Consultation

Chief Minister's Department

States of Jersey

Companies (Demerger) (Jersey) Regulations 201- Companies (Jersey) Law 1991

All references to the 'Regulations' in this paper are to the draft Companies (Demerger) (Jersey) Regulations 201-, being a draft of the proposed Regulations. All references to the 'Law' in this paper are to the Companies (Jersey) Law 1991 (as amended).

INTRODUCTION

This paper should be read in conjunction with the proposed Regulations which are found at Appendix 1, together with a copy of the Law which can be accessed at: https://www.jerseylaw.je/laws/revised/Pages/13.125.aspx.

The Companies (Amendment No. 11) (Jersey) Law 2014 introduced an enabling provision into the Law at Part 18BA to allow the States to make regulations to permit the demerger of Jersey companies. Following liaison with the industry as to the design of the legislation, due to the technical nature of the measures, the Regulations have been prepared, which Regulations form the backbone of this Consultation Paper. Further input on the Regulations is now requested and the concluded views of Government will be settled upon receipt and consideration of all consultation responses.

So far as is appropriate and relevant, the demerger provisions mirror the approach taken in the merger provisions set out in Part 18B of the Law.

Date published:	**Closing date:**
6 December 2017	**19 January 2018**

How we will use your information

The information you provide will be processed for the purpose of consultation. The Chief Minister's Department will use your information in accordance with the Data Protection (Jersey) Law 2005 and the Freedom of Information (Jersey) Law 2011. Please note that we may quote or publish responses to this consultation but we will not publish the names and addresses of individuals. If you do not want any of your response to be published, you should clearly mark it as confidential. Confidential responses will be included in any summary of statistical information received and views expressed.

Who should respond and ways to respond

The Government of Jersey is interested in receiving responses from individuals or businesses that have an interest in the financial services industry.

Responses should be submitted **by e-mail** to:

Louise Richardson/Tom Wherry
Financial Services Unit, Chief Minister's Department
Email: l.richardson@gov.je / t.wherry@gov.je

Alternatively, Jersey Finance will be collating an industry response and these responses should be sent to:

Helen De La Cour
Technical Manager, Jersey Finance Limited
Email: helen.delacour@jerseyfinance.je

Responses sent to Jersey Finance will be shared with the Government of Jersey unless the respondent indicates that they wish to remain anonymous. Please indicate clearly on your response if this is the case.

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This consultation paper has been sent to the Public Consultation Register.

Feedback on this consultation

We value your feedback on how well we consult or seek evidence. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact Communications.Unit@gov.je

1. Introduction

1.1. The introduction of a demerger regime is intended to enable the undertaking, property, rights and liabilities of a Jersey company to be divided amongst two or more companies, with assets and liabilities transferred by operation of law. Whilst it is possible to achieve a division in other ways (such as a scheme of arrangement, liquidation or a sale of assets), the demerger regulations will provide another alternative for a company to consider depending on the particular circumstances in place.

1.2. Following a demerger, the original entity may cease to exist with the business being continued by two or more new entities (sometimes called a 'Split Up Demerger'); or, the original entity may continue to exist alongside one or more new entities (sometimes called a 'Spin Off Demerger').

1.3. The company that is demerging is defined in the Regulations as the 'demerging company' and the resulting companies are the 'demerged companies'. If the original company continues to exist it is called a 'survivor company'; any company resulting from a demerger that is not a survivor company is defined as a 'new company'.

1.4. The current proposal envisages that the demerger regime will be applicable only to Jersey companies demerging into other Jersey companies and, for the time being, will be available only to Jersey companies which, in summary, are not liable to pay tax in Jersey either at the company or the shareholder level. The specific list of companies not eligible to demerge on these grounds is found in Regulation 2(3). It is intended to extend the regime to these companies once the consequential amendments to the tax legislation have been developed.

1.5. Specific procedures are already in place to govern transfers involving banking and insurance business which procedures include additional protections for consumers and creditors such as the supervision of the JFSC

and the courts, and, therefore, banking and insurance business is specifically excluded from these demerger regulations.

1.6. It is not envisaged that a demerger will require the sanction of the court unless the demerger involves potential insolvency or an application to the court is made by a dissenting creditor or shareholder.

