

**HOUSE COMMITTEE ON BUSINESS & INDUSTRY  
TEXAS HOUSE OF REPRESENTATIVES  
INTERIM REPORT 2002**

**A REPORT TO THE  
HOUSE OF REPRESENTATIVES  
78TH TEXAS LEGISLATURE**

**REPRESENTATIVE KENNETH “KIM” BRIMER  
CHAIRMAN**

**COMMITTEE CLERK  
BONNIE BRUCE**



Committee On  
Business & Industry

October 15, 2002

Representative Kenneth "Kim" Brimer  
Chairman

P.O. Box 2910  
Austin, Texas 78768-2910

The Honorable James E. "Pete" Laney  
Speaker, Texas House of Representatives  
Members of the Texas House of Representatives  
Texas State Capitol, Rm. 2W.13  
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Committee on Business & Industry of the Seventy-Seventh Legislature hereby submits its interim report including recommendations for consideration by the Seventy-Eighth Legislature.

Respectfully submitted,

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Representative Kenneth "Kim" Brimer, Chairman

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Rep. Frank Corte

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Rep. John Davis

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Rep. Dawna Dukes

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Rep. Gary Elkins

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Rep. Kenn George

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Rep. Helen Giddings

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Rep. Burt Solomons

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Rep. Beverly Woolley

Dawna Dukes  
Vice-Chair

Members: Frank Corte, John Davis, Gary Elkins, Kenn George, Helen Giddings, Burt Solomons, Beverly Woolley

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## **INTRODUCTION**

At the beginning of the 77th Legislature, the Honorable James E. “Pete” Laney, Speaker of the Texas House of Representatives, appointed nine members to the House Committee on Business & Industry. The committee membership included: Representatives Kenneth “Kim” Brimer, Chair; Dawnna Dukes, Vice-Chair; Frank Corte; John Davis; Gary Elkins; Kenn George; Helen Giddings; Burt Solomons; and Beverly Woolley.

During the interim, Speaker Laney assigned the Committee on Business & Industry the following five charges:

1. Review trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power.
2. Review the performance of the workers’ compensation system in returning injured workers to safe and productive employment in a timely manner. Consider system features, policies of the Texas’ Workers Compensation Commission and actions on the part of health care providers or other system participants that may adversely affect returns to work.
3. Review and evaluate the substantive recodifications of the Business Organizations Code that were considered by the 76th and 77th Legislatures.
4. Review the fiscal condition of the workers’ compensation subsequent injury fund. Determine whether changes will be needed to keep the fund viable in light of increased demands placed on it by recent legislation.
5. Assess the need for regulation or other consumer protections in the sale of caskets.

In addition, the committee was charged with conducting active oversight of the agencies under the committee’s jurisdiction (i.e. the Texas State Office of Risk Management, the Risk Management Board, the Texas Workers’ Compensation Insurance Fund Board, the Texas Workers’ Compensation Commission, and the Research and Oversight Council on Workers’ Compensation).

In order to effectively undertake these charges, Chairman Brimer created five separate subcommittees; one subcommittee for each charge. Chairman Brimer wishes to express his appreciation to the subcommittee chairs and their respective staff members for the time and effort

they extended to this project. This report represents the final conclusions and recommendations of each subcommittee and their supporting documentation. The members of the Committee on Business & Industry as a whole have approved all sections of this report.

As well, committee staff wishes to thank Legislative Council staff Cynthia Gonzalez; Secretary of State staff Carmen Flores and Lorna Wassdorf; the staff of the Texas Workers' Compensation Commission, especially Michael Barron, Judy Bruce, John Casseb, Susan Cory, Pat Crawford, Laurie Crumpton, Virginia May, Monica Menchaca, and Bob Shipe; the entire staff of the Research and Oversight Council on Workers' Compensation including Dana Baroni, D.C. Campbell, Teresa Cosper, Mario Gonzalez, Jerry Hagins, Anthony Haynes, Amy Lee, Scott McAnally, Jon Schnautz, and Joseph Shields; the staff of the Texas Funeral Services Commission including Cue Bokin, Anne Cosper, Ed Kubicek, and Chet Robbins. Committee staff once again would like to thank computer guru extraordinaire Ambrose Gonzales of the Texas Legislative Council Computer Center.

Lastly, the committee wishes to extend a very sincere thanks to the citizens of Texas who attended any of the public hearings. Your time and efforts are greatly appreciated.



**HOUSE COMMITTEE ON BUSINESS & INDUSTRY**  
**INTERIM STUDY CHARGES AND SUBCOMMITTEE**  
**ASSIGNMENTS**

**SUBCOMMITTEE ON BINDING ARBITRATION IN CONSUMER CONTRACTS**

CHARGE      Review trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power.

Burt Solomons, Chair  
Frank Corte  
Dawnna Dukes  
Helen Giddings  
Beverly Woolley

**SUBCOMMITTEE ON THE BUSINESS ORGANIZATIONS CODE**

CHARGE      Review and evaluate the substantive recodifications of the Business Organizations Code that were considered by the 76th and 77th Legislatures.

Gary Elkins, Chair  
John Davis  
Kenn George  
Burt Solomons  
Beverly Woolley

**SUBCOMMITTEE ON CASKET SALES REGULATION**

CHARGE      Assess the need for regulation or other consumer protections in the sale of caskets.

Helen Giddings, Chair  
John Davis  
Dawnna Dukes  
Gary Elkins  
Beverly Woolley

**SUBCOMMITTEE ON RETURN TO WORK**

CHARGE        Review the performance of the workers' compensation system in returning injured workers to safe and productive employment in a timely manner. Consider system features, policies of the Texas Workers' Compensation Commission and actions on the part of health care providers or other system participants that may adversely affect returns to work.

John Davis, Chair  
Frank Corte  
Dawnna Dukes  
Kenn George  
Burt Solomons

**SUBCOMMITTEE ON THE TEXAS WORKERS' COMPENSATION COMMISSION'S SUBSEQUENT INJURY FUND**

CHARGE        Review the fiscal condition of the worker' compensation subsequent injury fund. Determine whether changes will be needed to keep the fund viable in light of increased demands placed on it by recent legislation.

Dawnna Dukes, Chair  
John Davis  
Gary Elkins  
Kenn George  
Helen Giddings

**SUBCOMMITTEE  
ON  
BINDING ARBITRATION  
IN  
CONSUMER CONTRACTS**

## **BACKGROUND**

During the 77th Legislature, Representative Frank Corte filed HB 2465 requiring the following notice on any contract that contained a binding arbitration provision:

“By signing this contract you are agreeing to have any issue arising under this contract decided by neutral arbitration and you are giving up your right to a jury or court trial. The law does not require that you submit to binding arbitration.”

The bill failed to pass out of a committee. Interest in binding arbitration intensified due to the veto of HB 1862, a bill to address the prompt payment of healthcare providers for services. The veto was based on the bill not including binding arbitration as an alternative dispute resolution (“ADR”). During the interim both the Committee on Business & Industry and the Committee on Civil Practices were assigned interim charges that focused on different aspect of ADR.<sup>1</sup> The Committee on Business & Industry is charged with “reviewing trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power.”

## **WHAT IS BINDING ARBITRATION?**

Binding arbitration is a type of ADR, which refers to the use of a neutral third party facilitator to help the settlement of a dispute between two parties outside a court of law. There is no judge and no jury.

Some ADR methods are the beginning of the dispute process. Mediation and non-binding arbitration are pre-trial attempts to settle, described and governed by the 1987 **Texas Alternative Dispute Resolution Procedures Act (“ADR Act”)**.<sup>2</sup> The Texas ADR Act outlines five basic non-binding ADR procedures: mediation, mini-trial, moderated settlement conference, non-binding arbitration and summary jury trial. Other types of non-binding ADR procedures can be created by agreement of parties. The ADR Act states it is the policy of the State to encourage the early resolution of pending litigation through voluntary settlement procedures. Therefore, it is required of every Texas lawyer and court to become informed on the appropriate use of alternative procedures for settling disputes.

Contrary to mediation or non-binding arbitration, binding arbitration is a complete alternative to a trial. Binding arbitration is not mediation. It is not an attempt to find a mutually agreeable solution between the disputants. Rather, it is a dispute resolution method that allows parties to plead their

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<sup>1</sup> The Committee on Civil Practices was charged to “examine changes over the last decade to the civil justice system that affect the right of litigants (citizens or businesses) to receive appropriate review by a judicial body, including arbitration, mediation, other types of alternative dispute resolution.”

<sup>2</sup> Tex. Civil Practice & Remedies Code, Chapter 154, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

case to a neutral third party, the arbitrator. Either both sides agree on one arbitrator, or each side selects one arbitrator and the two arbitrators elect a third to comprise a panel. Arbitration hearings usually last only a few hours and the opinions are not public-record. Upon listening to and reviewing evidence and testimony, the arbitrator will make a ruling that all parties are bound to uphold. There are limited appeals and judicial review. Arbitration has long been used in labor, construction, and securities regulation, but is now gaining popularity in other business disputes.

Binding arbitration may be voluntary or mandated. Voluntary binding arbitration is agreed to by all parties after a dispute has arisen. Mandated binding arbitration is a stipulation of a contract or agreement and is agreed upon at the time of the contract, before a dispute arises. Mandated arbitration is only available under the **Texas General Arbitration Act (“TGAA”)**<sup>3</sup> or the **Federal Arbitration Act (“FAA”)**.<sup>4</sup>

## **REGULATION OF BINDING ARBITRATION**

Regulation of arbitration is done on both the state and federal levels. The FAA is Title 9 of the United States Code (9 U.S.C.A. Sec. 1-15 West 1970 and Supp. 1990). The FAA is a statute based on Congress’ plenary power over interstate commerce. It includes sanctioning and encouraging binding arbitration by private agreement in maritime transactions and contracts evidencing a transaction involving interstate or international commerce. Where it applies, its terms prevail over state law.

The FAA mandates that all arbitration clauses be enforced by the courts, and preempts state legislatures from banning them. The exception to this rule; however, is an arbitration clause in insurance contracts. The McCarran-Ferguson Act “reverse preempts” FAA and allows states to restrict the use of arbitration by insurance companies.<sup>5</sup>

Another federal law that is frequently mentioned during consumer disputes is the **Magnuson-Moss Warranty Act**.<sup>6</sup> The Magnuson-Moss Warranty Act is the federal law that governs consumer product warranties. Passed by Congress in 1975, the Magnuson-Moss Act covers only warranties on consumer products, not services. Thus only warranties on tangible property normally used for personal, family, or household purposes are covered (this includes property attached or installed to real property). However, if the warranty covers both the parts provided for a repair and the

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<sup>3</sup> Texas Civil Practice and Remedies Code, Chapter 171, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>4</sup> U.S.C. Title 9, *n.d.*, <<http://www4.law.cornell.edu/uscode/>>

<sup>5</sup> Some states ban the use of arbitration by insurers. In eleven states there is a statutory ban applying across the board to any insurance contract, although three of those states’ courts have not upheld the ban. In three other states, there is no statutory ban, but courts have refused to permit arbitration of bad faith lawsuits. Texas has no statute or regulation prohibiting or restricting the use of arbitration clauses in insurance contracts.

<sup>6</sup> U.S.C. Title 15, Chapter 50, *n.d.*, <<http://www4.law.cornell.edu/uscode/>>

workmanship in making that repair, the Act does apply.

This Act makes it easier for purchasers to sue for breach of a warranty by making breach of a warranty a violation of federal law, and allowing consumers to recover court costs and reasonable attorney fees. However, the Act allows warranties to include a provision that requires customers to try to resolve warranty disputes by means of an informal dispute resolution mechanism before going to court. If a warranty includes such a requirement, the dispute resolution must meet the requirements stated in the Federal Trade Commission’s Rule on Informal Dispute Settlement Procedures (the “Dispute Resolution Rule”) which includes the following provisions for ADR:

- Be available free of charge to the consumers;
- Be resolved within 40 days of receiving a notice of dispute;
- Be non-binding;
- Keep complete records on all disputes; and
- Be audited annually for compliance with the Rule.

However, the Texas Supreme Court has found that the Magnuson-Moss Act does not preempt the Federal Arbitration Act, therefore, a consumer can be forced into binding arbitration to arbitrate defects that would otherwise be covered under a consumer warranty.<sup>7</sup>

There are numerous states laws on ADR. In Texas, the TGAA provides this regulation. Both the FAA and the TGAA have similar requirements for an agreement to arbitrate, which is normally a contract. Both find an agreement to arbitrate valid unless the contract on the whole is invalid or the agreement was made under duress. The TGAA requires a notice on the actual contract, not unlike HB 2645, but this provision was eliminated by a 1987 amendment to the Act. Many of the limitations<sup>8</sup> for applicability of an agreement to arbitrate in the TGAA are not found in the FAA. The only limitation that would apply to consumer contracts states that:

“an agreement for the acquisition by one or more individuals of property, services, money, or credit in which the total consideration to be furnished by the individual is not more than \$50,000.”<sup>9</sup>

However, this exception can be waived if the parties agree in writing after being advised by counsel. Therefore, a contract between a consumer and a multi-state business containing a binding arbitration clause could be enforceable under federal or state statute for any binding arbitration clause. Both statutes express that the method for choosing an arbitrator will either be determined by the arbitration agreement or the courts. But the TGAA clarifies that for a panel all arbitrators must be present for a hearing, and if an arbitrator ceases to act, the remaining arbitrators may make an award.

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<sup>7</sup> *In re American Homestar of Lancaster and Nationwide Housing Systems, Inc. Realtors* 10-99-00134-CV, 3 SW3d 57, 06-29-99 (Tex. June 7, 2001), and *In re First Merit Bank, N.A. f/k/a Signal Bank N.A. and Mobile Consultants, Inc. Realtors* (Tex. June 14, 2001)

<sup>8</sup> Texas Civil Practice and Remedies Code, §171.002, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>9</sup> Texas Civil Practice and Remedies Code, §171.002(a)(2), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Both allow arbitrators to summon witnesses and material evidence. These summonses are enforceable by the court, with failure to appear considered contempt of court. Expert witnesses are paid the same as the witness fee in stated District courts.

In addition to these requirements, the TGAA provides a variety of substantive and procedural rules that govern arbitration unless otherwise specified by the parties. The TGAA qualifies that arbitrators shall set a time and place for the hearing and notify each party not later than the fifth day before the hearing. The arbitrators may also postpone or adjourn hearings (a hearing is delayed automatically if a party, who was notified, fails to appear). Parties have the right to testify, present evidence and cross-examine witnesses. The parties also may not waive their right to an attorney. The arbitrator may award separate payments for attorney fees only if the fees are provided for: 1) in the agreement to arbitrate; or 2) by law for a recovery in a civil action in a district court on a cause of action on which any part of the award is based.

The requirements for an arbitrators award is very different in the FAA and TGAA. The FAA declares that arbitrator awards are enforceable by a court. After a review the court may enforce an award, or modify the award based on a material mistake or omission. The court may also invalidate the award, but only for the following reasons:

- The award is procured by corruption, fraud, or undue means.
- There is evident partiality or corruption in the arbitrators, or either of them.
- The arbitrators are guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy or of any other misbehavior by which the rights of any party have been prejudiced.
- The arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

If an award is invalidated, the only option the court has is to reappoint another arbitrator or panel of arbitrators to rehear the dispute. Expenses for a rehearing would be borne by the parties.

The TGAA requires the arbitrator's award be determined in writing by the time line established in the contract or court, and delivered to each party personally or by registered or certified mail. The arbitrator's fee and expenses are either determined by contract or determined in the arbitrator's award. The TGAA also places time restrictions on a party to dispute an award. To dispute the timeliness of a decision, a party must notify the arbitrators of the objection before the delivery of the award to that party. A dispute to modify an award must be submitted within 20days.

Neither the FAA nor the TGAA require the arbitrator to follow Texas or Federal laws in making an award. In fact, the TGAA specifically states that an arbitrator's award does not have to follow Texas statutes.<sup>10</sup>

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<sup>10</sup> Texas Civil Practice & Remedies Code, §171.090, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Another state law which is frequently mentioned in conjunction with regulation of ADR is the **Texas Residential Construction Liability Act**.<sup>11</sup> The Texas Residential Construction Liability Act was passed in 1989 and outlines the liability of a contractor for defects to a residential dwelling which was constructed or on which repairs were negotiated through a residential construction contract. In 1999, a mandatory, non-binding mediation provision was added which requires a consumer and a contractor to submit to mediation before a trial if one party requests mediation. Therefore, if a party disputes a binding arbitration clause in their contract through the court system (i.e., based on duress) and prevails, mediation is still mandatory if the other party requests it.

In addition to these regulations, some states regulate the qualifications of the arbitrators themselves. The American Bar Association surveyed<sup>12</sup> dispute resolution practices in 52 state bar associations (representing all 50 states and the District of Columbia and Puerto Rico) and 30 local associations. Forty-four state bars reported that individuals from backgrounds other than law are used as dispute resolution providers. Only eighteen states reported that an entity (bar, courts, legislatures, etc.) certifies, approves or maintains a roster of dispute resolution providers. Further, twenty-seven state bar associations have mandatory training requirements for either mediators or arbitrators in the court annexed context, and only eight states require training for mediators and arbitrators in contexts other than court. Texas is not one. In Texas, 40 hours of basic mediation training, plus 24 hours of family training is required for family dispute mediators. However, arbitrators are not required to have any type of training. In addition, neither mediators nor arbitrators in Texas have to be licensed to practice law, even though they act as a judge. However, the lack of required training in Texas may provide more options.

In Texas, a consumer has several options for choosing an arbitrator. The Better Business Bureau operates a free arbitration program for consumers doing business with a member of the Better Business Bureau. Awards under this program are binding on the business, but not on the consumer. If the consumer is not pleased with the results of the award, they could file suit against the business.

Further, a consumer and business could obtain an arbitrator from a consumer group. No licensing requirements mean that the parties are free to obtain any arbitrator with which they mutually feel comfortable.

## **WHO ARE THE ARBITRATORS**

Unless arbitration is ordered by a court or the arbitrator is chosen by the parties, most arbitrations are done through an arbitration association. The three largest of those are the American Arbitration

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<sup>11</sup> Texas Property Code, Chapter 27, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>12</sup> “State and Local Bar Alternative Dispute Resolution Survey” 2001 Edition, American Bar Association, *n.d.*, <<http://www.abanet.org/statelocal/disputesurvey.html>>

Association; the National Arbitration Forum; and the Judicial Arbitration and Mediation Services.

**The American Arbitration Association (“AAA”)** was founded in 1926 (soon after the passage of the Federal Arbitration Act) and now has 37 offices in the United States and Europe and 55 cooperative agreements with arbitral institutions in 39 countries with 11,000 neutrals. The non-profit organization claims to be the largest provider of dispute resolution services, with 50 different speciality procedures including construction, automotive insurance claims, healthcare and consumer finance. The AAA’s construction dispute process (which was designed by a group of construction industry associations) is endorsed by the Texas Builders Association. In their

2000 annual report, the AAA reported the sixth successive year of record caseloads, with 198,491 cases filed and more than 218,000 cases administered in 2000 alone. Each year more than 6,000 corporations, organizations, professional firms, unions, academic institutions, governmental agencies and individuals provide membership support for the AAA. Members are kept informed of current industry trends, creative uses of ADR, case management techniques, case preparation and presentation recommendations, suggestions for drafting clauses for business contracts, and invitations to educational programs. Another primary benefit of membership is subscription to a number of award-winning periodicals, such as the *Dispute Resolution Journal* and *ADR Currents*, that offer articles, editorial views, and reports on current developments in conflict avoidance and management. Members are also entitled to discounted subscriptions to ADRWorld.com, the Internet-based ADR news service acquired by the AAA in 2000.

Founded in 1986, **The National Arbitration Forum (“NAF”)** is a private company, independent from any association with organizations or trades, with an international network of former judges, senior attorneys, and law professors who share the NAF principle that legal disputes should be decided according to established legal principles. Arbitrators for the NAF are retired judges, attorneys, and law professors, and are required to have more than 15 years experience, to have arbitrated commercial, financial and business disputes, and to be qualified under any local rules in his or her community. NAF arbitrators render decisions according to the law. Unlike other arbitration systems, NAF arbitrators are not permitted to ignore the law and make decisions based on “equity.”

**The Judicial Arbitration and Mediation Services (“JAMS”)** does mainly commercial

The American Arbitration Association is dedicated to the development and widespread use of prompt, Effective, and economical methods of dispute resolution. As a not-for-profit organization, our mission is one of service and education.

We are committed to providing exceptional neutrals, proficient case management, dedicated personnel, advanced education and training, and innovative process knowledge to meet the conflict management and dispute resolution needs of the public –now and in the future.

-AAA Mission Statement

The Mission of JAMS is to provide the highest quality dispute resolution services to our clients and to our local, national and global communities. We respect the parties and their representatives and commit to achieve the best possible resolution of their disputes.

- JAMS Mission Statement

arbitration, but does accept a few consumer arbitrations. After 20 years of providing clients with a complete range of ADR services, a group of 45 JAMS neutrals and management purchased the company from institutional investors in August 1999. JAMS has twenty offices in the United States and provides services to thousands of client here and abroad. All of their neutrals are either attorneys or judges.

Issues	National Arbitration Forum (NAF)	American Arbitration Association (AAA)		Judicial Arbitration and Mediation Services (JAMS) Founded in 1979, primarily for commercial disputes. Last year performed only 150 consumer disputes out of 12,000.
		Consumer Disputes	Construction Disputes	
<b>Are the Arbitrators independent contractors</b>	Yes	Yes	Yes	No. Some arbitrators have an ownership interest in the company.
<b>Arbitrators are all legal professionals</b>	Yes	No	No	Yes
<b>Arbitrators must apply the laws</b>	Yes	Rules are silent	No	No

## REASONS FOR ARBITRATION

Arbitration agreements have been used for centuries, and are even noted in the Bible.<sup>13</sup> In Texas, arbitration was recognized in the state constitution.<sup>14</sup> However, most courts refused to enforce pre-dispute mandatory arbitration clauses.<sup>15</sup> In 1925, the enactment of the FAA gave binding arbitration clauses, and the private justice system legitimacy. In the beginning, arbitration clauses were commonly used in disputes between businesses as a means to keep trade secrets confidential. In fact, the Texas Watch Foundation states in its report on Binding Arbitration:

“Original participants in the debate did not envision that the FAA would be applied in a consumer context. Mr. W. H. H. Piatt, the American Bar Association point person proposing the legislation, stated that the FAA would apply, ‘between merchants one with another, buying and selling goods.’ The bill’s authors and supporters emphasized the FAA would only apply to ‘merchants,’ as opposed

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<sup>13</sup> “If only there were someone to arbitrate between us, to lay his hand upon us both, someone to remove God’s rod from me, so that his terror would frighten me no more.” *Job 9:33* (NIV Version)

<sup>14</sup> TX Const Art. VII, §15 (1845) This section charges the legislature the duty “to decide differences by arbitration, when the parties shall elect that method.”

<sup>15</sup> Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 Yale L.J., 595 (1928)

to consumers. For over half a century, that sentiment prevailed.”<sup>16</sup>

Use of arbitration clauses grew in popularity in the mid-seventies, when state bars and law schools across the country started recognizing the need for an alternative to the judicial system. By the Eighties arbitration clauses made their way to consumer contracts, where they quickly became pervasive.

Originally, according to University of Houston Law Center Professor Richard M. Alderman, the reason for binding arbitration’s popularity was simple: “The legal system had become too expensive, too slow, and too inefficient to deal with the myriad of problems it was being asked to resolve.”<sup>17</sup> In 1998, it was reported that “many small claims courts cannot take cases less than \$20,000 because the amount exceeds their jurisdictional limit. And many lawyers wouldn’t take the case because it just isn’t worth their time.”<sup>18</sup> A year later, The American Bar Association found that “75% of all consumers have no access to the courts. Either they can’t afford a lawyer, or they don’t understand the legal system. ‘Arbitration lets people process smaller claims that a lawyer would never take on,’ says India Johnson, American Arbitration Association’s senior vice-president.”<sup>19</sup>

Binding arbitration was to be the remedy by providing accessible, impartial decisions in a quick, cost efficient and private manner. Texans for Lawsuit Reform assert that “arbitrations can be a faster, and less cumbersome method of resolving a wide variety of disputes. Arbitration agreements can also provide a means for parties to ensure — before a dispute arises — that it will be resolved by an independent, unbiased arbiter or arbiters with special expertise in the subject matter of the dispute.”<sup>20</sup>

The efficacy of arbitration is achieved through a less formal process allowing more flexibility in the scheduling, the evidentiary proceedings and the actual hearings. This reduction in the schedule allows for a cost savings in legal representation expenses alone. However, the inability to appeal an arbitrator’s award saves greater time and money which is why businesses include binding arbitration clauses in almost every consumer contract. Binding arbitration can be found in the fine print or “terms and conditions” of almost every contract a consumer signs, whether the risk is large or small. Arbitration is included in department store lay-away plans to a contract for some of the largest investments a consumer will ever make: a new home contract or an automobile purchase contract.

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<sup>16</sup> Cris Feldman, “The Consumer Pitfalls of Arbitration,” **Issue Paper**, Texas Watch Foundation, 2002, pg. 3

<sup>17</sup> Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform.*, Vol. 38, Number 4 Houston L. Rev., 1237, 1238 (Winter 2001)

<sup>18</sup> Channen, AMA J., (December, 1998)

<sup>19</sup> “When you want to sue — but can’t” *Business Week*, June 10, 2002

<sup>20</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

The Consumers’ Union admits that “When it works well, however, arbitration can help consumers settle their disputes faster and cheaper than by litigation. It commonly takes anywhere from two to five years to get a civil case before a judge; an arbitration case can often be resolved within a matter of weeks.”<sup>21</sup>

The United States Supreme Court Justice Burger, in support of arbitration, has said that “The notion that most people want black-robed judges, well-dressed lawyers and fine paneled courtrooms as the setting to resolve their dispute is not correct. People with problems, like people with pains, want relief, and they want it as quickly and inexpensively as possible.”<sup>22</sup> Indeed the idea of an informal procedure that avoids the need to appear before a judge may be the very appeal for consumers to ADR. A recent study conducted on behalf of the Institute for Advanced Dispute Resolution found that when informed of how the arbitration process works, 82% of adults said they would opt for arbitration over filing a lawsuit.<sup>23</sup>

## **PROBLEMS INHERENT IN PRE-DISPUTE CONSUMER BINDING ARBITRATION**

As a business-to-business ADR process, pre-dispute binding arbitration provides an informal, cost efficient and speedy access to justice. These advantages are desirable in business-to-consumer contracts as well. Texans for Lawsuit Reform state that “As long as the arbitration agreement is fair, balanced, and not forced on someone without informed consent, it is inherently fair and reasonable to allow Texans the option to agree to arbitrate”<sup>24</sup> Certainly, with its advantages, it is hard to imagine why a consumer would not opt for arbitration. In determining whether pre-dispute binding arbitration is fair, balanced and not forced on consumers without informed consent, the committee staff examined the agreement to arbitrate, the consumer’s access to justice in this alternative system and whether the process provides balanced and fair outcomes.

Common sense and both federal and state laws, require that a contract be voluntarily agreed to by both parties to be valid. To voluntarily agree to a contract a consumer must have an option of whether to enter into the contract or not. However, many consumers find themselves left with little or no alternatives.

### **Contracts of Adhesion**

The committee is charged with looking at contracts in which the consumer has little or no bargaining

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<sup>21</sup> Consumers’ Union “The Arbitration Trap: How consumers pay for ‘low cost’ justice” **Issue Paper**, August, 1999, pg. 1

<sup>22</sup> Justice Warren Burger, *Our Vicious Spiral*, Judges Journal 22, 49 (1977)

<sup>23</sup> “Roper Poll Reveals American’s Preferences for Resolving Legal Issues: Majority Believe Arbitration is their Best Option” *Archived News Items*, Jan. 27, 2000, <<http://www.texasadr.org/newsitems.cfm#roper>> Note: It is unclear how binding arbitration was explained.

<sup>24</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

power. These types of contracts are called contracts of adhesion. Contracts of adhesion are used in most consumer transactions and are presented to the consumer in a take-it-or-leave-it fashion. A consumer has little ability to negotiate the terms of the contract for their credit cards, their long distance service, their lay-away at the local department store or a contract for a new home. Certain parts of these contracts are negotiable, like a price for a product or service. However, consumers are finding that clauses on binding arbitration and liability are non-negotiable.

One business owner who testified before the Subcommittee<sup>25</sup> stated that he would walk away from a deal before he negotiated the clause out. One contract submitted as testimony to the Subcommittee gave the consumer the option of filing a lawsuit or going to binding arbitration. However, if the consumer chose to file a suit, they had to immediately pay the business \$10,000 in liquidated damages.<sup>26</sup> Most businesses that utilize these clauses routinely tell consumers if they will not accept the binding arbitration clause, to “go do business with someone else.” But the question is — can consumers readily find a business that does not require a binding arbitration clause?

This trend of using binding arbitration clauses has not only become common practice in individual businesses; It has spread to whole industries. A majority of the witnesses that testified before the Subcommittee, were either consumers or purveyors of new home construction. Consumers were at a disadvantage in negotiating these clauses out of their contracts, not only because the builder had more power in the individual transaction, but also because almost every builder in the state has binding arbitration clauses in their contracts. The Texas Association of Builders’ model Residential Construction Contract includes a binding arbitration clause. Further, it stipulates that all disputes are governed by Federal, not State, laws and that all arbitrations will be done by the American Arbitration Association. The recommended contract for the Texas Association of Realtors for preexisting homes does not include a binding arbitration clause, because the association feels that the public is uneducated about its scope or consequences.<sup>27</sup>

Texans for Lawsuit Reform believes that Texas law already has consumer protections to ensure that consumers are properly informed as to the consequences of signing an arbitration agreement. The organization feels the TGAA requirement that any valid arbitration agreement for an amount totaling less than \$50,000 must be signed by an attorney as well as the consumer ensures that consumers are educated in the majority of consumer disputes.

“The practical effect of this law is that enforceable arbitration provisions in consumer contracts will be rare under Texas law because it will be highly unusual for businesses to insist consumers retain a

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<sup>25</sup> Ray Tonjes Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

<sup>26</sup> D.R. Horton new home contract submitted by Steven Pawlowski, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

<sup>27</sup> Tom Morgan (Texas Association of Realtors) Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

lawyer and seek legal counsel in order to sell their service or product in transactions under \$50,000. When this does occur, the consumer will be entering the transaction informed of the effect of the arbitration provision and electing to accept it as part of the deal. This is a very practical method of addressing the ‘contract of adhesion’ issue because it essentially eliminates form arbitration agreements in most consumer transactions.”

Although courts previously had a history of voiding any contract of adhesion, most arbitration clauses today are upheld by courts, whether or not the consumer had any real ability to negotiate the clause out of the contract.<sup>28</sup>

### Mutual Agreement to Arbitrate

It would appear from recent court decisions that if a consumer signs a contract which contains an arbitration clause, they have voluntarily entered into a mutual agreement to arbitrate. However, many consumers do not ever sign a contract which binds them to arbitration and the courts have upheld these contracts. Binding arbitration clauses are incorporated in the terms and agreements included with the instructions on many household appliances. If the item is not returned within 30 days, the consumer is bound by arbitration for any future disputes.

