value of the company's assets is greater than the value of its liabilities [NZ Law continues 'including contingent liabilities']; and
>
> (c) in the case of a supervised company, the company satisfies any other requirements as to solvency imposed in relation to it by or under:
>
> (i) the Protection of Investors (Bailiwick of Guernsey) Law, 1987;
>
> (ii) the Insurance Business (Bailiwick of Guernsey) Law, 2002;
>
> (iii) the Insurance Managers and Insurance Intermediaries (Bailiwick of Guernsey) Law, 2002;
>
> (iv) the Banking Supervision (Bailiwick of Guernsey) Law, 1994;
>
> (v) the Regulation of Fiduciaries, Administration Businesses and Company Directors etc. (Bailiwick of Guernsey) Law, 2000; and

(vi) any other enactment prescribed by the Commission for the purposes of this section."

25 The solvency test therefore comprises two tests known colloquially as:

(a) the liquidity or cash flow test; and

(b) the balance sheet solvency test.

26 The company may be suffering a temporary liquidity crises whilst still solvent within the balance sheet test. Should the board wish to make a distribution in this case directors would need to convert sufficient assets to a readily usable form so the company is in a position to meet all of the debts as they become due and hence satisfy the liquidity test. However a position where there is liquidity whilst the balance sheet test is not met is not as easily corrected. Asset values would need to increase or shareholders would need to inject further equity capital.

27 For the purposes of s 303 (procedure for making distributions other than dividend), s 304 (procedure for paying a dividend), s 309 (recovery of distributions), s 321 (exemption for open-ended investment companies) the definition of "debts" is—

> "'debts' includes fixed preferential returns on shares ranking ahead of those in respect of which a distribution is made (except where that fixed preferential return is expressed in the memorandum or articles as being subject to the power of the directors to make distributions), but does not include debts arising by reason of the authorisation."

28 This definition is concerned only with the liquidity test, as it is only that test that refers to "debts". Fixed preferential returns (not expressed in the memorandum or articles to be subject to the discretion of the directors) will therefore need to be included in cash flow budgets where appropriate.

29 The definition of "liabilities" for the same sections is—

> "'liabilities' includes the amount that would be required, if the company were to be dissolved after the distribution, to repay all fixed preferential amounts payable by the company to members, at that time or on earlier redemption (except where such fixed preferential amounts are expressed in the memorandum or articles as being subject to the power of directors to make distributions) but, subject to [the definition of 'debts'] does not include dividends payable in the future."

30 This definition is used only in relation to the balance sheet solvency test. It requires the test to include taking into account

repayment of the preferential shareholders' investment and any arrears on it (unless they are expressed in the articles or memorandum to be subject to the powers of the directors) but not future payments.

Issues raised by the solvency test

31 Both the liquidity and the balance sheet solvency tests raise difficult questions regarding—

(a) cash flows;

(b) the valuation of both assets and liabilities;

(c) the use of accounting records or statutory financial statements to determine solvency; and

(d) the extent to which reliance may be placed on valuations or opinions provided by auditors and professional advisers.

Liquidity test

32 The liquidity test concentrates on the present and the future; whether, on the present facts, the company can, in the future, meet its obligations as they mature. The present cannot be viewed in isolation; it is relevant to look at the company's behaviour in the recent past and at obligations maturing in the near future. A failure to pay debts presently due is evidence of a near illiquid position, but it is not conclusive proof of not being able to satisfy the liquidity test. Account must be taken of outstanding debts. The phrase "as they become due" probably means as they become legally due, this is certainly the case under New Zealand case law.

33 The test concentrates on future cash flows but there is no guide as to how far ahead directors should look, this is a matter for business judgment. Should they be required as a minimum consider cash flows for the company's next business cycle.

34 Future cash flows (both in and out) are estimated using cash flow forecasts. The accuracy of cash flow forecasts will depend on subsequent events which are not entirely in management's control, and invariables. Such forecasts may often be inaccurate (with hindsight) because they depend on assumptions about future economic events. Such assumptions may not be realised.

