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MEMORANDUM

PROTECTED CELL COMPANY

Introduction and summary of conclusions

1. This Memorandum considers the operation of the protected cell company legislation of Gibraltar, specifically in the context of an entirely hypothetical case of a Gibraltar captive insurance company. This Memorandum is limited to Gibraltar law in force as at the date hereof. It is provided solely to Captive Review (http://captivereview.com/) and may be published by Captive Review at its discretion for the purposes of general information only but it may not be relied on by any person. This Memorandum is not delivered in connection with any specific transaction. In this Memorandum I make no recommendation whatsoever, nor owe a duty of care to any person in connection with any matter stated herein. The Memorandum is therefore provided on a non-reliance basis and without any liability whatsoever. Any reference to foreign legislation or Court decisions are made for information purposes and do not constitute an opinion of foreign law. References in this Memorandum to "PCC" are to "Protected Cell Companies".

2. I summarise the main conclusions in this Memorandum as follows: (a) A Gibraltar Court applying PCC legislation should have no reason not to give effect to the statutory segregation of assets and liabilities; (b) I am not aware of a Court ruling anywhere in the world where the Court has declined to give effect to PCC legislation or hold that the PCC regime is contrary to public policy, although there are only a few reported decisions on PCCs as far as I am aware (including the recent decision of the Montana Federal Court); (c) Whilst one cannot rule out the possibility that a foreign Court might not recognize the PCC regime and one would therefore need to take local advice in each relevant country, arguably it is less likely as more jurisdictions implement PCC legislation or a similar statutory regime and more countries develop experience with them; (d) However, unless the PCC has assets abroad that could attach to a claim in foreign Court proceedings, this lack of recognition should have no practical consequences; (e) A cell creditor is unlikely to be able to enforce a claim against the assets of other cells in a country that itself has implemented PCC legislation as part of its domestic law; (f) Where a PCC has contractual arrangements in place with its insured and cell shareholders that reinforce the

‘statutory ring-fence’, any potential lack of recognition of the PCC regime should be less of a risk, since there should be less reason for a Court to disturb such contractual arrangements if, as a matter of contact law, the relevant provisions are enforceable in accordance with their terms.

3. In this Memorandum I have responded to the hypothetical questions I have been asked to consider. I have also attempted to provide some historical context to the concept of the ‘cell captive’ (both historically as a matter of contract law, and more recently, under the PCC regime), have given a brief description of PCC legislation and its original intent, and finally, have tried to discuss the development of PCC and similar regimes in other jurisdictions. Most importantly, I make the point, and it is worth repeating here also, that there are a substantial number of jurisdictions who now have PCC or similar legislation, and this includes numerous states of the United States, the UK, and some member states of the European Union.

Background to PCC legislation

4. PCC legislation was first enacted in Guernsey, primarily, to encourage growth of the captive insurance industry, by bringing captive promoters together under a single corporate entity (with all the benefits of economies of scale, speed to market, single management and existing authorisation) but enabling the legal segregation of assets between them for satisfying third party claims and limiting their liability accordingly. In some jurisdictions a PCC is also known as a ‘Segregated Accounts Company’ or ‘Segregated Portfolio Company’. The clear statutory intention is therefore that the assets attributable to a particular 'cell' (a legal fiction) are not available to meet the claims of creditors of other cells (in and outside insolvency). It is noteworthy that ‘cell captives’ began their life well before PCC legislation was introduced through contractual arrangements that ‘ring-fenced’ specific assets from creditor claims against related assets, but only a statutory regime could provide the necessary certainty and predictability.

5. It would be wrong, however, to think that PCC legislation is the only segregated business form in existence. Segregated business forms exist in numerous jurisdictions around the world, including the US and Europe. They are intended to segregate assets and liabilities for specific business transactions. Whilst the most familiar is still the PCC, there are other types of structures in many jurisdictions that perform a similar function such as the US Series LLC, the Italian regime (’dedicated assets to a specified activity’ and ’financing allocated to a specific business activity’), the Luxembourg SICAV and securitisation regimes, the Irish investment fund, the French FCC, and more recently, the UK open-ended investment company (among others). Segregated business forms (and especially Protected Cell Companies) are today widely used for captive insurance and investment funds.

