

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

- (b) the value of the company's assets will not 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

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(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.

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.

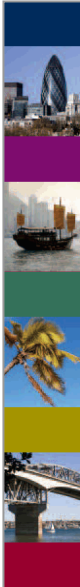
Conclusion

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.

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