35 Forecasts might be challenged as inadequate if they are not based on reasonable assumptions about anticipated operating conditions or if the forecasts are not compared periodically to actual performance to determine whether prior assumptions were accurate.

Use of ratios to determine solvency

36 Since the company's most recent financial statements are often used to define company solvency directors may also be tempted to use accounting ratios extracted from the company's financial statements to determine future solvency. Such an approach has severe limitations.

37 Use of ratios provides an indication of the kind of solvency at the point at which the financial information is presented, which gives a snap shot of the company's position at that time, the limitation is that the information is historic.

Balance sheet solvency

38 In essence, the balance sheet test is a net assets test. After making a distribution the company must have positive net assets. There are however a number of practical difficulties in relation to the implementation of the test. The principal of such difficulties lies in the identification and valuation of assets and liabilities.

39 The Company Law does not define, "assets". It defines a liability as including "duty, debt and obligation". It is clear however that notwithstanding what accounting standards may be adopted share capital, is not intended to be regarded as a liability.

Valuation of assets and liabilities

40 The valuation of assets and liabilities is critical, since the solvency test requires a calculation of net assets to satisfy the balance sheet test. Guidance is provided by s 527(2) which requires that the directors in determining whether the value of a company's assets is greater than its liabilities—

> "(a) must have regard to:
>
> > (i) the most recent accounts of the company; and
> >
> > (ii) all other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets and the value of the company's liabilities; and
>
> (b) may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances."

41 Section 527(4) provides that the solvency test applies to cells and cores of protected cell companies as if references to companies were references to cells or cores (as the case may be) of protected cell companies.

42 The reference at s 527(2), to the most recent accounts, replaces the reference in the New Zealand Act to "the most recent financial

statements of the company that comply with s 10 of the Financial Reporting Act 1993", i.e. audited accounts. "Accounts" is defined in the Company Law as meaning—

> "either individual accounts prepared in accordance with section 243 (individual accounts) or consolidated accounts prepared in accordance with section 244".

43 It is assumed the draftsman has not made reference to audited accounts because there are unaudited companies in Guernsey. The question is raised however as to the position of new companies, it seems clear that there was not a policy to prevent new companies from using the solvency test and therefore to the extent a company does not have audited statements some form of management statements would need to be prepared. It is considered likely to be best practice to make reference to the most recent financial statements (audited if they exist) preferably supplemented by management accounts in making any solvency determination.

44 There is a problem in determining what value should be ascribed to assets (even more so in the volatile markets of the present day). Should the value be based on historical cost, market value, book value, going concern value or break-up value? They are all possibilities. Valuations are also likely to be difficult where using a comparator if a seller is distressed, or if a secondary transaction is concluded at greater or less than an underlying net asset value. In private equity there are often issues with attempting to find comparables to assist in valuations and particularly how to mark to market. This is where the board of directors' judgment and skill comes into play. Any basis of valuation needs to stand up to the scrutiny of being reasonable.

45 A three step process in relation to valuation of assets and liabilities, is envisaged for directors, who—

(a) must take at face value the figures for assets and liabilities as represented in the company's most recent accounts;

(b) must step back and take a wider view to determine whether these figures should be adjusted (because of post balance date events or for any other reason); and

(c) may make adjustments to figures and financial statements, valuations or estimates that are reasonable in the circumstances.

46 Directors need only step beyond the company's current financial statements where—

(a) a company's solvency is suspect; or

(b) there are doubts about the correctness of the figures contained in the financial statements for example because of an awareness of deterioration in the value of the assets since the statements were produced (this is particularly pertinent in the current economic market and particularly relevant to those funds which may have invested in real estate or other assets which are not easily valued); or

(c) there are assets or liabilities not included in the financial statements which should be taken into account.

Contingent assets

47 The statutory solvency test makes no reference to contingent assets. Company solvency might be dependent upon the contingent assets such as letters of support from shareholders undertaking to provide financial support for the company when required. When considering these undertakings of financial support the directors need to take into account—

(a) the solvency of the supporting party;

(b) the terms on which the support is promised, whether it is enforceable or not; and

(c) its precise terms.