Qualifications and Experience

6. I have been asked to set out my qualifications and experience. I am a barrister admitted to the Gibraltar Bar and a senior partner of Hassans International Law

Firm (a leading law firm in Gibraltar). I have practised law from Hassans since 1993. I am a graduate of Manchester Metropolitan University (England) where I studied law between 1989-1991 and was awarded a Bachelor of Laws with First Class Honours. I hold a post-graduate from Manchester Victoria University (1991-1992) where I was awarded a Masters of Laws (LLM) with Distinction. At University I also received several prizes. For the past 15 years, in particular, I have acted in very many insurance matters, including in respect of insurance licence applications, a wide range of insurance law and regulatory issues, and advising on capital raising, stock market flotation and acquisitions involving insurance companies. I am the author of *"A Guide to Insurance: Combining Governance, Compliance and Regulation"* (Spiramus Press, 2012). I am the co-author of *"Protected Cell Companies: a Guide to their Implementation and Use"* (Nigel Feetham and Grant Jones, Spiramus Press, 2010, 2nd edition) which was recently cited by the judge in *PAC RE 5-AT v. AMTRUST NORTH AMERICA, INC., No. CV-14-131-BLG-CSO (D. Mont. May 13, 2015)*, a decision of the Federal Court of Montana (United States). I am also the author of a tax related book. I am a Visiting Professor at Nottingham Law School, Nottingham Trent University (England).

7. It should be noted that typically under PCC legislation, although a PCC is subject to the provisions of the PCC regime with regards to the segregation of assets and liabilities, it is a 'company' incorporated under local company legislation like any other.

8. The obvious point to make in looking at a Gibraltar PCC (in common with PCC legislation in other jurisdictions) is that the operating legislation's effectiveness is dependent upon a number of factors. The benefits of the statutory ring-fence will therefore not occur automatically simply because a company is established as a PCC; the company must also be managed and conduct its affairs in accordance with the terms of the operating legislation.

9. Accordingly, in the context of a cell transaction, first, it is necessary to ensure that the proposed transaction is identified to ensure that the assets and liabilities are properly attributed to the cell in accordance with the PCC Act. Second, one would need to consider the experience of the cell captive's management and the controls in place to limit the risk to individual cells.

The PCC Act

10. The following is a summary of some of the main features of the Gibraltar PCC legislation.

    Requirements on incorporation/conversion: A PCC must state that it is a PCC in its company name (for example, incorporating the terms "PCC" or "Protected Cell"). The PCC's Memorandum of Association must also state that the company is a protected cell company. Each cell must also have its own distinctive name or designation. (Section 10 of the PCC Act).

Duty to inform third parties: The directors of PCCs have a duty to inform third parties dealing with the company that they are transacting with a PCC and that the transaction is attributable to a particular cell. The directors of the PCC are personally liable for any failure to do so. (Section 15 of the PCC Act).

Creation of Cells: A PCC may create one or more cells for the purpose of segregating and protecting cellular assets. (Section 4 of the PCC Act). Cells may also create cell shares, the proceeds of issue of which will comprise the cellular assets attributable to the relevant cell. (Section 8 of the PCC Act).

Separation of assets: The cellular assets of each cell must be kept separate and separately identifiable from assets attributable to other cells of the PCC and all non-cellular assets. However, directors of PCCs may permit the assets of a cell to be held by or through a nominee or by a company whose shares and capital interests may be cellular assets and non-cellular assets or a combination of both. (Section 5 of the PCC Act).

Section 6 and 7 make it clear that the rights of creditors are limited to the assets of the cell for which they are creditors.

Cells are not legal entities: A PCC is a single legal person and the creation of a cell of a PCC does not, in respect of that cell, create a legal person separate from the company. (Section 3(2) of the PCC Act). This has two legal consequences. One, assets of a PCC are owned by the PCC itself (as a corporate entity) and not by individual cells. Two, cells cannot contract with each other nor can they contract with the core.

11. As I explain in my PCC book, the intended effect of the PCC statutory regime is to limit the right of a cell participant (or third parties) to enforce a claim against all the assets of the PCC. When PCC legislation was first introduced, it was sometimes customary to speak of cells as if they were separate legal entities; in fact they were not. Guernsey has since, however, introduced legislation to do precisely that – the so-called, Incorporated Cell Company (known as an 'ICC'). But typically (as in the case of Gibraltar law), PCC legislation, whilst recognising that there is only one legal person, legislates the effect of the statutory "contract' between the parties by providing for the segregation of cell assets and liabilities and limiting creditor liability to cell assets. This applies to both voluntary and involuntary creditors. The economic (not the legal) effect of a cell is therefore broadly similar for the counterparty to the taking of a security interest over particular assets.

