COMPANIES (AMENDMENT NO. 6) (JERSEY) LAW 2002

Introduction

The Companies (Amendment No. 6) (Jersey) Law 2002 (the "Amendment") which came into effect on 1st September 2002, constitutes the first major overhaul of the Companies (Jersey) Law, 1991 (the "1991 Law").

The Amendment is significant, yet leaves much of the 1991 law intact, notably that part which governs the activities of a company, post-incorporation. The main thrust of the Amendment is to widen the formation options for a Jersey Company and to allow much greater flexibility whilst maintaining appropriate protection for creditors and minority shareholders. The Amendment also provides for foreign companies to repatriate to Jersey, for Jersey companies to repatriate to other jurisdictions, and for two or more existing Jersey companies to merge into a new single corporate entity.

The Amendment addresses certain practical uncertainties which stem from the 1991 Law (notably, in relation to the issue of unlawful financial assistance), and underscores the Island's commitment to best practice, by increasing the disqualification period for directors of a company and by widening the ability of the Jersey Financial Services Commission (the "Commission") to assist overseas authorities with investigations involving Jersey companies.

The New Options

The new options available when incorporating companies are:

- Guarantor Members

  Members of companies may be either shareholders, or guarantor members whose liability is limited by the amount they guarantee, or a mixture of guarantor members and shareholders ("hybrid companies"). In the event of a winding-up of a company, guarantor members will be liable to contribute the amount they guaranteed to the company. Guarantor members do not have to hold an ownership interest in a company: instead, their interest can be characterised as a contingent liability owed to the company. This can have a number of advantages, as described in greater detail below.

- No Par Value Companies

  Companies may be formed as, or converted to, no par value companies, which will issue shares that have no nominal value ("no par value shares").

- Unlimited Shares

  Companies may be created with unlimited shares in respect of which the holders will have unlimited liability.

- Single Member Companies

  Private companies may be incorporated and owned by a single member. Only public companies are required to have two or more members.

The Amendment also offers two new options for companies following their incorporation:

- Mergers

  Two or more existing Jersey companies may merge and continue as a new single company, provided neither company has guarantor or unlimited members (these restrictions do not apply to mergers of wholly-owned subsidiaries). Creditors of either existing company have the right to object to a proposed merger.

- Continuance

  An overseas company, if permitted to do so under the law of its place of incorporation, may apply to the Commission to continue its corporate existence as a company incorporated in Jersey. In the same spirit, a Jersey incorporated company may be permitted, in certain circumstances, to repatriate in another jurisdiction.

Potential benefits and uses of the New Options

It is anticipated that hybrid companies, which may be very adaptable, will be widely used, particularly in relation to international tax planning or asset protection structures.

As with all companies, hybrid companies will be governed by their memorandum and articles of association, which can be as simple, or as complex, as circumstances demand. However, it is the combination of guarantor members and shareholders that gives a hybrid company an extra layer of flexibility to make it a vehicle uniquely suited to certain types of transactions.

For example, a company may be established with a single ordinary shareholder but with a number of guarantor members, the liability of each limited to, say, £100, in the event the company is wound up. The interests of the guarantor members may be expressed to be personal to them and non-transferable. The articles of association of the company may provide that the shareholder has no rights to any assets, and that the guarantor members are entitled to all of the income and capital. There will be total flexibility as to how voting rights are to be divided between the shareholder and the guarantor members. Effectively a structure may be established where the legal ownership of certain assets is held by a company, the legal ownership of the company is in the hands of the shareholder, the management of the company is in the hands of the directors and the ultimate benefit to the company's assets belongs to the guarantor members.

Such an arrangement would be, in many ways, analogous to a trust structure as there is a similar split between the legal and beneficial ownership of the assets. However, the arrangement would have a number of advantages over a trust:

1) The concept of a company is internationally better understood and recognised than that of a trust.

2) The responsibilities of a director are clearer, and in some ways less onerous, than those of a trustee. Thus directors of hybrid companies may engage more actively in business matters and to invest more speculatively than a trustee may feel able to.

3) There is a reduced risk of the structure being characterised as a sham. This allows the ultimate "beneficiary" of the company to exercise closer control over its assets than would be advisable in a trust context. Furthermore the articles of association may provide for a "golden shareholder" to supervise the directors in a manner analogous to the role of a Protector of a trust.

4) There are no perpetuity restrictions on a hybrid company.

5) As assets in a hybrid company belong to the company in perpetuity, there is no need for “certainty of objects” (as with a trust structure).

A hybrid company may be structured in such a way that it may be treated by a foreign tax or regulatory authority as a company, a trust or a partnership - as circumstances may require.

Guarantee companies may go one step further than hybrid companies by abandoning shares altogether. Instead, all members guarantee to provide a fixed sum in the event of the company's insolvent liquidation (a members liability to contribute continues if the company is wound up within the twelve months after he ceases to be a member). As with hybrid companies, the articles of association can be specifically tailored to meet requirements, albeit a guarantee company will not offer all of the options of a hybrid company. In particular, guarantee companies will not offer the separate level of ownership provided by a hybrid company.