Many consumers find themselves bound to arbitrate because of slips of paper known as bill stuffers. Included in the advertisements for vacation discounts, free phones and other goods that are “stuffed” into consumers’ bills for cable, phone or credit cards are important notices of any changes to the terms of their service agreement. They require no signature, no affirmative opt-in action. On the contrary, a consumer does not even have to read the notice, but any further use of the service or goods provided by the business binds the consumer to any changes, including binding arbitration. These “bill stuffers” were upheld in the courts as legitimate agreements to arbitrate.<sup>29</sup>

Further, even though a consumer reads, acknowledges and signs a binding arbitration agreement, he may not understand the differences between binding arbitration and mediation. Dawn Richardson, an Austin resident who testified at the Subcommittee hearing, stated “My husband and I are both college-educated, but we did not know that signing a construction contract meant that we forever gave up our constitutional rights to a trial by jury for any and all future disputes with our builder.”<sup>30</sup>

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<sup>28</sup> For examples of cases in which the court has refused to find a lack of consent based on a contract of adhesion, see the following cases cited in the article “Pre-dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform” (previously cited): *Great W. Mortgage Corp. v. Peacock*, 110 F .3d 222, 229-30 (3rd Cir. 1997) (refusing to find a lack of consent in an arbitration agreement even when the plaintiff-employee would have been fired had she not signed the agreement); *Hill v Gateway 2000, Inc.* 105 F .3d 1147, 1148 (7th Cir. 1997) (enforcing an arbitration agreement when the plaintiff failed to read the contract closely enough to discover the arbitration clause); *Engalla v. Permanente Med. Group, Inc.*, 938 P .2d 903, 924-25 (Cal. 1997) (rejecting the claim that the arbitration agreement was unconscionable because it resembled an adhesion contract). See generally Ian R. MacNeil et al., Federal Arbitration Law: Agreements, Awards, and Remedies Under the Federal Arbitration Act §19.3 (1999 & Supp.) (discussing the relationship between unconscionability and adhesion contracts.)

<sup>29</sup> *Marsh v. First USA Bank, N.A.*, North Texas Federal District Court (2000) (A billing insert amending a credit card agreement to include an arbitration clause creates a valid agreement to arbitrate when the consumer continues to charge to the account after the insert is mailed.); *In Re Alamo Lumber Co.*, 4th Court of Appeals (2000) (If an employee continues to work after being presented with a binding arbitration clause, it may form a unilateral contract.)

<sup>30</sup> Caroline E. Mayer, “No Suits Allowed: Increasingly, Arbitration Is the Only Recourse,” *Washington Post*, July 14, 2002

Many consumers echo the same disbelief. They simply do not understand that they can waive all their rights for a judge or jury to decide their case. However, as in other areas of the law, ignorance of the law is no defense, especially not in court.<sup>31</sup>

In some cases, consumers seek legal counsel before signing these clauses, yet are no more informed or protected. Laura Munoz, an Austin city resident, gave the following testimony at the Subcommittee hearing:

“I knew we had an arbitration clause in our contract, maybe unlike some other people, but we had an attorney look over the contract before we signed it. So, I thought we were in good shape. And I learned later that this particular attorney represented that same construction association of contractors (that the builder belonged to), and so maybe there was some bias there, I don’t know. But I was told that arbitration was cheaper and more expedient than going to court.”

Particularly vulnerable, are the elderly in nursing homes. Quality nursing homes are rare and often have long waiting lists for available space. However some nursing home patients are being forced to sign binding arbitration agreements for admittance into or continued treatment at nursing homes. These clauses state:

“This plan spells out the only way to deal with any and all disputes or differences between the nursing home and its residents. Residents cannot sue in a court of law the nursing home or its officers, directors, employees or agents...”<sup>32</sup>

Even if an elderly consumer, or her family, understands what an arbitration clause means, it is unlikely that either wish to jeopardize the continued living and medical arrangements. It is questionable whether any arbitration clause agreed to under this kind of duress could be voluntary. However, Federal law instructs courts to conclude that any consumer that signs a contract which includes arbitration voluntarily consented to the arbitration provision.

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), the Supreme Court observed that:

[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute. The court is to make this determination by applying the ‘federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.’ And that body of law counsels ‘that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration...The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of

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<sup>31</sup> *Hill v Gateway 2000, Inc.* 105 F .3d 1147, 1148 (7th Cir. 1997) (enforcing an arbitration agreement when the plaintiff failed to read the contract closely enough to discover the arbitration clause); *Doctor’s Assocs., Inc. v Stuart*, 85 F .3d 975, 980 (2d Cir. 1996) (refusing to find that the arbitration agreement was fraudulently induced when the defendants failed to read or inquire into the meaning of the arbitration clause)

<sup>32</sup> Feldman, pg. 20

arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.’ Thus, as with any other contract, the parties’ intentions control, but those intentions are generously construed as to issues of arbitrability.”

### Cost of Arbitration

Binding arbitration is often touted as being a cheaper alternative to lawsuits, and thus valuable to the judicial system as a whole. Limited discovery, less formal procedures and lack of an appellate review reduce the expense associated with litigation. However, both pro-tort reform organizations like Texans for Lawsuit Reform and consumer groups like Public Citizen agree that arbitration may be just as expensive, if not more than a lawsuit.

While it is true that an open-ended arbitration proceeding can be as costly as a traditional trial, experienced parties have the option to cut costs by agreeing to allow only discovery and evidence that is truly essential to the resolution of the dispute.

Texans for Lawsuit Reform  
Position Paper on Arbitration

While different arbitration associations have different fee schedules, almost all charge the following fees:

- Non-refundable filing fee
- Arbitrator’s Fee
- Arbitrator’s Expenses

Filing fees just to initiate a case can range from \$40 to over \$13,000, depending on the size of the claim and the arbitration association. In a study published May 1, 2002, Public Citizen found the filing fee for an \$80,000 consumer claim in the Circuit Court of Cook County, Illinois is \$221. The NAF fee would be \$11,625, a 5,260% difference. These high costs are not restricted to NAF; for the same \$80,000 claim, the AAA would charge up to \$7,950, amounting to a 3,009% and 3,597% difference in cost, respectively.<sup>33</sup> These high up-front costs strip away the benefits of attorney contingency fee arrangements in a court system, by which plaintiffs receive legal representation without advancing any money.

These fees can be cost prohibitive for consumers to even file a claim. “Lorraine Aho had to make that choice earlier this year in her wrongful firing case against Maxager Technology in San Rafael (CA). The American Arbitration Association ordered her to pay a \$3,000 filing fee, plus any fees the arbitrator might charge. Her attorney, Mary Dryovage, says the fees could have topped \$50,000. ‘We told them to forget it,’ Dryovage says. ‘I wasn’t going to let one of my clients get into a

<sup>33</sup> Jackson Williams, “The Costs of Arbitration” **Issue Paper**, Public Citizen, May 1, 2002, pg. 2

situation of having to declare bankruptcy to pursue her case.”<sup>34</sup>

The AAA responded to court rulings<sup>35</sup> which addressed the validity of arbitration that is cost-prohibitive to consumers and initiated changes in their fee structure for consumer cases. The intent of the new fee structure is to ensure access to consumers. Beginning March 1, 2002, where a consumer’s claim is between \$10,000 and \$75,000, the consumer will only be responsible for one-half of the arbitrator’s fee, capped at a maximum of \$375. The business will pay the \$750 administrative fee and the remaining balance of the arbitrator’s fee. Furthermore, filing fees will be calculated on the basis of compensatory or actual damages, and will not include any additional claims for punitive damages or attorneys’ fees, although these claims may be pursued before the arbitrator. AAA hopes that these restraints on the filing fees increase consumers’ access to arbitration, by ensuring that, for claims under \$75,000, arbitration “fees are equivalent to the cost of filing a lawsuit, and AAA has procedures to waive or defer the costs charged to consumers when appropriate.”<sup>36</sup>

AAA’s hardship provisions for fee reduction or waiver is based on the Federal Poverty Guidelines. They are issued each year in the *Federal Register* by the Department of Health and Human Services (HHS). The guidelines are a simplification of the poverty thresholds for use for administrative purposes — for instance, determining financial eligibility for certain federal programs. AAA’s guidelines are 200% of the Federal Poverty Guidelines.<sup>37</sup> The average annual wage in Texas is \$33,171.<sup>38</sup>

Family Size	2002 Federal Poverty Level <sup>39</sup>	AAA Hardship Provisions
1	\$8,860	\$17,720

<sup>34</sup> Reynolds Holding, “Private Justice: Millions are losing their legal rights” *The San Francisco Chronicle*, October 7, 2001

<sup>35</sup> *Green Tree Financial Corp. - Ala. v. Randolph* 99-1235 U.S. Supreme Court (December 11, 2000)

<sup>36</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>37</sup> “American Arbitration Association Continues Implementation of Changes Aimed at Fairness for Consumers in Arbitration” **Press Release**, American Arbitration Association, February 11, 2002 <<http://www.adr.org/index2.1.jsp?JSPssid=15766&JSPsrc=upload\LIVESITE\About\NewsAndEvents\Press\Employment%20Release.html>> (March 5, 2002)

<sup>38</sup> Texas Workforce Commission “Statewide Occupational Wage Data” *n.d.*, <<http://www.twc.state.tx.us/lmi/lfs/type/wages/texaswages.pdf>> (August 1, 2002)

<sup>39</sup> United States Department of Health and Human Services “Annual update of the HHS Poverty Guidelines” Feb. 14, 2002 <<http://aspe.hhs.gov/poverty/02fedreg.htm>> (August 1, 2002)

2	\$11,940	\$23,880
3	\$15,020	\$30,040
4	\$18,100	\$36,200
5	\$21,180	\$42,360
6	\$24,260	\$48,520
7	\$27,340	\$54,680
8	\$30,420	\$60,840

Proponents of arbitration reason that while these filing fees are higher than filing in court, arbitration is still a less expensive alternative for businesses and consumers, as well as for society. Texans for Lawsuit Reform argue “[a]rbitration opponents, including Public Citizen and Texas Watch, discuss only the cost of *initiating* an arbitration versus the cost of *initiating* a lawsuit. The cost of initiating either process is only a small part of the entire cost. The principal drivers of costs in litigation are discovery and attorneys’ fees. These costs dwarf the cost of initiating either an arbitration or a lawsuit.... While it is true that the cost of simply initiating an arbitration can be higher than the filing fee for a lawsuit, these fees are typically a fraction of the cost of the entire litigation.”<sup>40</sup>

A business will use an arbitration clause when it anticipates being the defendant in a civil lawsuit. Businesses generally do not use them if they anticipate being a plaintiff in a lawsuit, and usually draft the clauses so that only the business can force the consumer, employee, or franchisee into arbitration, and not the other way around. Because the high costs of arbitration and inability to bring class actions in arbitration discourage claims from being brought, arbitration clauses give an advantage to a potential defendant.

- Public Citizen  
Arbitration Watch Website

Filing fees for a lawsuit is a fraction of the cost of litigation, however it is also just one fee in the arbitration process. The additional fees required by every arbitration association are the arbitrator’s fees and expenses. An arbitrator’s fees cover the actual time spent in deciding motions and the actual dispute, while arbitrator’s expenses include any travel or administrative expenses. Rules laid out by arbitration associations indicate that an arbitrator’s fee may range from \$0 (in small claims for NAF) to over \$8,000. Most consumers testified before the Subcommittee that arbitrators charged an hourly fee that was between \$200-600.

In addition to these fees, “[a]rbitration saddles claimants with a plethora of extra fees that they

<sup>40</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

would not be charged if they went to court.”<sup>41</sup> For example, one arbitration association charges the consumer an administrative fee, another charges hearing fees, both paid simultaneously with the filing fee. Other fees include fees for requests (i.e., requests for injunctive relief or written awards), motions (i.e., subpoenas, discovery orders, continuances) and facilities for hearings. For example, the AAA has two office locations in Texas, but provide services to individuals throughout the state.<sup>42</sup> Parties in a hearing in San Angelo would be required to secure and pay for hearing facilities, while a party who lives near the AAA San Antonio office would not. Some of these fees are either split between the consumer and the business or paid solely by one party.

Many of these fees are to handle the administrative work that is usually done in the court system by support personnel. “The same support staff that expedite cases at a courthouse, such as file clerks and court administrators, are also necessary to manage arbitration cases. But because arbitration provider organization handle fewer cases over larger geographic areas, the economy of scale in a court clerk’s office cannot be achieved, increasing administrative cost per case. Thus, while it costs the Clerk of the Circuit Court of Cook County an average of \$44.20 to administer a case, AAA’s administrative cost per case averages \$340.63, about 700% more.”<sup>43</sup>

However, proponents of arbitration say it is this exact expense that arbitration saves society as a whole. “[T]he plaintiff is imposing on several citizens who must go to the courtroom to possibly be picked as a juror, taking the better part of a day, a week, or a month, of people’s time. Nor does this consider the cost to the tax payers, who have to support the court system. These are huge costs to society that arbitration does not impose.”<sup>44</sup>

Finally, consumers and businesses alike must pay for attorney representation and expert witness fees, however, these expenses are common to both arbitration and litigation.

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<sup>41</sup> “The Costs of Arbitration” Public Citizen, April 2002

<sup>42</sup> May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

<sup>43</sup> “The Costs of Arbitration” Public Citizen, April 2002

<sup>44</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit

### What Law Applies

When a dispute first occurs the consumer usually assumes that he will go to court to dispute his claim under Texas law. But as Texans for Lawsuit Reform recognize "...protections under the Texas Arbitration Act rarely come into play because of the broad reach of the Federal Arbitration Act and its preemption of state law."<sup>45</sup> Most consumer disputes arise against businesses that operate nationally. Unless jurisdiction is specified in the contract, the business has the option to invoke their rights under the TGAA or the FAA.

If arbitration is to be regulated under the federal statutes, state authority to provide additional guidelines beyond the federal statutes is preempted.

### Venue

Unless specified in the agreement, the venue of where the arbitration is to occur is unregulated by either the federal or state statutes.

When dealing with a national company, a consumer can be directed to travel to the business' national headquarters to arbitrate a dispute. The online auction service E-Bay mandates all disputes must go to an arbitrator in San Jose, California.<sup>46</sup>

Disputes in Texas can still be onerous because of the size of the state. "...[I]t is possible that venue in a location that is inconvenient for a consumer can operate as a barrier to meaningful access to arbitration" says Texans for Lawsuit Reform. "This type of venue requirement when applied to a consumer would likely be found to be unconscionable and, therefore unenforceable under Texas law."<sup>47</sup>

However, the Subcommittee heard testimony that a consumer from Austin was required to drive to San Antonio to resolve her dispute. Leslie Pettijohn, Commissioner of the Texas Consumer Credit Commission indicated that burdensome travel for venue requirements was not a common complaint that the Commission incurred when dealing with credit card consumers, although disputes about binding arbitration is increasing.

### Confidentiality of Proceeding

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<sup>45</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>46</sup> "User Agreement" April 19, 2002, <<http://pages.ebay.com/help/community/png-user.html>> (August 1, 2002) See Section 17 of the Agreement

<sup>47</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

Consumer complaints to a state agency, on binding arbitration is unique, first because many consumers are unsure if and which state agency might have jurisdiction, and secondly because of the confidentiality provisions of arbitration. While neither the FAA nor the TGAA require the proceeding to be private, most arbitration agreements require not only that non-parties to the dispute not be involved or contacted by the consumer, but also require confidentiality for the hearing and final award.

As discussed previously, the FAA was originally intended to provide a means to resolve business to business disputes. The advantage was a means for businesses to inexpensively resolve disputes without having to disclose trade secrets in court documents. "...[Confidentiality is generally important to businesses to protect private business matters and trade secrets and avoid being a target for litigation. The benefits of making arbitration awards public to competitors, plaintiff lawyers, the media, and others does not outweigh the parties' right to contract for confidentiality in their arbitration agreements. In addition, settlements in lawsuits are often confidential for similar reasons.]"<sup>48</sup>

While in business to business disputes confidentiality requirements provide protections for both businesses involved, confidentiality agreements in business to consumer disputes hinder consumers and continued responsible business practices.

One witness before the Subcommittee testified that because her contract prohibited the involvement of outside entities "there's no record of our builder's misconduct with the Better Business Bureau or the Attorney General's Office. Further, our arbitration records are closed, which means that home buyers have no way of accessing builders previous track records when it comes to arbitration, so my builder can continue to do this and nobody will ever know about it."<sup>49</sup>

This situation begs the question of whether confidentiality endangers consumers economically and even physically. A case involving the molestation of a forty-five year old woman with severe head injuries living in a nursing home by a nursing home employee was forced into binding arbitration agreed to upon admittance to the facility.<sup>50</sup> A confidentiality requirement in this case would not only prevent vital information about the safety and backgrounds of the employees of a facility from potential clients, but it could also possibly prevent a full investigation and criminal charges.

The pervasive use of confidentiality agreements and the lack public record of proceedings, further

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<sup>48</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>49</sup> Laura Munoz Testimony, May 15, 2002 public hearing of the Subcommittee on Binding Arbitration

<sup>50</sup> Ziva Branstetter, "Nursing Home Sues Family," *Tulsa World*, March 1, 2002

prohibit consumers from truly understanding the operations and reputation of a business.

Moreover, the removal of these cases from the court system and into arbitration, creates a lack of legal precedence and guidance of business operations and responsibilities. Private dispute resolution results in private punishment.

### Repeat Players/Unbiased Arbitrators

Whether private resolution can actually distribute justice is a major concern of consumers. Although arbitration is supposed to be a neutral process presided over a neutral third party, the arbitration associations attempt to match arbitrators with experience in the field of the dispute and the actual financial structure of the associations themselves lead to the perception of a biased process.

Most arbitration associations retain arbitrators based on subject matter. For example, arbitrators may have professional experience in construction, fiduciary, or employment law. The purpose is to bring to the dispute “...independent arbitrators who have experience and/or education in the relevant subject matter and who bring a greater level of expertise to the issues in the case than a lay jury.”<sup>51</sup>

While it sounds appropriate in theory, in practice this experience in and of itself can create the perception of bias for the consumer. If consumers learn that their arbitrator has represented the business party in past disputes or court proceedings or that the arbitrator has previously ruled in favor of the business party, consumers may question the neutrality of the arbitrator and possibly for good reason. Once a company wins before an arbitrator, the company may repeatedly choose the arbitrator. Conversely, a company is likely to strike an arbitrator that has previously awarded a consumer a large award against the company. According to Michael Young, co-chair of JAM’s Committee on Professional Standards and Public Policy, “the risks of the repeat player advantage are real and can be disturbing.”<sup>52</sup>

AAA responded to repeat player concerns from a Congressional inquiry. “At the request of aides to a federal senate legislative committee, we ran a computer search of twenty-seven companies in one industry for a period of 2.5 years, by company name, whom the aides had identified to us as citing the AAA as an arbitration provider in consumer dispute resolution clauses. Of these 27 companies, only eight had been involved in cases at the AAA. Of the 8 companies that did have AAA cases filed, a total of 51 cases were filed and no arbitrator served on more than one case.”<sup>53</sup>

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<sup>51</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>52</sup> Feldman, pg. 7

<sup>53</sup> Ibid., pg. 3

Texans for Lawsuit Reform also refute the idea of the repeat player by quoting one working paper that found that arbitrators tend to rule in favor of the plaintiff more than juries, and arbitrators and juries award similar amounts of damages in comparable cases.<sup>54</sup> They feel that the idea of bias because of repeat players “is not supported by evidence nor is it corroborated by any actual information of partiality by arbitrators on a systematic basis...If bias does unfairly affect the outcome of an arbitration or if arbitrators are biased toward either party, the party affected has grounds to vacate the award under Texas Arbitration Act section 171.088.”<sup>55</sup>

AAA reports that it “receives over 95% of its cases as a result of either being named as the administrative agency in an arbitration clause or because of a citation in a contract clause to one of the AAA rules, which are in the public domain.”<sup>56</sup>

In addition, the arbitration association’s ties to businesses involved in disputes is questioned by consumers. Texas Watch ponders the true neutrality of an association that is invested by or in a business that utilizes the association’s arbitration services.

“At time it can be hard to distinguish between arbitration firms from major clients. The AAA has held shares in AT&T, Bank of American, Aetna, Cigna Corp., General Electric — all of which the AAA has resolved disputes for. General Electric and Sprint corporate officers have sat on the AAA board. In 2000, the AAA received 2.1 million dollars in membership fees from GE industrial systems, Aetna, and other corporate interests.”<sup>57</sup>

But the AAA disputes this link claiming that “about half of AAA’s 6,000 members are individuals. The remaining members are law firms, corporations, unions, students, libraries and other groups interested in alternative dispute resolution. Members’ fees support education, training, and public service programs, and members receive a number of publications and other benefits for their dues. Members represent 2% of (the) revenue. Independent investment funds manage the AAA’d assets — both its operating investments and pension funds. AAA staff members do not select the particular stocks or bonds that comprise the AAA’s portfolio.”<sup>58</sup>

In fact, two Texas Supreme Court decisions have vacated an award by an arbitrator when the

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<sup>54</sup> Donald Whitman “Lay Juries, Professional Arbitrators and the Arbitration Selection Hypotheses,” **working paper no. 462**, University of California Sana Cruz, July, 2000, <<http://econ.ucsc.edu/faculty/workpapers.html>>

<sup>55</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>56</sup> May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

<sup>57</sup> Feldman, pg. 7

<sup>58</sup> May 31, 2002 letter to the Subcommittee from India Johnson, Senior Vice President for American Arbitration Association

arbitrator failed to notify all parties of former representation of one of the parties to the arbitration.<sup>59</sup> However, whether biases are detected is questionable, and consumers must bear a costly burden of proof. First USA, the nation’s second largest issuer of credit cards is in the middle of a class-action lawsuit over their binding arbitration clauses. Data revealed in court proceedings show “...that not only has the company sought arbitration far more often than consumers, it has also won in 99.6% percent of the cases that went all the way to an arbitrator.”<sup>60</sup>

Since arbitration associations do not routinely share its dispute information or statistics, there have been no scientific studies, however some reputable sources, like *Business Week*, report that arbitration awards are in favor of a business over a consumer 70% of the time and awards are usually much larger than they would have been in a court<sup>61</sup>.

### Limited Discovery

One reason many consumers feel like they are losing in arbitration is that they do not have the ability to fully develop their case because of limited discovery. While both the FAA and the TGAA allow for full discovery, most arbitration agreements limit discovery or charge for discovery motions. Proponents encourage limited discovery as a means to limit the length a dispute is in arbitration and the amount of attorneys fees. Opponents say limited discovery also hinders necessary discovery of evidence that may be crucial to the claims in dispute. David Bragg, from the AARP, reports that by withholding documents revealing evidence of liability, manufacturers can prevent consumers from proving the validity of their claims, no matter how egregious the harm.<sup>62</sup>

### Efficiency of Procedure

One of the stated advantages of arbitration is efficiency to resolution. However, many participants feel that this purported advantage has not materialized.

The Houston Chronicle reported that arbitration cases in Harris County run an average of “nine or more months” which is about the same time it takes a case to work through the civil justice system in the greater Houston area.<sup>63</sup> Vice President of Phillips Petroleum, Bryan Whitworth, has stated that “Arbitration may seem like it is an easy single way to solve problems. But we’ve found time delays;

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<sup>59</sup> *Texas Commerce Bank, National Association v. Universal Technical Institute of Texas, Inc.* (1999) 1st Court of Appeals.; also *Burlington Northern Railroad et al. v. TUCO Inc. et al.* (1997) TX Supreme Court

<sup>60</sup> Caroline Mayer, “Win Some, Lose Rarely?; Arbitration Forum’s Rulings Called One-Sided” *Washington Post*, March 1, 2000

<sup>61</sup> “Forced into Arbitration? Not Anymore.” *Business Week*, March 16, 1998

<sup>62</sup> David Bragg, “Binding Arbitration: A Wolf in Contract Clothing” **Issue Paper**, Texas AARP, 2001

<sup>63</sup> Mary Flood, “Arbitration Not Always Fair, Cheap for Parties in Dispute” *Houston Chronicle*, April 11, 2001

it's not saving expenses; and the courts offer just as good an opportunity." Whitworth stated that Phillips Petroleum hopes to keep arbitration clauses out of most future contracts. In addition, one witness testified before the Subcommittee that it took over a year to force their issue before an arbitrator. As with other statistical data, length of time till resolution is information that arbitration associations consider confidential.

### **Prohibition Against Class Action**

A class action is a legal method that allows an individual to sue on behalf of a class of similarly situated individuals in any federal or state court.<sup>64</sup> This allows a consumer to dispute a claim in which the claim of anyone individual would not justify the time and expense of a lawsuit. This method provides not only an incentive for attorneys to take a case, but it also acts as a deterrent for wrongful action.

Most arbitration clauses include a prohibition on the consumer from joining a current or future class action regarding the claim that is being disputed. Thus, each consumer is required to individually arbitrate the same claim while bearing the expense individually. The effect is to prevent a consolidation of similar claims qualifying for class action status.

However, Texans for Lawsuit Reform counter that there is no inherent right to be a participant in a class action lawsuit or an inherent right to class action plaintiff lawyers to have a class to certify.<sup>65</sup> And many small businesses feel that this is the only option to protect themselves against a frivolous lawsuit.<sup>66</sup>

One bank, FleetBoston Financial Corp., has gone one step further. Consumers that continue to use FleetBoston credit cards after receiving a recent bill stuffer, have given up their rights to file a lawsuit over current and future class action disputes because FleetBoston's binding arbitration clause is retroactive. In the name of fighting frivolous lawsuits, "We see no reason to distinguish between existing and potential class actions for the purposes of our arbitration in all cases," says Deborah Pulver, a spokeswoman for Fleet's credit card division.<sup>67</sup>

### **No Right to Appeal**

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<sup>64</sup> 28 U.S.C. Appendix - rule 23

<sup>65</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

<sup>66</sup> Tonjes testified "For a small business owner, this [arbitration] is our only protection."

<sup>67</sup> Jess Bravin, "Banks seek to Halt Suits by Cardholders" *The Wall Street Journal*, May 2, 2001

The fact that there are few grounds to appeal an arbitration award is a plus to some and a bane to others. The only reason a contract can be reviewed by a court of law is if the contract as a whole is invalid, or if the arbitration clause itself was agreed to under extreme duress or is unconscionable.

The only reason an award can be reviewed and invalidated by a court of law is because of bias, misconduct or coercive behavior by an arbitrator. However, if the courts find that the award is invalid, the only option the court has is to appoint a completely new arbitrator(s) and have the parties begin all over, at their expense. The Judge in the 3rd Court of Appeals case *Koch v. Koch* (2000) concluded that although the TAA states that a court “may” order a rehearing before arbitrators<sup>68</sup>, it provided the courts no other options, and therefore courts are compelled to order a rehearing before new arbitrators if an award is invalidated.

Consumers who are denied written decisions or rationales for the decision are also frustrated by the finality of the process. Laura Munoz’s testimony at the Subcommittee hearing:

“Well, it took us over a year to force our builder to go to arbitration and by the time the dust settled we spent a total of \$11,625 in arbitration and legal fees, not including witness fees etc. ... Although we were damaged to the tune of \$111,000 in arbitration we only recouped \$50,000 of our monies, which is less than half of our loss. And I have no idea why our arbitrator awarded us this amount and I was not allowed to ask him this. He doesn’t have to tell me why he decided that was the right figure.”

Appropriately summarized, Representative Giddings told a business owner at the Subcommittee hearing that “The same finality that gives you comfort, makes a consumer anxious.”

However, proponents claim that this lack of appeal, except in the most egregious of cases is what provides the greatest cost savings.

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<sup>68</sup> §179.089

## SUGGESTED REFORMS

When arbitration was first formalized by the FAA, it was intended for business to business transactions, which has caused a lack of protections for consumers. However, when the TGAA was created in 1965 it was obviously intended for use in both business-to-business and business-to-consumer transactions. Certain consumer protections were included in the TGAA, but because of the ever more pervasive use of binding arbitration consumers perceive them to be lacking.

Binding arbitration clauses are being insisted on by individual companies and by entire industries, leaving consumers with little or no option for services or goods without accepting arbitration. In a Dissent Opinion from the U.S. Supreme Court on arbitration, Justice Ginsberg states that "... the Court blends two discrete inquiries: First, is the arbitral forum *adequate* to adjudicate the claims at issue; second, is that forum *accessible* to the party resisting arbitration." Thus, it is the duty of the state to govern contractual law just to the extent to ensure that the agreement, the process and the award between a business and a consumer are fair and accessible.

The first concern is to ensure the agreement to arbitrate is voluntarily entered into by both parties after they are fully educated about the process. In order to guarantee that an agreement is entered into freely, the committee recommends that consumer arbitration agreements be separate addendums with disclosure notices. The disclosure clause should state that the addendum permanently removes a consumers right to dispute any claim on the contracted goods or services in a trial before a state or federal court and acceptance of the addendum is not required by state or federal law. Further, the committee recommends not only keeping the current consumer protection in the TGAA of exempting personal injury disputes from arbitration, but recommends strengthening other consumer protections. Currently binding arbitration under the TGAA is not applicable to any dispute under \$50,000 unless both the consumer and an attorney representing them sign a waiver. The committee would recommend increasing this threshold to \$150,000.

In addition to these current consumer protections, the committee recommends prohibiting the use of arbitration under the TGAA to dispute possible misdemeanor or felony crimes. The committee also recommends prohibitions against contractually creating incentive or penalizing consumers from choosing either arbitration or filing suit. In addition, the committee strongly recommends that any arbitrator's award must follow applicable state statute regulating the issue at dispute. These reforms should improve the fairness of an agreement between a business and a consumer, but the committee is also concerned about accessibility to the process itself.

One of the first and most egregious barriers to the arbitration process are the fees charged by arbitration associations. Since the objective of arbitration is to provide a less expensive alternative to suing, it would only be sensible that filing for arbitration should be no more expensive than filing for litigation. In addition, the consumer should not be burdened with fees or travel expenses that

would not be applicable in the court system. Thus, the committee would recommend that filing fees be prohibited from being higher than the filing fees in the consumer's local court that would adjudicate the dispute if it were not being arbitrated. Further, the venue for any arbitration should not be a greater distance than the jurisdictional boundaries of the consumer's local court. While the consumer and the business should remain responsible for the costs of any legal representation or expert witness testimony, any additional fees from the arbitration association should, the committee recommends, be paid by the business and not the consumer.

While fees present a barrier between consumers and arbitration, some clauses prevent consumers from seeking other avenues of justice. For example, some arbitration agreements prohibit consumers from joining current or future class action suits. While the committee feels that class actions provide avenues for consumers with small damages to collectively address egregious wrongs that would be impossible or not worthwhile for an individual to address, the committee also recognizes the risk to a business. A business enters into arbitration, willing to accept the denial of an appeal because arbitration shelters the company from future litigation risks. The committee would recommend the statutory creation and guarantee of class action arbitration.

Access to an arbitrator, mutually agreed upon, is also essential in guaranteeing the fairness of the process. The committee recommends that an agreement for arbitration be prohibited from naming a particular arbitration association by name or reference. While a consumer may be bound to arbitrate, this provides consumers a chance to investigate the rules, fees and records of arbitration associations. This would also help address the perception of a bias due to prior relationships between a business and an arbitrator. Further, it gives the consumer more control over the entire process of choosing an arbitrator, which can only lead to a more impartial procedure.

An impartial procedure is also an open one. The committee recommends that arbitration associations be required to file a list all consumer arbitrations with the County Clerk in which the arbitration was held. The filing should include:

- The names of the parties;
- The name of the parties' attorneys;
- The name of the arbitration association and the arbitrator;
- The disputed claim and relief sought;
- The date the arbitrator was chosen and the date an award was issued;
- The fees charged by the arbitration association and the arbitrator; and
- The award of the arbitrator.

In addition, the committee would recommend that an arbitration award be prohibited from being sealed. This would allow a consumer to search the complaint record of a business, the frequency of

a single arbitration association to arbitrate a single company's disputes, and if requested, the frequency of arbitrators to rule either for or against a consumer or business. Disclosure of this type would not only address the concerns of consumers of repeat/biased arbitrators, but it would also address consumers' perception that arbitration is a private justice system owned by and for the benefit of big business. Although business and arbitration associations assert that arbitration is fair and awards are statistically equally awarded to both parties, there is no access to data to prove this without disclosure.

While consumers complain of limited discovery and the efficiency of the procedure, the committee is not making any recommendations in these areas. The TGAA does not limit discovery, and with a more level negotiating field, the committee hopes that the parties to the contract can mutually agree either in advance or at the time of dispute as to the process of discovery. Further, the committee feels that tactics of both sides can delay the arbitration process. Many consumers testified before the Subcommittee that they were doing all they could to delay going to arbitration. The efficacy of the process is not only based on the terms agreed to by both parties, but also by their action or inaction, which cannot be legislated.