A PCC Captive Insurance

12. In an insurer established as a PCC the company's obligations to its insured are incurred under policies (insurance contracts) issued for the account of particular cells. The liabilities for those insurance obligations are met solely from funds held by the company for the designated business of individual cells and from the benefit of any reinsurance claims it may have under reinsurance contracts (if any) entered into for the benefit of a cell. Accordingly, the liability and entitlement by the insured to claim under their respective policies is limited to

the amount of available assets of, and the benefit of any reinsurance claims attributable to the specific cell in respect of which a policy is issued. An insurance creditor of a particular cell therefore does not have a claim to the assets of other cells. Each cell is essentially a separate business. This allows different economic interests to conduct business through a single corporate entity under the legal protection of the PCC structure.

13. For the purposes of this Memorandum, and in the assumed hypothetical scenario, one needs to look at the PCC regime in the context of the business as a 'captive'. A captive insurer underwrites risks of, or introduced by, the cell shareholders of each cell who, therefore, participate in the profits or losses of the insurance business conducted through 'their' relevant cell. Essentially, the 'cell captive' structure allows large corporates (usually groups that are not otherwise involved in insurance) to establish their own 'captive' insurance company in the form of a 'cell' to underwrite risks related to the group. A captive does not underwrite third party risks; in other words, direct consumer business, such as motor or household insurance, for third parties.

Treatment of a PCC by a foreign Court

14. Guernsey was the first jurisdiction to introduce Protected Cell Companies. It did so in 1997 and other 'offshore' jurisdictions followed soon after, including Cayman, Bermuda, Gibraltar and Malta. In more recent years a segregated company regime has been implemented in many states of the United States, in the UK, Dublin and Luxembourg.

15. Whilst the exact number of companies operating as protected cells across the European Union itself is not known, it is likely to be over one hundred in all jurisdictions and sectors (if we included, investment funds).

16. The question "would a foreign Court respect PCC legislation" (i.e. grant the assets of a cell the same level of protection afforded by its operating legislation) spurred the writing of the book *"Protected Cell Companies: a Guide to their Implementation and Use"*. The book contains a detailed assessment of this. I summarise some of the arguments below based on my research and analysis.

17. There are possibly three ways in which a PCC could be called into question in foreign Court proceedings. First, if local legislation required local courts to ignore PCC legislation on the issue of liability. Second, if PCC legislation was deemed contrary to local public policy. Third, if PCC legislation was classified as procedural, rather than substantive. Let me take each in turn.

18. The first is the easiest to deal with. I am not aware of any statute anywhere in the world that purports to declare that a local Court should not give effect to foreign PCC legislation. This is hardly surprising since such outright rejection of a foreign law would hardly sit well with the principle of comity of nations.

19. The second can also be dealt with swiftly. Far from offending any notion of public policy (or principle of justice), in my view PCC legislation underpins the fundamental principle of modern commerce that owners of capital should be able to deploy that capital in commercial enterprise and limit their liability to such capital and no more. Most (if not all) legal systems around the world recognise this as part of their substantive law in one way or another. Indeed, in my view, many countries have other laws which are almost indistinguishable from the PCC regime in what they are intended to achieve. It is therefore difficult to imagine how PCC legislation could be considered contrary to public policy or justice by a foreign Court if its own local laws contained or recognised something similar. In my view this is the case even in insolvency and it is an analysis developed in detail in the PCC book.

20. Lastly, absent any local rules to the contrary, and applying well established private international law principles recognised in most (if not all) civil and common law countries, it is not easy to conceive why a Court should decline to give effect to foreign 'substantive law'. To do otherwise would not only be an affront to principles of comity but also undermine international commerce. Most countries around the world establish under their conflict-of-laws rules the distinction between the application of foreign substantive law (where the rule is that foreign laws containing substantive rights should be applied) and procedural law (where local rules of procedure are applied). Since the PCC Act is undoubtedly intended to be substantive in nature, it is difficult to see why a foreign Court should not recognise PCC legislation as such.

