# THE SERIES LLC AND CAPTIVES – A BRIEF HISTORY

Jeffrey Simpson and Andrew Rennick of Gordon, Fournaris & Mammarella provide a unique look at Series LLC and captives

The use of Series Limited Liability Companies (Series LLC) is one of the most significant innovations in captive insurance over the past ten years. Similar to a protected cell company (PCC), a Series LLC permits the segregation of assets and liabilities into various series, each of which can be operated as a separate captive insurance company. This permits sponsors and users of Series LLC structures to achieve flexibility, cost savings and administrative efficiency. Given that Series LLCs have only been used in captive programmes since 2010, one could be forgiven for thinking that the Series LLC structure is much newer than the PCC, the first of which was authorised in Guernsey in 1997. In fact, Series LLCs pre-date PCCs, and their roots stretch back into the early twentieth century. Series LLCs have developed from a mechanism to facilitate the segregation of mutual funds in Delaware to a popular risk management tool in a half-dozen captive domiciles. In this article, we review the history of the Series LLC and trace its evolution into the powerful tool in the captive insurance market that it is today.


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### Series Investment Trusts

The story of the Series LLC begins in the world of investment trusts, which have been used since the early twentieth century to provide savings and efficiencies for mutual fund families. Using series in investment trusts allowed the segregation of various investment portfolios. This in turn permitted income from particular investments to be allocated to specific beneficiaries. By the middle of the century, the use of series investment trusts was prevalent enough that the Investment Company Act of 1940 contains language recognising the use of series. For most of the twentieth century, the trusts used in series structures were common law trusts; however, the surging popularity of series investment trusts in the 1980s prompted Delaware to amend its statutory trust law in 1990 to provide for the creation of series statutory trusts. Six years later, the Delaware Limited Liability Company Act (DLLCA) was amended to permit the creation of Series LLCs.

### Delaware creates the Series LLC

The 1996 revisions to the DLLCA provided a much more detailed description of the series than the original statutory trust act, particularly as it pertains to how to safeguard the separateness of each series for the purpose of limiting liability of a series' obligation to that series' assets. Under the DLLCA, a Series LLC's operating agreement could permit the LLC to designate series of owners, managers, or assets and liabilities, which are segregated from each other and from the LLC generally (often called the "Core"). As with the series investment trusts, this segregation would provide cost savings and administrative efficiencies by avoiding multiple filings with the Secretary of State and the Securities and Exchange Commission. Over the next 15 years, states such as Illinois, Nevada, Tennessee and Montana would follow Delaware's lead, amending their respective LLC Acts to expressly authorise the formation of series LLCs and provide liability protections for each individual series.

### Comparison with Protected Cell Companies

The year after Delaware adopted Series LLC legislation, Guernsey passed the Protected Cell Companies Ordinance 1997, authorising the creation of PCCs. A PCC functions similarly to a Series LLC, in that the assets and liabilities of each cell are

segregated from each other cell and from the Core. As with the Series LLC, this segregation enables each cell to operate as if it were separate from the Core and the other cells while still being administered and regulated in conjunction with the Core. A significant difference between the series of a Series LLC and the cells of a PCC is that while a series has the statutory authority to contract in its own name, a cell generally does not. Where a cell cannot contract in its own name, the Core generally contracts for and on behalf of the cell. Some practitioners believe that having the Core contract for and on behalf of the cell unnecessarily exposes the Core. It can also preclude contracts between and among cells because the Core cannot contract with itself.

As a corollary to the inability to contract separately, a cell generally cannot sue or be sued in its own name. This issue was addressed in the 2015 case of *Pac Re 5-AT v. AmTrust North America, Inc. CV-14-131-BLG-CSO, 2015 WL 2383406, (D. Mont. May 13, 2015)*. For a time, the ability of a Delaware series to pursue litigation on its own behalf had also been in question. In 2007, a federal court in Maine held in *GxG Management LLC v. Young Brothers* that a series holding title to a boat was not independently capable of pursuing its own legal claims. In response to that decision, later that year Delaware amended the DLLCA to expressly provide that a series could sue and be sued in its own name.

## Captive insurance and the Delaware Series LLC

When Delaware undertook a revision of its captive insurance statute in 2005, the drafters sought maximum flexibility in the type of entity structure that could be used. The 2005 revisions to the Delaware captive statute permitted the use of statutory trusts and LLCs for captives. In addition, the 2005 revisions created a licensing category called the special purpose captive, granting the Insurance Commissioner the flexibility to license programmes that did not fit squarely into an existing category. With the Series LLC structure already established as a viable entity form, the pieces were in place to establish captive insurance programmes using Series LLCs. Therefore, while Delaware also permitted the use of PCCs, it did not take long before Series LLCs became the favored 'serial' structure in Delaware. The first Series LLC was licensed in Delaware in 2010. Since then, dozens of Series LLC structures, with hundreds of individual series, have been formed in Delaware. Recognising the popularity of series, in 2015 Delaware updated its captive insurance statute to formalise the licensing, taxation, reporting and governance of what it now calls a "series captive insurance company".

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## Further developments

Other captive insurance domiciles have taken note of the success of the Delaware Series LLC and have either permitted Series LLCs to be licensed as special purpose captives (Montana) or utilise their protected cell provisions to create a hybrid "Series Protected Cell" structure (Tennessee). Under the Tennessee model, the Series LLC is formed under authority granted by the Tennessee Limited Liability Company Act and licensed as a PCC under the captive statute. Each series is therefore a 'cell' for regulatory purposes. Meanwhile, the use of the Series LLC is attracting national attention, as the Uniform Law Commission (ULC) has formed a committee to study whether the Revised Uniform Limited Liability Company Act should be amended to add Series LLC provisions. Since 2012, the ULC's drafting committee has released multiple drafts of such an amendment, most recently in July 2016.

In our view, the work of the ULC and the increased interest in Series LLCs from various states could have a salutary effect on the development of the Series LLC structure. As it currently stands, there is great variation in the substance of Series LLC statutes. For example, not every jurisdiction has followed Delaware's approach in expressly providing that a series can contract in its own name or sue and be sued in its own name. In light of the Pac Re decision, we believe that clear statutory language is essential to guarantee that the courts will respect not only the segregation of series assets and liabilities, but also the separate 'personhood' of the series. In addition, while the ability to form a series without a state filing is an attractive feature for many programmes, the downside is that other than in Illinois, it is not possible to obtain a Certificate of Good Standing from the Secretary of State, certifying as to the due formation and authorisation to conduct business in the state. Whether through the work of the ULC or through individual state initiatives, a statutory mechanism for obtaining a Certificate of Good Standing would be of great assistance in enabling series to open bank and investment accounts.

Over the past twenty-plus years, the Series LLC has evolved greatly from its original use in the mutual fund marketplace. By enabling series to function as separate business enterprises, and by permitting their use in special purpose programmes, Delaware's innovative approach to Series LLCs has brought risk management opportunities to a variety of domiciles and to hundreds, if not thousands of captive owners. As the Series LLC continues to grow in popularity, we look forward to continued innovation to maximise the potential of this powerful tool.