BOOK REVIEW: "Protected Cell Companies: a guide to their implementation and use", by Nigel Feetham and Grant Jones. Published by Spiramus. ***Review by Robin Amos.***

As the authors acknowledge, it is indeed surprising that this book represents the first ever detailed study of Protected Cell Companies. Practitioners involved with such companies will doubtless want to know whether this is required reading. This reviewer has no doubt that it is, due mainly to the clarity of the analysis; a difficult feat given the challenge of returning to first principles in the fields of company law, insolvency, accounting and insurance, and all of these in an international context.

So what is a PCC?

It 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 companies but have sufficient attributes such that they may trade under the umbrella of the PCC. In most jurisdictions, PCCs are akin to captive insurance companies, but the concept can also apply to investment funds and special purpose entities. There are over 300 PCCs world-wide with thousands of cells so the value of the concept is established beyond doubt. The reasons for their existence vary but mainly concern the efficiency of handling multiple cell users within a single legal entity, with the segregation between cells protected as a matter of law. The relative novelty of this concept raises an obvious but central question that is the core analysis of the book, namely: will any other jurisdiction recognise the PCC and its cells, especially in the event of an insolvency?

Insolvency of a PCC

The short answer is that probably yes, and almost certainly for voluntary creditors, but less likely if the PCC engages in compulsory insurances where liability is unlimited and particularly where the creditors are deemed to be involuntary. In getting to this answer some considerable background and supporting argument is provided and it is worth dealing with the key concepts here. A primary issue 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 will protect the concept of cell segregation of assets and liabilities. The authors argue that aside from international treaty or quasi-treaty requirements, the concept of ring-fencing liabilities should not conflict with accepted business practice. After all, the parties to the PCC have agreed contractually to conduct their business with no recourse to other cells. Further, it may actually go against principles of policyholder protection to put this aside to benefit just one creditor (say) at the expense of others. The problem, however, with this line of reasoning (as the authors emphasise) is that issues of public policy could intervene when the creditor is deemed involuntary. An example may make this apparent: Say an Insured owns a cell and writes a liability policy to itself or a subsidiary. The Insured incurs a liability in tort by negligently allowing a product to cause injury. Now the Insured becomes insolvent. By means of the Rights of Third Parties Act 1932, the claimant has a right to directly sue the Insurance Company. However, let us say that the cell has insufficient assets to settle the claim. A court may not wish to respect the principle of cell segregation since this particular creditor had not chosen to be a creditor of a PCC nor did he voluntarily agree to any kind of cell limitation clause. The counter argument (which may be less effective for compulsory covers) is that courts have always recognised that insurance policies can contain limitation of liability clauses. So long as the cell limitation concept is seen in this light – i.e substantive, rather than being seen as some form of (antecedent) blocking remedy contrary to the principle of treating creditors equally (pari passu), then the PCC concept may well survive such a test. Suffice to say, there is as yet no specific case law on the subject.

Mitigating Factors

Even on the worst case scenario above, there is some very practical advice, deriving directly from the authors' analysis. This indicates that the risk of the cell structure failing can be mitigated substantially. Such measures include the following:

- The PCC should be located in a territory whose laws are recognised internationally or trans-nationally. Gibraltar and Malta, being in the EU, have this advantage. The authors contend that due to international recognition of the EU this places these two jurisdictions as the most secure possible from the point of view of recognition of the PCC structure.
- 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 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 (including reinsurance assets if possible). Also, all the contracts should be subject to the law and jurisdiction of the local courts (as far as possible).
- All or specific cell policyholders could be given a security right to the assets of the cell (a right in rem) thus ranking them above other creditors, possibly even over some classes of involuntary creditors.
- The PCC's manager should adopt a "belt and braces" approach and complement statutory segregation of assets/liabilities with contractual means as far as possible.

Comparison of Domiciles

A very innovative section is the comparison of PCC domiciles. The authors approach this from a first principles basis which greatly helps understanding. For example, each domicile (or set of domiciles) will have varying approaches to inter-cellular liability and liability between the core/hub and cells. Also, the insolvency tradition of a domicile is an important differentiator, some of which are seen as pro-debtor, whilst others are pro-creditor. Paradoxically, a pro-debtor approach such as Administration can actually be seen as pro-creditor if it supports the segregation of cell assets and liabilities. This is the seen to be the case in Gibraltar which has significant flexibility to deal with an insolvency consistent with EU regulations./p>

Group Accounting Issues

An issue of interest to owners of cells is whether the results of a cell should be consolidated into group accounts. There is no simple answer but some pointers are provided. Per the IFRS standards, the issue is conventionally understood as one of "control". However, this may not deal with all cell scenarios and one may need to use the accounting standards concerning Special Purpose Entities and the concept here is one of "benefit". Since the IFRS issues no specific guidelines for PCCs, this is an area requiring advice on a case by case basis. ………………Whilst not every issue is dealt with in full detail, messrs Feetham and Jones almost certainly cover the full breadth of issues that can arise with a PCC. As such it is likely to become an invaluable sourcebook for practitioners. Robin Amos is Senior Insurance Manager at Aon Insurance Managers (Gibraltar) Limited.