

A winning combination

Matthew J. O'Toole and Robert L. Symonds, Jr. of Stevens & Lee examine series captives – a potent mix and a new Delaware advantage

In an apparent first, Delaware Insurance Commissioner Karen Weldin Stewart, CIR-ML, early in 2010 licensed a Delaware 'series' limited liability company as a special purpose captive insurance company. The authors initially conceived the "series captive" structure as a solution to a premium tax problem. The use of a series entity clearly can provide a cost-effective alternative to a sponsored (or protected cell) captive. Perhaps more importantly, however, by marrying the benefits of Delaware's highly regarded business entity laws with the features of the state's captive statute, the Delaware series captive can offer other advantages, including heightened flexibility and enhanced certainty. The series captive structure, therefore, represents a formidable combination.

Background

Delaware's business organisation statutes are widely esteemed. In addition to Delaware's well-known corporation law, the Delaware Limited Liability Company Act (the DLLC Act) and the Delaware Statutory Trust Act (the DST Act) are aptly characterised as preeminent. These laws have long have been recognised as flexible, "enabling" statutes that foster and support private contractual ordering of a business entity's internal affairs.

Similarly, flexibility has been a defining characteristic of the Delaware Revised Captive Insurance Company Act (the captive statute) since its enactment in 2005. For example, in addition to allowing for licensure of association

captives, industrial insured captives, pure captives, risk retention groups, and special purpose financial captives, the captive statute authorises special purpose captives and sponsored (for example protected cell) captives. Moreover, the captive statute enables a captive insurance company to take any of various business organisational forms. Under Delaware law, not only a corporation, but also a limited liability company or a statutory trust, among other types of business entities, may be licensed as a Delaware captive.

Sponsored captives

Among the various types of captive insurance companies authorised under Delaware law, a sponsored captive is one that has one or more protected cells. A protected cell is a separate and distinct account, established and maintained by or on behalf of the captive, in which assets are accounted for and recorded for one or more participants, as contractually agreed, to fund the liability of the sponsored captive assumed by contract on behalf of those participants. This structure allows for segregation of assets and liabilities within a single captive, and each cell may function largely as if it were a separate captive.

For sponsored captives, the captive statute applies a minimum premium tax per protected cell. The minimum premium tax per cell generally is not an issue for larger participants in a sponsored captive, but can prove cost-prohibitive and present a barrier to entry for certain small- to medium-sized participants in

search of a captive solution. The captive statute does not allow for waiver of or exemption from the minimum premium tax per protected cell of a sponsored captive.

Special purpose captives

One of the primary features highlighting the captive statute's flexibility is its authorisation of special purpose captive insurance companies. The essence of, and the primary advantage offered by, a special purpose captive is that (unlike any other type of captive) it may be exempted from otherwise applicable statutory provisions and regulations. The availability of exemptions, however, does not enable a special purpose captive to



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adopt the captive statute's protected cell provisions, which are available only to sponsored captives under the statute.

Series entities

One of the more unique aspects of the DLLC Act and the DST Act is their allowance for the creation of 'series', sometimes colloquially called series business units (SBUs). A series under the DLLC Act is a series of members, managers, limited liability company interests or assets. A series under the DST Act is a series of trustees, beneficial owners, assets or beneficial interests. If properly structured and maintained, a series has features traditionally associated with, and is treated in many important respects as if it were, a separate entity. Most prominently, a series can provide for segregation of assets and liabilities within a single limited liability company or statutory trust (for background and further information regarding the series features of Delaware law, see Robert L. Symonds, Jr. and Matthew J. O'Toole, *Symonds & O'Toole on Delaware Limited Liability Companies*, § 5.22, published by Aspen Publishers, Wolters Kluwer Law & Business). In this respect, a series bears a strong resemblance to a protected cell.

The protected cell premium tax problem

The authors encountered a situation in which the captive statute's minimum premium tax per cell rendered a proposed

sponsored captive insurance company economically unfeasible. What could be done to achieve segregation of assets and liabilities within a single captive, as in a sponsored captive, and at the same time obtain relief from the minimum premium tax per protected cell applicable to a sponsored captive? The captive statute's flexibility, coupled with the sophistication of Delaware's business entity laws, offered a solution.

The Delaware series solution

A series under the DLLC Act or the DST Act closely parallels a protected cell within a sponsored captive under the captive statute. In fact, the protected cell provisions under the captive statute were drafted with an eye on the series provisions in Delaware's business entity laws. Therefore, if it is established as a series limited liability company or statutory trust, even if it is not a sponsored captive, a captive insurance company under the captive statute may enjoy similar intra-entity segregation of assets and liabilities as afforded by the protected cell structure of a sponsored captive. Further, a captive other than a sponsored captive is not subject to the minimum premium tax per protected cell (as it has no protected cells), but rather is subject to premium taxation only at the entity level. Accordingly, a special purpose captive, structured as a series limited liability company or statutory trust, affords intra-entity segregation of assets and liabilities

as in a sponsored captive without the burden of a minimum premium tax per protected cell.

Features of a Delaware series captive can include:

- Custom-tailored allocation of management rights and responsibilities
- Custom-tailored apportionment of economic interests
- Encapsulation of assets (including statutory minimum capital and surplus)
- Entity-level premium taxation (without per series premium taxation)
- Entity-level statutory minimum capital and surplus (without per series statutory minimum capital and surplus)
- Combination of assets of multiple series for investment purposes
- Flexible investment requirements
- Separation of series for purposes of liquidation, rehabilitation or other delinquency proceedings

These features can not only be grounded in the captive statute and the certificate of authority issued by the Delaware Department of Insurance, but also derive from specific provisions in the DLLC Act or DST Act, the organic, non-captive law under which the licensed entity is formed and organised.

Putting Delaware series captives to work for you

Proper formation and successful implementation of any Delaware series entity requires careful planning and a thorough understanding of relevant legal and practical issues. Inadequate attention to the series entity's organisational and contractual documents or improper operation or administration of the entity can result in loss of the desired segregation of assets and liabilities. There are other questions and risks associated with a series entity as well, as there are with a protected cell company. With experienced and knowledgeable advice and support services, however, these issues can be identified and suitably managed.

Unique opportunities

The sophistication and elasticity of Delaware's business entity laws, when coupled with the flexibility afforded by the State's captive statute, can offer unique opportunities for structuring captive insurance companies. One such opportunity lies in combining the series features of the DLLC Act or the DST Act with the captive statute's provision for special purpose captives. This fusion of Delaware captive and business entity advantages can yield impressive results. The series captive structure is indeed a potent mix. ●