Cell Segregation in Protected Cell Companies

*A matter of law or governance or both?*

August 2012

Brief Description: Robin Amos discusses the extent of which users of cell structures can be confident in the segregation of assets and liabilities. This is an extract article previously published in the Captive Review, Cell Company Guide 2012, with the author’s kind permission.
A Protected Cell Company (or Segregated Account Company) is a limited liability company with the ability to form cells that are segregated from each other and from the company. The basic idea is to ensure that any one cell cannot be affected by the business of another cell. Such a company form is facilitated by local statute. The cells themselves are not recognised legal entities but have sufficient attributes such that they may trade under the umbrella of the PCC. In any action instituted in the courts of the jurisdiction of incorporation of the PCC, there cannot be any doubt that PCC legislation would be given effect to.

But the concept often raises the obvious question: will a foreign jurisdiction recognise the PCC and the security and segregation of its cells? A related question is whether the answer can be dealt with solely in terms of legal principles or whether a wider governance perspective is needed for a business to fully understand the relevant risks and implications.

The risk of non-recognition may arise if the PCC engages in compulsory insurances giving rise to third party liability claims (such as third party personal injury claims in motor insurance). This is because such an injured third party will not have agreed to any concept of cell segregation – he is an involuntary creditor. The risk is that a court may attempt to impose liability on the company as a whole without regard to cell segregation.

Another example is non-compulsory liability insurance. Say a manufacturing company owns a cell and writes a liability policy to itself or a subsidiary. The company is the subject of a tort claim in respect of third party personal injury. The company then becomes insolvent. If local legislation gives a claimant the right to directly sue the insurance company under the policy and the cell has insufficient assets to settle the claim, what view would the foreign court take?

These are key legal issues discussed in the leading reference book on the subject of protected cell companies - “Protected Cell Companies: a guide to their implementation and use” (Spiramus Press, now in its second edition) by Nigel Feetham and Grant Jones.

The following observations may be relevant:

- An important consideration is recognition of the domicile’s laws by other jurisdictions. In this regard Gibraltar and Malta have a distinct advantage because the EU Insurance Insolvency Directive requires mutual recognition of a local insolvency process. Clearly, the local jurisdiction of the PCC will apply the statutory principle of cell segregation of assets and liabilities.

- The concepts of ring-fencing of assets and liabilities and claims limitation are widely recognised in most (if not) all jurisdictions. In a PCC the parties have agreed contractually to conduct their business with no recourse to the assets of other cells on an informed basis. Further, it would actually undermine the principle of policyholder protection to allow one involuntary creditor to disregard the statutory ring-fence at the expense of other creditors.

- The PCC should be managed to the highest standards such that all parties understand they are contracting with a PCC. The Manager of a PCC can make a fundamental difference, achieving effective “back to back” reinsurance contracts and compliance with local insurance laws and market conventions.

- The management of a PCC should be kept local as far as possible. Assets should be held locally. Also, all the contracts should be subject to the law and jurisdiction of the local PCC courts (as far as possible).
- Cell policyholders could be given a security interest to the assets of the cell (a right *in rem*) to reinforce the statutory ring-fence.

- The PCC’s manager should adopt a “belt and braces” approach and complement statutory segregation of assets/liabilities with contractual limitation of liability clauses. The principle of ‘limitation of liability’ whereby the liability of a trader or investor was limited to specific amounts has been recognised in commerce over very many years.

- There are many examples of structures used around the world that perform a similar function to a PCC and statutory segregation in the corporate form exists in many jurisdictions.

- Moreover, if the cell limitation is seen as a rule of substantive law, rather than as the blocking of remedies, then there is a strong argument that the court should respect this.

- The PCC (or its various incarnations) exists in over 39 domiciles around the world including numerous States of the US.

Of course, there is as yet no specific case law on the subject; however in England there is an important judgment of the Supreme Court in *McGrath v Riddell* [2008] UKHL 21. In this judgment, the principle of respecting the insolvency proceedings of another jurisdiction is very helpful for the future prospects of a PCC in the context of an insolvency with cross-border issues. Quoting Lord Hoffman:

“The primary rule of private international law which seems to me applicable to this case is the principle of (modified) universalism, which has been the golden thread running through English cross-border insolvency law since the eighteenth century. That principle requires that English courts should, so far as is consistent with justice and UK public policy, co-operate with the courts in the country of the principal liquidation to ensure that all the company’s assets are distributed to its creditors under a single system of distribution.”

A further confirmation that a court will look to protect cell assets was the “Gottex” case in Bermuda in 2010. In this case, the Bermuda court affirmed the principle of a protected class of assets within a Segregated Account Company.

Even with all these considerations and mitigating factors, it is clear that the Board of directors of a PCC should consider this as a matter of governance. The new book by Nigel Feetham – *“A Guide to Insurance: combining Governance, Compliance and Regulation” (Spiramus Press, 2012)* – discusses the nature of governance in insurance companies. The formal trappings of good governance are clearly important but without a sense and understanding of the risks these formalities will not help. True cell security is going to be ensured to the highest degree in a well-governed company that is also alert to regulatory and legal developments.
Contact Information

**Robin Amos**
Director
Aon Risk Solutions
Aon Insurance Managers (Gibraltar) Limited
+350 200 43882
robin.amos@aon.gi

**John Rowson**
Executive Director
Aon Risk Solutions
Aon Insurance Managers (Guernsey) Limited
+44 (0) 1481 707954
john.rowson@aon.co.gg
About Aon

Aon plc (NYSE: AON) is the leading global provider of risk management, insurance and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 61,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative and effective risk and people solutions and through industry-leading global resources and technical expertise. Aon has been named repeatedly as the world’s best broker, best insurance intermediary, reinsurance intermediary, captives manager and best employee benefits consulting firm by multiple industry sources. Visit www.aon.com for more information on Aon and www.aon.com/manchesterunited to learn about Aon’s global partnership and shirt sponsorship with Manchester United.

Copyright 2012 Aon Corporation