Contingent liabilities

48 There are two types of potential liability:

(a) obligations arising out of an existing legal obligation but dependent upon events which may or may not occur; and

(b) obligations contemplated but not yet incurred.

The first is a contingent liability, which is examined below. The second is not a liability for the purposes of the solvency test.

49 Contingent liabilities are not specifically referred to in the Company Law. However, they must be taken into account at least in relation to the balance sheet test (in New Zealand statute a board of directors is required to take into account contingent liabilities in relation to the balance sheet test) and also, possibly, the cash flow test. Contingent liabilities are seldom recorded in a company's financial statements, they may be disclosed by notes to the accounts, if at all. The directors are expected to exercise reasonable judgment as to the likelihood, amount and time of any recovery against the company, after giving consideration to the extent to which the company is insured or otherwise protected against such loss should it occur.

Conclusion

50 The commentary accompanying the US Model Business Corporation Act on the solvency test is helpful in addressing the solvency test issues on an operational basis. Such commentary is likely to be of persuasive authority should any issues come before a Guernsey court:

> "In most cases involving a corporation operating as a going concern in the normal course, information generally available will make it quite apparent that no particular inquiry concerning the equity insolvency test is needed. While neither a balance sheet nor an income statement can be conclusive as to this test, the existence of significant shareholders' equity and normal operating conditions are of themselves strong indication that no issue should arise under that test. Indeed, in the case for a corporation having regularly audited financial statements, the absence of any qualification in the most recent auditors opinion as to the corporation's status as 'a going concern', coupled with a lack of subsequent adverse events would normally be decisive.
>
> It is only when circumstances indicate that the corporation is encountering difficulties or is in an uncertain position concerning its liquidity and operations that the board of directors or, more commonly, the officers or others upon whom they may place reliance … may need to address the issue … in determining whether the equity insolvency test has been met, certain judgments or assumptions as to the future course of the corporation's business are customarily justified, absent clear evidence to the contrary. These include the likelihood that (a) based on existing and contemplated demand for the corporation's products or services, it will be able to generate funds over a period of time sufficient to satisfy its existing and reasonably anticipated obligations as they mature, and (b) indebtedness which matures in the near term will be refinanced where, on the basis of the corporation's financial condition and future prospects and the general availability of credit to businesses similarly situated, it is reasonable to assume that such refinancing may be accomplished. To the extent that the corporation may be subject to asserted or unasserted contingent liabilities, reasonable judgments as to the likelihood, amount, and time of any recovery against the corporation, after giving consideration to the extent to which the corporation is insured or otherwise protected against loss, may be utilised. There may be occasions when it would be useful to consider a cash flow analysis, based on a business forecast and budget, covering a sufficient period of time to permit a conclusion that known

obligations of the corporation can reasonably be expected to be satisfied over the period of time that they will mature.

In exercising their judgment, the directors are entitled to rely ... on information, opinions, reports, and statements prepared by others. Ordinarily, they should not be expected to become involved in the details of the various analyses or market or economic projections that may be relevant. Judgments must of necessity be made on the basis of information in the hands of the directors when a distribution is authorised. They should not, of course, be held responsible as a matter of hindsight for unforeseen developments. This is particularly true with respect to assumptions as to the ability of the corporation's business to repay long-term obligations which do not mature for several years, since the primary focus of the directors' decision to make a distribution should normally be on the corporation's prospects and obligations in the shorter term, unless special factors concerning the corporation's prospects require the taking of a longer term perspective."

51 The implementation of the solvency test as a regime considerably enhances the flexibility by which a company can return money to its investors from a position where profits only were distributable to a position where companies have the freedom to distribute capital and earnings to shareholders in ways that have previously not been available. The definition of distributions is wide and includes share redemptions, buy backs and financial assistance and directors should be aware of this extended definition and the particular prescribed procedures for making distributions.

52 However, there is a price to pay for that flexibility in terms of potential liability for directors. This however is not to be overstated. It has always been the case that the consequences of unlawful distributions could be reclaimed from shareholders when the shareholders knew that the dividend was unlawful. Common law also provided that the directors who paid dividends improperly could be liable to compensate the company for the loss.