1.7. As with a merger involving only Jersey companies, the consent of the Jersey Financial Services Commission (the "JFSC") is not required for a demerger, save that a licence or consent (or similar) issued by the JFSC to a demerging company can only be transferred with the permission of the JFSC. It should also be noted that the Registrar can refuse to register any new company created in the demerger if he or she would refuse to do so in the normal course of events.

1.8. All demerging companies must seek approval from their members and give notice to their creditors (of over £5,000). Both members and creditors can serve objections on the demerging company and can also apply to the Royal Court for relief on the basis that their interests are unfairly prejudiced by the demerger.

1.9. However, the principal means of protection for creditors, shareholders and employees is the requirement for a solvency statement to be given by the directors of the demerging company and the proposed directors of the demerged companies in respect of the demerging company and also in respect of the demerged companies for the twelve month period following the demerger.

2. The benefits of a demerger regime

2.1. It is considered that the introduction of demerger rules will strengthen the corporate law offering already available in Jersey and, it is anticipated, provide additional flexibility and cost-efficiency to those using Jersey

companies. Industry representatives have reported a commercial need for a process which enables a division in this manner and which might be simpler than alternatives currently available, whilst of course still providing protections for other interested parties (particularly creditors, shareholders and employees).

2.2. It is anticipated that the Regulations may be used in various situations such as the following (which is a non-exhaustive list):-

- where a company wishes to separate out key business strands thereby enabling the management of each new company to concentrate on a core business. Such separation often results in higher performance and better growth prospects for each sector and may have a consequential effect on value.
- where a company considers it to be advantageous to separate out businesses or activities that are no longer compatible into separate vehicles;
- where a company needs to restructure in anticipation of a sale;
- where a family business wishes to split assets in order to enable succession planning;
- in a funds context, it may be that the fund manager could warehouse certain illiquid assets of a fund near the end of its life into a special purpose vehicle (SPV) thereby reducing the costs of the fund whilst it is wound down.

2.3. Reports of experience elsewhere suggest that the value of each underlying activity or business is more fully recognised in its share price post demerger. Furthermore, investors may be able to analyse more easily the profitability and risks of a particular part of a business once it is a separate company.

3. Other jurisdictions

3.1. There is no statutory demerger regime in the UK, although a demerger is in effect possible through the use of other procedures in the Companies Act 2006. Cayman and the BVI have similar alternatives. None of Hong Kong, Singapore, Delaware, the Isle of Man, and Guernsey has a statutory regime.

3.2. Other jurisdictions which do have demerger or 'spin off' regimes of some sort include, Austria, Australia, Belgium, Chile, France, Germany, Italy, Japan, the Netherlands, and Norway.

4. Tax position

4.1. The introduction of the demerger regime is intended to support a restructuring transaction with a dominant commercial purpose rather than to provide a means for a company or its shareholders to avoid tax, and the general anti avoidance rule at Article 134A of the Income Tax (Jersey) Law 1961 is noted.

4.2. It is noteworthy that many of the other jurisdictions offering a statutory demerger regime of some kind have different tax regimes from Jersey particularly in connection with corporation tax and capital gains tax and the respective demerger regimes, therefore, usually permit the companies to avail themselves of certain tax advantages (as long as a demerged business is not then divested to a third party within a set time period). These taxes do not apply in Jersey in the same way and, as stated above, there are not intended to be any advantages in terms of tax for a company choosing to demerge rather than using one of the demerger alternatives.

4.3. The Regulations require that notice of any demerger must be given to the Comptroller of Taxes which will initially be by way of an electronic self-certification confirming, in summary, that the company is a Jersey company

which is not liable to pay Jersey tax and which does not have any shareholders who are liable to pay Jersey tax (see Regulation 2(3) for a full list of eligibility criteria).

5. Protection for third parties

5.1. A key issue for government in considering these proposals is the balance to be struck between providing optimum flexibility for a business with the need to protect third parties.