However, another efficiency of the process which concern consumers is the very strict limitation on judicial appeal. The committee understands that this lack of judicial appeal, except to dispute the validity of an agreement or award, is the majority of the cost and time savings afforded by arbitration. However, the committee does not find it a less expensive or a more efficient process to require a judge to send the parties back to arbitration with new arbitrators after invalidating an award or agreement. Therefore the committee recommends permitting a summary judgement of a dispute if an arbitration is determined to be invalid.

Arbitration is a useful alternative to the costly and sometimes intimidating judicial system. With some stronger consumer protections to address the issues of accessibility and fairness, the committee feels that arbitration can be a vital option for businesses and consumers.

All of the recommendations of the committee are specifically to address *consumer* contracts with pre-dispute, mandatory arbitration clauses. The committee did not address issues of binding arbitration in clauses in business-to-business contracts because of the limit of the committee's charge.

## EXECUTIVE SUMMARY

The committee is charged with “reviewing trends in the use of binding arbitration requirements in consumer agreements, with special attention to transactions in which the consumer has little or no bargaining power.” The committee has found that industry-wide adoption of pre-dispute binding arbitration clauses traps consumers in a take-it-or-leave-it position when purchasing some of the most vital goods and services of their life; i.e., homes, vehicles, insurance, and even nursing homes.

This creates an extremely uneven bargaining power between a consumer and a business about how, by whom and how much will it cost to resolve disputes. Testimony taken by the Subcommittee on Binding Arbitration emphasized that current consumer protections under the Texas General Arbitration Act are insufficient. Although testimony from the business community was supportive of arbitration, they admitted that there may be some perception problems regarding bias of arbitrators from certain national arbitration associations. Support from the business community for binding arbitration is beginning to waiver as more and more encounter the same issues described by consumers. Doctors<sup>69</sup>, auto dealers<sup>70</sup> — even the arbitrators themselves<sup>71</sup> — recognize the many problems with binding arbitration.

While there may be problems with arbitration, Texans for Lawsuit Reform state that “As long as the arbitration agreement is fair, balanced, and not forced on someone without informed consent, it is inherently fair and reasonable to allow Texans the option to agree to arbitrate”<sup>72</sup> and the committee agrees. By adding additional consumer protections, and strengthening the current ones already provided in statute, the committee feels that arbitration can and should remain a viable option for parties. Reforms should include protections to level the bargaining power of consumers and businesses in contract negotiation, provide greater financial access to arbitration for consumers, and to ensure a procedure that is fair, unbiased and lives up to the promise of a more efficient, less expensive alternative to the court system.

To this end, the committee has made the following recommendations.

- Arbitration agreements in consumer contracts should be separate addendums with conspicuous disclosure notices.

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<sup>69</sup> Walt Borges, “In a Bind: Binding Arbitration Not Always Preferable to Lawsuits” *Texas Medicine*, September 1, 2001

<sup>70</sup> National Automobile Dealers Association, “House Passes NADA-backed Arbitration Bill Unanimously” **Press Release**, October 4, 2000 <[http://www.nada.org/Content/NavigationMenu/MediaCenter/PressReleases/Leg\\_10\\_04\\_00.htm](http://www.nada.org/Content/NavigationMenu/MediaCenter/PressReleases/Leg_10_04_00.htm)> (August 1, 2002)

<sup>71</sup> Charles Ornstein, “Arbitration Provider Breaks with HMOs” *Los Angeles Times*, March 11, 2002

<sup>72</sup> August 14, 2002 letter to the Subcommittee from G. Alan Waldrop (Locke Liddell & Sapp L.L.P.) representing Texans for Lawsuit Reform

- The disclosure notice should be in 12-pt or larger type and should state:
  - THIS CONTRACT REMOVES ANY RIGHTS TO ADJUDICATE A DISPUTE ARISING FROM THIS CONTRACT IN A JURY TRIAL. STATE NOR FEDERAL LAW REQUIRES THE ACCEPTANCE OF THIS ADDENDUM, AND YOU SHOULD CONSULT AN ATTORNEY BEFORE SIGNING.
  
- The Texas General Arbitration Act exempts personal injury disputes from the scope of any binding arbitration clause. This provision should be maintained.
  
- The Texas General Arbitration Act exempts any dispute under \$50,000 from binding arbitration unless both the consumer and their attorney sign the contract. This threshold should be raised to \$150,000.
  
- An exemption should be added to prohibit the use of arbitration under the Texas General Arbitration Act to dispute possible misdemeanor or felony crimes.
  
- The Texas General Arbitration Act should be amended to prohibit contractually incentivizing or penalizing consumers from choosing either arbitration or filing suit.
  
- The Texas General Arbitration Act should be amended to require an arbitrator to follow applicable state and federal statutes in deciding the findings and conclusions of any dispute.
  
- Arbitration associations that administer arbitration should be prohibited from charging filing fees higher than the filing fees in the consumer's local court that would adjudicate the dispute if it were not being arbitrated.
  
- Venue for any arbitration should not be a greater distance than the jurisdictional boundaries of the consumer's local court.
  
- Any fees charged by an arbitration association after filing fees should be borne by the business, not the consumer.
  
- The Texas General Arbitration Act should be amended to permit and guarantee class action arbitration.

- An arbitration agreement should be prohibited from naming a particular arbitration association by name or reference to their rules or procedures.
  
- Arbitration associations should be required to disclose all consumer arbitrations with the County Clerk of the County in which the Dispute was conducted.
  - The disclosure should contain the following:
    - The names of the parties;
    - The name of the parties' attorneys;
    - The name of the arbitration association and the arbitrator;
    - The disputed claim and relief sought;
    - The date the arbitrator was chosen and the date an award was issued;
    - The fees charged by the arbitration association and the arbitrator; and
    - The award of the arbitrator.
  
- Arbitration awards should be prohibited from being sealed.
  
- If a judge determines that a contract or arbitration award is invalid, a summary judgement should be permitted of the dispute.

The committee recognizes that these reforms will only affect consumer contracts with binding arbitration provisions under the regulation of the Texas General Arbitration Act. Further, the committee recognizes that a majority of consumer-to-business contracts are with national companies that will claim federal jurisdiction under inter-state commerce. However, to the extent that Texas can provide consumer protections to its citizens it should provide a fair, balanced, accessible and voluntary alternative to the judicial system.

**SUBCOMMITTEE  
ON THE  
BUSINESS  
ORGANIZATIONS CODE**

## **BACKGROUND**

In 1995, the Business Law Section of the State Bar of Texas established the Ad Hoc Codification Committee for the sole purpose of studying, drafting and making recommendations for a new proposal for a comprehensive code that would include all Texas statutes governing the formation and internal affairs of private-sector, for-profit and nonprofit entities, including corporations, partnerships, limited liability companies, real estate investment trusts, and associations<sup>1</sup>. After four years working in collaboration with the Secretary of State’s Office and the Texas Legislative Council, the project culminated with the creation of the Business Organizations Code (the “Code”).

In 1999, Representative Fred Bosse (Houston) filed the Code as HB 2681. The House bill passed the Committee on Business & Industry with amendments but never was placed on the House Calendar. The Code was re-filed during the 2001 legislative session, by Senator John Carona (Dallas) as SB 967 and by Representative Bosse as HB 327. The House bill again passed the House committee with amendments but was never placed on the calendar. The main barriers to passage for the 700-plus page bill mainly is a lack of legislator education of the Code’s content or the need for recodification.

Hence, in 2002 the House Committee on Business & Industry was assigned the interim task of reviewing and evaluating the substantive recodifications of the Business Organizations Code that were considered by the 76th and 77th Legislatures. .

## **THE ISSUE**

Texas Statutes are divided into codes and statutes. However, there were originally only statutes. When first published by Vernon’s Civil Statutes in 1925 the statutes were organized into 131 alphabetically arranged Titles that grouped common subjects. This alphabetical topic method proved inadequate to accommodate growth of the statutory law. The user of the statute books is often forced to review several books to research one relatively narrow legal problem. Much of the 1925 Revised Civil Statutes has impliedly been repealed or replaced by new law.<sup>73</sup>

In 1949 the 51st Legislature created the Texas Legislative Council (the “Council”). Part of the Council’s duties are to have a statutory revision program which continually updates statutes<sup>74</sup>. It was

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<sup>73</sup> Business Law Section Codification Committee “Report of the Codification Committee of the Section of Business Law of the State Bar on the Proposed Business Organizations Code,” 1999, 2000 <[http://www.texasbusinesslaw.org/608127\\_6\\_date\\_12262000.pdf](http://www.texasbusinesslaw.org/608127_6_date_12262000.pdf)> (August 1, 2002) See Appendix A

<sup>74</sup> Texas Government Code, §§323.007(a) May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

the statutory revision program which first introduced the codification of statutes.

Codes are the codification of law on a topical basis. However, while compiling the pertinent statutes the Council will also eliminate provisions, but they can not alter the meaning of the law. Steven R. Collins, Executive Director and Chief Legislative Counsel for the Legislative Council, describes the codification process as such:

Statutory revision under the Texas program is the non-substantive revision and recodification of all general and permanent law for the purpose of making the law more accessible and understandable by all by : 1) rearranging the statutes into a more logical order...; 2) employing a format and numbering system designed to facilitate citation of the law and to accommodate future expansion...; 3) eliminating repealed, duplicative, unconstitutional, expired, executed, and ineffective provisions...; and 4) restating the law in modern American English to the greatest extent possible....<sup>75</sup>

In 1963, the Texas Legislative Council's statutory revision program originally contemplated that all general and permanent statutes in Texas would be incorporated into one of 26 topical codes. These codes are as follows:

Agriculture Code, Alcoholic Beverage Code, Business and Commerce Code, Civil Practice and Remedies Code, Corporations and Associations Code, Criminal Procedures Code, Education Code, Election Code, Family Code, Financial Code, Government Code, Health and Safety Code, Human Resources Code, Insurance Code, Labor Code, Local Government Code, Natural Resources Code, Occupations Code, Parks and Wildlife Code, Penal Code, Probate Code, Property Code, Tax Code, Transportation Code, Utilities Code, and the Water Code.

Of these, the Corporations and Associations Code is the only code that has yet to be adopted as part of a substantive or nonsubstantive codification.

However, that does not mean that all of these codes were drafted by the Council. The Council is directed to proposed non-substantive recodifications only. Several recodifications were substantial and were drafted by the Council with substantial assistance from outside organizations. Examples of substantive revisions are the Election Code and Title I of the Tax Code. The State Bar of Texas has been one of the major participants in these types of substantive revisions in the past. For example, the Penal Code of 1974 and the Family Codes of 1972 and 1974 were projects that were substantive revisions primarily drafted by the State Bar.

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<sup>75</sup> *Where Did the Civil Practice and Remedies Code Come From?*, Texas Bar Journal 135 (Feb. 1987)

In the summer of 1995, the State Bar of Texas approached the Council about codifying the statute that govern corporations, associations, partnerships and other profit and non-profit entities. The Business Law Section formed an Ad Hoc Committee for the specific purpose of the codification of the 11 statutes and other exiting provisions of Texas statutes governing domestic entities to create the Business and Organizations Code. The Ad Hoc Committee is comprised of the chairs of standing committees in the Business Law Section, Law Professors, representatives from the Secretary of State's Office and other interested Texas attorneys. Mr. Daryl Robertson<sup>76</sup> has served as the Chair of the Ad Hoc Committee since its inception.

The initial meetings of the Ad Hoc Committee focused on organizing and preparing an outline of the new proposed code. The committee decided a more appropriate name for the Code would be the Business Organization Code; more accurately describing the breadth of the Code primarily because partnerships and business trusts are to be included in the code.

The most significant decision that the Ad Hoc Committee made, in this early process, was to create a "Hub and Spoke" approach for the structure of the Code. Under this approach, provisions common to all entities are included in a central "hub" of the code, in this case Title 1 of the Business Organizations Code. Examples of common details are definitions. Outside Title 1, separate "spokes" contain provisions governing different types of entities which are not common or similar among the different entities.

The task of preparing the initial drafts of several of the Code's "spokes" was undertaken by the various standing committees of the Business Law Section (e.g., Partnership Law Committee, Corporation Law Committee and Limited Liability Company Committee). Each title that constitutes a "spoke" of the Code contains provisions that are particular to one entity. The Partnership Law Committee, the Corporation Law Committee and the Limited Liability Company Committee prepared the initial drafts of their respective titles or subtitles of the new Code. Various other committee members prepared the initial drafts of other titles and subtitles of the Code, including subtitles for non-profit corporations and real estate investment trusts and titles for professional entities (i.e., professional corporations, professional associations and professional limited liability companies) and associations (i.e., cooperatives and unincorporated non-profit association).

A subcommittee of the Ad Hoc Committee comprised of Professor Leon Lebowitz and Lorna Wassdorf and Carmen Flores of the Secretary of State's Office studied various statutes that had been designated by the Council for inclusion in the Code. Based on the subcommittee's recommendations, the Ad Hoc Committee recommend the repeal of a number of outdated statutes. These statutes include Tex. Rev. Civ. Stat. art. 1527a (International Commerce Development Corporation; foreign trade zone), 1524b-k (loan and brokerage companies), 1525 (drainage corporations), 1526 (irrigation

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<sup>76</sup> Attorney at Jenkins and Gilchrist in Dallas, TX.

and water power corporations), 1527 (international trading corporations), 1528 (ice companies), 1528a (State Housing Law), and 1528h (dealing in acceptances).

In addition, the Ad Hoc Committee attempted to modernize the Code by repealing or eliminating arcane organizational forms. Examples of these include ice companies (Tex. Civ. Stat. Art. 1528) and loan and brokerage companies (Tex. Civ. Stat. Arts. 1524b-1524k). The Code has also been updated by allowing use of electronic technologies for filings and communications.

Drafting on the Code began in 1996, and revisions have continued to date with the Ad Hoc Committee meeting bimonthly. In 1999, the first version of the Code was introduced to the Texas Legislature for adoption in the form of HB 2680 by Representative Bosse. The following session, Representative Bosse and Senator Carona filed the Ad Hoc Committee's latest version (revisions were done to reflect legislation adopted in the 76th Legislature), HB 327.

Apparently, the biggest barrier to full consideration by the legislature has been the sheer size of the bill and knowledge of what substantive changes were made. The bill itself is over 600 pages, the bill analysis (which was prepared by the Ad Hoc Committee) was 150 pages. The analysis was a word by word examination of what has changed rather than a general review of the changes that would affect the different entities. Testimony before the Committee on Business & Industry in favor of the bill was limited to representatives of the Ad Hoc Committee and two individuals of the public.

Favorable testimony before the committee emphasized that there were no substantive changes in the intent of the law. However, a standardization of fees for the 11 organizations, which led to an increase for a majority of the organizations' fees, developed into a positive fiscal note of \$1,174,450. In light of this limited discussion on such a large bill, the fiscal note drew concern that no independent review of the impact of the bill had been done.

In addition, the diligence of the Ad Hoc Committee to consistently update and improve the bill after each session leads to delayed introduction of the bill.

The Ad Hoc Committee continues the revision of the third version of the Code. To this end, the interim report deviates from its charge to "review and evaluate the substantive recodifications of the Business Organizations Code that were considered by the 76th and 77th Legislatures" and focuses on the version which will be introduced to the 78th Legislature and its comparison to current statutes for the affected entities. However, this proved more difficult than expected.

Since committee staff lacked the complex legal knowledge necessary for understanding the impact of the Code, it attempted to seek independent, expert comments on the Code. After contacting

several law firms, educational institutions, and respected leaders in the Business Law field, the staff could find no one to significantly review the Code. Either the persons contacted were unavailable for such a large project or had some connection to the Business Law Foundation. However, since the committee was attempting a review independent of the Business Law Foundation, assistance from these individuals was declined.

Therefore, the committee staff opted for a different approach. The staff created a chart of all the entities and the various regulations (filings, taxes, officers, etc.) governed by the current statutes being codified in the Code. The Council provided the current regulatory provisions while the Ad Hoc Committee provided the regulation under the Code. Hopefully, this chart will provide a comparison which can be easily digested entity by entity and will elevate understanding of the proposed changes in this legislation.

**((LIMITED PARTNERSHIP))**

<p><b>Quick Summary:</b></p>	<p>A partnership formed by two or more persons, having at least one general partner and at least one limited partner. It has some corporate attributes such as limited liability for its limited partners but also has partnership attributes since it is based on an agreement between the participants.</p>	
	<p align="center"><b>Texas Revised Limited Partnership Act ( V.A.C.S. Art. 6132a-1, et seq.)</b></p>	<p align="center"><b>Business Organizations Code</b></p>
<p><b>FILINGS</b></p>	<p>Formation: A certificate of limited partnership executed by one or more partners (including all of the general partners) and filing fee must be filed with the secretary of state. (Sec. 2.01(a)) §750 fee. (Sec. 12.01)</p> <p>Other filings include:</p> <p>Amendment to certificate of limited partnership: Certificate of amendment and filing fee may be filed with the secretary of state; must follow execution procedures prescribed under Section 2.04(a)(2). (Secs. 2.02(a), (b), 2.04(a)(2))</p> <p>Cancellation of certificate of limited partnership: Certificate of cancellation and filing fee may be filed with the secretary of state; must follow execution procedures prescribed under Section 2.04(a)(3). (Secs. 2.02(a), 2.04(a)(3))</p> <p>Change in registered office or registered agent: A required statement and duplicate copy of the statement and a filing fee must be filed with the secretary of state; must be executed by a general partner of the limited partnership. (Sec. 1.06)</p> <ul style="list-style-type: none"> <li>• Registration of partnership as registered limited liability partnership. (Sec. 2.14)</li> </ul> <p>Reservation of name: An application and duplicate copy of the application to reserve a specified name and a filing fee may be filed with the secretary of state; must be executed by the applicant or an agent of the applicant. (Sec. 1.04)</p> <p>Restated certificate of limited partnership: Restated certificate and filing fee may be filed with the secretary of state; must follow applicable execution procedures prescribed under Sections 2.04 and 2.10 of the Act. (Secs. 2.04, 2.10)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Clarifies that required filings must be filed promptly (4.004)</li> <li>5. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>6. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>7. Eliminates need to file certificate of existence along with its application to register its name (5.152)</li> <li>8. Fees             <ol style="list-style-type: none"> <li>(a) Fee for new entity created by merger or conversion (4.151)</li> <li>(b) Reduce fee for certificate of amendment for limited partnership to match for-profit corporation (4.155)</li> </ol> </li> <li>9. Common simplified form of, and common procedures for, application for registration to do business in Texas for all foreign filing entities (9.004)</li> <li>10. Requires amendment to application for registration to be filed within 90 days if foreign limited partnership changes its name or business or activity (9.009)</li> <li>11. New or revised civil penalties or late filing fees imposed on foreign limited partnership's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>12. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign limited partnership (9.104)</li> <li>13. Simplifies filing form of certificate of merger (10.151, 10.153):             <ol style="list-style-type: none"> <li>(a) Eliminates multiple copy requirement</li> </ol> </li> <li>14. Requires filing of certificate of exchange after plan of exchange is approved if interests in filing entity are acquired (10.153)</li> <li>15. Clarifies that certificate of conversion must be filed after plan of conversion is approved (10.155)</li> <li>16. Clarifies effect of certificate of amendment (3.056)</li> </ol>

<p><b>FORMATION</b></p>	<p>To form a limited partnership, the partners must enter into a partnership agreement and must execute and file a certificate of limited partnership with the secretary of state. (Sec. 2.01(a))</p> <p>Existence of the limited partnership begins at the time of the filing of the initial certificate of limited partnership or a later date or time specified in the certificate (on substantial compliance with the formation requirements under the Act). (Sec. 2.01(b))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Acknowledgment of filing by Secretary of State is conclusive evidence of formation (3.001)</li> <li>3. Perpetual existence is default rule (3.003)</li> <li>4. Eliminates specific lists of acceptable abbreviations in names of limited partnership (5.055)</li> <li>5. Removes outmoded prohibition on name of limited partner in name of limited partnership (5.055)</li> <li>6. Registered agent             <ol style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by filing entity (5.023)</li> </ol> </li> <li>7. Deletes concept of "substituted compliance" for formation and amendments (3.001, 153.051)</li> <li>8. Clarifies that limited partnerships may not engage in a business or activity that is unlawful or prohibited by law, that requires a license that cannot be granted to a limited partnership or that is included in a list of specified types of businesses (such as banking and insurance) that are regulated under other statutes, which was only implied in TRLPA (2.003)</li> </ol>
<p><b>GOVERNING</b></p>	<p>The general partners manage the limited partnership's affairs. Limited partners do not participate in the management of the limited partnership without losing their limited liability. (Sec. 3.03)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Partnerships may adopt Code provisions relating to meetings and voting (6.301)</li> <li>2. Clarifies that the general partnership statute does not apply to limited partners if it would be inconsistent with the nature and role of a limited partner as contemplated by the limited partnership statute (153.003)</li> <li>3. Clarifies that a foreign limited partnership may vote or consent as to its interest in and participate in the management of as domestic entity even if not registered to transact business in Texas (9.204)</li> <li>4. Clarifies that partnerships may incur indebtedness and make guarantees subject to certain conditions and requirements previously applicable only to corporate entities (2.103-2.104)</li> <li>5. Code provisions or the partnership agreement may expressly permit a waiver or modification of otherwise non-waivable provisions in certain circumstances (153.004)</li> <li>6. Specifies Code Title 1 provisions that may not be waived or modified in the partnership agreement except in certain circumstances (153.004)</li> <li>7. Explicitly requires consent of thirty party to waive or modify that party's rights under the Code (153.005)</li> <li>8. General partners may rely on certain types of information, opinions, reports, and statements (3.102)</li> </ol>
<p><b>OFFICERS</b></p>		<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Confirms that partnerships may appoint officers unless prohibited by the governing documents (3.103)</li> <li>2. Removal of officers with or without cause as a default rule (3.104)</li> <li>3. Officers may rely on certain types of information, opinions, reports, and statements (3.105)</li> </ol>
<p><b>LIABILITY</b></p>	<p>Liability of limited partners:</p> <ul style="list-style-type: none"> <li>• A limited partner is not liable for the obligations of a limited partnership unless:             <ol style="list-style-type: none"> <li>(1) the limited partner is also a general partner;</li> </ol> </li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Adopts modern for-profit corporate provisions clarifying that a disposition of assets is not a merger or conversion and that a purchaser of property is not liable for obligation of transferring limited partnership if purchaser does not expressly assume the obligation (10.254)</li> </ol>

	<p>(2) the limited partner participates in the control of the business (liable only to persons who reasonably believe the limited partner is a general partner during the transaction of business). (Sec. 3.03); or</p> <p>(3) the limited partner allows its name to be used in the name of the limited partnership (liable to creditors who extend credit to the limited partnership without knowledge that the limited partner is not a general partner). (Secs. 3.03(a), (d))</p> <p>Liability of general partners:</p> <ul style="list-style-type: none"> <li>• With respect to third persons: in general, has the liabilities of a partner in a general partnership (jointly and severally liable for business obligations) unless provided otherwise by the Act. (Sec. 4.03(b))</li> <li>• With respect to the partnership and to the other partners: in general, has the liabilities of a partner in a general partnership unless otherwise provided by the Act or the partnership agreement. (Sec. 4.03(b))</li> </ul> <p>Liability of person who is both a general partner and limited partner:</p> <ul style="list-style-type: none"> <li>• is subject to the liabilities of a general partner and, except as otherwise provided by the partnership agreement or the Act, is subject to the liabilities of a limited partner to the extent of the general partner's participation in the partnership as a limited partner. (Sec. 4.04)</li> </ul> <p>Liability for filing of a false, forged, or unauthorized certificate of limited partnership, or certificate of amendment, merger, or cancellation is imposed on:</p> <p>(1) a partner or other person who executed the certificate and knew or should have known of the forgery, lack of authorization, or false statement or of the omission when the certificate was executed; and</p> <p>(2) a certain general partner who had knowledge of the false statement or omission of a material fact and had sufficient time to amend or cancel the certificate before being reasonably relied on. (Sec. 2.08)</p>	<p>2. Limits liability of terminated limited partnership to claims that existed before termination and post-termination contractual obligations, in a manner similar to corporations (11.351)</p> <p>3. Eliminates outmoded provisions permitting limited partner liability based on partnership name including limited partner's name (5.055)</p>
<p><b>INDEMNITY</b></p>	<p>With a few exceptions, the indemnity provisions in Article 11 of the Act are basically identical to the indemnity provisions found in the Texas Business Corporation Act (substitute general partner for director). (Art. 1396-2.22A)</p> <ul style="list-style-type: none"> <li>• Indemnification must be authorized in a written partnership agreement. (Sec. 11.02)</li> <li>• Required report to the limited partners of a limited partnership of any indemnifications or advances of expenses must be made not later than the sixth month after the date on which indemnification occurs (as opposed to twelve months under the Texas Business Corporation Act). (Sec. 11.14)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Determination that standard for indemnification has been met can be made by a committee of disinterested general partners (8.103)</li> <li>2. All of owners may approve indemnification of general partners, which was only implied in TRLPA (8.103)</li> <li>3. The owners may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a general partner, which was only implied in TRLPA (8.105)</li> <li>4. Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> <li>5. Increases the maximum time for reporting to limited partners any indemnification or advancement of expenses to a general partner from six months to 12 months (8.152)</li> </ol>

<p><b>MERGERS</b></p>	<p>A certain domestic limited partnership may merge with one or more domestic or foreign limited partnerships or other entities under a plan of merger. (Sec. 2.11)</p> <p>A certain domestic limited partnership may convert to a foreign limited partnership or any other entity under a plan of conversion. (Sec. 2.15)</p> <p>A domestic or foreign limited partnership may convert, on the affirmative vote of a majority-in-interest of the partners, to a partnership that is not a limited partnership by:</p> <ul style="list-style-type: none"> <li>(1) cancelling its certificate of limited partnership in the state of formation or otherwise complying with the provisions for terminating the existence of the limited partnership as of the date the limited partnership's existence as such is to end; and</li> <li>(2) complying with the applicable procedures under Section 9.01 of the Texas Revised Partnership Act. (TRPA, Art. 6132b-9.01)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>2. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>3. Clarifies that interest exchange provisions can be included in plan of merger (10.002)</li> <li>4. Clarifies, consistent with TBCA provisions, that a plan of merger or exchange may treat differently the owners of ownership interests in the same class or series (10.002 and 10.052)</li> <li>5. Permits short form merger between parent partnership and one or more subsidiary entities (other than partnerships) in which the parent partnership owns at least 90% of the voting interests (10.006)</li> <li>6. Deletes the specific conversion provision applicable to conversion of a general partnership to a limited partnership and vice versa as unnecessary and redundant in view of broad conversion provisions applicable to domestic entities generally and in order to standardize conversion provisions applicable to the various entities (10.101 et seq.)</li> <li>7. Permits partnership to adopt Code provisions on dissenting owners in its governing documents (10.351)</li> <li>8. Clarifies that merger, exchange or conversion can be abandoned after approval and before filing of the certificate of merger, exchange or conversion, which was only implied in existing law (10.201)</li> <li>9. Specifies the contents of a plan of exchange (10.052-10.053)</li> </ol>
<p><b>SALE OR TRANSFER OF ASSETS</b></p>	<p>A partner may lend money to and transact business with the limited partnership unless otherwise provided by the partnership agreement. (Sec. 1.10)</p> <p>A distribution of cash or other assets of a limited partnership shall be made to the partners in the manner provided by a written partnership agreement. (Sec. 5.04)</p> <p>On the winding up of a limited partnership, its assets shall be paid or transferred first to creditors to satisfy liabilities and then, unless otherwise provided in the partnership agreement, to partners and former partners in accordance with the Act. (Sec. 8.05)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Adds explicit and more detailed provisions regarding transfers of property (10.251-10.253)</li> </ol>

<p><b>TERMINATION OF ENTITY</b></p>	<p>Voluntary dissolution: Dissolution occurs and the partnership's affairs must be wound up on the first of the following to occur:</p> <ol style="list-style-type: none"> <li>(1) the occurrence of an event specified in the partnership agreement to cause dissolution unless all remaining partners (or another group or percentage of partners as specified in the partnership agreement) agree in writing within 90 days after the date of occurrence to continue the business;</li> <li>(2) written consent of all partners to dissolve; or</li> <li>(3) an event of withdrawal of a general partner unless: <ol style="list-style-type: none"> <li>(A) the partnership agreement permits the business to be continued by the remaining general partner(s); or</li> <li>(B) all remaining partners (or another group or percentage of partners as specified in the partnership agreement) agree in writing within 90 days after the date of withdrawal to continue the business and agree to the appointment of one or more new general partners if necessary or desired; or</li> </ol> </li> <li>(4) entry of a judicial decree of dissolution as prescribed by Section 8.02 of the Act. (Secs. 8.01, 8.02)</li> </ol> <p>On dissolution, the limited partnership's affairs must be wound up as soon as is reasonably practicable and its assets shall be paid or transferred in the manner prescribed by the Act. (Secs. 8.04, 8.05)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Confirms that partnership may apply for court supervision of winding up (11.054)</li> <li>2. Common, simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>3. Authorizes Secretary of State to cancel certificate of formation after expiration of period of duration (11.104)</li> <li>4. Permits reinstatement of voluntarily terminated limited partnership before third anniversary date of its termination if certain conditions exist (11.201-11.202)</li> <li>5. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>6. Clarifies right of Secretary of State to involuntarily terminate a filing entity for failure to maintain a registered office address (11.251)</li> <li>7. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>8. Authorizes Secretary of State to terminate for failure to pay filing fees or maintain a registered agent or registered office (11.252)</li> <li>9. Extends time limit from 90 days to three years upon expiration of period of duration and one year for certain other events requiring winding up in order to cancel such expiration or events and to continue the business (11.152)</li> <li>10. Clarifies that reinstatement by the Secretary of State of an involuntarily terminated limited partnership with retroactive treatment does not affect any issue of personal liability of the governing persons, officers or agents (11.253)</li> <li>11. Extends the time for the remaining partners, after an event of withdrawal of a general partner, to continue the limited partnership from 90 days to one year (11.058 &amp; 153.501)</li> <li>12. New provisions governing involuntary judicial winding up and termination consistent with those previously contained in TBCA, TNPCA and TLLCA (11.301-11.315)</li> <li>13. New receivership provisions consistent with those previously contained in TBCA, TNPCA and TLLCA (11.401-11.413)</li> <li>14. New post-termination provisions for claims resolution consistent with those previously contained in TBCA, TNPCA and TLLCA (11.351-11.359)</li> <li>15. More detailed provisions governing revocation of registration of foreign limited partnership consistent with those previously contained in TBCA, TNPCA and TLLCA (Chapter 9, Subchapters C and D)</li> </ol>
<p><b>ADMINISTRATIVE POWERS</b></p>	<p>Certain books, records, and other information regarding the business, affairs, and financial condition of the limited partnership are required to be maintained.</p> <ul style="list-style-type: none"> <li>• may be examined at any reasonable time by a partner of or an assignee of a partnership interest in the limited partnership if the request is made in writing and is for a proper purpose. (Sec. 1.07)</li> </ul> <p>The secretary of state may require a domestic limited partnership or a foreign limited partnership authorized to transact business in this state to file (not more than once every four years) a report that includes the name and address of the business and of each of the general partners and other required information. Failure to file the report will result in a forfeiture of the right to transact business. (Secs. 13.05, 13.06)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>2. Confirms power of Secretary of State to perform its duties (12.001)</li> <li>3. Confirms interrogatory power of Secretary of State (12.002)</li> <li>4. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>5. Permits court appeal of disapproval by Secretary of State of the filing of an instrument (12.004)</li> <li>6. New provisions authorizing Attorney General to investigate or to examine and copy records and imposing criminal liability for a failure or refusal to permit these activities, based on existing corporate provisions (12.151-12.156)</li> <li>7. New provisions authorizing or governing enforcement liens and proceedings, receivers, termination and liquidation of insolvent filing entities and other remedies and procedural matters, based on existing corporate provisions (12.201, 12.251-12.261)</li> </ol>