Guarantee companies may be particularly suited to charitable, social, political or other non-trading purposes. As a guarantor member is under a contingent liability to the company, the articles of association may provide that his interest be non-transferable, without the possibility of this being attacked as a fraud, as would be the case were such a restriction to be applied to a shareholder. This effectively controls membership of the company, allowing new members to be introduced by election among the existing members. The articles of association may also provide for the appointment of “ex officio” or honorary members (who will not necessarily be guarantor members). Depending on the manner in which the articles of association are drafted, it can be easier to protect the rights of minority members in a guarantee company than in a traditional company. This makes a guarantee company well suited as a vehicle for owning timeshare resorts or similar assets, or where shareholdings are unnecessary or undesirable. The fact that a member's interest is a “contingent liability”, rather than an asset, may also be advantageous in the context of tax and inheritance planning.

The voting rights of guarantor members are determined by the articles of association of the company. In default of such provision, the Amendment provides that guarantor members shall be entitled to vote on a show of hands and shall each be entitled to one vote on a poll.

The introduction of **no par value companies** is expected to be of particular benefit to the investment funds industry. Under the 1991 Law, strict requirements were imposed upon a company to maintain its share capital for the benefit of creditors. While the requirement is understandable in the context of trading companies, it imposed an unnecessary burden upon investment and special purpose vehicles, which tended to have few creditors, even although a relaxation of the general requirement was incorporated for open-ended investment companies holding a permit under the Jersey Collective Investment Funds legislation. Open-ended funds, by their very nature, have a dynamic share capital; investors generally purchase and redeem shares in a constant cycle. The maintenance of capital requirements required funds to issue shares at nominal value whenever shares were redeemed, which frequently led to large numbers of shares, and large amounts of capital, effectively lying dormant within the fund structure. The introduction of no par value companies will avoid these problems.

Companies having **no par value shares** may be incorporated with a share structure, setting out the classes and the number of shares in each class. When shares are issued, the value will be transferred to a "stated capital account", analogous to a combination of share capital, share premium and capital redemption accounts of a company which has issued shares with a par value. However, the company may redeem and purchase its own shares and reduce the amount in its "capital accounts", provided, it meets standard solvency tests. Companies having shares with a par value may convert to no par value shares, and vice versa. The result will be a more fluid share structure, better suited to companies having a frequently changing membership and limited numbers of creditors.

Unlimited companies are introduced into Jersey company law for the first time. They can be private or public companies, issuing par or no par value shares, although an unlimited company will not be permitted to have guarantor members nor members holding limited shares. As the name suggests, the members of an unlimited company will have unlimited liability as they effectively underwrite the company's liabilities to the extent of their personal assets. An unlimited company has some similarities to a partnership, but unlike a partnership it has a legal personality, which will allow a creditor bring an action directly against a member only as part of the process to wind up the company. In return for accepting the greater risks of unlimited liability, a number of the requirements of the 1991 Law, particularly in relation to the maintenance of share capital, will not apply to unlimited companies. It is also notable that an unlimited company can reduce the number of its unlimited shares without the consent of the court, an exception to the general rule that a reduction in capital requires the court's consent

The use of unlimited companies is likely to be driven by international tax planning and regulatory considerations.

The introduction of **single member private companies** will allow companies to be established by a single subscriber, and to continue with a single shareholder, without the potential loss of the corporate veil. A sole member, if he is also a director of the relevant company, must ensure that any contracts made by him (as director) with the company are recorded in writing, and recorded as decisions made by the shareholder, which will then have the same effect as a resolution passed at a general meeting of the company.

Mergers

Under current Jersey law, a merger can only occur by one company transferring its assets to another, before liquidating itself. This could be more accurately described as a takeover or scheme of arrangement, rather than a merger. The Amendment provides for "true mergers", where two or more Jersey companies may come together to form one new entity which combines the assets, undertakings and liabilities of the merging companies. The shareholders of each of the companies must approve the merger by a special resolution, also the articles of association to govern the new company. There are safeguards in place to protect minority members who may apply to the court for relief if they deem their interests may be unfairly prejudiced.

It is expected that the new merger provisions will be particularly useful when a parent company wishes to merge subsidiaries. The new provisions do not apply to companies with guarantor members or unlimited shares.

Continuance

Companies incorporated in foreign jurisdictions may apply to the Commission for a certificate to continue as a company incorporated in Jersey, provided the laws of their place of incorporation enable them to take advantage of the new provision. The Commission will issue certificates of continuation to companies only if, upon repatriation in Jersey, they cease to be incorporated in their country of origin.

Jersey companies may also repatriate elsewhere, provided the members resolve to do so by special resolution, and the proposed new jurisdiction meets criteria set out in the Amendment. There are a number of safeguards to provide for creditors and minority members of a company to object, if they believe that continuance overseas will unfairly prejudice their position.