53 The solvency test presents challenges to the board of a company and it is clear that accounts prepared for financial reporting purposes provide only a starting point for determining the solvency test. Directors must use supplementary information extracted from the company's accounting records, together with their own assessment of the company's present position and future trading prospects, before making a considered assessment of the company's solvency.

54 Directors will not incur liability just because they got the solvency test wrong. They will incur liability if there is no reasonable

justification for the stance taken in their assessment of the solvency test.

Paul Christopher joined Ozannes' Corporate Department in 1999 and became a partner of the firm on 1 January 2006. He specialises in investment, finance and corporate work and regularly advises on the establishment of offshore investment funds of all kinds and on the regulatory and commercial issues in relation to them. Paul also advises on a broad range of corporate work including local and multi-jurisdictional mergers and acquisitions. He has an established trust practice and acts for a number of the leading trust institutions on the island. He is the Bar Council representative on the Guernsey International Business Association's council and is a member of the Guernsey Joint Money Laundering Steering Group. He was described in the Legal 500 (2008) as "responsive, professional and always thinking outside the box".

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3 - REGISTER OF DIRECTORS

3.1 Jersey is unusual among mature jurisdictions in not maintaining a register of directors of all companies[3]. A company search does not reveal the identity of the directors of a private company. This is often information that those requesting a company search both expect and require. In comparable jurisdictions, such a register is maintained, open to public inspection, with details of a company's directors typically provided to the relevant registry on both an ongoing basis and within the annual return.

3.2 This is an anomalous position. Directors are responsible for the day to day administration of the company, and it is reasonable that anyone seeking to transact with a company should be able to confirm the identity of that company's directors. The Commission feels that this information should be in the public domain.

3.3 The Commission can see no reason why the directors of each Jersey registered company should not be revealed by a company search. It is therefore proposed that the Registrar of Companies establish a Register of Directors containing this information.

3.4 Article 71 of the Law currently provides that public companies must submit details of their directors and secretary as part of the annual return process. It is proposed that private and public companies should be subject to the same requirements in relation to this matter, as set out in the following paragraph.

3.5 In order to create and maintain the Register of Directors, it is suggested that an obligation be placed upon all companies to ensure that details of their directors are included at the time each Jersey company is incorporated and in each annual return thereafter. To minimise any administrative burden, it is proposed that existing private companies will not be required to notify the Registrar of their directors until the first annual return following the coming into force of the Amendment No.X. It is further proposed that, following initial registration of directors, both private and public companies be required to inform the Registrar of changes in directorship on an

3. Dublin, the Isle of Man and the UK all operate registers of directors along the lines proposed in this paper. Guernsey does not have a centralised register, but requires each company to keep a register of directors open for public inspection at its registered office. Currently, in Jersey, a similar requirement applies only in relation to public companies.

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3 - REGISTER OF DIRECTORS - CONTINUED

ongoing basis, within 28 days of such changes occurring. It is hoped and anticipated that the majority of all necessary filings in this regard will be made electronically.

3.6 The Commission proposes that the information disclosed to the Registrar should comprise that information kept in the register of directors maintained by each company secretary in accordance with Article 84 of the Law, namely:

3.6.1 his present forenames and surname;
3.6.2 any previous forenames or surname;
3.6.3 his business or usual resident address;
3.6.4 his nationality;
3.6.5 his business occupation (if any);
3.6.6 his date of birth; and
3.6.7 the date upon which he became a director and, where appropriate, the date on which he ceased to be a director.

The Commission would ask the following questions in relation to the above:

3.7.1 Do any practical difficulties arise from the requirement to disclose directors' particulars in the manner proposed?

3.7.2 Are there any circumstances when it would not be appropriate for the identity of the directors of a Jersey company to be revealed by a company search? If so, what criteria should be established to determine when such information should be withheld?