21. Ultimately, however, the argument that I think would prevail is this: if investors pursuing a bona fide commercial activity have sought the benefit of the capital protection laws afforded by PCC legislation (in much the same way they would have done had they decided to conduct their business through an ordinary limited company or limited partnership, or as ship-owners seeking the benefit of maritime limitation of liability laws have done for well over a century), why should they (and the body of creditors who have dealt with the PCC expecting that their rights will be determined in accordance with PCC laws) be deprived of such protection by the Court? Viewed in this way, PCC legislation is, in effect, a capital and creditor protection rule like any other. For a foreign Court to hold otherwise would in my view be to undermine the very principles on which international trade has developed since at least the eighteenth century, namely, the dual principle of limited liability for those that put capital at risk and also acceptance that in a global economy countries must recognise each others commercial laws.

22. Of course, there is always the risk that a foreign Court will not share the views I have expressed on the issue of recognition. As I am only competent to advise on the legal position in relation to Gibraltar law, the views I have expressed are not to be taken as a statement of foreign law and are subject to local legal advice being obtained in each jurisdiction where a PCC transacts business.

23. Surprisingly, as far as I am aware there have only been a handful of reported Court cases on the subject of cell companies anywhere in the world, and, until recently, none in an 'onshore' jurisdiction where a Court has considered in detail the legal status of a protected cell company. That recent case is the decision of the Montana Federal Court in *PAC RE 5-AT v. AMTRUST NORTH AMERICA, INC., No. CV-14-131-BLG-CSO (D. Mont. May 13, 2015)*. Whilst the Montana case did not concern a cross-border situation, the judge did consider the legal status of a PCC. Essentially, the question before the Court was who the proper party to a contractual dispute concerning a PCC was. This decision is widely considered by captive professionals as making an important contribution to judicial understanding of the workings of PCCs. In setting the background, the judge (Carolyn S Ostby) stated:

> *"The capacity to sue or be sued is determined under the laws of the state where the court is located. F. R. Civ. P 17(b)(3). In 2003, Montana enacted statutory provisions enabling the creation of a protected cell captive insurance company ("PCC"). MCA § 33-28-301 et al. Protected cell company legislation is a relatively recent creation in offshore jurisdictions such as Guernsey, Bermuda and the Cayman Islands, and in onshore jurisdictions in many states. See generally Nigel Feetham & Grant Jones, Protected Cell Companies: A Guide to Their Implementation and Use (2d ed. Spiramus Press 2010)."*

24. I would also mention the very recent decision of the Court of Special Appeals of Maryland in *Kurz v. AMCP-1, LLC 2016 WL 547146* (unreported, 10 February 2016). It is not necessary to restate the facts. For present purposes my interest in the case is not its facts nor the decision but certain dicta in the judgment concerning "Series LLCs". A Series LLC is a segregated business form adopted in various States of the United States of America (with its origins in Delaware in 1996) akin to a Protected Cell Company. One of the plaintiff's arguments was that the trial court *created* a Series LLC (a new corporate structure that did not exist under local law) by, in effect, merging two entities into one entity. The Court off Special Appeals disagreed.

25. First, the Court was *"not clear—at least in the abstract—that the distinctions between a family of traditional LLCs and a series LLC are as stark as Honey G–R would have us believe."* It noted that *"The series LLC is a relatively new innovation"* first emanating in Delaware but was clearly not impressed by the argument that a Series LLC is an entity which the Maryland Courts could not have recognised. Per the Court Opinion: *"Many of the benefits of a series LLC can be obtained by creating a family of traditional LLCs, with one master traditional LLC of which the members are, in turn, other traditional LLCs. The only differences that we perceive—at least in the abstract— are differences of nomenclature and the requirement for filing fees."*

26. Second, the Court noted the plaintiff's argument that the Maryland legislature had not adopted legislation authorizing the use of the Series LLC form. In other words, it was not a business form known to local law. The Court made quick

work of rejecting this outright: *"While certainly true, to the best of our knowledge, the legislature hasn't even considered whether to adopt such legislation. It certainly hasn't done anything to suggest that adoption of the series LLC form will violate an important public policy of the State…Thus, we think the third step in Honey G–R's argument, that a Maryland court is prohibited from ordering the creation of a series LLC (if that is what happened here), assumes a prohibition that simply does not exist."*

27. In my view, this dicta is important because it is the first case I am aware of where a Court anywhere in the world was being asked, albeit in a round about way, not to recognise a segregated business form akin to a PCC on the basis that such a structure was unknown to local law. Therefore I consider the judicial commentary in this case might inform us of how a foreign Court could view PCC legislation.