Practical Issues

Financial Assistance

It will remain "prima facie" unlawful for a Jersey company to provide financial assistance for the purchase of its own shares. However, the Amendment to Article 58 of the 1991 Law addresses two recurrent difficulties. Firstly, the test has been amended so that it is only financial assistance given *"for the purpose of that acquisition"* which is unlawful. Currently, the test is whether assistance is given *"for the purpose of or in connection with*" the acquisition. The words "in connection with" had wide implications: in particular, they seemed to render irrelevant the motive behind the act of assistance. By introducing a new "purpose" test, much of the uncertainty and caution that arose, particularly in relation to complex structured financing transactions, has been removed, easing structuring considerations and therefore speed and cost efficiency of execution. The change brings this aspect of Jersey Law into line with its UK equivalent

The second part of the amendment to Article 58 relaxes the requirements under the so-called "whitewash procedure", by which actions which would otherwise have constituted unlawful financial assistance were permitted, if sanctioned by a prior special resolution, and provided the company giving the assistance satisfied a simplified solvency test. Furthermore if the company was a wholly-owned subsidiary, a prior special resolution of any holding company (which was not itself a wholly owned subsidiary) was also required. Due to a quirk in the statutory drafting of the definition of "special resolution" in the 1991 Law, there was no certainty that a special resolution for the purposes of the test (and the 1991 Law generally) could be passed by a non Jersey company. The Amendment provides that, in order to sanction the giving of financial assistance, a prior special resolution of the company proposing to give the financial assistance is required, but there is no requirement for a special resolution or for any act on behalf of any parent company.

While relaxing these provisions for the benefit of companies, the Amendment bolsters the protection offered to creditors in the event that a company (or any Jersey subsidiary) gives financial assistance for the purchase of its own shares. A company can only give such assistance if the directors are satisfied that after the provision of assistance the realisable value of the company's assets exceeds its liabilities.

Public and Private Companies

Under the 1991 Law, private companies were permitted to have up to 30 members. Any company with more than 30 members was treated as a public company, and subject to the extra regulations which apply to public companies. The Amendment relaxes this strict requirement, so that a private company may seek advance consent to increase its membership beyond 30, and a public company with more than 30 members may seek dispensation to become a private company. The Commission will allow private companies to exist with more than 30 members if satisfied that the affairs of the company can be properly regarded as the domestic concerns of its members. It will be within the discretion of the Commission whether a company with more than 30 members can become, or, once consent is granted, remain, a private company.

Redemptions and Distributions

As well as the introduction of no par value companies, the Amendment relaxes the provisions requiring a company to maintain its share capital. The Amendment relaxes the provisions governing the distribution of a company's assets to its members. Article 56 of the 1991 Law, which sets out a complex financial test to determine whether a company could redeem shares and, if so, from which sources has been repealed and replaced by a provision which will allow a company to redeem shares at any time and from any source (including the company's share premium account). Payments made in redeeming shares will, however, be subject to Article 181 of the 1991 Law, which provides that in the event of a creditors' winding up within a year of a redemption of shares, the former holders of redeemed shares will be required to pay back an amount up to the amount of the sum received in respect of the redeemed shares in the previous year.

An amendment to Article 114 of the 1991 Law, which governs when and from what source a company may pay dividends or make other distributions provides that the redemption or purchase by a company of its own shares cannot be classed as a distribution. The change allows companies the maximum amount of freedom to structure their internal affairs as they wish, and to protect creditors by ensuring that transactions which, when they occurred, were to the prejudice of creditors can be unwound in any subsequent insolvency of the company.

Maintaining High Standards

In the ten years since the introduction of the 1991 Law, international standards have evolved, and a number of amendments have been introduced to ensure that Jersey's reputation for providing a responsible and well-regulated environment is preserved and enhanced. This is part of Jersey's ongoing commitment to ensure that it remains at the forefront of best international practice. Amongst the amendments are:

- The Commission is empowered to increase the penalties to companies which fail to file annual returns on time.
- Limiting the power of the Commission to grant time extensions for the late filing of a public company's accounts.
- Increasing the powers of the court to disqualify a person for up to 15 years from being a director of or being directly or indirectly involved in the management of a Jersey company or in the management of a foreign company in Jersey.

- The Commission may require the registrar of companies to disclose information held on the register of directors and secretaries maintained by the company secretary.
- Creating a new offence of knowingly or recklessly misleading or withholding information from an inspector in the course of an investigation by the Commission into the affairs of a company.
- Allowing inspectors' reports prepared on behalf of the Commission in relation to a company to be released to equivalent foreign supervisory authorities.
- A Jersey company will no longer be required to have a company seal.

This memorandum is intended to provide a brief commentary on the Companies (Amendment No. 6) (Jersey) Law 2002. It is not intended to be comprehensive nor to provide legal advice and should not be acted or relied upon as so doing. Professional advice appropriate to the specific situation should always be obtained.

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