ORIGINAL INSTRUCTION

REGISTER of DIRECTORS

Jsy/Banking/13754733

Client briefing

Briefing

Companies (Amendment No.8) (Jersey) Law 2005 - Solvency Tests

Introduction

The Companies (Amendment No. 8) (Jersey) Law 2005 (the 'Amendment Law') came into force on 1 February 2006, although certain provisions relating to insolvency will not come into effect until later in the year. Amongst other things, the Amendment Law amends the Companies (Jersey) Law 1991 (the 'Law') to introduce provisions relating to:-

1. protected cell companies and incorporated cell companies. A separate briefing note on this is available;

2. conversion of unlimited companies;

3. the power of the Registrar of Companies to refer applications for formation of a company to the Royal Court if he is of the opinion that such formation is not in the public interest; and

4. distributions.

In addition, the Amendment Law amends the Law in a number of areas with regard to the application of certain solvency tests. This briefing note addresses these amendments.

Position before the Amendment Law

The Law, prior to the Amendment Law, included a number of references to solvency tests. These divide into:-

(a) cashflow tests, which focus on the ability of a company to pay its debts as they fall due; and

(b) balance sheet tests, which focus on the value of a company's assets as against the value of its liabilities.

The Law referred to solvency tests in, amongst others, the following provisions:-

1. Article 55, in the context of redemption or repurchase of shares by a Jersey company. A company (not being an open-ended investment company) may redeem or repurchase its own shares only if the directors who authorise the payment on redemption or repurchase reasonably believe that, immediately after such payment:

(a) the company will be able to discharge its liabilities as they fall due;

(b) if the payment is made from share premium account (for a par value company) or stated capital account (for a no par value company), the realisable value of the company's assets will not be less than the amount of its liabilities; and

(c) in the case of a payment out of unrealised capital or revenue profits, the realisable value of the company's assets will not be less than the aggregate of its liabilities and the amounts standing to the credit of its capital accounts.

2. Article 58, with regard to the whitewash procedure for financial assistance by a Jersey company for the purpose of acquisition of its shares. The whitewash procedure requires, amongst other things, that the directors reasonably believe that, immediately after giving of financial assistance:

(a) the company will be able to discharge its liabilities as they fall due; and

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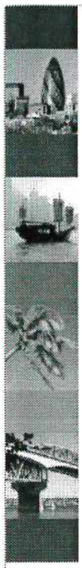

Briefing

Companies (Amendment No.8) (Jersey) Law 2005 - Solvency Tests

be less than the aggregate of its liabilities and any amounts standing to the credit of its capital accounts.

The failure to comply with the whitewash procedure could result in severe consequences. The relevant transaction could be void and the company and its directors may be guilty of a criminal offence.

3. Article 74, in respect of the sanction procedure to be followed where the directors of a Jersey company have potentially breached their fiduciary duty to act in the best interests of such company. The procedure requires, amongst other things, that, after the relevant act or omission:

(a) the company is able to discharge its liabilities as they fall due; and

(b) the realisable value of the company's assets is not less than its liabilities.

4. Article 127F(2), in respect of the declaration to be given by the directors of companies being merged to form a single company. The declaration must state that, immediately after the merger:

(a) the merged company will be able to discharge its liabilities as they fall due; and

(b) the realisable value of the merged company's assets will not be less than the aggregate of its liabilities and the amounts standing to the credit of its capital accounts.

5. Article 127W, in respect of the statement of solvency required for continuance either in or out of Jersey. The statement to be provided by each director must state that, having made full inquiry, that director reasonably believes:-

(a) that the applicant is and will be able to discharge its liabilities as they fall due; and

(b) the value of the assets of the applicant is and will be greater than the value of its liabilities.

Proposed Changes

There has been an increasing concern that the balance sheet solvency test has become less relevant, as capital structures become more complex. The States of Jersey has accepted this and the Amendment Law marks a general move away from the balance sheet test to a 'look forward' cashflow solvency test, which requires the directors to consider the ability of the company to continue to be able to discharge its liabilities as they fall due for a period of one year into the future.

In addition, the use of the phrase 'realisable value' has caused some concern, given that there is no specific accounting term equivalent to this. The lack of clarity in such language was implicitly recognised by the draftsman when, as a recognition of the severe consequences of non-compliance with the financial assistance whitewash, Article 58 was amended to remove reference to 'realisable value'.