5.2. As is the general policy direction in the principal Law, the key protection for a third party affected by a demerger is the focus on solvency. There are two aspects to this. First, each director of the demerging company who votes for the demerger must sign a certificate stating that in their opinion the demerger is in the best interests of the demerging company and that they are satisfied on reasonable grounds either that they can make a solvency statement (saying that the demerging company is, and will remain until after the demerger is complete, able to discharge its liabilities as they fall due) or that there is a reasonable prospect of obtaining the permission of the court to the demerger under Regulation 8. Second, the proposed directors of the demerged companies must sign a similar certificate as to the expected solvency of the demerged companies for the twelve month period following the demerger. If none of the existing directors are to be directors of the demerged companies, then at least one of the existing directors of the demerged company who signed the certificate confirming the solvency of the demerging company up to the demerger date must also sign the post demerger certificates. Making a false statement or signing a certificate without reasonable grounds is an offence punishable with imprisonment or a fine.

5.3. If the declarations of solvency are not possible, court sanction is required for the demerger to proceed pursuant to Regulation 8, which sanction will only be given if the court is satisfied that the demerger would not be unfairly

prejudicial to the interests of any creditors or shareholder (member) of the demerging company. Such a situation might arise where, for example, a company has cash flow difficulties such that it cannot discharge its debts in the short term but has significant assets (perhaps real property or intellectual property rights) which will be valuable in the longer term.

5.4. Creditors, shareholders and employees also have certain rights to access information such as the demerger instrument so that they can make informed decisions. Currently, however, there is no obligation in the Regulations for the demerging company to prepare interim accounts which is a requirement in certain jurisdictions. Shareholders and creditors have the right to file an objection with the demerging company and to bring court proceedings as set out below.

Protection for shareholders

5.5. Shareholders have the opportunity to approve or veto the demerger proposition at an EGM and must be provided with access to sufficient information in order to make an informed decision (Regulation 5).

5.6. Furthermore, a shareholder can notify a company of their objection to the demerger and then make an application to the court (Regulation 6). If the directors are not able to make a solvency statement, court approval must be sought in any event and the shareholders have a right to be heard at that court hearing (Regulation 8(5)).

5.7. On application to the court, where the court is satisfied that the member would be unfairly prejudiced by the demerger, the court may make such order as it thinks fit for giving relief in respect of the matters complained of (Regulations 6(3) and 6(4)).

Protection for creditors

5.8. Notice of the demerger must be sent to all creditors with a claim over £5,000 (Regulation 7). Furthermore, notice of the demerger must be published in a local newspaper (or published in another approved manner). Any creditor may inspect the demerger instrument free of charge although the demerging company may redact commercially sensitive information.

5.9. Where solvency statements have been made by the directors, a creditor with a claim exceeding £5,000 has a right to serve a notice of objection on the company and if their claim remains unsatisfied, may then apply to the court seeking an order restraining the demerger or modifying it on the basis that their interests (or those of any other creditor) will be unfairly prejudiced.
If the court modifies the demerger instrument, the demerging company is given the option of terminating the demerger if it so wishes.

5.10. If the directors are not able to make a solvency statement, court approval must be sought and the creditors have a right to be heard at that court hearing (Regulation 8(5)).

5.11. Whilst an alternative approach might be to permit creditors to ask for security for their claims from the new companies (as adopted, for example, in Switzerland) this is seen as a somewhat complicated and potentially time consuming approach if there is a number of smaller creditors. Whilst one might introduce a *de minimis* threshold, as matters stand prior to consultation, the Government prefers the protection offered by the solvency statement procedure.

Protection for employees

5.12. There is no equivalent in Jersey of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (as amended) (which apply in England and Wales when a business or undertaking is transferred to a new employer). However, it is not intended that a demerger under the

Regulations will of itself disadvantage any employees. Regulations 12 and 13 provide that, unless express provision is made to the contrary, the contracts of employment between the demerging company and its employees are automatically transferred across to the designated demerged company with no change in terms and conditions. In addition, the employee's period of continuous employment is preserved. The provisions of any collective agreements in force immediately before the demerger and which apply to the employee continue to have effect.

5.13. Written notice must be provided to the demerging company's employees, and opportunity given for them to inspect the demerger instrument (which can be redacted to remove commercially sensitive information).

5.14. Any employee may object (in writing) to the transfer of their contract of employment. Such objection (if still in place on completion of the demerger) acts to prevent any transfer of their contract of employment so that the employee is treated as having resigned from the demerging company with effect from the date of demerger and thus not ever having been employed by the relevant demerged company.