<b>TAXES</b>	<b>Federal</b>		No change.
	<b>State</b>		No change.
<b>CONTRIBUTION REQUIREMENT</b>	<p>A partner or the partner's legal representative or successor is obligated to make a contribution to, or otherwise pay cash or transfer property to, a limited partnership unless otherwise provided by the partnership agreement. (Secs. 5.02(a), (b))</p> <p>Form of contribution for limited partner: any tangible or intangible benefit to the limited partnership or other property, including cash, a promissory note, or services performed. (Sec. 5.01)</p>		<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Partnerships may adopt Code provisions relating to certificates of ownership interests (3.201)</li> <li>2. Adds standardized provisions governing form of certificates representing debt, based on corporate provisions (2.114)</li> </ol>

**(((GENERAL PARTNERSHIPS)))**

<b>Quick Summary:</b>	An association of two or more persons to carry on a business for profit as owners.	
	<b>Texas Revised Partnership Act (V.A.C.S. Art. 6132b-1.01, et seq.)</b>	<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>Formation: No filings required.</p> <p>Other filings:</p> <ul style="list-style-type: none"> <li>• Registration of partnership as registered limited liability partnership. (Art. 6132b-3.08(b))</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Clarifies that required filings must be filed promptly (4.004)</li> <li>5. Civil liability for filing a false instrument (4.007)</li> <li>6. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>7. Permits at of any filed instrument prior to effectiveness (4.059)</li> <li>8. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>9. Authorizes corrections of filed instruments (4.101, 4.103-4.105)</li> <li>10. Fees             <ol style="list-style-type: none"> <li>(a) Fee for pre-clearance of documents (4.151)</li> <li>(b) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>11. Simplifies requirements for certificate of merger (10.151, 10.153):             <ol style="list-style-type: none"> <li>(a) No need to include plan of merger</li> <li>(b) Eliminates multiple copy requirement</li> </ol> </li> <li>12. Requires filing of certificate of exchange after plan of exchange is approved if interests in filing entity are acquired (10.153)</li> </ol>
<b>FORMATION</b>	<p>A written partnership agreement may, but is not required to be, executed.</p> <p>Factors indicating that persons have created a partnership include their:</p> <ol style="list-style-type: none"> <li>(1) receipt or right to receive a share of profits of the business;</li> <li>(2) expression of an intent to be partners in the business;</li> <li>(3) participation or right to participate in control of the business;</li> <li>(4) sharing or agreeing to share:             <ol style="list-style-type: none"> <li>(A) losses of the business; or</li> <li>(B) liability for claims by third parties against the business; and</li> </ol> </li> <li>(5) contributing or agreeing to contribute money or property to the business. (Art. 6132b-2.03)</li> </ol>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Perpetual existence is default rule (3.003)</li> <li>2. Clarifies that partnerships may not engage in a business or activity that is unlawful or prohibited by law, that requires a license that cannot be granted to a partnership or that is included in a list of specified types of businesses (such as banking and insurance) that are regulated under other statutes, which was only implied in the TRPA (2.002)</li> <li>3. Eliminates specific list of acceptable abbreviations in names of limited liability partnerships (5.063)</li> <li>4. Code provisions or the partnership agreement may expressly permit a waiver or modification of otherwise non-waivable provisions in certain circumstances (152.002)</li> </ol>

<p><b>GOVERNING</b></p>	<p>Each partner has equal rights in the management and conduct of the business of a partnership. (Art. 6132b-4.01(d))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Partners may rely on certain types of information, opinions, reports and statements (3.102)</li> <li>2. Clarifies that partnerships may incur indebtedness and make guaranties subject to certain conditions and requirements previously applicable only to corporate entities (2.102-2.104)</li> <li>3. Partnerships may adopt Code provisions relating to meetings and voting (6.301)</li> <li>4. Clarifies that foreign partnership is subject to same rights, powers, duties and restrictions as a domestic partnership (9.202-9.203)</li> <li>5. Expands provisions permitting expulsion of corporate or partnership partner under certain circumstances to other types of entities that are partners (152.501)</li> </ol>
<p><b>OFFICERS</b></p>		<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Confirms that partnerships may appoint officers unless prohibited by the governing documents (3.103)</li> <li>2. Removal of officers with or without cause as a default rule (3.104)</li> <li>3. Officers may rely on certain types of information, opinions, reports and statements (3.105)</li> </ol>
<p><b>LIABILITY</b></p>	<p>Partnership:</p> <ul style="list-style-type: none"> <li>• Liable for loss or injury to a person, including a partner, or for a penalty caused by or incurred as a result of a wrongful act or omission or other actionable conduct of a partner who was acting: <ol style="list-style-type: none"> <li>(1) in the ordinary course of business of the partnership; or</li> <li>(2) with the authority of the partnership. (Art. 6132b-3.03(a))</li> </ol> </li> <li>• Liable for the loss of money or property of a person not a partner that is received in the course of the partnership's business and misapplied by a partner while in the custody of the partnership. (Art. 6132b-3.03(b))</li> </ul> <p>Partners:</p> <ul style="list-style-type: none"> <li>• A partner generally is jointly and severally liable for all debts and obligations of the partnership unless otherwise agreed by the claimant or provided by law. (Art. 6132b-3.04)</li> <li>• An incoming partner into an existing partnership does not have personal liability for an obligation that: <ol style="list-style-type: none"> <li>(1) arose before the partner's admission into the partnership;</li> <li>(2) relates to an action taken or omission occurring before the partner's admission into the partnership; or</li> <li>(3) arises under a contract entered into before the partner's admission into the partnership. (Art. 6132b-3.07)</li> </ol> </li> <li>• Liable to the partnership and the other partners for a breach of the partnership agreement or for a violation of a duty to the partnership or the other partners under the Act that causes harm to the partnership or the other partners. (Art. 6132b-4.05)</li> <li>• Liable to the partnership for a loss caused to the partnership arising from a liability incurred under Section 8.05(2) of the Act by an action that is not appropriate for winding up the partnership business and while knowing that an event requiring a winding</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Adopts modern for-profit corporate provision clarifying that a disposition of assets is not a merger or conversion and that a purchaser of property is not liable for obligation of transferring general partnership if purchaser does not expressly assume the obligation (10.254)</li> </ol>

	<p>up has occurred. (Art. 6132b-8.04(b))</p> <p>Withdrawn partner: (Arts. 6132b-7.02, 6132b-7.03)</p> <ul style="list-style-type: none"> <li>• Withdrawal of a partner from the partnership does not on its own discharge the partner's liability for any obligation of the partnership incurred before the date of withdrawal. (Art. 6132b-7.03(a))</li> <li>• Liable to the partnership for loss arising from an obligation incurred by the withdrawn partner after withdrawal and for which the partnership is liable under Section 7.02(a) of the Act. (Art. 6132b-7.02)</li> <li>• Liable to certain creditors without knowledge of withdrawal for a transaction entered into by the partnership within two years after the date of withdrawal if the withdrawal results from a circumstance that does not constitute an event requiring a winding up of the partnership's affairs. (Art. 6132b-7.03(e))</li> </ul>	
<b>INDEMNITY</b>	A partnership may indemnify a person who was, is, or is threatened to be made a defendant or respondent in a proceeding and may purchase and maintain liability insurance for the person. (Art. 6132b-3.01(15))	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits partnership agreement to adopt Code's statutory provisions relating to indemnification (8.002)</li> <li>2. Clarifies that partnership agreement may contain enforceable provisions regarding indemnification of partners (8.002)</li> </ol>
<b>MERGERS</b>	<p>One or more domestic partnerships may merge with one or more domestic or foreign partnerships or other entities under a plan of merger. (Art. 6132b-9.02)</p> <p>A general partnership may convert (with the consent of a majority-in-interest of the partners) to a domestic or foreign limited partnership by properly filing a certificate of limited partnership in the state in which the limited partnership is to be formed. (Art. 6132b-9.01(a))</p> <p>A domestic or foreign partnership may acquire all of the outstanding partnership interests of one or more domestic partnerships in exchange for cash or securities of the acquiring partnership or other entity under a plan of exchange. (Art. 6132b-9.03)</p> <p>A domestic partnership may convert to a foreign partnership or any other entity under a plan of conversion. (Art. 6132b-9.05)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>2. Clarifies, consistent with TBCA provisions, that a plan of merger or exchange may treat differently the owners of ownership interests in the same class or series (10.002 &amp; 10.052)</li> <li>3. Eliminates the need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by a merger (10.002)</li> <li>4. Clarifies that interest exchange provisions can be included in plan of merger (10.004)</li> <li>5. Permits short-form merger between parent partnership and one or more subsidiary entities (other than partnerships) in which the parent partnership owns at least 90% of the voting interests (10.006)</li> <li>6. Specifies the contents of a plan of exchange (10.052-10.053)</li> <li>7. Deletes the specific conversion provisions applicable to conversion of a general partnership to a limited partnership and vice versa as unnecessary (10.101 et seq.)</li> <li>8. Provides explicit provisions for abandonment of merger, exchange or conversion, which were only implied in TRPA (10.201-10.202)</li> <li>9. Permits partnership to adopt Code provisions on dissenting owners in its governing documents (10.351)</li> <li>10. Adds provisions clarifying how federal bankruptcy reorganization laws apply based on provisions in the TBCA, TREITA and TRLPA (10.301-10.303)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>A partner may lend money to or transact other business with a partnership. (Art. 6132b-4.01(k))</p> <p>In winding up the partnership business, the property of the partnership must be applied to discharge its obligations to creditors. (Art. 6132b-8.06(a))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Adds explicit and more detailed provisions regarding transfers of property (10.251-10.253)</li> </ol>

	<ul style="list-style-type: none"> <li>With certain exceptions, each partner must contribute the amount necessary to satisfy partnership obligations. (Arts. 6132b-8.06(c), 6132b-3.07, 6132b-3.08(a))</li> </ul>	
<b>TERMINATION OF ENTITY</b>	<p>Winding up of partnership affairs is required:</p> <ul style="list-style-type: none"> <li>if the partnership is for a definite term or particular undertaking, on: <ul style="list-style-type: none"> <li>(1) the express will of all the partners; or</li> <li>(2) the expiration of the term or the completion of the undertaking, unless otherwise continued under Section 4.07 of the Act. (Art. 6132b-8.01(b))</li> </ul> </li> <li>if the partnership agreement provides for winding up on a specified event, on: <ul style="list-style-type: none"> <li>(1) the express will of all the partners; or</li> <li>(2) the occurrence of the specified event, unless otherwise continued under Section 4.07 of the Act. (Art. 6132b-8.01(c))</li> </ul> </li> <li>if an event occurs that makes it illegal for all or substantially all of the business of the partnership to be continued. (Art. 6132b-8.01(d))</li> <li>by a judicial decree rendered after certain conditions are met. (Art. 6132b-8.01(e))</li> <li>if all or substantially all of the partnership property is sold outside the ordinary course of business. (Art. 6132b-8.01(f))</li> <li>A request for winding up is made by a partner of a certain partnership (not for a specific term or particular undertaking and whose partnership agreement has no provision with respect to a specified event requiring winding up) unless: <ul style="list-style-type: none"> <li>(1) the request is made by a partner who has agreed not to withdraw; or</li> <li>(2) a majority-in-interest of the partners agree to continue the partnership. (Art. 6132b-8.01(g))</li> </ul> </li> </ul> <p>All of the partners of a partnership may agree to continue the business of the partnership despite the expiration of the partnership term, the completion of the undertaking, or the occurrence of a specified event requiring the winding up of the partnership's affairs. (Art. 6132b-4.07)</p> <p>A partnership continues after the occurrence of an event requiring winding up until the winding up of its affairs is complete, at which time the partnership is terminated. (Art. 6132b-8.02)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Confirms that partnership may apply for court supervision of a winding up (11.054)</li> <li>Partnership agreement may require notice of termination to the partnership's partners or other persons which is implied in the TRPA (11.103)</li> <li>New time limits of one year and three years to cancel certain events requiring winding up and to continue the business (11.152)</li> <li>Permits reinstatement after termination if certain conditions are satisfied (11.201-11.206)</li> <li>New receivership provisions consistent with those previously contained in TBCA, TNPCA and TLLCA (11.401-11.413)</li> </ol>
<b>ADMINISTRATIVE POWERS</b>	<p>Books and records of the partnership are required to be maintained. (Art. 6132b-4.03 (a))</p> <ul style="list-style-type: none"> <li>Access during business hours must be provided to current partners and their attorneys and agents.</li> <li>Access during business hours must be provided to a former partner and their agents and attorneys to books and records pertaining to the period during which the former partner participated in the partnership or to any other period if the examination is for any other proper purpose. (Art. 6132b-4.03(b))</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Confirms power of Secretary of State to perform its duties (12.001)</li> <li>Permits court appeal of disapproval by Secretary of State of the filing of an instrument (12.004)</li> </ol>

<b>TAXES</b>	<b>Federal</b>	No change.
	<b>State</b>	No change.
<b>CONTRIBUTION REQUIREMENT</b>	Each partner is credited with an amount equal to the cash and the value of property the partner contributes to a partnership and the partner's share of the partnership's profits. (Art. 6132b-4.01)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Partnerships may adopt Code provisions relating to certificates of ownership interests (3.201)</li> <li>2. Adds standardized provisions governing form of certificates representing debt, based on corporate provisions (2.114)</li> </ol>

**((REGISTERED LIMITED LIABILITY PARTNERSHIP))**

Quick Summary:		
		<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>To register as a registered limited liability partnership:</p> <p>A general partnership:</p> <ul style="list-style-type: none"> <li>• Must file with the secretary of state two copies of an application executed by a majority-in-interest of the partners (or at least one partner authorized by those persons) and a fee of \$200 for each partner. (V.A.C.S. Art. 6132b-3.08(b))</li> </ul> <p>A limited partnership:</p> <ul style="list-style-type: none"> <li>• Same filing as above, except that an application to become a registered limited liability partnership or to withdraw the registration must be executed by at least one general partner and any other reference to partners in applying Section 3.08(b), Texas Revised Partnership Act, means general partners only. (V.A.C.S. Art. 6132a-1, Sec. 2.14)</li> <li>•</li> </ul> <p>Other filings include:</p> <ol style="list-style-type: none"> <li>(1) a written withdrawal notice terminating status as a registered limited liability partnership;</li> <li>(2) renewal of registration; and</li> <li>(3) articles of amendment to amend or correct any filed document. (V.A.C.S. Art. 6132b-3.08(b))</li> </ol> <p>Criminal penalty: Class A misdemeanor offense for signing a false document the person knows is false in a material respect with the intention that it be delivered for filing to the secretary of state on the partnership's behalf. (V.A.C.S. Art. 6132b-3.08(b)(13))</p>	

<p><b>FORMATION</b></p>	<p>To register as a registered limited liability partnership, a general partnership must:</p> <ol style="list-style-type: none"> <li>(1) file an application with the secretary of state;</li> <li>(2) contain the words "registered limited liability partnership" or the abbreviation "L.L.P." as the last words or letters of its name; and</li> <li>(3) carry at least \$100,000 of liability insurance designed to cover errors, omissions, negligence, malfeasance, or incompetence for which liability is limited by Article 6132b-3.08(a)(2) or provide \$100,000 of funds to satisfy any judgment against the partnership based on those errors, omissions, negligence, malfeasance or incompetence. (V.A.C.S. Arts. 6132b-3.08(c), (d))</li> </ol> <p>A limited partnership is a registered limited liability partnership as well as a limited partnership if it:</p> <ol style="list-style-type: none"> <li>(1) registers as a registered limited liability partnership as provided by Section 3.08(b), Texas Revised Partnership Act, as: <ol style="list-style-type: none"> <li>(A) authorized by its partnership agreement; or</li> <li>(B) with the consent of partners required to amend its partnership agreement if the agreement does not include provisions for becoming a registered limited liability partnership;</li> </ol> </li> <li>(2) complies with the insurance or financial responsibility requirements of Section 3.08(d), Texas Revised Partnership Act; and</li> <li>(3) has as the last words or letters of its name the words "Limited Partnership" or the abbreviation "Ltd." followed by the words "registered limited liability partnership" or the abbreviation "L.L.P." (V.A.C.S. Art. 6132a-1, Sec. 2.14(a))</li> </ol>	
<p><b>GOVERNING</b></p>		
<p><b>OFFICERS</b></p>		
<p><b>LIABILITY</b></p>	<p>A partner in a registered limited liability partnership is not individually liable, directly or indirectly, for a debt and obligation of the partnership arising from an error, omission, negligence, incompetence, or malfeasance committed while the partnership is a registered limited liability partnership and in the course of the partnership business by another partner or a representative of the partnership not working under the supervision or direction of the first partner unless the first partner:</p> <ol style="list-style-type: none"> <li>(1) was directly involved in the specific activity in which the error, omission, negligence, incompetence, or malfeasance was committed by the other partner or representative; or</li> <li>(2) had notice or knowledge of the error, omission, negligence, incompetence, or malfeasance by the other partner or representative at the time of occurrence and then failed to take reasonable steps to prevent or cure the action or omission. (V.A.C.S. Art. 6132b-3.08(a))</li> </ol> <p>With respect to a registered limited liability partnership, Section 3.08(a), Texas Revised Partnership Act, prevails over the other parts of the Texas Revised Partnership Act regarding the liability of partners and their chargeability for debts and obligations of the partnership. (V.A.C.S. Art. 6132b-3.08(a)(5))</p> <p>For a limited partnership that is a registered limited liability partnership, Section 3.08(a), Texas Revised Partnership Act, applies to its general</p>	

		partners and to any of its limited partners who are liable for debts or obligations of the limited partnership under the Texas Revised Limited Partnership Act. (V.A.C.S. Art. 6132a-1, Sec. 2.14(c))	
<b>INDEMNITY</b>			
<b>MERGERS</b>			
<b>SALE OR TRANSFER OF ASSETS</b>			
<b>TERMINATION OF ENTITY</b>			
<b>ADMINISTRATIVE POWERS</b>			
<b>TAXES</b>	<b>Federal</b>		
	<b>State</b>		
<b>STOCK/CAPITAL REQUIREMENT</b>			

**(((CORPORATIONS--FOR PROFIT)))**

<b>Quick Summary:</b>	A legal entity created by statute existing separate and apart from its shareholders.	
	<b>Texas Business Corporation Act</b>	<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>Formation: Original and copy of the articles of incorporation signed by the incorporator(s) must be filed with the secretary of state (Art. 3.03). \$300 fee. (Art. 10.01)</p> <p>Other filings include:</p> <p>Agreement restricting transfer of shares: A copy of a bylaw or written agreement placing a restriction on the transfer of corporate shares and the original and copy of an attached statement executed by an officer of the corporation may be filed with the secretary of state. (Art. 2.22, Sec. E)</p> <p>Amendment of articles of incorporation: After approval by the corporation, original and copy of the articles of amendment executed by an officer of the corporation (or by the majority of the directors if no shares are issued and the amendment is adopted by the board) must be filed with the secretary of state. (Arts. 4.04, 4.05)</p> <p>Articles of dissolution: Original and copy of the articles of dissolution executed by an officer of the corporation must be delivered to the secretary of state, along with a certificate from the comptroller that taxes owed under Title 2, Tax Code, have been paid. (Arts. 6.06, 6.07)</p> <p>Cancellation of treasury shares and reduction of stated capital: After adoption of board resolution authorizing the action, original and copy of applicable statement executed by an officer of the corporation must be filed with the secretary of state. (Arts. 4.11, 4.12)</p> <p>Change in registered office and registered agent: Original and copy of the statement executed by an officer of the corporation must be filed with the secretary of state. (Art. 2.10)</p> <p>Change of address of registered agent: Original and copy of the statement signed by the registered agent (or officer of a corporation serving as the registered agent) must be filed with the secretary of state. (Art. 2.10-1)</p> <p>Registered name: A certain corporation, including a bank, trust company, or savings and loan association, may register its corporate name by filing an application executed by an officer of the corporation with the secretary of state. (Art. 2.07)</p> <p>Reserved name: An application to reserve a specified corporate name executed by the applicant or an attorney or agent of the applicant may be filed with the secretary of state. (Art. 2.06)</p> <p>Resignation of registered agent: Original and copy of the notice required to be provided to the corporation must be filed with the secretary of state</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003.)</li> <li>4. Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>5. Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>6. Civil liability for filing a false instrument (4.002)</li> <li>7. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>8. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>9. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>10. Fees             <ol style="list-style-type: none"> <li>(a) Fee for pre-clearance of documents (4.151)</li> <li>(b) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>11. Eliminates need for foreign for-profit corporation to file a certificate of existence along with its application to register its name or to transact business in Texas (5.152 &amp; 9.005)</li> <li>12. Eliminates need for foreign for-profit corporation to state in its application to register that consideration of at least \$1,000 has been paid for issuance of shares (9.002)</li> <li>13. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>14. Requires amendment to application for registration to be filed within 90 days if foreign for-profit corporation changes its name or business or activity (9.009)</li> <li>15. New or revised civil penalties or late filing fees imposed on foreign for-profit corporation's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>16. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign for-profit corporation (9.104)</li> <li>17. Simplifies filing form of certificate of merger, exchange or conversion (10.151, 10.153, 10.154):             <ol style="list-style-type: none"> <li>(a) No need to specify actual voting results</li> <li>(b) Eliminates multiple copy requirement</li> </ol> </li> <li>18. Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> <li>19. Renewal of name reservations permitted (5.105)</li> </ol>

	<p>not later than the 10th day after the date on which the notice is provided. No fee required for filing. (Art. 2.10, Sec. D)</p> <p>Restated articles of incorporation: After authorization by the corporation, original and copy of the restated articles of incorporation executed by an officer of the corporation (or by the majority of the directors if no shares are issued and the restated articles are adopted by the board) must be filed with the secretary of state. (Art. 4.07)</p> <p>Penalties:</p> <p>For signing false document: Class A misdemeanor offense for signing a false document the person knows is false in any material respect with the intention that it be delivered for filing to the secretary of state on the corporation's behalf. (Art. 10.02)</p> <p>Failing to file certain documents within prescribed time: A civil penalty in an amount not to exceed \$2500 will be imposed on a corporation that does not file the following documents before the earlier of the 30th day after the date of the action or the date otherwise required by law for filing:</p> <ol style="list-style-type: none"> <li>(1) change of registered office or agent;</li> <li>(2) application or certificate of withdrawal or termination; or</li> <li>(3) articles of dissolution. (Art. 9.07)</li> </ol>	
<b>FORMATION</b>	<p>A business corporation is created by filing articles of incorporation with the secretary of state. (Arts. 3.02, 3.03)</p> <p>Incorporators: any natural person 18 years of age or older, domestic or foreign corporation, estate, or other entity. (Art. 3.01)</p> <p>Corporate existence generally begins when the certificate of incorporation is issued (on conformance of the articles of incorporation with the law and the payment of required fees). (Art. 3.04, Sec. A)</p> <ul style="list-style-type: none"> <li>• The filing may become effective at a later date specified in the articles of incorporation or on the occurrence of a subsequent event within 90 days of the filing. (Art. 10.03)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Perpetual existence is default rule (3.003)</li> <li>3. Omits outmoded statement of receipt of \$1,000 of value by new for-profit corporation (3.007)</li> <li>4. Adds "limited" to approved list of words indicating corporation (5.054)</li> <li>5. Registered agent <ul style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by for-profit corporation (5.203)</li> </ul> </li> <li>6. Clarifies that for-profit corporation has same powers as individual except as otherwise provided by the Code (2.101)</li> <li>7. Requires organizer to have legal ability to contract rather than 18 years of age (3.004)</li> </ol>
<b>GOVERNING</b>	<p>Governed by a board of directors: one or more members elected as provided by the articles of incorporation or bylaws unless shareholder agreement provides otherwise. Initial board named in the articles of organization. (Arts. 2.31, 2.32, 2.30-1)</p> <ul style="list-style-type: none"> <li>• A director does not have to be a resident of this state or a shareholder of the corporation unless required by the articles of incorporation or bylaws. (Art. 2.31)</li> </ul> <p>One or more committees designated by the board of directors from among its members may exercise some of the board's authority in the management of the corporation if:</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>2. Permits electronic meetings (6.002)</li> <li>3. Notices of meetings may be transmitted via facsimile or electronic message (6.051)</li> <li>4. Clarifies that owner participating in meeting deemed to waive notice of meeting (6.052)</li> <li>5. Adopts SEC rule permitting notices not to be sent to lost securityholders of public for-profit corporation (6.053)</li> </ol>

	<p>(1) the designation is approved by board resolution adopted by a majority of the directors; and</p> <p>(2) the articles or incorporation or bylaws so provide. (Art. 2.36)</p> <p>The board of directors are required to adopt bylaws that may contain provisions for the regulation and management of the corporation's affairs that are consistent with the articles of incorporation. (Art. 2.23)</p> <p>The organization of the corporation (election of officers, adoption of bylaws, share authorization, and other business matters) occurs at the initial meeting of the board of directors called by a majority of the initial directors. (Art. 3.06)</p>	<p>6. Eliminates strict delivery requirements for owner consents when for-profit corporation is soliciting the consent (6.203)</p> <p>7. Authorizes electronic and telephonic proxies (21.367)</p> <p>8. Removal of directors by owners with or without cause (21.409)</p> <p>9. Clarifies that persons authorized to perform functions of the board of directors under a shareholder's agreement are part of the definition of "board of directors" (21.002)</p> <p>10. Clarifies that written waiver of notice of directors' meeting is effective (21.472)</p> <p>11. Clarifies that if annual meeting has been effectively held by consent, no annual meeting may be ordered (21.351)</p> <p>12. Requires shareholder to request annual meeting before attempting to obtain a court order therefor (21.351)</p>
<b>OFFICERS</b>	<p>President and secretary elected by the board of directors at the time and in the manner prescribed by the bylaws. Other officers, if considered necessary, are elected or appointed by the board or according to bylaws. (Art. 2.42)</p> <p>Two or more offices may be held by the same person. (Art. 2.42)</p>	<p>The following changes:</p> <p>1. Removal of officers with or without cause as a default rule (3.104)</p>
<b>LIABILITY</b>	<p>Directors:</p> <ul style="list-style-type: none"> <li>Jointly and severally liable to the corporation or its creditors for certain actions including: <ul style="list-style-type: none"> <li>(1) authorizing a distribution in violation of the Texas Business Corporation Act or restrictions set in the articles of incorporation (liable for the amount by which the distributed amount exceeds the permitted amount unless acted in good faith and with ordinary care). (Art. 2.41, Secs. A(1), C); or</li> <li>(2) permitting the corporation to commence business without receiving the required \$1,000 in capital (the liability terminates when the required consideration is received). (Art. 2.41, Sec. A(2))</li> </ul> </li> </ul> <p>Subscribers and shareholders:</p> <ul style="list-style-type: none"> <li>Have an obligation to the corporation or its creditors to pay the full amount of the consideration for which the shares are or are to be issued. (Art. 2.21, Sec. A(1))</li> <li>No obligation to corporation or its creditors unless used corporation for fraud directly benefiting that person. (Art. 2.21, Sec. A(2))</li> <li>A shareholder may be held liable for receipt of an illegal distribution in the amount received by the person if the person knew the distribution was not permitted. (Art. 2.41, Sec. E)</li> </ul>	
<b>INDEMNITY</b>	<p>Directors:</p> <ul style="list-style-type: none"> <li>Corporation required to indemnify a person who is a party to a proceeding because the person is or was a director of the corporation if the person is wholly successful, on the merits or otherwise, in a defense of the proceedings. The right of indemnification may be eliminated or restricted by the articles of incorporation. (Art. 2.02-1, Secs. H, U)</li> <li>Indemnification is discretionary with the corporation in the following cases if the director meets the substantive standards prescribed in the Act:</li> </ul>	<p>The following changes:</p> <p>1. Determination that standard for indemnification has been met can be made by a committee of one disinterested director instead of two disinterested directors (8.103)</p> <p>2. All of owners may approve indemnification of directors, which was only implied in TBCA (8.103)</p> <p>3. Owners may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a director, which was only implied in TBCA (8.105)</p>

	<ul style="list-style-type: none"> <li>(1) the criminal prosecution of a director;</li> <li>(2) litigation settled by a director before a judgment is rendered; or</li> <li>(3) a director is found liable to a third party in which the transaction does not involve an improper personal benefit. (Art. 2.02-1, Secs. B, C, E)</li> </ul> <ul style="list-style-type: none"> <li>• A director who has been held liable to the corporation or has been found to have received an improper personal benefit is generally not entitled to indemnification. (Art. 2.02-1, Sec. C)</li> <li>• A court in its discretion may order indemnification under certain circumstances to a director who received an improper personal benefit. (Art. 2.02-1, Sec. J)</li> </ul> <p>Officers and employees:</p> <ul style="list-style-type: none"> <li>• Nonstatutory rights of indemnification of an officer, employees, or agent who is not a director not affected. (Art. 2.02-1, Sec. Q)</li> <li>• An officer, employee, or agent of the corporation may be indemnified to the same extent as a director. (Art. 2.02-1, Sec. D)</li> </ul> <p>Other persons:</p> <ul style="list-style-type: none"> <li>• A person serving at the corporation's request as a director, officer, partner, venturer, employee, agent, or similar functionary of another corporation, employee benefit plan, other enterprise, or other entity may be indemnified to the same extent as a director even though the person was not an officer or employee of the corporation. (Art. 2.02-1, Sec. P)</li> </ul> <p>A director may be granted an advance on indemnification if the director submits a written affirmation that he believes in good faith that he is entitled to indemnification and an undertaking to repay the advancement if the person is found not to be entitled to indemnification. (Art. 2.02-1, Sec. K)</p> <p>A corporation is authorized to purchase directors' and officers' liability insurance that covers employees, agents, and other persons who are or were serving at the corporation's request at another corporation or other entity. (Art. 2.02-1, Sec. R)</p>	<p>4. Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</p>
<p><b>MERGERS</b></p>	<p>One or more domestic corporations may merge with one or more domestic or foreign corporations or other entities under a plan of merger (Arts. 5.01, 5.03-5.06); or</p> <p>One or more domestic or foreign corporations may acquire all of the outstanding shares of one or more domestic corporations under a plan of exchange. (Arts. 5.02-5.06)</p> <p>Merger with subsidiary entities under certain circumstances authorized. (Art. 5.16)</p> <p>A domestic corporation may convert to a foreign corporation or any other entity under a plan of conversion. (Arts. 5.17-5.20)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>2. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>3. All surviving entities in merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>4. Supplies definition of "fair value" for dissenting owner provisions (10.362)</li> <li>5. Harmonizes provisions, including dissenters' rights, for short-form mergers and regular mergers (10.006)</li> </ol>