Therefore, the Law has been amended as follows:-

1. the balance sheet solvency test in Article 55 has been removed and a look forward cashflow solvency test inserted. Now the directors must be satisfied that, having made full enquiry into the affairs of the company, they have formed the opinion, having regard to the prospects of the company and the intentions of the directors with respect to the management of the company's business and the amount and character of the company's financial resources, the company will be able to carry on business and will be able to discharge its liabilities as they fall due for a period of one year following the payment of the redemption/repurchase monies or until the company is dissolved under a summary winding-up, whichever is sooner.

It is notable that the Law, as amended, does not require any accountant's or auditor's statement, although the directors must act reasonably in considering what financial information should be considered before reaching their decision.

2. Article 58 has been amended in a similar manner to Article 55, with inclusion of the 'look forward' cashflow solvency test. In addition, it is made clear that it is only the directors authorising the giving of the assistance who are required to consider this solvency position.

3. Article 74 dispenses with the balance sheet solvency test in its entirety so that the sanction procedure is dependent solely upon the company being able to discharge its liabilities as they fall due.

Briefing

Companies (Amendment No.8) (Jersey) Law 2005 - Solvency Tests

4. Article 127F(2) is amended so that the directors' statements of solvency refer to the ability of the relevant company being able to discharge its liabilities as they fall due. The balance sheet solvency test referring to 'realisable value' is removed.

5. Article 127W remains unchanged, so that the balance sheet solvency test remains.

Conclusion

The willingness of the draftsman to move away from the balance sheet solvency test shows a commerciality and a flexibility that is crucial in the offshore market today.

About Ogier

Ogier is one of the world's leading providers of offshore legal and fiduciary services employing over 800 professional and support staff. The group has a presence in 11 jurisdictions around the world, namely Bahrain, the British Virgin Islands, the Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, London, Montevideo, New Zealand and Tokyo.

Ogier provides advice on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets including the rapidly growing Asian and Chinese markets.

Ogier continues to be recognised as a leading law firm by the leading legal directories, including Legal 500 and Chambers.

- In Legal 500, Ogier has more lawyers recommended and more Tier 1 rankings for individual practice areas than any other Jersey firm.

- In Chambers, the firm has more lawyers recommended than any other Jersey firm.

Client Briefing

Briefing

Companies (Amendment No.8) (Jersey) Law 2005 - Solvency Tests

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APPLEBY

Guide to recent developments to legislation in Jersey governing companies

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TABLE OF CONTENTS

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PREFACE

The States of Jersey recently brought into force fundamental amendments to the Companies (Jersey) Law 1991 (the "**Companies Law**") in the Companies (Amendment No. 8) (Jersey) Law 2005 ("**Amendment No. 8**").

The aim of the amendments are to allow as much flexibility as possible in the structuring and operation of Jersey corporate vehicles, whilst ensuring appropriate creditor protection is maintained, by the introduction of cell companies and streamlining of the solvency tests that are currently in the Companies Law.

This note is a brief overview of certain developments to legislation in Jersey governing companies brought into effect on 1 February 2006 by the introduction of the Companies (Amendment No. 8) (Jersey) Law 2005.

It is recognised that this Guide will not completely answer detailed questions which clients and their advisers may have. It is intended to provide a sketch of the subject matter covered. The Guide is, therefore, designed as a starting-point for a more detailed and comprehensive discussion of the issues.

Appleby
St Helier, Jersey
February 2006

1. KEY CHANGES TO THE COMPANIES LAW

a. Cell companies

Amendment No. 8 introduces for the first time the concept of cell companies to Jersey. Two types of cell company are permitted: protected cell companies and incorporated cell companies. A protected cell company (or PCC) is a company that has a number of cells, each cell having its own assets and liabilities being "ring fenced" from the assets and liabilities of other cells.

Incorporated cell companies (or ICCs) are a development beyond PCCs. Each cell of the ICC is itself an individual company with separate legal identity and each cell therefore holds its assets in its own name. ICCs are unique to Jersey and do not have an equivalent in any other jurisdiction.

i. PCCs

The concept of PCCs is not new to offshore jurisdictions and the key features of the proposed Jersey PCCs are based upon the model established in Guernsey and the Isle of Man. There are however a number of important proposed developments from the Guernsey PCC.