5.15. In relation to retirement schemes, it is not usually possible to transfer pension rights due to the terms of the individual schemes. However, if the demerging company provided a pension scheme and had a contractual obligation to pay a certain level of contribution, this obligation in respect of payment of contributions will be transferred to the new employer (Regulation 14). The basic premise is that the employer must provide something broadly comparable.

6. Ownership of assets and responsibility for liabilities after a demerger

6.1. In jurisdictions which do have a demerger regime, there is no consistent approach to the question of whether a demerging company should have complete freedom to determine the destination of assets and liabilities or

whether the freedom should be limited in some way. Whilst it is not possible to fully analyse the situation in other jurisdictions without a full understanding of the underlying company and associated legislation, by way of example, it appears that in Belgium and the Netherlands, the demerging company may, broadly speaking, specify where assets and liabilities end up. In France, however, the joint and several liability for liabilities is imposed on all of the resulting demerged entities unless it is specified that liability will relate to the proportion of the share of assets transferred.

6.2. The proposal put forward in the Regulations is, with certain limitations, to permit the demerging company to have freedom to determine the destination of the assets and liabilities of the demerging company provided that the destination of the assets and liabilities is specified in the demerger instrument (Regulation 3). On balance, the Government position is that this flexibility is in keeping with the general tenor of the Law whilst recognising in other parts of the Regulation the need for third party protection.

6.3. It is recognised that whilst other jurisdictions will no doubt respect Jersey law, Jersey law cannot be wholly determinative as to how non-Jersey situs assets may transfer and checks will have to be made by advisors accordingly.

6.4. There is currently no *de minimis* level in respect of the list of company assets and liabilities and it is anticipated that general provision should be made to cover all minor items in the demerger instrument.

6.5. If the destination of any assets and liabilities is omitted from the demerger instrument (whether inadvertently or deliberately) ("Omitted Assets" and "Omitted Liabilities"), there is a range of options. The demerger instrument may, and should, include a 'sweep up' provision setting out what will happen to Omitted Assets and Liabilities. However, there is need for a default statutory position in the event there is not such a provision. In Belgium,

unidentified liabilities are shared in proportion to the value of the assets which were transferred to the respective demerged companies, with joint and several liability between the demerged entities so that if a demerged company is unable to discharge the liability in full, one of the other entities will have to cover the remaining balance. The Netherlands provides for joint and several liability for unidentified liabilities and joint ownership of unidentified assets.

6.6. A further alternative is to leave any Omitted Assets and Liabilities with the survivor company if it survives.

6.7. As currently drafted, the Regulations envisage that Omitted Assets would be held jointly in common in equal parts between the demerged companies in equal shares. Omitted Liabilities of a civil nature are to be apportioned on a joint and several basis equally amongst the demerged companies.

6.8. Joint ownership and joint and several liability are easy and well understood concepts and avoid any difficulties in determining the respective value of the business acquired by a demerged company. In addition, it is considered that the approach discourages a company from omitting to deal with unidentified assets and liabilities and provides protection for third parties.

6.9. Criminal liability is, understandably, an exception to the principle of freedom of designation of assets and liabilities. It is not appropriate for private individuals or companies to decide which entity is or is not liable for a criminal act and to what extent. A company which has been charged with a criminal offence or is under investigation will not be permitted to demerge pending the outcome of the proceedings. Should a potential offence come to light after a demerger, it is a matter for the Attorney General, taking into account the usual factors of the public interest and principles of natural justice to decide upon who to prosecute. Any financial penalty will be

considered as a joint and several liability on all the demerged companies to ensure enforcement is possible.

7. The path to demerger

7.1. Full detail is included in the Regulations but the process in summary is as follows:

Assuming directors can sign statement of solvency at Step 3

Step 1 Prepare demerger instrument

Step 2 Directors pass resolution

Step 3 Directors and/or proposed directors of demerged companies sign certificates

Step 4 Notice of EGM given with specified information/documents

Step 5 Approval of Demerger by Special Resolution of members at EGM

Step 6 Written notice to each creditor with claim over £5,000 and notice to employees. Self-certification to Taxes office.