<p><b>SALE OR TRANSFER OF ASSETS</b></p>	<p>Unless the articles of incorporation state otherwise, the board of directors is authorized to sell, lease, or otherwise dispose of all or substantially all of the corporation's assets without shareholder approval if the disposition is made in the regular course of business. (Art. 5.09)</p> <p>Sale, lease, or other disposition of all or substantially all of assets not made in the regular course of business require shareholder approval. (Art. 5.10)</p> <p>A corporation may lend money to its employees, officers, and directors if the loan may reasonably be expected to directly or indirectly benefit the corporation. (Art. 2.02, Sec. A(b))</p> <p>A distribution of corporate assets may be made subject to any restrictions in its articles of incorporation and the limitations provided in Article 2.38 of the Act. (Art. 2.38)</p> <p>Land may be conveyed when authorized by board resolution. (Art. 5.08)</p>	
<p><b>TERMINATION OF ENTITY</b></p>	<p>Voluntary dissolution:</p> <ul style="list-style-type: none"> <li>• A corporation that has not issued shares or commenced business may be voluntarily dissolved at any time by an election of a majority of the incorporators or directors; articles of dissolution are prepared and submitted to the secretary of state. (Art. 6.01)</li> <li>• Any other corporation may be voluntarily dissolved by written consent of all of its shareholders or by act of the corporation. (Arts. 6.02, 6.03)</li> <li>• Dissolution by corporate action involves the adoption of a resolution to dissolve by the directors which must be approved by the affirmative vote of at least two-thirds of the corporation's outstanding shares (an additional class vote may be required if any class or series is entitled to vote as a class). (Art. 6.03)</li> <li>• After adoption, the corporation must comply with notice and other procedural requirements before filing articles of dissolution with the secretary of state. (Arts. 6.04-6.07)</li> </ul> <p>Involuntary dissolution:</p> <ul style="list-style-type: none"> <li>• Attorney general files action or by order of the secretary of state. (Part 7 of Act)</li> <li>• The attorney general may proceed to dissolve a corporation in a variety of circumstances, including: <ul style="list-style-type: none"> <li>(1) the articles of incorporation or any amendment were procured through fraud;</li> <li>(2) the corporation has continued to transact business beyond the scope of the purpose for which it was formed as expressed in the articles of incorporation; or</li> <li>(3) the corporation has been convicted of a felony or a high managerial agent has been convicted of a felony with respect to conducting the affairs of the corporation. (Art. 7.01, Secs. A, F)</li> </ul> </li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Extends ability to reinstate a voluntarily terminated for-profit corporation from 120 days to three years following termination; however, the ability to reinstate is limited to specified circumstances (11.201-11.202)</li> <li>2. Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>3. Common, simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>4. Permits cancellation by approval of owners of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> <li>5. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>6. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>7. Authorizes Secretary of State to involuntarily terminate for failure to pay filing fees or maintain a registered office (11.251)</li> <li>8. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</li> <li>9. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>10. Extends reinstatement by the Secretary of State of an involuntarily terminated for-profit corporation to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</li> <li>11. Permits authorized, non-corporate entities to serve as receivers (11.406)</li> <li>12. Clarifies that board of directors has responsibility for winding up the corporation's affairs (21.504)</li> </ol>

	<ul style="list-style-type: none"> <li>• The secretary of state is authorized to order the dissolution of a corporation that: <ol style="list-style-type: none"> <li>(1) has failed to file a report within the time prescribed by law;</li> <li>(2) has failed to pay any fee, franchise tax, or penalty prescribed by law when due and payable;</li> <li>(3) has failed to maintain a registered agent in this state; or</li> <li>(4) has failed to pay the filing fee for its articles of incorporation or the initial deposit for the franchise tax or payment when presented was dishonored (opportunity to cure default within 90 days of notification of violation of Subdivisions (1)-(3) and if dissolved, corporation may be reinstated by filing an application for reinstatement signed by an officer or director of the dissolved corporation and payment of a filing fee). (Art. 7.01, Secs. B, C, E)</li> </ol> </li> </ul> <p>The secretary of state, from time to time, is required to certify to the attorney general the names of corporations giving cause for judicial dissolution of their charters or revocations of their certificates of authority. The corporation has an opportunity to cure the default before the attorney general files action in the name of the state. (Art. 7.02)</p>	
<b>ADMINISTRATIVE POWERS</b>	<p>The secretary of state has the power reasonably necessary to administer the Texas Business Corporation Act and to perform any duty prescribed to the secretary of state under the Act. (Art. 9.03)</p> <p>The secretary of state may send interrogatories to a corporation or its officers or directors to investigate compliance with the Act. (Art. 9.01)</p> <p>Books and records of account and minutes of the proceedings of its shareholders, board of directors, and each committee of its board of directors and share transfer records are required to be maintained. (Art. 2.44, Sec. A)</p> <ul style="list-style-type: none"> <li>• Certain documents, including corporate books and records and minutes and share transfer records, may be examined by a director for any purpose related to the director's service as such; court may compel inspection. (Art. 2.44, Sec. B)</li> <li>• Shareholder records may be examined by a person who is a shareholder of the corporation for at least six months before the date of the request or a holder of at least five percent of all the outstanding shares (on written request for any proper purpose); corporation liable for costs and expenses incurred by a person in enforcing their rights to examine the documents. (Art. 2.44, Secs. C, D)</li> <li>• A beneficial or record holder of the corporation's shares may initiate court action to compel examination of certain documents on proof of proper purpose. (Art. 2.44, Sec. E)</li> </ul> <p>An annual statement of a corporation's affairs, including its assets and liabilities, for the last fiscal year must be mailed to a shareholder of the corporation on written request. (Art. 2.44, Sec. F)</p> <p>A written agreement among the holders of the securities of a corporation among themselves or the corporation placing any restriction on the transfer of those securities may be examined by a shareholder of the corporation to the same extent as the books and records of the corporation. (Art. 2.22, Sec. B)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>2. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.002)</li> <li>3. Clarifies certain failures or refusals of managerial officials are a "class B" misdemeanor (12.156)</li> </ol>
<b>STOCK/CAPITAL REQUIREMENT</b>	<p>Authorized to issue the number of shares stated in the articles of incorporation, with or without par value. (Art. 2.12)</p> <p>May commence business once the corporation receives for the issuance of shares \$1,000 in consideration. (Art. 3.05)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits more flexibility in names in which trustee may hold record title to ownership interests (6.154)</li> <li>2. Reverses default rules for preemptive rights and cumulative voting, with special grandfather provisions added to preserve shareholder</li> </ol>

	<ul style="list-style-type: none"> <li>• Shares and other securities of a corporation may be transferred in accordance with Chapter 8, Business &amp; Commerce Code, except as otherwise provided by this Act. A restriction on the transfer of a security may be imposed by the articles of incorporation, bylaws, or by written agreement. (Art. 2.22)</li> </ul>	<p>rights in existing corporations; requires certificate of formation provision to invoke these statutory rights (21.203-21.205, 21.208, 21.360-21.362)</p> <ol style="list-style-type: none"> <li>3. Modernizes subscription provisions (21.165-21.166)</li> <li>4. Eliminates outmoded filing requirements for reductions in stated capital (21.251-21.254)</li> <li>5. Validation of shareholder rights plans (21.169)</li> <li>6. Permits directors to amend series of stock by single board resolution if no shares of that series are outstanding (21.155)</li> <li>7. Provides that a written commitment to acquire shares may bind a person to act in a specified manner after such acquisition (21.167)</li> </ol>
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**(((NON-PROFIT CORPORATION)))**

<b>Quick Summary:</b>	A corporation organized for charitable, religious, educational, social, or related purposes in which no part of its income is distributable to its members, directors, or officers.	
	<b>Texas Non-Profit Corporation Act (V.A.C.S. Art. 1396-1.01, et seq.)</b>	<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>Formation: Original and copy of the articles of incorporation signed by each of the incorporators must be filed with the secretary of state. (Arts. 1396-3.01-3.03) \$25 fee (Art. 9.03)</p> <p>Required periodic report: Not more than once every four years, one copy of required report signed by an officer of the nonprofit corporation (or receiver or trustee if the corporation is in the hands of either person) must be delivered to the secretary of state. (Art. 1396-9.01)</p> <p>Other Filings include:</p> <p>Application for name reservation: Subject to the procedures and period prescribed by Article 2.06, Texas Business Corporation Act. (Art. 1396-2.04A, Sec. B)</p> <p>Articles of Amendment: Original and copy of articles of amendment signed by an officer of the nonprofit corporation may be filed with the secretary of state. (Arts. 1396-4.03, 1396-4.04)</p> <p>Articles of dissolution: Original and copy of the articles of dissolution signed by an officer of the nonprofit corporation must be delivered to the secretary of state. (Arts. 1396-6.05, 1396-6.06)</p> <p>Change in registered office or agent: Original and copy of required statement signed by an officer of the nonprofit corporation must be filed with the secretary of state. (Art. 1396-2.06)</p> <p>Change of address of registered agent: Original and copy of the statement signed by the registered agent (or officer of a corporation serving as the registered agent) must be filed with the secretary of state. (Art. 1396-2.06A)</p> <p>Resignation of registered agent: Original and two copies of the written notice provided to the nonprofit corporation may be filed with the secretary of state. (Art. 1396-2.06, Sec. D)</p> <p>Restated articles of incorporation: Original and copy of the restated articles of incorporation signed by an officer of the nonprofit corporation may be filed with the secretary of state. (Art. 1396-4.06)</p> <p>Penalties: For failing to file required report: Nonprofit corporation forfeits its right to conduct its affairs for failing to file the report required by Article 9.01 of the Act unless it revives its rights to do so (within 120 days, files report and late filing fees). If the right to conduct its business affairs is not revived within the prescribed time, sufficient ground exists for the voluntary dissolution of the corporation or the revocation of its certificate of authority. (Art. 1396-9.02)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>5. Clarifies that required filings must be filed promptly (4.004)</li> <li>6. Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>7. Civil liability for filing a false instrument (4.007)</li> <li>8. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>9. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>10. Adopt Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>11. Fees             <ol style="list-style-type: none"> <li>(a) Fee for pre-clearance of documents (4.151)</li> <li>(b) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>13. Eliminates need for foreign non-profit corporation to file a certificate of existence along with its application to register to transact business in Texas (9.005)</li> <li>14. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>15. Requires amendment to application for registration to be filed within 90 days if foreign non-profit corporation changes its name or business or activity (9.009)</li> <li>16. New or revised civil penalties or late filing fees imposed on foreign non-profit corporation's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>17. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign non-profit corporation (9.104)</li> <li>18. Simplifies filing form of certificate of merger (10.151, 10.153):             <ol style="list-style-type: none"> <li>(a) No need to include plan of merger</li> <li>(b) No need to specify actual voting results</li> <li>(c) Eliminates multiple copy requirement</li> </ol> </li> <li>18. Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> <li>19. Renewal of name reservations permitted (5.105)</li> </ol>

	For signing false document: Class A misdemeanor offense for signing a false document the person knows is false in a material respect with the intention that it be delivered for filing to the secretary of state on the nonprofit corporation's behalf. (Art. 1396-9.03A)	
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<p><b>FORMATION</b></p>	<p>Incorporators: One or more natural persons 18 years of age or older may incorporate by executing and delivering the articles of incorporation to the secretary of state. (Art. 1396-3.01, Sec. A)</p> <p>A religious society, a charitable, benevolent, literary, or social association, or a church may incorporate under the Act with the consent of a majority of its members. (Art. 1396-3.01, Sec. B)</p> <p>May have one or more classes of members or no members. (Art. 1396-2.08, Sec. A)</p> <p>Corporate existence begins when the certificate of incorporation is issued (on conformance of the articles of incorporation to legal requirements and the payment of required fees). (Arts. 1396-3.03, 1396-3.04)</p> <p>At the call of the incorporators or a majority of the directors named in the articles of incorporation, an organizational meeting shall be held to adopt bylaws and elect officers. (Art. 1396-3.05)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Perpetual existence is default rule (3.003)</li> <li>3. Registered agent             <ol style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by non-profit corporation (5.203)</li> </ol> </li> <li>4. Clarifies that non-profit corporation has same powers as individual except as otherwise provided by the Code (2.101)</li> <li>5. Requires organizer to have legal ability to contract rather than 18 years of age (3.004)</li> </ol>
<p><b>GOVERNING</b></p>	<p>Authorized to adopt bylaws for the administration and regulation of affairs of the nonprofit corporation that are consistent with the articles of incorporation. Bylaws must be adopted by the board of directors (or members if the corporation's members manage the corporation). (Arts. 1396-2.02, Sec. A(12), 1396-2.09)</p> <p>Corporate affairs managed by three or more directors unless there is an express provision to the contrary in the articles of incorporation or bylaws.</p> <ul style="list-style-type: none"> <li>• The articles of incorporation of a nonprofit corporation may vest the management of the affairs of the corporation in its members.</li> <li>• The number of directors set in the articles of incorporation or bylaws may never be decreased to fewer than three. (Arts. 1396-2.14, Secs. A, C, 1396-2.15)</li> </ul> <p>Directors are not required to be residents of Texas or members of the corporation unless required by the articles of incorporation or bylaws. (Art. 1396-2.14, Sec. A)</p> <p>Directors are elected or appointed in the manner and for the terms specified in the articles of incorporation or bylaws.</p> <ul style="list-style-type: none"> <li>• If those documents are silent on the matter, directors are elected by the board of directors.</li> <li>• If the nonprofit corporation has no members with voting rights, one or more associations or corporations may elect the board of directors, wholly or partly, if the articles of incorporation or the bylaws so provide. (Arts. 1396-2.14, Sec. E, 1396-2.15, Sec. B)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>2. Notice of meetings may be transmitted via electronic message (6.051)</li> <li>3. Clarifies that member participating in meeting deemed to waive notice of meeting (6.052)</li> <li>4. Permits notice of meeting not to be given to member when prior mailed notices have been returned undeliverable (6.053)</li> <li>5. Omits 90-day time limit on adjournments of meetings to conform with modernized provisions for real estate investment trusts and for-profit corporations (6.101)</li> <li>6. Omits strict delivery requirements for member consents when nonprofit corporation is soliciting the consent (6.202)</li> <li>7. Makes interested director provisions parallel to the same provisions for for-profit corporations (22.230)</li> <li>8. Clarifies that private institutions of higher education described in the Education Code and their foundations are exempt from specific record-keeping and reporting obligations in the Code (22.355)</li> <li>9. Clarifies that a foreign non-profit corporation may vote or consent as to its interest in and participate in the management of a domestic entity even if not registered to transact business in Texas (9.204)</li> <li>10. Directors or managing members have right to inspect books and records (3.152)</li> </ol>

	<p>One or more committees designated by the board of directors may exercise the board's authority in the management of the nonprofit corporation if:</p> <ol style="list-style-type: none"> <li>(1) the designation is approved by board resolution adopted by a majority of the directors; and</li> <li>(2) the articles of incorporation or bylaws so provide. (Art. 1396-2.18, Sec. A)</li> </ol>	
<p><b>OFFICERS</b></p>	<p>The officers of a nonprofit corporation consist of a president and secretary. The nonprofit corporation may have other officers and assistant officers as considered necessary. (Art. 1396-2.20, Sec. A)</p> <p>An officer is elected or appointed in the manner and for the term (not to exceed three years) specified in the articles of incorporation or bylaws. If those documents are silent on the matter, officers are elected or appointed by the board of directors or members, as applicable. (Art. 1396-2.20, Sec. A)</p> <p>Any two or more offices may be held by the same person, except the offices of president and secretary. (Art. 1396-2.20, Sec. A)</p> <p>A nonprofit corporation that is a church is not required to have officers. (Art. 1396-2.20, Sec. C)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Removal of officers with or without cause as a default rule (3.104)</li> </ol>
<p><b>LIABILITY</b></p>	<p>Member:</p> <ul style="list-style-type: none"> <li>• A member may not be held personally liable for the debts or obligations of the nonprofit corporation. (Art. 1396-2.08, Sec. E)</li> </ul> <p>Officer:</p> <ul style="list-style-type: none"> <li>• An officer is not liable to the nonprofit corporation or any other person for any action taken or omission made by the officer in the person's capacity as an officer for conduct exercised: <ol style="list-style-type: none"> <li>(1) in good faith and with ordinary care; and</li> <li>(2) with reasonable belief that it was in the corporation's best interests. (Art. 1396-2.22 (a))</li> </ol> </li> </ul> <p>Director:</p> <ul style="list-style-type: none"> <li>• A director is not liable to the nonprofit corporation, a member of the nonprofit corporation or any other person for any action taken or not taken in the discharge of the director's duties or a power conferred on the director. To establish liability, a person must prove that the director has not acted: <ol style="list-style-type: none"> <li>(1) in good faith and with ordinary care; and</li> <li>(2) in a manner the director reasonably believes to be in the best interest of the corporation. (Art. 1396-2.28, Sec. D)</li> </ol> </li> <li>• A director who authorizes a corporate loan to a director (expressly prohibited by the Act) and any officer who participates in the making of the loan are jointly and severally liable to the nonprofit corporation for the amount of the loan until it is repaid. (Art. 1396-2.25)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>2. Adopts modern for-profit corporate provision clarifying that a disposition of assets is not a merger or conversion and that a purchaser of property is not liable for obligation of transferring non-profit corporation if purchaser does not expressly assume the obligation, which is implicit in existing law (10.254)</li> </ol>

	<ul style="list-style-type: none"> <li>With certain exceptions, a director who authorizes the distribution of the nonprofit corporation's assets under certain circumstances for a purpose other than the payment of debts may be held jointly and severally liable to the corporation for the value of the distributed assets to the extent the debts and obligations have not been paid and discharged. (Art. 1396-2.26)</li> </ul>	
<b>INDEMNITY</b>	The indemnity provisions in Section 2.22A of the Act are basically identical to the indemnity provisions found in Article 2.02-1, Texas Business Corporation Act. (Art. 1396-2.22A)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Determination that standard for indemnification has been met can be made by a committee of one disinterested director instead of two disinterested directors (8.103)</li> <li>All of members may approve indemnification of directors, which was only implied in TNPCA (8.103)</li> <li>Members may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a director, which was only implied in TNPCA (8.105)</li> <li>Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> </ol>
<b>MERGERS</b>	<p>Two or more domestic corporations may merge into one of the corporations under a plan of merger. (Art. 1396-5.01, et seq.)</p> <p>Two or more domestic corporations may consolidate into a new corporation under a plan of consolidation. (Art. 1396-5.02, et seq.)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Updates provisions governing mergers to parallel modernized for-profit corporate provisions. Accordingly, provisions are added governing conversions and interest exchanges, folding "consolidation" into the term "merger" and specifying that member approval is not necessary where the non-profit corporation is not a "party to the merger." Important restrictions on mergers with or conversions into for-profit entities are retained, added or clarified. (Chapter 10 generally)</li> <li>Permits the plan of merger or exchange to treat membership interests of the same class or series differently (10.002 &amp; 10.052)</li> <li>Clarifies that interest exchange provisions can be included in plan of merger (10.002)</li> <li>Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>All surviving entities in a merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>Updates provisions to authorize special mergers for parent/subsidiary and creation of holding company (10.005 &amp; 10.006)</li> <li>Allows abandonment of mergers after filing of certificate of merger and before effectiveness (10.202)</li> <li>Adds provisions clarifying how federal bankruptcy reorganization laws apply based on provisions in the TBCA, TREITA and TRLPA (10.301-10.303)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>The sale, lease, or exchange of all or substantially all of the property and assets of a nonprofit corporation may be made in the following manner:</p> <ol style="list-style-type: none"> <li>if there are members of the corporation with voting rights, the action, following submission of a board resolution, must be authorized by at least a two-thirds vote of the members present at a meeting in person or by proxy (additional class vote may be required);</li> <li>if the corporation has no members or no members with voting rights, action must be authorized by majority vote of the directors in office;</li> <li>if the affairs of the corporation are managed by its members, the action, following submission of a resolution, must be authorized by at least a two-thirds vote of the members present at a meeting; or</li> <li>if the corporation is insolvent, action must be authorized by majority vote of the directors in office. (Art. 1396-5.09, Sec. A)</li> </ol>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Updates definition of sale of all or substantially all of assets to parallel more modern for-profit corporate provisions (22.252)</li> </ol>

	<p>A nonprofit corporation may convey land by deed, signed by an officer or attorney of the corporation, if authorized by board resolution. (Art. 1396-5.08)</p> <p>A nonprofit corporation may lend money to its employees and officers, but not its directors, under certain circumstances if it may be reasonably expected to benefit the corporation. (Arts. 1396-2.02, Sec. A(b), 1396-2.25)</p> <p>No part of the income of a nonprofit corporation may be distributed to its members, directors, or officers. (Art. 1396-2.24)</p> <p>The board may delegate to certain advisors, including investment advisors and banks, the authority to sell, transfer, or dispose of the nonprofit corporation's assets at a time and for consideration considered appropriate by the advisor. (Art. 1396-2.29, Sec. A)</p>	
<p><b>TERMINATION OF ENTITY</b></p>	<p>Voluntary dissolution:</p> <ol style="list-style-type: none"> <li>(1) if there are members of the corporation with voting rights, the board of directors adopts a resolution recommending the nonprofit corporation's dissolution which must be approved by at least a two-thirds vote of the members present at a meeting in person or by proxy (additional class vote may be required);</li> <li>(2) if the corporation has no members or no members with voting rights, the dissolution of the corporation must be authorized by majority vote of the directors in office on adoption of a resolution to dissolve; or</li> <li>(3) if the affairs of the corporation are managed by its members, the dissolution of the corporation, following submission of a resolution on the action, must be authorized by at least a two-thirds vote of the members present at a meeting. (Art. 1396-6.01, Sec. A)</li> </ol> <p>Involuntary Dissolution:</p> <ol style="list-style-type: none"> <li>(1) by court decree for: <ol style="list-style-type: none"> <li>(A) failing to comply with condition precedent to incorporation;</li> <li>(B) articles of incorporation or any of its amendments were procured through fraud;</li> <li>(C) nonprofit corporation transacts business beyond the scope of the purpose for which it was formed; or</li> <li>(D) a misrepresentation of a material matter in a certain document. (Art. 1396-7.01, Sec. A)</li> </ol> </li> <li>(2) by order of the secretary of state for: <ol style="list-style-type: none"> <li>(A) failing to file a report within time required by law;</li> <li>(B) failing to pay a fee, franchise tax or penalty prescribed by law when it becomes due;</li> <li>(C) failing to maintain a registered agent in this state; or</li> <li>(D) failing to pay the filing fee for its articles of incorporation or paying the fee with an instrument that was dishonored when presented for payment. (Art. 1396-7.01, Sec. B)</li> </ol> </li> </ol>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits reinstatement of voluntarily terminated nonprofit corporation before third anniversary date of its termination if certain conditions exist (11.201-11.202 &amp; 22.302)</li> <li>2. Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>3. Common, simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>4. Permits cancellation by approval of members of certain types of events requiring winding up, including expiration of period of duration (11.152, 22.302)</li> <li>5. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>6. Permits member to apply for a court to supervise the winding up (11.054)</li> <li>7. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after the expiration (11.101, 11.104)</li> <li>8. Authorizes Secretary of State to involuntarily terminate for failure to pay filing fees or maintain a registered office (11.251)</li> <li>9. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</li> <li>10. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>11. Extends reinstatement by the Secretary of State of an involuntarily terminated nonprofit corporation to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</li> <li>12. Clarifies that the directors or, if management is vested in members, the members shall manage the winding up of a non-profit corporation's affairs (22.307)</li> <li>13. Permits authorized, non-corporate entities to serve as receivers (11.406)</li> </ol>
<p><b>ADMINISTRATIVE POWERS</b></p>	<p>The secretary of state has the power reasonably necessary to administer the Texas Non-Profit Corporation Act and to perform any duty prescribed</p>	<p>The following changes:</p>

	<p>to the secretary of state under the Act. (Art. 1396-9.04)</p> <p>Required to maintain correct and complete books and records of account and minutes of the proceedings of its members or the group in which the management of the nonprofit corporation is vested. (Art. 1396-2.23, Sec. A)</p> <p>Required to prepare and file (not more than once every four years) a report containing names and addresses of a corporation, the corporation's registered agent, and the directors and officers of the corporation. (Art. 1396-9.01)</p> <p>A member of the nonprofit corporation, on written request, is entitled to examine and copy the books and records at any reasonable time for a proper purpose. (Art. 1396-2.23, Sec. B)</p> <p>The books and records of a certain nonprofit corporation other than a bona fide alumni association are subject to audit by the state auditor. (Art. 1396-2.23B, Sec. B)</p> <p>Unless expressly exempt by Article 2.23A of the Act, a nonprofit corporation is required to maintain and make available for public inspection financial records and an annual financial report for at least three years after the close of each fiscal year. (Art. 1396-2.23A, Secs. A, B, C, E)</p> <p>Criminal penalty: Class B misdemeanor offense for failing to maintain a financial record, prepare a required annual report, or make the record or report available to the public in the manner prescribed by law. (Art. 1396-2.23A, Sec. D)</p>	<ol style="list-style-type: none"> <li>1. Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>2. Confirms interrogatory power of Secretary of State (12.002)</li> <li>3. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>4. Clarifies that certain failures or refusals of managerial officials are a "Class B" misdemeanor (12.156)</li> <li>5. Authorizes service of process by a political subdivision collecting delinquent ad valorem tax on a foreign nonprofit corporation (5.257)</li> </ol>
<b>STOCK/CAPITAL REQUIREMENT</b>	<p>Not authorized to issue shares.</p>	<p>No change.</p>

**(((LIMITED LIABILITY COMPANY)))**

<b>Quick Summary:</b>	A distinct type of entity that has attributes of both a corporation (limited liability) and a partnership (favorable tax treatment).	
	<b>Texas Limited Liability Company Act (V.A.C.S. Art. 152.8n)</b>	<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>Formation: Original and copy of the articles of organization signed by the organizers must be filed with the secretary of state. (Art. 3.03) \$200 fee (Art. 9.01)</p> <ul style="list-style-type: none"> <li>To form a professional limited liability company, articles of organization that conform to Part Three of the Act and a required statement must be filed with the secretary of state. (Art. 11.01)</li> </ul> <p>Other filings include:</p> <p>Articles of Amendment: Original and copy of articles of amendment executed by an authorized manager or member of the company (or a majority of the initial members or managers if amending the articles of organization) may be filed with the secretary of state. (Arts. 2.23, Sec. 6, 3.06)</p> <p>Change of registered office or registered agent for service of process: Original and copy of required statement executed by an authorized manager or member of the company must be filed with the secretary of state. (Art. 2.06, Secs. A, B)</p> <p>Dissolution: Original and copy of articles of dissolution executed by a manager or authorized member of the company (or the persons authorizing the dissolution of the company, if applicable) and a certificate from the comptroller that all taxes and applicable penalties and interest have been paid may be filed with the secretary of state. Certificate of dissolution issued on payment of a fee and conformance with legal requirements. (Arts. 2.23, Sec. 6, 6.08)</p> <p>Reservation of name: An application to reserve a specified company name signed by the applicant or the applicant's agent may be filed with the secretary of state. (Art. 2.04, Sec. B)</p> <p>Restated articles of organization: Original and copy of restated articles of organization executed by an authorized manager or member of the company (or by a majority of the persons adopting the restated articles if capital has not been paid into the company) may be filed with the secretary of state. (Art. 3.09)</p> <p>Resignation of registered agent for service of process: Original and copy of written notice of resignation executed by resigning agent may be filed with the secretary of state. (Art. 2.06, Sec. D)</p> <p>Criminal penalty for signing a false document:</p> <ul style="list-style-type: none"> <li>A person commits a Class A misdemeanor offense for signing a document knowing it is false in a material respect with the intent that it be delivered to the secretary of state on a limited liability company's behalf. (Art. 9.02)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Standardizes filing procedures (4.001)</li> <li>Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>Civil liability for filing a false instrument (4.007)</li> <li>Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>Eliminates need to file certificate of existence along with its application to register its name (5.152)</li> <li>Fees             <ol style="list-style-type: none"> <li>Fee for pre-clearance of documents (4.151)</li> <li>Fee for new entity created by merger or conversion (4.151)</li> <li>Increase filing fees for limited liability companies to match for-profit corporations (4.154)</li> </ol> </li> <li>Common simplified form of, and common procedures for, application for registration to do business in Texas and certificates of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>Requires amendment to application for registration to be filed within 90 days if foreign limited liability company changes its name or business or activity (9.009)</li> <li>New or revised civil penalties or late filing fees imposed on foreign limited liability company's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign limited liability company (9.104)</li> <li>Simplifies filing form of certificate of merger (10.151, 10.153):             <ol style="list-style-type: none"> <li>Eliminates multiple copy requirement</li> </ol> </li> <li>Requires filing of certificate of exchange after plan of exchange is approved if interests in filing entity are acquired (10.153)</li> <li>Foreign entities of a type that have no counterpart under Texas law (for example, business trusts) may register to do business in Texas directly without having to qualify to do business as a limited liability company (101.001)</li> <li>Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> <li>Renewal of name reservations permitted (5.105)</li> </ol>

<p><b>FORMATION</b></p>	<p>Organized by any natural person 18 years of age or older or any other person by filing articles of organization. (Art. 3.01)</p> <p>A professional limited liability company may be formed by one or more persons. (Art. 11.01)</p> <p>Unless it is being organized under a plan of merger or conversion, the existence of a limited liability company begins when the certificate of organization is issued (on conformance of articles of organization to legal requirements and payment of required fees). (Arts. 3.01, 3.03, 3.04)</p> <p>A limited liability company may have one or more members. (Art. 4.01)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Perpetual existence is default rule (3.003)</li> <li>3. Eliminates specific lists of acceptable abbreviations in names of limited liability companies (5.056 &amp; 5.059)</li> <li>4. Registered agent       <ol style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by limited liability company (5.203)</li> </ol> </li> <li>5. Allows limited liability company to have nonprofit powers and purpose (2.003 &amp; 2.102)</li> <li>6. Clarifies that limited liability companies may not engage in a business or activity that is unlawful or prohibited by law, that requires a license that cannot be granted to a limited liability company or that is included in a list of specified types of business (such as banking and insurance) that are regulated under other statutes, which was only implicit in the TLLCA (2.003)</li> <li>7. Permits professional limited liability company to provide more than one professional service subject to any limits under special regulatory law (2.004)</li> <li>8. Requires organizer to have legal ability to contract rather than 18 years of age (3.004)</li> </ol>
<p><b>GOVERNING</b></p>	<p>Business and affairs of a limited liability company are managed under the direction of one or more managers of the company unless the articles of organization or regulations reserve management of the company to its members. (Art. 2.12)</p> <ul style="list-style-type: none"> <li>• The regulations may contain provisions for the management of the affairs of the company not inconsistent with law or the articles of organization. (Art. 2.09)</li> </ul> <p>The number of managers (except for the initial managers) is set under the regulations of the company. (Art. 2.13)</p> <p>A manager of a limited liability company is not required to be a member of the company or a resident of Texas unless required by the regulations of the company. (Art. 2.12)</p> <p>Officers, agents, managers, and members of a limited liability company are authorized to perform duties in the management of the company as provided in the regulations or the group in which management of the company is vested if consistent with the regulations or articles of organization. (Art. 2.21, Sec. B)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>2. Permits electronic meetings (6.001)</li> <li>3. Notices of meetings may be transmitted via facsimile or electronic message (6.051)</li> <li>4. Adopts SEC rule permitting notices not to be sent to lost securityholders of public limited liability companies (6.053)</li> <li>5. Adds strict delivery requirements for member consents when less than unanimous consent (6.202-6.203)</li> <li>6. Clarifies that a foreign limited liability company may vote or consent as to its interest in and participate in the management of a domestic entity even if not registered to transact business in Texas (9.204)</li> <li>7. Reverses the former rule that, unless otherwise specified in the TLLCA, each provision of the TLLCA is mandatory, so that of the company agreement takes precedence over the Code, except for those sections of the Code listed in 101.054; this makes the Code a "default" provision in the absence of a governing provision in the company agreement (101.052)</li> <li>8. Certain provisions of the Code may not be waived or modified by the company agreement or may only be waived or modified in certain circumstances (101.054)</li> <li>9. Clarifies that there is no default rule as to the form of management (e.g. member-managed or manager-managed) because the form of management must be addressed in the articles of organization (101.252)</li> <li>10. Clarifies that a limited liability company, whether member-managed or manager-managed, is governed first by its company agreement and second by the Code to the extent the company agreement does not provide for management of the company (101.252)</li> <li>11. Allows the designation of committees by resolution of the limited liability company's governing authority, even if the company agreement does not provide (101.253)</li> </ol>