- In the event of insolvency of a cell, the only assets that will be available to creditors will be the assets of the particular cell with which the creditors contracted, as opposed to the company's non-cellular assets. The entire structure does not therefore need to be wound-up, for example, while a restructuring takes place.

- The activities of a PCC are to be distinguished from the activities of the cells of that PCC to enable clarity as to which liabilities fall to a particular cell or to the PCC as a whole.

ii. ICCs

The concept of ICCs is new and unique to Jersey. It reflects the best aspects of PCCs but is designed to give clarity to the ring fencing of assets and liabilities of the cells of a cell company held in jurisdictions which are unfamiliar with PCCs.

We expect that Jersey PCCs and ICCs will be widely used in many structures and very flexible. They are likely to be used in any area where legal segregation of assets is an attractive feature such as:

- investment funds;

- commercial paper conduits;

- rent-a-captive structures;
- segregation of individual policy holders for life companies;
- composite insurance to segregate assets and liabilities of non-life business;
- nominee companies to enable separation of each beneficiary's assets.

It is also anticipated that they will be used as joint venture vehicles due to the ability to ring fence assets and liabilities although they may not be used as trading vehicles.

A separate client guide is available in relation to PCCs and ICCs.

b. Solvency tests

Previously a company wishing to

- redeem its shares;
- purchase its own shares;
- "whitewash" financial assistance;
- authorise a breach of director's duties; or
- make a distribution to its member.

needed to assess whether or not it is solvent for the purposes of the Companies Law. Amendment No. 8 replaces the current combined balance sheet and cash-flow solvency tests with a simpler cash flow based solvency test throughout the Companies Law.

In addition, where a company wishes to redeem or purchase its own shares, the directors will also need to make a statement that having regard to the company's prospects it will be able to carry on business for at least one year.

A separate client guide is available in relation to the new solvency test.

c. Other changes

- A company will no longer need to display its name on the outside of its registered office as company names and addresses are available on the website of the Jersey Financial Services Commission ("**JFSC**").
- Companies that are able to pay their liabilities as they fall due will be able to commence a summary winding up, regardless of the timescale within which such liabilities fall due (rather than within 6 months, as previously).

- Regulations may be passed specifying classes of people who may not act as directors of a company.

- The Courts will be able to order that a person be disqualified from holding certain private or public office.

- The JFSC and/or the Economic & Development Committee may apply to the Court to have a company wound up if it is in the public interest to do so.

- The liability of a shareholder in respect of any purchase or redemption of his shares will be limited to occasions where he knew or ought to have known that the company was insolvent at that time.

For more specific advice on the information covered in this guide, we invite you to contact one of the following in the Corporate and Commercial Practice Group:

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Appleby is one of the largest and most well respected offshore-based legal, fiduciary and administration service providers. With over 600 lawyers and staff, the organisation is uniquely positioned in the key offshore jurisdictions of Bermuda, the British Virgin Islands, the Cayman Islands, Jersey and Mauritius as well as the financial centres of London and Hong Kong.

The group provides sophisticated, specialised services primarily in the areas of: Corporate and Commercial, Litigation and Insolvency, Trusts and Property. Complementing our legal expertise are our service companies, Appleby Corporate Services, Appleby Trust and Reid Management.

Appleby's associated service companies provide clients with a range of supplementary services:

- **Appleby Corporate Services** provides corporate administration services to thousands of companies that have their registered offices in the offshore jurisdictions in which we are located.

- **Appleby Trust** consists of licensed trust companies in Bermuda, Cayman Islands,, Jersey and Mauritius offering a comprehensive range of trust services. In Jersey, the group also provides employee benefits trusts, corporate and funds administration services. Appleby Securities (Jersey) Limited acts as a listing sponsor for the Channel Islands Stock Exchange.

- **Reid Management Limited** provides professional management, consulting and accounting services and also acts as a listing sponsor for the Bermuda Stock Exchange.

Appleby is also a member of TerraLex, an international association of law firms; the World Services Group, a global multi-disciplinary network of service providers; and is represented in many of the major international legal organisations.

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