28. It is noteworthy that since the publication of my PCC book in 2010 the UK itself has introduced its own regime for open ended investment funds. The relevant statutory provisions are contained in Open-Ended Investment Companies (Amendment) Regulations 2011.

29. As I pointed out in the book, in July 2009 HM Treasury published a consultation document setting out its proposals for introducing a protected cell regime for Open-Ended Investment Companies (OEICs). This was in response to the support received for earlier proposals where the response to that consultation *"was unanimously in favour of developing a protected cell regime".* The new UK legislation is now in force but is only applicable to authorised OEICs. The important point to make therefore is that the UK already has a segregated liability company akin to a PCC.

30. Still, it would be wrong to assume that such statutory segregation was entirely new to the UK. The UK, for example, did already have its own segregation of assets and matching liabilities in the context of an insurance company insolvency; that is, where part of the business of an insurance company being wound up was long term business. Rule 5 of the Insurance Companies (Winding up) Rules 1985 (UK) provided for assets which were available for meeting the company's liabilities attributable to its long term business *"… be applied in discharge of those liabilities as though those assets and those liabilities were the assets and liabilities of a separate company."* In other words, there was already in UK legislation a statutory provision which attempted to match assets and liabilities as between general and long term insurance business.

31. This now reflects the requirement in Article 19 of the Consolidated Life Directive (2002/83/EC) that an insurer offering life assurance and non-life insurance business is required to manage them separately (implemented both in Gibraltar and in the UK).

32. Equally, as was also pointed out in the book, conceptually (but not legally), the conduct of business at Lloyd's of London has some similarities with a

segregated business structure akin to a PCC. Except for the right to call upon the Central Fund (which is funded by members contribution annually) to satisfy any excess liability, the business of each Lloyd's 'syndicate' is (as in the case of a cell in a PCC) separate and distinct from other syndicates and one member is not responsible for the liabilities (or losses) of other members. Substantial business is conducted through Lloyd's of London every year around the world.

33. Interestingly, the UK Government has also now launched its own initiative for the development of a legal framework for the authorisation and supervision, corporate structure and taxation of vehicles designed to attract insurance linked securities business ("ILS") to the UK. The UK Government has recently published a consultation document (1 March 2016) and aims to produce draft regulations for a new ILS framework later this year. UK Treasury proposes to amend the corporate and insolvency laws of the United Kingdom to allow the creation of protected cell companies.

34. Finally, it is of note that EU Directive 2001/17/EC of the European Parliament and of the Council of the 19 March 2001 on the reorganisation and winding up of insurance undertakings ("EU Insurance Insolvency Directive") would have now been implemented by all EU member states. It has also been implemented in Gibraltar. Accordingly, an EU cross-border insolvency of a PCC insurance company should be governed by the Directive and as a general rule, but subject to any local legislation to the contrary, should be respected throughout the EU.

35. I will now turn to each question I have been asked.

<u>What level of confidence can we have that a Court will respect the statutory ring-fencing within a PCC and can any mitigation be put in place?</u>

36. In any action instituted in the Courts of Gibraltar (the jurisdiction of incorporation of our hypothetical PCC), the PCC Act should be given effect to. Therefore, as I have explained, creditors of the core or a cell would not be able to claim against the assets of the other cells due to PCC legislation. The Directors of the PCC owe a duty of care and fiduciary duty to each cell and are statutorily obliged to keep cellular assets and liabilities separate.

37. The critical test for a PCC, however, would arise where there is a cross-frontier element and the company has assets abroad. The directors of the company can properly minimise such risk by keeping assets in Gibraltar rather than outside Gibraltar. This could be achieved by having a Gibraltar custodian holding the assets (instead of a foreign custodian). The alternative is to use a foreign custodian in a jurisdiction that itself has PCC-type legislation and therefore should, in theory, have no difficulty in recognising the cell structure in the event of any attempt by a creditor of another cell to have recourse to the assets of the relevant cell.