		<p>12. Omits language requiring express authority in resolutions, the certificate of formation or the company agreement for a committee to authorize a distribution or the issuance of membership interests; the Code specifies that the committee's authority is provided by the resolution designating the committee (101.232)</p> <p>13. Clarifies that acts by agents not apparently for carrying out the ordinary course of business may bind the company only if authorized, which was only implied in the TLLCA (101.254)</p> <p>14. Makes explicit that rules applicable to managers do not apply to limited liability companies without managers (101.301)</p> <p>15. Removal of managers by members with or without cause (101.304)</p> <p>16. Specifies requirements for notice of regular and special meetings (101.352)</p> <p>17. Resolves inconsistencies in current law regarding default vote required for certain actions (issuance of additional membership interests, change from member-management to manager-management or vice versa, and acts in contravention of regulations) by deleting majority approval provision and retaining provisions requiring unanimity (101.356)</p> <p>18. Permits company agreement to authorize proxies for managers or committee members (101.357)</p> <p>19. Governing persons may rely on certain types of information, opinions, reports and statement (3.102)</p> <p>20. Managers or members (if company has no managers) have right to inspect books and records (3.152)</p>
<b>OFFICERS</b>	<p>One or more persons as designated by the group in which management of the limited liability company is vested (managers or members). A person is not required to be a manager or member of the limited liability company to be eligible to serve as an officer of the company. (Art. 2.21)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Removal of officers with or without cause as a default rule (3.104)</li> <li>2. Officers may rely on certain types of information, opinions, reports, and statements (3.105)</li> </ol>
<b>LIABILITY</b>	<p>A member or manager of a limited liability company is not liable for the debts, obligations, or liabilities of the company except as provided otherwise by the regulations. (Art. 4.03)</p> <p>A promise to make a contribution to the limited liability company is not enforceable unless it is in writing and signed by the member. (Art. 5.02)</p> <p>Liabilities of a member, manager, officer, or other person with respect to a limited liability company or to another member or manager may be expanded or restricted by provisions in the regulations. (Art. 2.20, Sec. B)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Adopts modern for-profit corporate provision clarifying that a disposition of assets is not a merger or conversion and that a purchaser of property is not liable for obligation of transferring limited liability company if purchaser does not expressly assume the obligation (10.254)</li> </ol>
<b>INDEMNITY</b>	<p>Subject to the articles of organization or regulations, a limited liability company is authorized to:</p> <ol style="list-style-type: none"> <li>(1) indemnify a member, manager, officer, and other persons; and</li> <li>(2) purchase and maintain liability insurance for the persons described in Subdivision (1). (Art. 2.20, Sec. A)</li> </ol>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits company agreement to adopt Code's statutory provisions relating to indemnification (8.002)</li> <li>2. Clarifies that company agreement may contain enforceable provisions regarding indemnification of members (8.002)</li> </ol>

<p><b>MERGERS</b></p>	<p>One or more domestic limited liability companies may merge with one or more domestic or foreign limited liability companies under a plan of merger. (Arts. 10.01-10.07)</p> <p>A domestic limited liability company may convert to a foreign limited liability company or any other entity under a plan of conversion. (Arts. 10.08-10.11)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>2. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>3. Clarifies that interest exchange provisions can be included in plan of merger (10.002)</li> <li>4. All surviving entities are secondarily liable for payment to any dissenting owners (10.003)</li> <li>5. Updates provisions to authorize special mergers for creation of holding company (10.005 and 10.006)</li> <li>6. Allows limited liability company to adopt Code provision on dissenting owners in its governing documents (10.351)</li> <li>7. Clarifies that merger, exchange or conversion can be abandoned after approval and before filing of the certificate of merger, exchange or conversion, which was only implied in existing law (10.201)</li> <li>8. Specifies the contents of a plan of exchange (10.052-10.053)</li> </ol>
<p><b>SALE OR TRANSFER OF ASSETS</b></p>	<p>Distribution of cash or other assets of a limited liability company must be made to a member in the manner provided by the regulations of the company (or based on the agreed value of the contribution made by the member if the regulations do not have a provision addressing the matter). (Art. 5.03)</p> <p>A conveyance of real or personal property owned or purchased by a limited liability company may be made in the name of the company. (Art. 2.11)</p> <p>Following dissolution and winding up of the company: Assets shall be paid first to creditors (to the extent permitted by law) then to members and certain former members to the extent provided by law. (Art. 6.04)</p>	<p>The following change:</p> <ol style="list-style-type: none"> <li>1. Adds explicit and more detailed provisions regarding transfers of property (10.251-10.252)</li> </ol>
<p><b>TERMINATION OF ENTITY</b></p>	<p>A limited liability company shall be dissolved on the first of the following to occur:</p> <ol style="list-style-type: none"> <li>(1) period fixed for duration of the company expires;</li> <li>(2) the occurrence of an event specified in the articles of organization or regulations to cause the company's dissolution;</li> <li>(3) action by the members to dissolve the company;</li> <li>(4) action by the organizer or managers of the company to dissolve if no capital has been paid into the company;</li> <li>(5) the occurrence of an event that ends the continued membership of a member in the company; or</li> <li>(6) judicial dissolution under Section 6.02 of the Act. (Art. 6.01, Sec. A)</li> </ol> <p>The members may elect to continue the business of the limited liability company within 90 days of the occurrence of an event described by Subdivision (1),(2), or (5). (Article 6.01, Sec. B)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits reinstatement of voluntarily terminated limited liability company before third anniversary date of its termination if certain conditions exist (11.201-11.202, 101.552)</li> <li>2. Permits cancellation by approval of members of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> <li>3. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>4. Omits unnecessary dissolution events for limited liability companies as a result of changes in applicable Treasury Regulations (11.056)</li> <li>5. Common simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>6. Adds termination of membership of last remaining member as an event requiring winding up (11.056)</li> <li>7. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>8. Authorizes Secretary of State to involuntarily terminate for failing to pay filing fees or maintain a registered office (11.251)</li> <li>9. Omits failure to pay franchise tax or tax deposit as grounds for termination in deference to Tax Code provisions (11.251)</li> <li>10. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>11. Extends reinstatement by the Secretary of State of an involuntarily terminated entity to any time, with retroactive treatment only if reinstated before</li> </ol>

		<p>the third anniversary of the involuntary termination (11.253)</p> <p>12. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</p> <p>13. Standardizes the voting requirements to a majority of members and a majority of managers if the company has no members for voluntary winding up, revocation of voluntary decision to wind up, cancellation of an event requiring winding up or a reinstatement (101.552)</p> <p>14. Permits authorized, non-corporate entities to serve as receivers (11.406)</p>
<b>ADMINISTRATIVE POWERS</b>	<p>The secretary of state has the power reasonably necessary to administer the Act and to perform any duty prescribed to the secretary of state under the Act. (Art. 8.03)</p> <p>Certain records and information of the limited liability company are required to be maintained and made available for inspection at any reasonable time to a member of the company or an assignee of the member's membership interest. The request must be in writing for any proper purpose and may include an inspection of other just and reasonable information regarding the business, affairs, and financial condition of the company. (Art. 2.22)</p> <p>The secretary of state is authorized to send interrogatories to a limited liability company or any of its managers to determine whether the company is complying with the Act. (Art. 8.01)</p> <p>The secretary of state shall certify to the attorney general for appropriate action all interrogatories and answers that disclose a violation of the Act. (Art. 8.01)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments</li> <li>Recognizes the possible disclosure of answers to interrogatories under the Public Information Act</li> <li>New provisions authorizing Attorney General to investigate or to examine and copy records and imposing criminal liability for a failure or refusal to permit these activities, based on existing corporate provisions (12.151-12.156)</li> <li>New provisions authorizing or governing enforcement liens and proceedings, receivers, termination and liquidation of insolvent filing entities and other remedies and procedural matters, based on existing corporate provisions (12.201, 12.251-12.261)</li> </ol>
<b>TAXES</b>	<b>Federal</b>	No change.
	<b>State</b>	No change.
<b>STOCK/CAPITAL REQUIREMENT</b>	<p>A person must make a contribution to acquire a membership interest in a limited liability company (unless it is assigned to the person). (Arts. 4.01, 4.05, 5.01)</p> <p>Form of membership contribution: any tangible or intangible benefit to the limited liability company or other property including cash, property, services rendered, or a promissory note or other obligation to pay cash or transfer property to the company. (Art. 5.01)</p>	<p>The following change:</p> <ol style="list-style-type: none"> <li>Limited liability companies may adopt Code provisions relating to certificates of ownership interests (3.201)</li> <li>Specifically authorizes voting trusts and voting agreements for limited liability companies (6.251-6.252)</li> <li>Clarifies that the company need not have a member for a reasonable time (i) between the formation date of a manager-managed limited liability company and the admission of its first member, and (ii) between the date of termination of the last remaining member and the date of an agreement to continue the company (101.101)</li> <li>Allows a person not to make any contribution as a condition to becoming a member or acquiring a membership interest (101.102)</li> <li>Approval of all members needed to issue additional membership interests in the company to remain consistent with other provisions (101.105)</li> </ol>

		6. Establishes that no member is entitled to receive or demand a distribution until declared by the governing authority (101.204)
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**((SOLE PROPRIETORSHIP))**

<b>Quick Summary:</b>		A sole proprietorship is an unincorporated business that is owned, managed, and controlled by one individual. It is the simplest form of business organization to start and maintain. The business has no existence apart from its owner. The liabilities of the business are the personal liabilities of the owner and the owner undertakes the risks of the business for all assets owned, whether used in the business or personally owned. Income and business expenses are included in the owner's tax return.	
			<b>Business Organizations Code</b>
<b>FILINGS</b>	No specific state filing requirements.  If operating under an assumed name, owner must file an assumed name certificate, showing that the person is the owner, with the county clerk in each county in which the person has or will maintain a business premise. (Section 36.10, Business & Commerce Code)		Not applicable.
<b>FORMATION</b>	Owner is responsible for obtaining appropriate licenses, for tax identification numbers, and for registering business name.		Not applicable.
<b>GOVERNING</b>	Managed and controlled by the owner.		Not applicable.
<b>OFFICERS</b>			Not applicable.
<b>LIABILITY</b>	Owner is personally responsible for torts and contracts.		Not applicable.
<b>INDEMNITY</b>			Not applicable.
<b>MERGERS</b>			Not applicable.
<b>SALE OR TRANSFER OF ASSETS</b>	Can sell all of the business assets to another person who becomes new sole proprietor of business.		Not applicable.
<b>TERMINATION OF ENTITY</b>	Expires on the death of the owner.		Not applicable.
<b>ADMINISTRATIVE POWERS</b>			Not applicable.
<b>TAXES</b>	<b>Federal</b>	Profits taxed at individual taxpayer rate.	Not applicable.
	<b>State</b>	No state franchise tax owed.	Not applicable.
<b>STOCK/CAPITAL REQUIREMENT</b>			Not applicable.

**((PROFESSIONAL ASSOCIATION))**

<p><b>Quick Summary:</b></p>	<p>Professionals associate themselves to perform a specific kind of professional service. Certain licensed professionals such as physicians and podiatrists may jointly form and own a professional association to perform a professional service that falls within the scope of practice of those practitioners.</p> <p><i>Explanatory Note: The TPAA incorporates as a supplement to its provisions the law governing for-profit corporations contained in the TBCA. In the Code, many of these same supplemental legal principles are contained in Title 1 (Chapters 1-12) and apply directly to professional associations, instead of by incorporation by reference. Thus, many, if not most, of the changes listed under the "BOC" column represent the same changes made for for-profit corporations, as compared to the TBCA, by Chapters 1 through 12 of the Code. For completeness purposes, these same changes are duplicated in this table in lieu of cross-references to the change table for for-profit corporations.</i></p>	
	<p><b>TEXAS PROFESSIONAL ASSOCIATION ACT (V.A.C.S. Art. 1528f)</b></p>	<p><b>Business Organizations Code</b></p>
<p><b>FILINGS</b></p>	<p>Formation: Original and copy of articles of professional association signed by each of the members and a \$200 fee must be filed with the secretary of state. (Secs. 8(E), 12, 22)</p> <p>Other filings include:</p> <p>Annual statement: In June of each year, an annual statement executed by an officer of the professional association regarding licensure and a fee must be filed with the secretary of state. (Secs. 21, 22)</p> <p>Articles of amendment: Original and copy of articles of amendment executed by an officer of the professional association and a fee may be filed with the secretary of state. (Secs. 15, 16, 22)</p> <p>Articles of dissolution: Original and copy of articles of dissolution executed by an officer of the professional association and a fee may be filed with the secretary of state. (Secs. 18, 19, 22)</p> <p>Changes in registered office and agent and mergers: Procedure same as Texas Business Corporation Act. (Sec. 25)</p> <p>Criminal penalty for signing a false document:</p> <ul style="list-style-type: none"> <li>• A person commits a class A misdemeanor offense for signing a document the person knows is false in any material respect with the intention that it be delivered to the secretary of state on the professional association's behalf. (Sec. 26)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>5. Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>6. Civil liability for filing a false instrument (4.007)</li> <li>7. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>8. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>9. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>10. Fees             <ol style="list-style-type: none"> <li>(a) Increase fee from \$200 to \$750 for formation of professional association to match limited partnership (4.156)</li> <li>(b) Fee for pre-clearance of documents (4.151)</li> <li>(c) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>11. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>12. Requires amendment to application for registration to be filed within 90 days if foreign professional association changes its name or business or activity (9.009)</li> <li>13. New or revised civil penalties or late filing fees imposed on foreign professional association's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>14. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign professional association (9.104)</li> <li>15. Simplifies filing form of certificate of merger, exchange or conversion (10.151, 10.153, 10.154):             <ol style="list-style-type: none"> <li>(a) No need to specify actual voting results</li> <li>(b) Eliminates multiple copy requirement</li> </ol> </li> <li>16. Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> </ol>

<p><b>FORMATION</b></p>	<p>One or more licensed professionals associate themselves to perform a professional service. (Sec. 2(A))</p> <p>Applies to individuals licensed as doctors of medicine, osteopathy, podiatry, dentistry, and mental health professionals. Mental health professionals includes individuals, other than physicians, who are licensed by this state to engage in the practice of professional therapy or counseling services, including clinical social workers, licensed professional counselors, and licensed marriage and family therapists. (Sec. 2(B))</p> <p>Each member must be an individual licensed to perform the type of professional service for which a professional association is formed. (Sec. 2(B))</p> <p>Existence of a professional association begins when a certificate of association is issued by the secretary of state (on conformance of the articles of association with legal requirements and payment of all required fees). (Sec. 13)</p>	<p>17. Renewal of name reservations permitted (5.105)</p> <p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Simplifies and clarifies form of certificate of formation (3.014, 3.015)</li> <li>3. Perpetual existence is default rule (3.003)</li> <li>4. Eliminates specific lists of acceptable abbreviations in names of professional associations (5.058)</li> <li>5. Registered agent <ol style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by filing entity (5.203)</li> </ol> </li> <li>6. Permits professional association to provide more than one professional service subject to any limits under special regulatory law (2.004)</li> <li>7. Clarifies that professional association has same powers as individual except as otherwise provided by the Code (2.101)</li> <li>8. Clarifies that professional association is limited to practice of certain types of professional services consistent with current legal interpretations and legislation updates (301.003)</li> <li>9. Provides a qualification process for foreign professional associations (301.005)</li> <li>10. Gives effect to Art. 4495b, Sec. 5.12 (Texas Medical Practices Act) and Art. 4552-5.22 (Texas Optometry Act) in the joint formation of professional entities by certain professionals (301.012)</li> </ol>
<p><b>GOVERNING</b></p>	<p>Governed by, and the business and affairs are managed under the direction of, a board of directors or an executive committee elected by the members. (Sec. 9(A))</p> <p>A member of the board of directors or executive committee must be a member of the professional association. (Sec. 9(C))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>2. Permits electronic meetings (6.001)</li> <li>3. Notices of meetings may be transmitted via facsimile or electronic message (6.051)</li> <li>4. Clarifies that owner participating in meeting deemed to waive notice of meeting (6.052)</li> <li>5. Omits strict delivery requirements for owner consents when professional association is soliciting the consent (6.203)</li> </ol>
<p><b>OFFICERS</b></p>	<p>A president, vice president, secretary, treasurer, and other officers as determined by the group in which the management of the professional association is vested (the board of directors or executive committee). (Sec. 9(6))</p> <p>An officer is elected by the group in which the management of the professional association is vested. (Sec. 9(A))</p> <p>An officer must be a member of the professional association, and the president of the association must be a member of the group in which the management of the professional association is vested. (Sec. 9(C))</p> <p>A person may serve in more than one office, except that the president and secretary of a professional association may not be the same person unless the association consists of only one member. (Sec. 9(6))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Removal of officers with or without cause as a default rule (3.104)</li> </ol>
<p><b>LIABILITY</b></p>	<p>A professional association is subject to the liabilities of a business corporation under the Texas Business Corporation Act except</p>	<p>The following change:</p>

	<p>as limited or enlarged by the Texas Professional Association Act. (Sec. 25)</p> <p>A professional association is jointly and severally liable with an officer or employee of the association for a tortious action or omission of the person in rendering professional services while in the course of employment with the association. (Sec. 24)</p> <p>An individual member, officer, or director of the association may not be held liable with the officer or employee of the association rendering professional services for a tortious act taken or omission made on the part of that officer or employee while in the course of employment with the association. (Sec. 24)</p>	<ol style="list-style-type: none"> <li>Expressly states Code does not affect a person's legal remedies against a professional providing services</li> </ol>
<b>INDEMNITY</b>	<p>Same as a business corporation under the Texas Business Corporation Act. (Sec. 25)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Determination that standard for indemnification has been met can be made by a committee of one disinterested director instead of two disinterested directors (8.103)</li> <li>All of members may approve indemnification of directors, which was only implied in TBCA (8.103)</li> <li>Members may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a director, which was only implied in TBCA (8.105)</li> <li>Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> </ol>
<b>MERGERS</b>	<p>Same as a business corporation under the Texas Business Corporation Act. (Sec. 25)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>All surviving entities in merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>Supplies definition of "fair value" for dissenting owner provisions (10.362)</li> <li>Harmonizes provisions, including dissenters' rights, for short-form mergers and regular mergers (10.006)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>Same as a business corporation under the Texas Business Corporation Act. (Sec. 25)</p> <p>A share or unit of ownership is transferable only to a person licensed to perform the same type of professional service for which the professional association was formed. (Sec. 10)</p>	
<b>TERMINATION OF ENTITY</b>	<p>Same as a business corporation under the Texas Business Corporation Act with certain exceptions including:</p> <ol style="list-style-type: none"> <li>specific procedures are applicable for the voluntary dissolution of the professional association; and</li> <li>no member of a professional association has the power to dissolve the association by the member's independent act. (Secs. 8(C), 18-20)</li> </ol>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Extends ability to reinstate a voluntarily terminated professional association from 120 days to three years following termination; however, the ability to reinstate is limited to specified circumstances (11.201-11.202)</li> <li>Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>Permits cancellation by approval of owners of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> <li>Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> </ol>

		<ol style="list-style-type: none"> <li>5. Common, simplified form of certificate of termination for all domestic entities (11.101)</li> <li>6. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>7. Authorizes Secretary of State to involuntarily terminate for failure to maintain a registered office (11.251)</li> <li>8. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</li> <li>9. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>10. Extends reinstatement by the Secretary of State of an involuntarily terminated professional association to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</li> <li>11. Permits authorized, non-corporate entities to serve as receivers (11.406)</li> </ol>
<b>ADMINISTRATIVE POWERS</b>	Same as a business corporation under the Texas Business Corporation Act. (Sec. 25)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>2. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>3. Clarifies that certain failures or refusals of managerial officials are a "Class B" misdemeanor (12.156)</li> </ol>
<b>TAXES</b>	<b>Federal</b>	No change.
	<b>State</b>	A professional association is exempt from the state franchise tax. No change.
<b>STOCK/CAPITAL REQUIREMENT</b>	Same as a business corporation under the Texas Business Corporation Act. (Sec. 25)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits more flexibility in names in which trustee may hold record title to ownership interests (6.154)</li> <li>2. Clarifies that uncertificated, not certificated, ownership interests are default rule (3.201)</li> </ol>

**((REAL ESTATE INVESTMENT TRUST))**

<p><b>Quick Summary:</b></p>	<p>An unincorporated trust formed by one or more trust managers to purchase, hold, lease, manage, sell, exchange, develop, subdivide, and improve real property and interests in real property.</p>	<p>Explanatory Note: The TREITA incorporates as a supplement to its provisions the law governing for-profit corporations contained in the TBCA. In the Code, many of these same supplemental legal principles are contained in Title 1 (Chapters 1-12) and apply directly to real estate investment trusts, instead of by incorporation by reference. Thus, many, if not most, of the changes listed under the "BOC" column represent the same changes made for for-profit corporations, as compared to the TBCA, by Chapters 1 through 12 of the Code. For completeness purposes, most of these changes are duplicated in this table in lieu of cross-references to the change table for for-profit corporations.</p>
	<p align="center"><b>Texas Real Estate Investment Trust Act (V.A.C.S. Art. 6138A)</b></p>	<p align="center"><b>Business Organizations Code</b></p>
<p><b>FILINGS</b></p>	<p>Formation: Declaration of trust must be filed for record with the county clerk of the county of the principal place of business of the real estate investment trust. (Sec. 3.10(B))</p> <p>Other Filings include:</p> <p>Articles of amendment: A copy of the articles of amendment executed by an officer of the real estate investment trust may be filed with the county clerk of the county of the principal place of business of the trust (may be executed by a majority of the trust managers if no shares have been issued). (Secs. 22.40, 22.50)</p> <p>Articles of dissolution: On the termination and liquidation of the real estate investment trust, an officer of the real estate investment trust shall execute articles of dissolution; a copy of the articles of dissolution must be filed with the county clerk of the county of the principal place of business of the trust. (Sec. 19.20)</p> <p>Change in registered office or agent: A statement of the change executed by an officer on behalf of the real estate investment trust must be filed with the county clerk of the county where the declaration of trust was filed. (Sec. 5.10(B))</p> <p>Restated declaration of trust: A copy of the restated document executed by an officer of the real estate investment trust (or a majority of the trust managers if no shares have been issued) may be filed with the county clerk of the county of the principal place of business of the trust (may be executed by a majority of the trust managers if no shares have been issued). (Sec. 22.70)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Civil liability for filing a false instrument (4.007)</li> <li>5. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>6. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>7. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>8. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>9. Requires amendment to application for registration to be filed within 90 days if foreign real estate investment trust changes its name or business or activity (9.009)</li> <li>10. New or revised civil penalties or late filing fees imposed on foreign real estate investment trust's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>11. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign real estate investment trust (9.104)</li> <li>12. Simplifies filing form of certificate of merger or exchange (10.151, 10.153):             <ul style="list-style-type: none"> <li>(a) No need to specify actual voting results</li> <li>(b) Eliminates multiple copy requirement</li> </ul> </li> <li>13. Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> </ol>
<p><b>FORMATION</b></p>	<p>One or more persons (trust managers) subscribe and acknowledge to a declaration of trust before an officer authorized to take acknowledgment of deeds. (Sec. 3.10(A))</p> <p>Existence of the real estate investment trust begins when the declaration of trust is filed as required by the Act. (Sec. 3.10(B))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Perpetual existence is default rule (3.003)</li> <li>3. Omits outmoded statement of receipt of \$1,000 of value by new real estate investment trust (3.012)</li> <li>4. Registered agent             <ul style="list-style-type: none"> <li>(a) Any entity may serve as registered agent (5.201)</li> <li>(b) Registered agent may file change in its name without action by filing entity (5.203)</li> </ul> </li> </ol>

<p><b>GOVERNING</b></p>	<p>Operation and management of a real estate investment trust is vested in one or more trust managers named in the declaration of trust. (Successors are selected in accordance with the declaration of trust.) (Sec. 4.10(A))</p> <p>A trust manager must be a natural person; does not need to be a resident of Texas or a shareholder of the trust unless required by the declaration of trust or the bylaws. (Sec. 4.10(A))</p>	<p>5. Clarifies that real estate investment trust has same powers as individual except as otherwise provided by the Code (2.101)</p> <p>The following changes:</p> <ol style="list-style-type: none"> <li>2. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>3. Permits electronic meetings (6.001)</li> <li>4. Notices of meetings may be transmitted via facsimile or electronic message (6.051)</li> <li>5. Clarifies that trust manager or owner participating in a meeting deemed to waive notice of meeting (6.052)</li> <li>6. Adopts SEC rule permitting notices not to be sent to lost securityholders of a public real estate investment trust (6.053)</li> <li>7. Eliminates strict delivery requirements for owner consents when real estate investment trust is soliciting the consent (6.203)</li> <li>8. Authorizes elective and telephonic proxies (200.264)</li> <li>9. Clarifies provisions by which transactions with interested trust managers and officers can be authorized by owners or disinterested trust managers to conform to corporate provisions (200.317)</li> </ol>
<p><b>OFFICERS</b></p>	<p>One or more persons designated by the trust managers. (Sec. 4.10(F))</p> <p>Officers may exercise all of the powers of the trust managers with respect to the business and affairs of the real estate investment trust, unless action of the trust managers is specified by the Act or an applicable law. (Sec. 4.10(F))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Removal of officers with or without cause as a default rule (3.104)</li> <li>2. Officers may rely on certain types of information, opinions, reports, and statements (3.105)</li> </ol>
<p><b>LIABILITY</b></p>	<p>Trust Managers:</p> <ul style="list-style-type: none"> <li>• Liability is imposed by the Act on trust managers for mishandling assets of the real estate investment trust. A trust manager is jointly and severally liable to the trust under the Act for authorizing (voting for or assenting to): <ol style="list-style-type: none"> <li>(1) the distribution of assets to shareholders during the liquidation of the trust without paying and discharging or making provision for the payment and discharge of liabilities (limited liability for the value of the distributed assets to the extent liabilities are not discharged);</li> <li>(2) the trust to make a loan to an officer or trust manager, or to make a loan secured by shares of the trust (limited liability for loan amount until it is repaid); or</li> <li>(3) the trust to begin business before receiving consideration of at least \$1,000 for shares of beneficial interest (liability ends when required consideration is received). (Sec. 15.10(A))</li> </ol> </li> <li>• Defenses to liability may apply. (Secs. 15.10(B), (C))</li> <li>• A trust manager is entitled to receive contribution from each trust manager who is liable with respect to a claim. (Sec. 15.10(F))</li> </ul> <p>Subscribers and shareholders:</p> <ul style="list-style-type: none"> <li>• Have an obligation to the real estate investment trust or its creditors to pay the full amount of the consideration for which the shares are or are to be issued. (Sec. 8.10(A)(1))</li> <li>• No obligation to the real estate investment trust or its creditors unless the subscriber or shareholder used the trust to perpetuate and did perpetuate a fraud on a creditor that directly benefited the subscriber or</li> </ul>	

	shareholder. (Sec. 8.10(A)(2))	
<b>INDEMNITY</b>	<p>The indemnity provisions in Section 9.20 of the Act are basically identical to the indemnity provisions found in the Texas Business Corporation Act. (Sec. 9.20)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Determination that standard for indemnification has been met can be made by a committee of one disinterested trust manager instead of two disinterested trust managers (8.102)</li> <li>2. All of owners may approve indemnification of trust managers, which was only implied in TREITA (8.103)</li> <li>3. Owners may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a trust manager, which was only implied in TREITA (8.105)</li> <li>4. Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> </ol>
<b>MERGERS</b>	<p>One or more domestic real estate investment trusts may merge with one or more domestic or foreign corporations, real estate investment trusts, partnerships, or other entities under a plan of merger as prescribed by the Act. (Sec. 23.10)</p> <p>One or more domestic or foreign corporations, real estate investment trusts, partnerships, or other entities may acquire all of the outstanding shares of one or more classes or series of one or more domestic real estate investment trusts under a plan of exchange as prescribed by the Act. (Sec. 23.20)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Updates provisions governing mergers and share exchanges to parallel more modern for-profit corporation provisions. Accordingly, provisions are added governing conversions and specifying that owner approval of a merger is not necessary where the real estate investment trust is not a "party to the merger." (Chapter 10 generally, 200.401-200.410)</li> <li>2. Provisions governing rights of dissent and appraisal are updated to parallel modernized corporate provisions (Chapter 10, Subchapter H)</li> <li>3. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>4. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>5. All surviving entities in merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>6. Updates provisions to authorize special mergers for parent/subsidiary and creation of holding company (10.005-10.006)</li> <li>7. Supplies definition of "fair value" for dissenting owner provisions (10.262)</li> <li>8. Harmonizes provisions, including dissenters' rights, for short-form mergers and regular mergers (10.006)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>Unless the declaration of trust provides otherwise, the trust managers are authorized to sell, lease, or otherwise dispose of all or substantially all of the real estate investment trust's assets without shareholder approval if the disposition is made in the usual and regular course of business. (Sec. 24.10)</p> <p>Sale, lease, or other disposition of all or substantially all of the assets not made in usual and regular course of business require shareholder approval. (Sec. 24.20)</p> <p>The trust managers may authorize a distribution of trust assets subject to any restrictions in the declaration of trust and to the limitations provided by Section 14.10 of the Act. (Sec. 14.10)</p> <p>Land may be conveyed by resolution of the trust managers. (Sec. 24.10)</p>	<p>No change.</p>
<b>TERMINATION OF ENTITY</b>	<p>Dissolution is initiated by the affirmative vote of at least two-thirds of the outstanding voting shares of the real estate investment trust (an additional class vote may be required for the holders of any class or series of shares). On receiving the vote, the trust managers liquidate the trust and distribute the remaining property and assets. (Sec. 19.10)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Extends ability to reinstate a voluntarily terminated real estate investment trust from 120 days to three years following termination; however, ability to reinstate is limited to specific circumstances (11.201-11.206)</li> </ol>

		<ol style="list-style-type: none"> <li>2. Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>3. Permits cancellation by approval of owners of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> <li>4. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>5. Common simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>6. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>7. Authorizes Secretary of State to involuntarily terminate for failure to maintain a registered office (11.251)</li> <li>8. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</li> <li>9. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>10. Extends reinstatement by the Secretary of State of an involuntarily terminated entity to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</li> <li>11. Omits unnecessary provision requiring withdrawal of assumed name certificate (200.451)</li> <li>12. Permits authorized, non-corporate entities to serve as receivers (11.406)</li> </ol>
<b>ADMINISTRATIVE POWERS</b>	<p>Books of account and minutes of the proceedings of its shareholders and trust managers are required to be maintained. (Sec. 18.10(A))</p> <ul style="list-style-type: none"> <li>• Records and shareholder documents may be examined, on written request for any proper purpose, by a person who has been a shareholder of the real estate investment trust for at least six months before the date of the request or a holder of at least five percent of all of the outstanding shares. (Sec. 18.10(B))</li> <li>• A shareholder of the real estate investment trust may initiate court action to compel examination of records and shareholder documents on proof of proper purpose. (Sec. 18.10(C))</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Confirms power of Secretary of State to perform its duties (12.001)</li> <li>2. Confirms interrogatory power of Secretary of State (12.002)</li> <li>3. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>4. New provisions authorizing Attorney General to investigate or to examine and copy records and imposing criminal liability for a failure or refusal to permit these activities, based on existing corporate provisions (12.151-12.156)</li> <li>5. New provisions authorizing or governing enforcement liens and proceedings, receivers, termination and liquidation of insolvent filing entities and other remedies and procedural matters, based on existing corporate provisions (12.201, 12.251-12.261)</li> </ol>
<b>TAXES</b>	<b>Federal</b>	No change.
	<b>State</b>	No change.
<b>STOCK/CAPITAL REQUIREMENT</b>	<p>Authorized to issue shares with or without par value. (Secs. 3.10(A)(7), 3.30)</p> <p>Shares issued for consideration in an amount not less than par value as set from time to time by the trust manager(s). The form of consideration includes cash, promissory notes, services performed, contracts for services to be performed, or other securities of the real estate investment trust. (Sec. 7.30)</p> <p>May commence business once the real estate investment trust receives for the issuance of shares \$1,000 in consideration. (Sec. 3.10(A)(9))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Permits more flexibility in names in which trustee may hold record title to ownership interests (6.154)</li> <li>2. Clarifies that property of any kind can serve as consideration for stock to conform to corporate law (200.105)</li> <li>3. Modernizes subscription provisions (200.110-200.111)</li> </ol>