Step 7 Demerger instrument and Articles of Association and Memorandum available for inspection and notice of demerger published in Jersey paper (or other approved method of publication)

Step 8 Apply to Registrar of Companies to complete demerger providing specified documents

Step 9 Demerger registered by Registrar upon which registration the demerger is complete

If the directors cannot sign statement of solvency at Step 3, court permission is required

Step 5A Company applies to court for permission on the ground that the demerger is not unfairly prejudicial to the interests of any creditor or member (with copies of application to specified parties).

Step 5B Court order

If a Member objects

Step 6A Objecting member notifies company of objection and applies to court for order that demerger would unfairly prejudice the interests of the member

Step 6B Court order and filing with Registrar

If a Creditor objects

Step 7A Objecting creditors notify company of objection and apply to court for order restraining or modifying demerger

Step 7B Court Order

8. Previous Consultation

8.1. The subject of demergers was canvassed in a February 2010 consultation entitled 'Cross-border Mergers of Jersey Companies' (the "February 2010 Consultation"). The question was posed: 'Do you agree that the introduction of demergers should be investigated? If so, what factors should be taken into account?'[1]

8.2. As part of the a November 2011 consultation in relation to the Companies Amendment (No. 11) (Jersey) Law 2014 ("Amendment No. 11") (the "November 2011 Consultation"), views were sought on 'demerger and division' with the questions asked: 'What are considered to be the chief legal and tax considerations of permitting company demergers outside of the traditional 'scheme of arrangement' model?' And 'Is there a market demand for demerger provisions of this type and, if so, does it extend to cross-border demergers and to demergers into non-company bodies corporate?'[2]

8.3. The response to the February 2010 Consultation did not directly address the issue of demergers. The combined response to the November 2011 Consultation supported the idea in principle and accordingly, Amendment

[1] The Consultation Paper can be found here; a Summary of Responses can be found here.
[2] The Consultation Paper can be found here; a Summary of Responses can be found here.

No. 11 included provision for a demerger regime to be introduced by way of regulations, with an intention for further consultation about the detail of the proposed procedure.

9. Time periods

9.1. Under the merger provisions of the Law, the original notification and objection periods were either 28 or 30 days. Following the consultation relating to Amendment No. 11, to which comments were received to the effect that the periods were too long, the Government decided to reduce the periods to 21 days and to permit abridgement of the time periods where all relevant parties consented. Similarly, notification and objection periods for both members and creditors have been set at 21 days in the Regulations. In addition, there is opportunity for abridgment of the time periods for both members and creditors where all relevant parties consent.

QUESTIONS

The Chief Minister welcomes general comments on the proposal to allow Jersey companies to demerge and in particular on the following specific questions:-

1) Do you have any comments relating to the eligibility criteria for companies that wish to utilise the demergers scheme as set out in Regulation 2?

2) Do you agree that the approach concerning the supervision of demergers should contain protections that are broadly commensurate with those that are already in place for company mergers under the Law?

3) Do you agree with the proposed approach to protection for third parties, the key to which is the certification as to solvency required from the directors as part of their approval of the demerger?

4) Do you agree that an insolvent company should be permitted to demerge subject to court approval?

5) Do you agree that only creditors with a debt of £5,000 or more should be able to object to a demerger?

6) The demerger instrument is to be made available (in potentially redacted form) to the shareholders or creditors in order to provide them with essential information so as to make an informed decision. Should there be a specific requirement for a demerging company to prepare interim accounts up to the date of the demerger?

7) Are you satisfied that Regulations 13 and 14 provide appropriate protection for employees particularly regarding their retirement schemes?

8) Overall, are you satisfied with the proposed measures for the protection of third parties such as creditors, shareholders and employees of a demerging company?

9) The general policy direction is to permit a demerging company to have freedom to determine the destination of its assets and liabilities subject to some limitations and provided that the destination is specified in the demerger instrument. Do you consider this as the most appropriate way forward or do you prefer other more restrictive options?

10) Where, despite the above, the destination of assets and obligations (including debts) of the demerging company is not specified in the demerger instrument (referred to in the Paper as Omitted Assets and Omitted Liabilities), the proposal is that those assets are jointly owned in equal shares and those obligations are held jointly and severally by the demerged companies? Do you agree with this approach or do you consider that alternatives would be preferable?

11) Do you agree that the demerging company should be able to redact commercially sensitive information when it makes the demerger instrument available to creditors and employees?

12) Do you agree with the time periods for notification in the Regulations, and with the abridgment capability?

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