38. Clearly, it is impossible to give a definitive global picture of the integrity of a cell structure in every jurisdiction. Nor would I be competent to advise save in relation to Gibraltar law. But we might derive some comfort from the fact that many jurisdictions around the world now have PCC legislation or a similar type of regime. In my PCC book I provided the following summary and concluding remarks:

> *"As we have seen, cell transactions take place across many jurisdictions around the world including Europe and the US, the two leading trading blocs. A court decision that holds against the ring-fence (or internal shield) within a PCC would have a significant impact on thousands of cross border cell transactions and contracting parties will be faced with a consequence which neither they nor PCC legislation had intended. It would be a mistake for a court to look at the PCC narrowly in terms of legislation that only exists in some 'offshore islands'. Many States in the US have PCC legislation. Also, and more importantly, legislation and business forms in many jurisdictions perform a similar function. Some are difficult to distinguish from cell legislation in what they are intended to achieve, such as the US Series LLC, the Italian regime ('dedicated assets to a specified activity' and 'financing allocated to a specific business activity'), the Luxembourg SICAV and securitisation regimes, the Irish Investment Fund and the French FCC (among others). They are all intended to segregate assets and liabilities for specific business transactions. Even outside these legislative regimes, there are other legal concepts that have been used to achieve the same purpose over many years and in very many commercial transactions including the use of the trusts and security arrangements (such as the collateralised contract). Deliberately disregarding the law of the jurisdiction of the PCC's incorporation and thereby the statutory ring-fence on the basis that a local court can only apply national law, would not only be an outright attack on internationalisation and principles of comity, but also disrupt cross border trade (perhaps, too, inward investment) and constitute an indirect challenge of specific rules and concepts that exist across legal systems and numerous other jurisdictions. This is so even for an involuntary creditor. It is therefore not a decision that a judge sitting in a local court room can take easily or lightly."*

39. Whilst we cannot rule out the possibility that a foreign Court might disregard PCC legislation in future, in reality however, because of the type of insurance arrangements and additional protections that a cell captive will usually put in place, these concerns may be significantly mitigated. Let me explain this further.

40. In the case of a cell captive registered as a PCC, typically, the (main) creditors are insurance creditors (policyholders) making a claim under a policy issued by the company (as insurer) and such insurance creditors would ordinarily be bound by the terms of their insurance contracts. In this scenario, the only

extraneous creditors would be the tax authorities of the PCC country of incorporation (assuming there are no foreign tax liabilities) and other local creditors such as employees or landlord where the company leased its own premises. In these cases, such creditors would be bound by PCC legislation as they would have to bring their claim in the PCC country of incorporation (Gibraltar). It is difficult to see who else could attempt to challenge PCC legislation if there are no third party (including tort) claims. Even so, under a Gibraltar insurance insolvency (in accordance with the EU Insurance Insolvency Directive) insurance creditors rank above non-insurance creditors, and as this should also apply to a PCC, it minimises the risk on insolvency that non-insurance claims would deplete policyholder funds. Further, where the company is a 'captive' it would be underwriting first party risk for corporate/sophisticated buyers of insurance. This point is important because it minimises the risk of challenge to the PCC structure from third parties, if say a 'cell' was permitted to sell third party liability motor insurance and the third party claimed against the policy. In fact, Gibraltar does not permit non-captive, third party motor insurance, to be written through a cell company.

41. It is common in a cell captive for the insurance contracts with policyholders to also contain special claims limitation, jurisdiction and/or pay as paid clauses ("Risk Mitigation Clauses"), where these are applicable to the cell.

42. A 'cell limitation clause' would, typically, be inserted in the insurance contacts limiting any claims to the available assets of the relevant cell. A cell limitation clause is intended to expressly reinforce, through contract law, the statutory regime for segregation of assets and liabilities within a PCC. Although such a clause is not, strictly speaking, necessary as a matter of Gibraltar law given that such a clause is implied by Gibraltar law into any contract with a Gibraltar PCC, it does help to provide an additional level of protection. Further, where a cell captive provides 'fronting' facilities whereby the insurance risk is fully (100%) reinsured so that no net insurance risk is retained by a PCC cell, typically, additional protection (again, in line with the statutory ring-fence mechanism) is afforded by the inclusion of a 'pay as paid' clause. Under a pay as paid clause the insured agrees that his claim is limited to available assets in the cell and to that extent the obligation to pay a claim under the policy is dependent on the cell receiving an equivalent payment in reinsurance recoveries (thereby mitigating the credit risk of the reinsurance recovery and removing the obligation to pay a claim if the reinsurer defaults). In the case of cell limitation and pay as paid clauses (assuming they are held to be enforceable under the express governing law of the contract), the risk that the assets in a cell will not be sufficient to meet payment of claims in full is borne by the policyholder and not by the cell captive. In other words, all things being equal, the cell itself is not exposed to indeterminable liability since if the value of the assets attributable in a cell is reduced to say nil, the payment to the policyholder is also reduced to a comparative amount. This is intended to remove most of the risk for a PCC captive insurer.