**(((COOPERATIVE ASSOCIATION)))**

<p><b>Quick Summary:</b></p>	<p>An entity organized on a cooperative basis to acquire, produce, build, operate, manufacture, furnish, exchange, or distribute any type of property, commodity, good, or service for the primary and mutual benefit of its members.          Explanatory Note: The CAA incorporates as a supplement to its provisions the law governing nonprofit corporations contained in the TNPCA. In the Code, many of these same supplemental legal principles are contained in Title 1 (Chapters 1-12) and apply directly to cooperative associations, instead of by incorporation by reference. Thus, many, if not most, of the changes listed under the "BOC" column represent the same changes made for nonprofit corporations, as compared to the TNPCA, by Chapters 1 through 12 of the Code. For completeness purposes, these same changes are duplicated in this table in lieu of cross-references to the change table for nonprofit corporations.</p>	
	<p><b>Cooperative Association Act (V.A.C.S. Art. 1396-50.01, et seq.)</b></p>	<p><b>Business Organizations Code</b></p>
<p><b>FILINGS</b></p>	<p>Formation: Articles of incorporation and fee delivered to the secretary of state for filing and recording. (Sec. 9) (Art. 1396-9.03)</p> <ul style="list-style-type: none"> <li>• Articles of Incorporation must be signed and acknowledged by each of the incorporators (if natural persons) or by the president and secretary (if an association). (Sec. 8(a))</li> </ul> <p>Annual Report: A copy of required annual report of its financial condition must be filed by certain large cooperative associations with the secretary of state. (Sec. 3b)</p> <p>Other Filings include:</p> <p>Amendments to the articles of incorporation: After verification by the president and secretary, an amendment to the articles of incorporation must be filed with the secretary of state not later than the 30th day after the adoption date in accordance with Article 4.04, Texas Non-Profit Corporation Act. (Sec. 10)</p> <p>Change in registered office and registered agent: Filings in accordance with Article 2.06, Texas Non-Profit Corporation Act. (Sec. 7)</p> <p>Other documents: Same filing procedures prescribed in the Texas Non-Profit Corporation Act. (Sec. 3)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>5. Clarifies that required filings must be filed promptly (4.004)</li> <li>6. Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>7. Civil liability for filing a false instrument (4.007)</li> <li>8. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>9. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>10. Adopt Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>11. Fees             <ol style="list-style-type: none"> <li>(a) Fee for pre-clearance of documents (4.151)</li> <li>(b) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>13. Omits outmoded officers' verification of adoption of amendment (251.052)</li> <li>14. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.071)</li> <li>15. Requires amendment to application for registration to be filed within 90 days if foreign cooperative associations changes its name or business or activity (9.009)</li> <li>16. New or revised civil penalties or late filing fees imposed on foreign cooperative association's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>17. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign cooperative association (9.104)</li> <li>18. Simplifies filing form of certificate of merger (10.151, 10.153):             <ol style="list-style-type: none"> <li>(a) No need to include plan of merger</li> <li>(b) No need to specify actual voting results</li> <li>(c) Eliminates multiple copy requirement</li> </ol> </li> <li>19. Simplifies of required statements in certificate of amendment by eliminating vote details (3.053)</li> <li>20. Renewal of name reservations permitted (5.105)</li> </ol>
<p><b>FORMATION</b></p>	<p>Incorporators:</p> <p>(1) five or more natural persons;</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> </ol>

	<p>(2) five or more hospitals or a hospital council or related subgroup; or</p> <p>(3) two or more associations. (Sec. 4)</p> <p>Corporate existence begins when the secretary of state issues a certificate of incorporation (on conformance of the articles of incorporation to legal requirements and the payment of required fee). (Secs. 9(a), (b))</p> <p>After the issuance of the certificate of incorporation, an organizational meeting shall be held in accordance with Article 3.05, Texas Non-Profit Corporation Act. (Sec. 9(c))</p>	<p>2. Perpetual existence is default rule (3.003)</p> <p>3. Registered agent</p> <p>(a) Any entity may serve as registered agent (5.201)</p> <p>(b) Registered agent may file change in its name without action by filing entity (5.203)</p> <p>4. Clarifies that cooperative association has same powers as individual except as otherwise provided by the Code (2.101)</p> <p>5. Permits the University Cooperative Society, a domestic non-profit corporation related to the University of Texas, to use the word "cooperative" despite general prohibition against such use (251.452)</p>
<b>GOVERNING</b>	<p>Managed by a board of five or more directors. Elected by the membership for a term set in the bylaws not to exceed three years. (Sec. 21(a))</p> <p>An executive committee of the board of directors may be elected in the manner and with the powers and duties as prescribed by the articles of incorporation or bylaws. (Sec. 21(c))</p>	<p>The following changes:</p> <p>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</p> <p>2. Notices of meetings may be transmitted via electronic message (6.051)</p> <p>3. Permits notice of meeting not to be given to member when prior mailed notices or distributions have been returned undeliverable (6.053)</p> <p>4. Omits 90-day time limit on adjournments of meetings to conform with modernized provisions for real estate investment trusts and for-profit corporations (6.101)</p> <p>5. Omits strict delivery requirements for member consents when cooperative association is soliciting the consent (6.203)</p> <p>6. Clarifies that a foreign cooperation association may vote or consent as to its interest in and participate in the management of a domestic entity even if not registered to transact business in Texas (9.204)</p> <p>7. Clarifies that a meeting by a unit of the membership must be called and held in the same manner as a regular meeting of the members unless the governing documents provide otherwise (251.253)</p> <p>8. Clarifies that Code Chapter 251 does not apply to a corporation or association organized on a cooperative basis under another statute (251.003)</p> <p>9. Authorizes provisions in governing documents governing removal of director (251.103)</p> <p>10. Directors or managing members have right to inspect books and records (3.152)</p>
<b>OFFICERS</b>	<p>Consist of a president, one or more vice presidents, and a secretary and a treasurer or a secretary-treasurer. (Sec. 22)</p> <p>Elected annually by the directors unless otherwise provided by the bylaws. (Sec. 22)</p> <p>Any two or more offices may be held by the same person, except for the offices of president and secretary. (Sec. 22)</p>	<p>The following changes:</p> <p>1. Authorize provisions in governing documents governing removal of officers (251.103)</p>
<b>LIABILITY</b>	<p>Subject to the same liabilities as a nonprofit corporation under the Texas Non-Profit Corporation Act except to the extent limited or enlarged by the Cooperative Association Act. (Sec. 3)</p> <p>Member or subscriber: Not jointly or severally liable for the debts of the cooperative association except to the extent of any unpaid amount on the membership certificate or invested capital certificates. (Sec. 32)</p> <p>A subscriber who assigns an interest in a membership or invested capital certificate is jointly and severally liable with the</p>	<p>The following changes:</p> <p>1. Adopts modern for-profit corporate provision clarifying that a disposition of assets is not a merger or conversion and that a purchaser of property is not liable for obligation of transferring cooperative association if purchaser does not expressly assume the obligation (10.254)</p>

	assignee until the certificate is fully paid up. (Sec. 32)	
<b>INDEMNITY</b>	Same as Texas Non-Profit Corporation Act. (Sec. 3)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Determination that standard for indemnification has been met can be made by a committee of one disinterested director instead of two disinterested directors (8.103)</li> <li>2. All of members may approve indemnification of directors, which was only implied in TNPCA (8.103)</li> <li>3. The members may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a director, which was only implied in TNPCA (8.105)</li> <li>4. Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> </ol>
<b>MERGERS</b>	Same as Texas Non-Profit Corporation Act. (Sec. 3)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Updates provisions governing mergers to parallel modernized for-profit corporate provisions. Accordingly, provisions are added governing conversions and interest exchanges, folding "consolidation" into the term "merger" and specifying that member approval is not necessary where the cooperative association is not a "party to the merger." Important restrictions on mergers with or conversions into for-profit entities are retained, added or clarified. (Chapter 10 generally)</li> <li>2. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>3. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>4. Clarifies that interest exchange provisions can be included in plan of merger (10.002)</li> <li>5. Permits the plan of merger or exchange to treat membership interests of the same class or series differently. (10.002 &amp; 10.052)</li> <li>6. All surviving entities in a merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>7. Updates provisions to authorize special mergers for parent/subsidiary and creation of holding company (10.005 &amp; 10.006)</li> <li>8. Allows abandonment of mergers after filing of certificate of merger and before effectiveness (10.202)</li> <li>9. Adds provisions clarifying how federal bankruptcy reorganization laws apply based on provisions in TBCA, TREITA and TRLPA (10.301-10.303)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>Same as Texas Non-Profit Corporation Act. (Sec. 3)</p> <p>Member withdrawal: Member's certificates offered to directors; director may purchase within 90 days by paying par value. (Sec. 29(a))</p> <p>Investor: Sale or transfer of investor certificates done in accordance with association's bylaws; otherwise, directors may purchase within 90 days following receipt of written notice by paying par value and accrued investment dividend. (Sec. 29(b))</p>	<p>The following change:</p> <ol style="list-style-type: none"> <li>1. Updates definition of sale of all or substantially all of assets to parallel more modern for-profit corporate provisions (251.002, 22.252)</li> </ol>
<b>TERMINATION OF ENTITY</b>	<p>Voluntary dissolution: Two-thirds vote of entire membership. Three member trustees liquidate and distribute the cooperative association's assets. (Secs. 38(a), (c))</p> <p>Involuntary dissolution: Instituted and prosecuted in accordance with Articles 7.01-7.12, Texas Non-Profit Corporation Act, except assets are distributed in accordance with the Cooperative Association Act. (Secs. 38(b), (c))</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>2. Permits reinstatement of voluntarily terminated cooperative association before third anniversary date of its termination if certain conditions exist (11.201-11.202, 22.302)</li> <li>3. Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>4. Permits cancellation by approval of members of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> </ol>

		<ol style="list-style-type: none"> <li>5. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>6. Permits member to apply for a court to supervise the winding up (11.054)</li> <li>7. Common simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>8. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>9. Authorizes Secretary of State to involuntarily terminate for failure to maintain a registered office (11.251)</li> <li>10. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251, 9.101)</li> <li>11. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251)</li> <li>12. Extends reinstatement by the Secretary of State of an involuntarily terminated entity to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</li> <li>13. Permits authorized, non-corporate entities to serve as receivers (11.406)</li> <li>14. Permits a person designated as a liquidating trustee to execute the certificate of termination (251.402)</li> </ol>
<b>ADMINISTRATIVE POWERS</b>	<p>Generally same as Texas Non-Profit Corporation Act. (Sec. 3)</p> <p>Each cooperative association is required to maintain books of its business operation according to standard accounting practices. (Sec. 35)</p> <p>Cooperative association with 100 or more members or an annual business of \$20,000 or more is required to prepare an annual report on its financial condition. (Sec. 36)</p> <p>To compel the filing of the required annual financial report, a member of the association or the attorney general may seek a writ of mandamus against the cooperative association and the appropriate officer(s). (Sec. 37)</p> <p>Criminal Penalty: Subscribing or verifying a report containing a materially false statement, knowing it is false, is a misdemeanor offense (punishable by a fine of \$25-\$200; jail term of 30 days to one year). (Sec. 36(c))</p> <p>Other criminal penalties:</p> <ul style="list-style-type: none"> <li>• misdemeanor offense for using the term "cooperative" or an abbreviation or derivation of the term in violation of the law. (Sec. 39(b))</li> <li>• misdemeanor offense for giving or receiving a promotion commission in violation of Section 40 of the Act. (Sec. 40(b))</li> <li>• misdemeanor offense for a person, firm, corporation, or association to maliciously and knowingly spread false reports about the management or finances of a cooperative association. (Sec. 41)</li> </ul>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>15. Confirms interrogatory power of Secretary of State (12.002)</li> <li>16. Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>17. Clarifies that certain failures or refusals of managerial officials are a "class B" misdemeanor (12.156)</li> </ol>

<b>TAXES</b>	<b>Federal</b>		No change.
	<b>State</b>	Exempt from franchise tax in general and exempt from franchise tax imposed under Chapter 171, Tax Code, only if exempt by that chapter. (Sec. 44)	No change.
<b>STOCK/CAPITAL REQUIREMENT</b>		<p>Generally same as Texas Non-Profit Corporation Act. (Sec. 3)</p> <p>Certificate for membership capital may be issued only when par value is paid in full. (Sec. 28)</p> <p>Certificate for invested capital issued may be issued only when par value is paid in full. (Sec. 28)</p>	No change.

**((PROFESSIONAL CORPORATION))**

<p><b>Quick Summary:</b></p>	<p>A corporation organized solely for the purpose of rendering a specific type of professional service.</p>	<p>Explanatory Note: The TPCA incorporates as a supplement to its provisions the law governing for-profit corporations contained in the TBCA. In the Code, many of these same supplemental legal principles are contained in Title 1 (Chapters 1-12) and apply directly to professional corporations, instead of by incorporation by reference. Thus, many, if not most, of the changes listed under the "BOC" column represent the same changes made for for-profit corporations, as compared to the TBCA, by Chapters 1 through 12 of the Code. For completeness purposes, these same changes are duplicated in this table in lieu of cross-references to the change table for for-profit corporations.</p>
	<p align="center"><b>Texas Professional Corporation Act (V.A.C.S. Art. 1528e)</b></p>	<p align="center"><b>Business Organizations Code</b></p>
<p><b>FILINGS</b></p>	<p>Formation: Original and copy of articles of incorporation must be filed with the secretary of state. (Sec. 4) \$300 filing fee (Sec. 5) (Texas Business Corporation Act, Art. 10.01)</p> <p>Other filings include:</p> <p>Amendments, changes of registered office and registered agents, dissolutions: Follow procedures set forth for business corporations in the Texas Business Corporation Act. (Sec. 5)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Standardizes filing procedures (4.001)</li> <li>2. Confirms permissibility of electronic filings and signatures (4.001, 4.003)</li> <li>3. Confirms permissibility of electronic acknowledgments and communications by Secretary of State (4.002, 4.003)</li> <li>4. Acknowledgment of filing by Secretary of State rather than certificates (3.001, 4.002)</li> <li>5. Changes rule as to certain basic filings that they are effective when filed, not when Secretary of State issues a certificate (4.051)</li> <li>6. Civil liability for filing a false instrument (4.007)</li> <li>7. Felony provided for false instruments if intent to defraud or harm another (4.008)</li> <li>8. Permits abandonment of any filed instrument prior to effectiveness (4.057)</li> <li>9. Adopts Secretary of State rule that certificate of correction cannot revoke or void filed filing instrument (4.102)</li> <li>10. Fees             <ol style="list-style-type: none"> <li>(a) Fee for pre-clearance of documents (4.151)</li> <li>(b) Fee for new entity created by merger or conversion (4.151)</li> </ol> </li> <li>13. Common simplified form of, and common procedures for, application for registration to do business in Texas and certificate of withdrawal for all foreign filing entities (9.004, 9.011)</li> <li>14. Requires amendment to application for registration to be filed within 90 days if foreign professional corporation changes its name or business or activity (9.009)</li> <li>15. New or revised civil penalties or late filing fees imposed on foreign professional corporation's failure to register when required; venue for action to collect penalty is specified (9.052-9.054)</li> <li>16. Adopts Secretary of State form for certificate of reinstatement and requires comptroller's letter of eligibility to accompany certificate of reinstatement of registration of foreign professional corporation (9.104)</li> <li>17. Simplifies filing form of certificate of merger, exchange or conversion (10.151, 10.133, 10.154):             <ol style="list-style-type: none"> <li>(a) No need to specify actual voting results</li> <li>(b) Eliminates multiple copy requirement</li> </ol> </li> <li>18. Simplifies required statements in certificate of amendment by eliminating vote details (3.053)</li> <li>19. Renewal of name reservations permitted (5.105)</li> </ol>

<b>FORMATION</b>	<p>One or more individuals may incorporate (by filing articles of incorporation) to render one specific type of professional service and ancillary services. (Secs. 4, 6)</p> <p>A physician, surgeon, and other doctor of medicine is specifically excluded from incorporating under the Act, but may form a professional association under Article 1528f, Vernon's Texas Civil Statutes. (Sec. 3(a))</p> <p>A shareholder of the professional corporation must be an individual licensed or otherwise authorized to render the same professional service as the corporation. (Sec. 3)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Common form of certificate of formation for all domestic filing entities (3.005)</li> <li>2. Perpetual existence is default rule (3.003)</li> <li>3. Eliminates specific list of acceptable abbreviation in name of professional corporation (5.055)</li> <li>4. Add "limited" to approved list of words indicating corporation (5.055)</li> <li>5. Registered agent <ol style="list-style-type: none"> <li>(a) Adopts Secretary of State rule requiring street address (5.201)</li> <li>(b) Any entity may serve as registered agent (5.201)</li> <li>(c) Registered agent may file change in its name without action by filing entity (5.203)</li> </ol> </li> <li>6. Permits professional corporation to provide more than one professional service subject to any limits under special regulatory law (2.004)</li> <li>7. Clarifies that professional corporation has same powers as individual except as otherwise provided by the Code (2.101)</li> <li>8. Provides a qualification process for foreign professional corporations (301.005)</li> <li>9. Gives effect to Art. 4495b, Sec. 5.12 (Texas Medical Practices Act) and Art. 4552-5.22 (Texas Optometry Act) in the joint formation of professional entities by certain professionals (301.012)</li> </ol>
<b>GOVERNING</b>	<p>Same as Texas Business Corporation Act except only a person licensed or otherwise authorized to render the professional service of the professional corporation may serve on the board of directors of the corporation. (Sec. 9)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. All persons entitled to notice of a meeting may set the meeting's location (6.001)</li> <li>2. Permits electronic meetings (6.001)</li> <li>3. Notices of meetings may be transmitted via facsimile or electronic message (6.051)</li> <li>4. Clarifies that owner participating in meeting deemed to waive notice of meeting (6.052)</li> <li>5. Eliminates strict delivery requirements for owner consents when professional corporation is soliciting the consent (6.203)</li> </ol>
<b>OFFICERS</b>	<p>Same as Texas Business Corporation Act except only a person licensed or otherwise authorized to render the professional service of the professional corporation may hold an office in the corporation. (Sec. 10)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Removal of officers with or without cause as a default rule (3.104)</li> </ol>
<b>LIABILITY</b>	<p>Same as Texas Business Corporation Act. A shareholder of a professional corporation has no greater liability than a shareholder of a business corporation. (Sec. 5)</p> <p>The professional corporation (but not an individual shareholder, officer, or director) is jointly and severally liable with the officer, employee, or agent rendering professional service for tortious acts committed (professional errors, negligence, incompetence, or malfeasance) or omissions made on the part of that person while in the course of employment for the corporation. (Sec. 16)</p>	<p>No change.</p>
<b>INDEMNITY</b>	<p>Same as Texas Business Corporation Act. (Sec. 5)</p>	<p>The following changes:</p>

		<ol style="list-style-type: none"> <li>1. Determination that standard for indemnification has been met can be made by a committee of one disinterested director instead of two disinterested directors (8.103)</li> <li>2. All of owners may approve indemnification of directors, which was only implied in TBCA (8.103)</li> <li>3. Owners may by resolution approve indemnification and advancement of expenses of any officer, employee, agent or delegate who is not also a director, which was only implied in TBCA (8.105)</li> <li>4. Clarifies that permitted "self-insurance" includes implementation by indemnity contract (8.151)</li> </ol>
<b>MERGERS</b>	Same as Texas Business Corporation Act. (Sec. 5)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Clarifies that plan of merger must contain a description of the organizational form of each organization that is a party to the merger or is created by the plan of merger (10.002)</li> <li>2. Eliminates need to attach to the plan of merger the governing documents of certain non-Code organizations that survive or are created by the merger (10.002)</li> <li>3. All surviving entities in merger are secondarily liable for payment to any dissenting owners (10.003)</li> <li>4. Supplies definition of "fair value" for dissenting owner provisions (10.362)</li> <li>5. Harmonizes provisions, including dissenters' rights, for short-form mergers and regular mergers (10.006)</li> </ol>
<b>SALE OR TRANSFER OF ASSETS</b>	<p>Unless otherwise provided by the bylaws, articles of incorporation, or stock purchase or redemption agreement, ownership shares may be transferred to:</p> <ol style="list-style-type: none"> <li>(1) another shareholder of the professional corporation;</li> <li>(2) the issuing professional corporation; or</li> <li>(3) person licensed or qualified under Texas law to render the same type of professional service for which the corporation was formed. (Sec. 12)</li> </ol>	
<b>TERMINATION OF ENTITY</b>	<p>A shareholder has no power to dissolve the professional corporation solely by the person's independent action. (Sec. 17)</p> <p>The existence of a professional corporation is independent of the life or status of its shareholders. (Sec. 17)</p> <p>Dissolution procedures are the same as the Texas Business Corporation Act. (Sec. 5)</p>	<p>The following changes:</p> <ol style="list-style-type: none"> <li>1. Extends ability to reinstate a voluntarily terminated professional corporation from 120 days to three years following termination; however, the ability to reinstate is limited to specified circumstances (11.201-11.202)</li> <li>2. Confirms that governing documents may require winding up upon specified event (11.051, 11.059)</li> <li>3. Permits cancellation by approval of owners of certain types of events requiring winding up, including expiration of period of duration (11.152)</li> <li>4. Continuation of business for the limited period necessary to avoid unreasonable loss of property or business (11.053)</li> <li>5. Common, simplified form of certificate of termination for all domestic filing entities (11.101)</li> <li>6. Requires filing of certificate of termination after expiration of stated period of duration; authorizes Secretary of State to cancel certificate of formation after expiration (11.101, 11.104)</li> <li>7. Authorizes Secretary of State to involuntarily terminate a filing entity for failure to maintain a registered office (11.251)</li> <li>8. Omits failure to pay franchise tax or tax deposit as grounds for termination or revocation of registration in deference to Tax Code provisions (11.251)</li> <li>9. Adopts present practice of the Secretary of State for mailing of notices of termination (11.251, 9.101)</li> </ol>

		<p>10. Extends reinstatement by the Secretary of State of an involuntarily terminated professional corporation to any time, with retroactive treatment only if reinstated before the third anniversary of the involuntary termination (11.253)</p> <p>11. Permits authorized, non-corporate entities to serve as members (11.406)</p>
<b>ADMINISTRATIVE POWERS</b>	Same as the Texas Business Corporation Act. (Sec. 5)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Specifically authorizes Secretary of State to adopt procedural rules for the filing of instruments (12.001)</li> <li>Recognizes the possible disclosure of answers to interrogatories under the Public Information Act (12.003)</li> <li>Clarifies that certain failures or refusals of managerial officials are a "class B" misdemeanor (12.156)</li> </ol>
<b>TAXES</b>	<b>Federal</b>	No change.
	<b>State</b>	No change.
<b>STOCK/CAPITAL REQUIREMENT</b>	Same as the Texas Business Corporation Act, except that shares in the professional corporation may be issued only to individuals licensed in Texas to render the same type of professional service for which the professional corporation was formed. (Secs. 5, 12)	<p>The following changes:</p> <ol style="list-style-type: none"> <li>Permits more flexibility in names in which trustee may hold record title to ownership interests (6.154)</li> <li>Ownership may be by another professional organization, as well as by professional individuals (301.004(2) and 301.007)</li> </ol>

**((NONPROFIT ASSOCIATIONS))**

<b>Quick Summary:</b>	An unincorporated organization, other than one created by a trust, formed by mutual consent by three or more members for a common, nonprofit purpose.	
	<b>Texas Uniform Unincorporated Nonprofit Association Act (V.A.C.S. Art. 1396-70.01, et seq.)</b>	<b>Business Organizations Code</b>
<b>FILINGS</b>	<p>Not incorporated.</p> <p>Discretionary filings:</p> <ul style="list-style-type: none"> <li>• A nonprofit association may file with the secretary of state a statement appointing an agent to receive service of process signed both by an authorized person and the person appointed as agent. (Sec. 12)</li> <li>• A statement of authority to transfer an estate or an interest in real property may be filed and recorded with the county clerk of the county in which the transfer of the property would be recorded. Must be executed in the same manner as a deed by a person not authorized to transfer the interest or estate. (Sec. 6)</li> <li>• An amendment or cancellation of the statement of authority of an authorized agent, a cancellation of the statement appointing an agent for service of process, or a statement of resignation by the agent may also be filed with the secretary of state. Filing fees may apply for different actions. (Sec. 12)</li> </ul>	<p>The following change:</p> <ol style="list-style-type: none"> <li>1. Codifies fees for unincorporated nonprofit associations previously provided by Secretary of State rules (4.159)</li> </ol>
<b>FORMATION</b>	Three or more members join to form the organization. (Sec. 2)	No change.
<b>GOVERNING</b>	Affairs managed by persons selected by the members of the nonprofit association. (Sec. 2)	No change.
<b>OFFICERS</b>	No specific statutory provision although Section 14 of the Act requires a nonprofit association to submit to the attorney general the names and addresses of officers of the association.	No change.
<b>LIABILITY</b>	<p>A nonprofit association is a legal entity separate from its members for purposes of determining liability in contract and tort. (Sec. 7(a))</p> <p>A tortious act or omission of a member or other person for which a nonprofit association is liable is not imputed to a person merely because the person:</p> <ol style="list-style-type: none"> <li>(1) is or is considered to be a member of the association; or</li> <li>(2) is authorized to participate in the management of the association. (Sec. 7(d))</li> </ol>	No change.
<b>INDEMNITY</b>	No specific statutory provision.	No change.
<b>MERGERS</b>	No specific statutory provision.	No change.
<b>SALE OR TRANSFER OF ASSETS</b>	<p>If a nonprofit association is inactive for three years or longer (or a shorter period specified in a document of the association), personal property of the association must be distributed to:</p> <ol style="list-style-type: none"> <li>(1) if it holds itself out as an association for charitable, religious, or educational purposes or is classified as a Section 501(c)(3) organization under federal law, another nonprofit association or a nonprofit corporation with similar purposes;</li> </ol>	No change.

		<p>(2) if the association does not hold itself out as an association for charitable, religious, or educational purposes or is not classified as a Section 501(c)(3) organization under federal law:</p> <p>(A) a person specified in any document of the association as the recipient under these circumstances; or</p> <p>(B) if no recipient is so specified, another nonprofit association, a nonprofit corporation with similar purposes, or a government or governmental subdivision, agency, or instrumentality. (Sec. 10)</p>	
<b>TERMINATION OF ENTITY</b>		No specific statutory provision.	No change.
<b>ADMINISTRATIVE POWERS</b>		<p>Books and records of account must be maintained for at least three years after the end of each fiscal year. Available to members for inspection and copying on request. (Sec. 11)</p> <p>Attorney general may inspect, examine, and make copies of books, records, and other documents considered necessary. (Sec. 11)</p> <p>Attorney general may investigate a nonprofit association to determine whether it is in compliance with state law. (Sec. 11)</p> <p>Attorney general is authorized to request from a nonprofit association or an officer or board member of the association the names of persons authorized to participate in the management of the association or of any other person authorized to receive service of process on the association's behalf. (Sec. 14)</p>	No change.
<b>TAXES</b>	<b>Federal</b>		No change.
	<b>State</b>		No change.
<b>STOCK/CAPITAL REQUIREMENT</b>		No specific statutory provision.	No change.

**SUBCOMMITTEE**  
**ON**  
**CASKET SALES REGULATION**

## BACKGROUND

During the 77th Legislature, Representative Harold Dutton introduced HB 2640 in response to concerns from the Houston Minority Funeral Directors Association about retail, direct-to-consumer casket stores (“casket stores”) selling funeral merchandise and services to consumers. The Texas Funeral Services Commission (FSC) regulates funeral directors and their sale of funeral merchandise and funeral services. The bill, as introduced, would have precluded any person except a licensed funeral home director from selling a casket. This wording created an issue about whether a manufacturer could sell a casket to a funeral home director. Hence, Representative Dutton introduced a committee substitute that would require a casket store to be regulated by the FSC. During a hearing on the bill funeral directors testified that they were concerned about retail casket stores providing sub-standard merchandise and service. Retail casket store owners and consumer groups testified that casket stores provided a less expensive alternative to purchasing funeral merchandise from a funeral home, which otherwise would have a monopoly on the industry. The bill died in committee and the Speaker assigned an interim study to the committee on Business & Industry to assess the need for regulation or other consumer protections in the sale of caskets.

## THE ISSUE

A funeral is one of the most expensive purchases a consumer will make in their lifetime. Arranging a funeral is an expensive ordeal usually done during an emotionally vulnerable time for the consumer. Even if a consumer has the ability to comparison shop or contracts for pre-need funeral arrangements, the most frugal of consumers can be uncomfortable haggling over the price of funeral goods and services. According to the Federal Trade Commission<sup>77</sup> (FTC) a traditional funeral can cost from \$6,000 to over \$10,000. Usually the most expensive purchase of all of the goods and services acquired for a funeral is the casket.

## CASKETS

Again according to the FTC, the average casket can cost slightly more than \$2,000, although some mahogany, bronze, or copper caskets sell for as much as \$10,000. The Texas Funeral Directors Association (TFDA) states they believe the average cost of a casket used in a traditional funeral in Texas to be between \$3,000 - \$5,000.<sup>78</sup>

Caskets are made of either metal or wood. Metal caskets can be made of bronze, copper, steel or stainless steel. Bronze and copper are among the most durable of metals; both are naturally non-

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<sup>77</sup> Federal Trade Commission, “Funerals: A Consumer Guide” *n.d.* <<http://www.ftc.gov/bcp/online/edcams/funerals/index.html>> (August 1, 2002)

<sup>78</sup> Letter to the committee from the TFDA dated July 29, 2002

rusting. Stainless and carbon steel caskets come in a variety of grades, gauges, styles and finishes. Most metal caskets are usually made of rolled steel of varying gauges - the lower the gauge, the thicker the steel. Batesville, one of the nations leading manufacturers of caskets, markets metal caskets as “manufactured and tested to be completely resistant to the entrance of air and water, metal caskets combine lasting protection and beauty.”<sup>79</sup> In addition, metal caskets frequently are described as “gasketed,” “protective” or “sealer” caskets. These terms mean that the casket has a rubber gasket or some other feature that is designed to delay the penetration of water into the casket and prevent rust. Some metal caskets even come with warranties for longevity. However, no casket regardless of its qualities or costs, will preserve a body forever. Both the federal rules and state statutes prohibit claims that these features help preserve the remains indefinitely.<sup>80</sup>

Hardwood caskets include a variety of species: mahogany, walnut, cherry, maple, oak, pecan, poplar, and pine. Wooden caskets are less expensive and generally are not gasketed or covered by a longevity warrantee. However, manufacturers of both metal and wooden caskets usually warrant workmanship and materials.

Traditionally, caskets are manufactured and then sold via a funeral home. But increasingly, retail merchants have opened websites and showrooms to sell caskets directly to the consumer. A casket purchased from a third-party supplier is then be shipped to the funeral home.

## **REGULATION**

During the session the Committee on Business & Industry found it confusing to understand the multiple layers of regulation on the funeral industry and which of these regulations may or may not apply to casket stores.

The business of funeral services is heavily regulated by a multitude of both state and federal agencies in accordance with statutes and rules. While the average consumer may assume that a retail casket store is regulated by these state and federal statutes and agencies, that is not the case. Regulation seems to boil down to the definitions of what and who are regulated.

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<sup>79</sup> Batesville “Burial Caskets” *n.d.*, <[www.batesville.com/html/2.htm](http://www.batesville.com/html/2.htm)> (August 1, 2002)

<sup>80</sup> C.F.R. Title 16, Chapter 1, Part 453.3 (e)(1) and Texas Occupations Code 651.455(a)(2), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Federally, the funeral industry is regulated by the FTC in accordance with the Funeral Industry Practices Revised Rule (Rule)<sup>81</sup>. The Rule states that a funeral provider is “any person, partnership or corporation that sells or offers to sell funeral goods and funeral services to the public (emphasis added).” However, the applicability of this definition to casket providers depends on whether the casket provider is also delivering funeral services. Funeral services under the Rule are defined as “any service which may be used to : (1) care for and prepare deceased human bodies for burial, cremation, or other final disposition; and (2) arrange, supervise or conduct the funeral ceremony or the final disposition of deceased human bodies.” Since a casket store ships merchandise directly to the funeral store and is never directly responsible for the care of a human body, it cannot be conducting funeral services and thus is not a funeral provider regulated by the FTC.