43. The third mitigation technique is for a cell captive to either insert a jurisdiction clause in the insurance contracts applying local law, or where the policyholder insists on a different choice of law, for the express foreign law to still be made

subject to any mandatory provisions of the law of the jurisdiction of incorporation of the PCC (including PCC legislation).

44. Whilst different cell captives around the world may have quite different approaches, cells would usually contain one or more of these Risk Mitigation Clauses (where applicable to a cell transaction). In addition, under cell contractual arrangements, a cell shareholder may be required to enter into an agreement with the PCC to govern their rights and obligations qua shareholder and in particular to reinforce the special status of the company as a protected cell company ("Cell Captive Agreement").

45. Therefore, in the light of PCC legislation itself and the further contractual protection provided by Risk Mitigation Clauses (assuming these are inserted into existing insurance policy/contract) and Cell Captive Agreement (assuming they are entered into), and whilst taking into account that the insurance arrangements in place in respect of the cells are first party insurance business (captive) as opposed to third party business (open market, insuring risks for consumers), in my view, from a Gibraltar law perspective, the cell structure is as strong as possible (subject to creating a security interest over the assets of the cell).

46. Notwithstanding this, we should also consider the impact of the insolvency of another cell (i.e. insolvency contagion risk within the PCC). Although protected cells within a Gibraltar PCC are not separate legal entities from the company as a whole, the PCC Act does make provision for the liquidation of a cell as if it was a separate legal person in the event of insolvency of that cell. I was involved in the drafting of the relevant amendments to achieve this. As a result, where a cell is 'insolvent', an individual cell can be liquidated separate from the entity as a whole and therefore it is 'deemed' to be a separate legal person for the purposes of cell liquidation. (See Section 20A of the PCC Act). In essence, it reinforces the statutory ring-fencing and separation of assets within a PCC so that the insolvency of one cell does not disrupt the whole or other cells and at the same time create a further argument for the protection of assets abroad. I was also previously involved in the drafting of the amendments to the PCC Act to specifically provide for cells to be treated as if they were separate companies in relation to taxation matters. In both cases (liquidation and taxation), this is despite the fact that it is the PCC that still carries on business as a single legal person and that does not change.

What are the risks for assets being located abroad?

47. As I have pointed out above, the position would, theoretically, be stronger if the assets were held locally in Gibraltar with a local custodian holding the assets.

48. This concern, of course, assumes that a foreign Court would allow a cell creditor to sue in their jurisdiction in the first place, but even so, many jurisdictions have now implemented PCC legislation and therefore a local court, in theory at least, should recognise the cell structure.

49. But even a foreign court in a jurisdiction which itself does not have PCC legislation might have little sympathy for a claim put forward by a voluntary user of a cell against the assets of another cell. After all, as I have pointed out, a cell user has willingly participated in the company on the basis that it was a PCC; accordingly, any attempt to litigate outside the jurisdiction of incorporation of the PCC might be viewed by a foreign Court simply as an attempt to evade the application of the 'statutory contract' he has freely entered into and itself may be regarded as an abuse of process. The underlying principle of PCC legislation is that persons who transact with the PCC transact on an informed basis as to their rights (in the same way as for an ordinary 'limited company'). But assuming the potential litigant would get past the '*forum non conveniens*' point, there would be the further issue, as I have also tried to explain, that the foreign Court would still have to view the PCC regime as a matter of procedure (instead of substantive law). There is then, the question of the Risk Mitigation Clauses and Cell Captive Agreement as a matter of contract law. In our hypothetical scenario a potential litigant would therefore have to overcome a number of legal hurdles.

50. I consent to have this Memorandum published by Captive Review at their discretion for general information purposes only. This Memorandum, however, is based on an assumed hypothetical scenario, is given for the sole benefit of Captive Review and may not be relied on by any person for any purpose. Nor should it be construed as a legal opinion or legal advice on any specific facts or factual circumstances. It is provided to Captive Review strictly on the basis that no claim shall arise from or in relation to this Memorandum and that no responsibility is assumed to any person as a result of its publication or otherwise.

51. This Memorandum shall be governed by Gibraltar law.

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