However, the Rule does not ignore casket stores. In fact, it specifically states that a consumer has the right to purchase a casket, and other merchandise from an outside vendor and that a funeral home is required to accept this merchandise and, further is prohibited from charging any additional fees for the utilization of merchandise not purchased from their establishment. The applicability of the federal statute over direct-to-consumer casket stores has never been legally challenged.

As part of their ongoing review of FTC Rules and Regulations, the agency posted a notice in the Federal Register on May 5, 1999 soliciting comments on the pending review of the Rule. One proposal raised by several commentators during the regulatory review is to expand the Rule to cover some sellers of funeral goods or services not currently within the scope of the Rule’s coverage. The FTC staff is currently examining the record of the regulatory review and preparing a recommendation on whether to initiate an amendment proceeding.

In Texas the funeral industry is regulated by the FSC, The Texas Department of Insurance (TDI), The Texas Department of Health (TDoH) and the Texas Department of Banking (TDB), as well as under the Finance Code<sup>82</sup>, the Health and Safety Code<sup>83</sup>, and the Occupations Code<sup>84</sup>.

TDI, the TDB and the statutes in the Finance Code all have regulatory authority over pre-paid funeral contracts. Rarely are retail casket stores involved in these arrangements. Thus, the committee report will not focus on these regulatory authorities.

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<sup>81</sup> C.F. R. Title 16, Chapter 1, Part 453

<sup>82</sup> Texas Finance Code, Chapter 154, Sub-chapter A “Prepaid Funeral Services” May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>83</sup> Texas Health and Safety Code, Chapter 651 “Disposition of a Body” May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>84</sup> Subtitle L, “Funeral Directing and Embalming” May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Likewise, the TDoH and the Health and Safety Code deal with the requirements for disposition of a dead human body. Since a retail casket store never takes possession of a body, the committee will not explore these regulatory authorities.

The Occupations Code<sup>85</sup> outlines the responsibilities of the FSC and the occupations which it licenses. Subtitle L of the Occupations Code focuses on the licensure of funeral directors, embalmers, and the inspection of funeral homes, cemeteries or crematoriums, etc.

Many of the FSC's enforcement authority is linked to licenses that it issues. For example, in addition to fines, the ultimate penalty for non-compliance of statutes or FSC rules is revocation of a license. Conversely, it is a violation of the statute for an individual to falsely represent to a consumer that the person is licensed to perform services of funeral directing.

However, the sale of funeral merchandise alone does not constitute the act of funeral directing. According to an Attorney General's opinion<sup>86</sup> on the subject:

"While it might be argued that such sales are 'associated with...the disposition of a dead human body,' in the sense that the caskets are sold to those who intend to use them for that purpose, no 'first call' occurs in this context, and the sale does not directly involve the disposition of a body. It is clear from the statutory definition of 'first call,' as set out above, that what distinguishes a funeral director is the 'duty....to take charge of,' and prepare for burial or other disposition, a dead human body. Absent such a duty, the activity under discussion here is not funeral directing."

Therefore, while a casket is included in the definition of funeral merchandise for Chapter 651 of the Occupations Code, the regulations on selling funeral merchandise, and specifically the regulations on selling caskets apply only to transactions that involve a licensed funeral director.

A casket store may or may not be owned by a funeral director. There is nothing in the statute that specifically allows the FSC to regulate or investigate someone they do not license. An Attorney General's Opinion<sup>87</sup> on the regulation of crematoriums restricts the FSC's right to investigate complaints to only those entities that are required to be registered with the FSC and further restricts them to only upholding specific violations that are listed in the statute. Thus, there appears to be no requirement to be licensed by the FSC to operate a retail casket store, no right to inspection by the FSC and no authority to investigate or enforce any violations of regulations on the sale of funeral

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<sup>85</sup> Texas Occupations Code, Chapter 651, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>86</sup> Opinion JC-0505 (2002)

<sup>87</sup> Opinion JC-0512 (2002)

merchandise under the Occupations Code. Therefore, retail casket stores are not subject to federal or state statutes or rules that regulate the funeral industry.

## **CURRENT CONSUMER PROTECTIONS**

This committee is charged with determining whether there is a need for regulation or other consumer protections in the sale of caskets.

While retail casket stores are not regulated by the FSC, this does not mean that they are unregulated. A casket store, just like any other retailer, is subject to the Texas Deceptive Trade Practices Act.<sup>88</sup> Under these regulations, a retailer could not misguide a consumer to the quality of a casket; the items covered in any warranty for that casket; the source of a casket; or any certification or industry approval of a casket. Further, a retail store cannot sell a refurbished casket as a new one.

An agent of a casket store could not falsely tell a consumer that other products or services are required by federal or state law. Additionally, an agent of a casket store cannot withhold information about services or products for the purpose of influencing the consumer to purchases.

In the area of advertising, the Deceptive Trade Practices Act prohibits retailers from advertising goods or services with the intent not to sell them as advertised; advertising goods or services with the intent not to supply a reasonable, expectable public demand, unless the advertisements disclosed a limitation of quantity; or make false or misleading statements of fact concerning the reasons for, existence of, or amount of price reductions. Moreover, a casket store is prohibited from disparaging the goods, services, or business of another by false or misleading representation of facts.

Under the Deceptive Trade Practices Act, neither a retail casket store owner nor an employee, who is not a licensed funeral director, could not impersonate a funeral director or imply that they have the authority to provide the services that only a licensed funeral director is allowed to perform.

Although not specifically stated in the Occupations Code, a licensed funeral director or a funeral home which owns and sells caskets via a casket store is subject to these same regulations. Further, licensed funeral directors have additional standards for the sale of funeral goods under the Texas Funeral Act.

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<sup>88</sup> Texas Business & Commerce Code, Chapter 17, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Funeral directors and funeral homes must provide a consumer, upon the first consultation, with the FSC promulgated brochure which explains to the consumer the function of the FSC and how to file a complaint against a funeral home, director, embalmer or cemetery or crematorium.

Funeral homes, cemeteries and crematoriums must also provide a consumer with a retail price list for any services and goods. The purpose of this is to allow the consumer to comparison shop if they choose. A retail price list must contain the name, address, and telephone number of the funeral establishment, the effective date for the stated prices, and the following printed notice:

"The goods and services shown below are those we can provide to our customers. You may choose only the items you desire. However, any funeral arrangements you select will include a charge for our basic services and overhead. If legal or other requirements mean you must buy any items you did not specifically ask for, we will explain the reason in writing on the statement we provide describing the funeral goods and services you selected."

A funeral establishment must also discuss general prices with a consumer over a telephone communication, although this conversation is not considered by the FSC to be a fulfillment of their obligation to provide a price list.

Funeral homes, cemeteries and crematoriums also have specific requirements for their purchase agreements and contracts. The name, telephone number and address for the funeral establishment is required on the contract as well as an itemized list of goods purchased, and charges that the funeral establishment owes or will pay on the consumers behalf to another service provider (i.e. limousine driver), a notice that any goods required by law that a consumer has not requested will be fully explained in writing, and the FSC's procedure and address for submitting complaints.

When soliciting a customer, a funeral director may not deceive a consumer by providing false information on legal or religious requirements for burial, the qualities of any funeral goods in delaying decomposition or invasion of a burial container by water or soil.

In addition, the funeral director is strictly forbidden from directly or indirectly employing a person to solicit individuals or institutions by whose influence dead human bodies may be turned over to a particular funeral director, embalmer, or funeral establishment. A funeral director or embalmer violates chapter 651 of the Occupations Code if the funeral director or embalmer states or implies that a customer's concern with the cost of any funeral service or funeral merchandise is improper or indicates a lack of respect for the deceased.

## **NEED FOR FURTHER CONSUMER PROTECTIONS**

In investigating the need for further consumer protections, the committee could not ascertain any complaints filed by consumers against casket stores that had been submitted to any agency. However, it did find complaints filed against casket stores, by funeral directors. Herein lies the crux of any need for further regulation. While it appears that there is just as adequate protection for a consumer in this retail transaction as there is in any retail transactions, there remains an inequity in the regulations for the sale of a casket by a casket store and by a funeral home. These inequities create animosity and misunderstandings between the two types of providers. The consumer is caught in the middle, and thus the consumer may need further protections.

Examples were provided to the committee during public testimony where a consumer was made to wait while a funeral director and an employee of a retail casket store argued over the delivery of a casket. The consumer was forced to watch as these two employees argued, literally over the container which was to be the eternal resting place for her spouse. Consumers have been forced to sign waivers of liability for funeral homes for the quality of a casket that was purchased elsewhere. While this seems legally reasonable, one consumer admitted that they felt that they were being punished because they chose to purchase the casket from an outside provider, and that the funeral home was going to refuse funeral services unless the waiver was signed.

Conversely, one funeral home testified that during the transportation of the casket to the limousine a casket handle fell off causing the upheaval of the deceased, which obviously caused the loved ones great distress. The consumer became very angry with the funeral home director even though the casket had been purchased at a retail casket store and was not the funeral director's product.

While it may be advantageous to statutorily clarify the liability and requirements in delivery of a casket from a retail store to a funeral home, the question remains, who is best to regulate those transactions.

The FSC is run by a Governor-appointed board. The board consists of two members licensed as both a funeral director and an embalmer, one cemetery owner and four members of the general public with no financial or familial relationship to an individual licensed by the FSC. From this language, a retail casket store not only lacks representation on the board, but is actually prohibited from having representation because they have a financial interest in the funeral industry and may closely work with licensed individuals.

It is particularly burdensome to casket retailers to have requirements for casket stores that are regulated and enforced by a board they have no representation on or chance to elect.

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## **RECOMMENDATIONS**

It appears to the committee a need to clarify requirements for solicitation, pricing, and the transaction of the product from the retailer to the funeral home and the liability of both parties to the consumer.

To require retail casket providers to have specific pricing information available and specific information for consumers is not unreasonable. Further specific pricing information would ensure that a consumer receives the same information regardless of the retail establishment they chose to patronize.

Retail providers of caskets are not required to be licensed funeral directors, nor should they be. As retailers, the licensing tests, apprenticeships and continuing education is irrelevant to their business. These retailers are no different from retailers who sell flowers, candelabras or other goods that are used during a funeral. Licensed funeral directors are required to pass an exam which, in addition to business and professional ethics, includes topics such as the signs of death; the manner by which death may be determined; sanitation and hygiene; mortuary management and mortuary law. A retailer that does not take possession of a dead body has no need for this knowledge, nor does a retailer need to pass an exam on this knowledge to effectively, professionally, and ethically sell merchandise to consumers which does not include funeral directing.

However, since a casket is a large purchase and the state has found it necessary to have a funeral director provide the consumer with information before the purchase of any funeral merchandise or services, it seems only reasonable that the consumer should have access to this information regardless of where they shop.

This could be accomplished in one of two ways. The first solution, would be to change the makeup of the FSC to allow representation of casket retailers. The FSC then would license casket retailers, requiring tests on the ethical and statutory requirements. All statutory references to selling funeral merchandise would be applicable to these license holders.

A second option would be to not change the makeup of the FSC, but create requirements for retail casket providers elsewhere in the Occupations Code that would mirror those of funeral establishments. A violation of these requirements could be a violation of the Deceptive Trade Practices Act<sup>89</sup> and could be investigated by the Attorney General's Office.

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<sup>89</sup> Business & Commerce Code, Chapter 17, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

Specifically, retailers selling caskets should be required to meet the following requirements that funeral directors already meet:

1. Be prohibited from:
  - a. impersonating a funeral director, embalmer, or other person licensed under the Texas Funeral Act;
  - b. providing funeral directing services unless licensed to do so;
  - c. using an advertising statement of a character that misleads or deceives the public or uses, in connection with an advertisement, the name of a person who is falsely represented to be a license holder;
  - d. soliciting business or offers an inducement to secure or attempt to secure business for the casket retail provider made under a permit issued under Chapter 154, Finance Code;
  - e. taking custody of human remains; and/or
  - f. engaging in fraudulent, unprofessional, or deceptive conduct in providing funeral merchandise to a customer;
  
2. Be required to:
  - a. Provide a display of caskets with sufficient, merchandise to permit a reasonable selection.
    - i. The display should include at least five adult caskets, two of which must be full-size.
    - ii. The least expensive casket must be a full-size casket displayed in the same manner as the other full-sizes are displayed.
  - b. When funeral goods are discussed, provide each prospective customer with the brochure prepared by the FSC under Section 651.201. The retail casket establishment shall print additional copies of the brochure if the FSC is unable to provide the number of brochures needed by the retail casket establishment.
  - c. Provide general information over the telephone in a timely manner.
  - d. Provide the prospective consumer with an itemized price list for the consumer in accordance with TAC §203.7 which includes the retail price range of all goods and services. A retail price list must include:
    - i. the name, address and telephone number of the retail casket establishment,
    - ii. the effective date for the stated prices,
    - iii. the following printed notice, “The goods and services below are those that we can legally provide to our customers. You may choose only the items you desire. If you need funeral directing services, please consult a licensed funeral director.”
  - e. Provide the customer with a purchase agreement which includes the following:
    - i. the name, address and telephone number of the retail casket establishment;

- ii. the name, mailing address and telephone number of the Consumer Protection Division of the Attorney General's Office;
    - iii. a statement that complaints may be directed to the Consumer Protection Division of the Attorney General's Office;
    - iv. signature of the provider; and
    - v. the following printed notice, "The goods and services listed below are those that we can legally provide to our customers. You may choose only the items you desire. If you need additional funeral directing services, please consult a licensed funeral director."
  - f. Retain and make available to the Attorney General, on request, copies of all price lists, written notices, and memoranda or agreement required by this section for two years after the date of distribution or signing.
3. Be prohibited from restricting, hindering, or attempting to restrict or hinder:
- a. advertising or disclosure of prices and other information regarding the availability of funeral services and funeral merchandise that is not unfair or deceptive to consumers; or
  - b. an agreement for funeral services between a consumer and a funeral director or embalmer.
4. Be prohibited from using a statement that misleads or deceives the public, including a false or misleading statement regarding:
- a. a legal, religious, or cemetery requirement for funeral merchandise or funeral, cemetery, or crematory services;
  - b. the preservative qualities of funeral merchandise or funeral, cemetery, or crematory services;
  - c. the preservative qualities of funeral merchandise or funeral, cemetery, or crematory services in preventing or substantially delaying natural decomposition of human remains;
  - d. the airtight or watertight properties of a casket or outer enclosure; or
  - e. the licenses or registrations held by the personnel in the operation of the cemetery, crematory, funeral establishment or retail casket establishment.

In addition to these further regulations on casket retailers, the FSC should reexamine their brochure that funeral directors, and under committee recommendations, casket retailers would need to distribute to potential consumers. Even though it is specifically spelled out in the FTC's consumer brochure that consumers have a right to purchase a casket at a third party retailer without being charged an additional fee by a funeral home, it is not mentioned anywhere in the FSC's brochure. This should be included in the literature disseminated to the consumer.

Other regulatory issues were brought forward by stakeholders during the interim. They include the definition of a retail casket establishment, package pricing by funeral homes and taxes on caskets.

The question of the definition of a retail casket establishment hinges on the location of the business. Many retail casket providers in Texas operate via a website or operate through catalogs. Would a definition of a retail casket establishment which includes a physical location eliminate some providers from doing business or just exempt them from regulation?

Package pricing is when a funeral home creates a package of services and goods and prices the packages as a unit for less than the goods and services would have cost independently. The Texas Association of Funeral Merchandise Retailers (TAFMR) feel that “funeral establishments increasingly are inflating the prices of individual services and goods to discourage consumers from ‘picking and choosing.’ They then offer a ‘discount’ price on a package of goods and services, conditioned on the purchase of a casket. ...the penalty for purchasing caskets from retail establishments is as high as \$2,000.”<sup>90</sup>

The committee is uncomfortable with being put in the position of judging whether this utilization is legitimate business practice or an unfair practice meant to squash competition. For just as the retail casket stores’ mere existence creates a more competitive market in the funeral industry, funeral establishments have a right to competitively price their product to be viable in that market. Further, as both the TAFMR and the TFDA have pointed out, funeral directors are prohibited by federal law from preventing a consumer from purchasing a casket from a third party by charging the consumer additional fees for purchasing that casket, or to condition the provision of any good or service to the purchase of any other good or service. However, federal law does not state that a funeral home can not incentivize a consumer.

In a federal challenge<sup>91</sup> of the prohibition of a “handling fee” for merchandise provided by a third party, the United States Third Court of Appeals stated:

“On the other hand, the FTC distinguishes direct casket handling fees from offering discounts to people who buy caskets from the funeral home. The former is an anti-competitive penalty (the fee) and the latter is a method used to deal with competition from third party casket sellers which is pro-competitive. The fee essentially requires consumers to buy their caskets from the funeral homes, or pay for it anyway. The other methods (e.g. discounts) represents a way to encourage consumers to buy their caskets from a funeral home.”

TAFMR’s concern is that packages are only available with caskets. But this does not leave the consumer without an option of purchasing the casket from a third party. Further, there have been no complaints before the committee about these package deals except from the TAFMR, just as the

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<sup>90</sup> TAFMR, pp 4-5

<sup>91</sup> *Pennsylvania Funeral Directors Association v. Federal Trade Commission*, 41 F.3d 81 (3rd Cir. 1994)

committee has found no verifiable evidence of consumer complaints against the quality of service or merchandise from retailers except from funeral directors.

In addition, if TAFMR is concerned that these package deals violate the spirit or letter of the federal Funeral Industry Act, there are remedies available under that statute.

A third issue raised has to do with when a casket is taxed. Sales taxes on caskets are paid at the point of a retail sale. Retail casket providers purchase a casket from a manufacturer with the intent to resell the casket to a consumer, at which point the consumer will pay sales tax on the purchase.

However, licensed funeral directors are considered to be providing a service by arranging the merchandise and services required for a funeral. The Comptroller's office does not seek sales tax on these services when they are provided to a consumer,<sup>92</sup> regardless of whether the merchandise is sold in a package or is itemized. Therefore, the funeral director pays sales tax on the casket and any other funeral merchandise provided the consumer at the time it is purchased from the manufacturer.

The difference is similar to what would happen if a consumer hired a general contractor to build a new home versus the consumer acting as the general contractor. If the consumer hired a contractor, she would pay an agreed upon amount for the service, and the contractor would pay the sales tax on all the materials used to build the home. Conversely, if the consumer acted as her own contractor, she would not pay for the services, but she would pay directly for all the materials. Those purchases would include sales tax. The difference would be that the sales tax for the contractor would be on the wholesale price of the materials and the consumer would pay sales taxes on the retail price of the materials.

TAFMR is concerned about the disparity that occurs when a casket is purchased at a retail casket store and a funeral home. If purchased in one location the merchandise would be taxable, but in another it would not. However, the committee is unaware of any complaints from consumers stemming from this situation and retail casket stores do not seem to be at a competitive disadvantage. Further, the committee feels that consumers are familiar with the taxability of merchandise versus the taxability of merchandise included in a service. Texans encounter these situations in everyday situations from food service to automobile repair.

If the Legislature felt that the disparity was of concern, legislative changes would need to occur. The Comptroller's office has developed rules to include merchandise with the non-taxable services because there was no direction in the statute. Legislative options could include requiring funeral

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<sup>92</sup> Texas Administrative Code, Rule §3.304, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

directors to itemize services and merchandise and collect sales tax on non-service items or to specify that both funeral directors and retail casket providers are not required to collect taxes at the point of resale. Since this situation does not seem to create an economic disadvantage for consumers or a competitive issue for retail casket providers, it is not within the scope of the committee's interim charge.

## **CONCLUSION**

The Committee on Business & Industry has been charged with assessing the need for regulation or other consumer protections in the sale of caskets. Although concerns were raised by both the TFDA and the TAFMR, the committee found little evidence of consumer complaints that stem from the competition between funeral homes and retail casket stores. However, the committee did identify certain statutory requirements for consumer education and protection that retail casket stores are not required to follow. The committee recommends applying these same requirements to retail casket providers. Regulatory authority for these new requirements should not rest with the FSC unless serious board restructuring is done to allow retailers representation on the board. Rather, the committee recommends that the requirements be enforced by the Attorney General's Office through the Deceptive Trade Practices Act, which all retailers are subject to currently.

**SUBCOMMITTEE**  
**ON**  
**RETURN TO WORK**

## BACKGROUND

The 77th Legislature passed H.B. 2600, a sweeping workers' compensation reform bill. Included in these reforms were changes to strengthen the communication between stakeholders about an employee's ability to return-to-work. Although, the main focus of workers' compensation in Texas is to provide timely and necessary medical treatment for injured workers with the objective of returning them to work as quickly and safely as possible, little is known about the effectiveness of the system in achieving this goal. The Committee on Business & Industry was assigned with reviewing the performance of the workers' compensation system in returning injured workers to safe and productive employment in a timely manner. The committee considered system features, policies of the Texas' Workers Compensation Commission (TWCC) and actions on the part of health care providers or other system participants that may adversely affect returns to work.

## THE ISSUE

Unlike group health insurance, workers' compensation insurance focuses on the concept of returning employees back to the workforce. This goal benefits employees, employers and a state's economic system overall. The longer an injured worker is off work, the less likely they are to ever return to any gainful employment. In fact, returning to work within 15 days after a cumulative trauma injury was the most important factor in determining whether an injured worker would be employed two years after the reported injury.<sup>93</sup> Whereas, employers not only lose productivity while an employee is off work, but profits as well. Disability costs can absorb as much as 6 to 12 percent of a company's payroll, while estimates of direct and indirect savings for companies with return-to-work programs range from 3 to 4 percent of payroll.<sup>94</sup>

Effective return-to-work programs would include incentives for all parties involved (employer, employee, physician, and carrier) to monitor the progress of rehabilitation from an injury and to find modified duty opportunities for the early reintegration of a worker back to gainful employment.

However, of the 41 states that passed major workers' compensation reform packages between 1992 and 1996, only six states included return-to-work legislation.<sup>95</sup> Part of the question is whether it is the state's duty to perform or regulate the intense case management needed.

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<sup>93</sup> Mark J. Melhorn M.D., "The Benefits of Returning the Injured worker to Work Early: A Review of the Research," *The Journal of Workers' Compensation*, Vol. 10, No. 1 (Fall 2000), pg. 8

<sup>94</sup> Dave Johnson, "Bringing the Injured Worker Back to Work" *Industrial Safety and Hygiene News Magazine*, 1998. See also, D. Galvin J. Chelius and P. Owens, "Disability: It's More Expensive Than You Think," *Business and Health*, Vol. 11, 1992, pg.4

<sup>95</sup> Aubrey Jewett, "Workers' Compensation Reform in Florida: Why Did Two Innovative Return-to-work Programs Fail?," *Policy Studies Review*, Vol. 18, No. 3, Autumn 2001

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## **TWCC POLICIES**

While the Texas Workers’ Compensation Act<sup>96</sup> (the Act) does not specifically define the purposes of the workers’ compensation system clearly, return-to-work is clearly an objective. The 1988 Texas Joint Select Committee on Workers’ Compensation policy recommendations included statements that a system reform should:

- provide appropriate and quality medical care directed toward prompt restoration of the workers’ physical condition and earning capacity; and
- encourage the speedy return to employment which is safe, meaningful, and commensurate with the abilities of the accident victim.<sup>97</sup>

The efforts of the Joint Select Committee on Workers’ Compensation resulted in Texas’ workers’ compensation system reform of 1991. The system inherently encourages return-to-work for workers and requires TWCC to collect data to measure the effectiveness of this model.

Currently, a worker is encouraged to return-to-work through the workers compensation benefits structure. An injured workers’ entitlement to medical benefits is linked to treatment which “promotes recovery or enhances ability to return to or retain employment.”<sup>98</sup> Further, an injured workers’ income benefits is decreased by any bona fide offer of employment whether the employee accepts or not, which encourages an employee to accept a position to return-to-work.<sup>99</sup>

To assist workers in finding employment, TWCC was directed to refer employees entitled to supplemental income benefits (SIBs) to the Texas Rehabilitation Commission with recommendations for appropriate services.<sup>100</sup>

Additional legislation in 1999 required TWCC to also focus on employers in the efforts to return workers to gainful employment. Not only was TWCC to implement a program to encourage employers and treating doctors to discuss the availability of modified duty, but TWCC was also to

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<sup>96</sup> Texas Labor Code, Title 5, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>97</sup> 1998 Policy Recommendations of the Texas Joint Select Committee on Workers’ Compensation provided by the Research and Oversight Council on Workers’ Compensation

<sup>98</sup> Texas Labor Code, §408.021, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>99</sup> Texas Labor Code, §408.103 and §408.144, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>100</sup> Texas Labor Code, §408.150, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

provide outreach programs to provide information to employers regarding effective return-to-work programs.<sup>101</sup>

To measure the effectiveness of these efforts TWCC is statutorily required to collect data on return-to-work. Specifically, TWCC is supposed to collect return-to-work data during periodic reviews of treatment guideline compliancy<sup>102</sup>, determinations of impairment income benefits (IIBs) and SIBs.<sup>103</sup>

Unfortunately, except for the incentive built into the formula determining income benefits, TWCC has made little or no effort to meet their statutory requirements linked to return-to-work.<sup>104</sup>

§408.086 of the Labor Code requires TWCC to determine annually the extent to which an injured worker receiving either IIBs or SIBs are unemployed or underemployed<sup>105</sup>. To assist, the statute allows TWCC to require periodic reports from the employee and the carrier and, at the carrier's expense, require physical exams, vocational assessments or other tests or diagnoses necessary to make this determination.

TWCC field offices are responsible for enforcement of this provision, however TWCC rarely ascertains an employee's employment status. The Commission only checks on an employee's employment status during a dispute over income benefits. No other determination of unemployment or underemployment is ever done. The reason for this is TWCC has no current report or notice that is supplied to them that reports an employee's employment or wage status unless there is a dispute over the wage replacement benefits. TWCC claims their only alternative would be to call the employee and ask for employment and wage information. Although this requirement was passed in 1993, TWCC has never developed a method to track this information outside of the dispute resolution process.

Further, TWCC claims that if this information was track it would be difficult to determine whether underemployment is directly related to the employee's injury. However, §408.149 requires them to be able to make just such a determination. The 1993 statute allows an employee or a carrier to request TWCC to determine the employee's unemployment or underemployment and whether it is a direct result from the compensable injury.

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<sup>101</sup> Texas Labor Code, §413.018(c)-(d), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>102</sup> Texas Labor Code, §413.018(a), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>103</sup> Texas Labor Code, §408.086, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>104</sup> All information about TWCC compliancy with statutory provisions come from a meeting between TWCC, ROC and committee staff on March 6, 2002 unless otherwise noted.

<sup>105</sup> TWCC defines underemployment where an employee is making 80% less than their pre-injury wage.

§ 413.018 of the Labor Code, adopted in 1993 and amended in 1999, has several return-to-work related requirements of TWCC. The first requires TWCC to perform “periodic reviews of medical care and specific treatments provided in claims in which exceed return-to-work guidelines and may take appropriate action to ensure that necessary and reasonable care is provided.” TWCC has never reviewed medical care because it has never adopted a return-to-work guideline. Although the statutes refer to a guideline it did not require TWCC to adopt return-to-work guidelines until the passage of HB 2600 in 2001. TWCC did not attempt to adopt one until October of 2001. However, stakeholder protest over the appropriateness of the guide that was chosen made TWCC withdraw the proposed rule. To date, no new proposal has been made. Although the Commission’s current review of any “outlier” medical treatment is done by the Compliance and Practices Division of TWCC and in the future by the Medical Quality Review Panel (MQRP), until a return-to-work guideline is adopted the periodic reviews dictated by statute cannot occur because they have comparison of whether an employee’s time off of work is excessive for their injury.

The second provision in §413.018 was required by legislation from 1999.<sup>106</sup> This legislation required TWCC to “implement a program to encourage employers and treating doctors to discuss the availability of modified duty to encourage the safe and more timely return-to-work of injured employees.” The statute gave TWCC the authority to order a functional capacity exam to determine an employee’s ability to perform a modified duty assignment. However, instead of creating a program, TWCC created the Work Status Form (TWCC-73). According to TWCC the purpose of the TWCC-73 is for an employee’s treating doctor to determine and describe the functionality of the employee at that stage in their recovery. The TWCC-73 is sent to the carrier and the employer to determine whether an opportunity exists for modified duty.

The last provision in §413.018 requires TWCC to provide an outreach program to provide information to employers on how to develop an effective return-to-work program. A well developed employer return-to-work program would include clear defined policies for an employee on how the employer intends to help them return to employment within the company. It would also include a modified duty program and/or possible retraining for another position. This provision was effective in July of 2001. TWCC hired a Return-to-work Program Administrator in August of 2000. The Administrator developed a manual entitled Developing A Return-to-work Program: A Resource for Employers by January 2001. The document is distributed at TWCC’s annual educational conference and through the Workers’ Health and Safety Division. Approximately 3,500 copies are distributed through these avenues.

As for outreach, the Administrator offers presentations for employers, case managers, healthcare providers, adjusters and other interested parties. In 2001, the Administrator had made 25 presentations with a total of 1,845 attendees, which was an amazing feat considering the return-to-work program had no funding from TWCC until after the committee inquired as to the resources

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<sup>106</sup> 76R H.B. 2513

dedicated for the outreach program in March of 2002. By a subsequent meeting in April, TWCC stated that funds had been allocated for the return-to-work program out of the Medical Review Division Budget. However, TWCC could not provide the committee an exact monetary amount of the budget.

In 2001 the Return-to-work administrator, and the medical review and customer service divisions developed a stakeholder survey on the use, satisfaction and compliancy of TWCC-73 usage. The survey was developed because of extensive complaints received from TWCC that doctors were not complying with the requirements. Out of the 1,531 surveys that were sent, 195 employers, 193 workers, 275 health care providers and 137 carriers responded.

While most stakeholders indicated that they were familiar with the TWCC-73, whether stakeholders feel that it has improved communication is not certain.

Most employees say that they did not receive (52%) or were not explained the contents (62%) of the TWCC-73 by their doctor. Further, 59% of employees said they were not offered modified duty and 51% declined modified duty that was offered.

77% of employers were familiar with the TWCC-73 and 84% felt that the information it provided was useful in returning an employee to work, even though only 52% felt that improved their communication with doctors. One reason for this may be that only 81% of employers said that restrictions were clearly stated on the TWCC-73 and only 59% said that they received the TWCC-73 within two days of the doctors examination with the injured worker, as required.

Conversely, 98% of doctors surveyed were familiar with the TWCC-73 and 65% felt it had not improved communication between them and employers. Only 38% of doctors feel that they are informed of any modified duty opportunities by the employers and 23% of doctors feel that they receive adequate job description information on modified duty opportunities from employers.

The problems between doctors and employers may be confusion over the purpose of the TWCC-73, as discussed later in the section on System Participants. Doctors feel that employers should notify them of modified duty opportunities and the TWCC-73 should be used to determine whether the employee could meet the qualification of that specific job. Whereas, employers feel that a TWCC-73 should be provided to employers with the all of the injured workers' possible restrictions and capabilities, and from that information the employer can design a modified position for the injured worker. Carriers, seem to align more closely with employers. Their stance being that the carrier needs to know all of the injured workers capabilities and restrictions to determine whether the worker has received a bona fide offer of employment from any employer.

Carriers do seem to be very familiar (99%) with the TWCC-73, yet are not completely satisfied with its performance. Only 67% of carriers felt the information in the TWCC-73 was useful. This may be low because of lack of understanding of the material provided. Only 23% of carriers felt that the information on the was provided in a clear and understandable method. Finally, only 52% of carriers felt that the form had improved communication.

Clearly, while the TWCC-73 may provide useful information, its success as an outreach program to improve communication is minimal at best.

ROC is currently conducting a study of employer return-to-work programs, the use of the TWCC-73, and the quality of communications between carriers, providers and employers regarding return-to-work issues. The ROC is currently in the data collection phase of the project, which includes surveys of insurance carriers, health care providers, and employers. A full report will be issued in the Spring of 2003.

In addition to the outreach program, the legislature also passed an amended §408.150 in 1999 to require TWCC to "refer an employee to the Texas Rehabilitation Commission (TRC) with recommendations for appropriate services if the commission determines that an employee entitled to supplemental income benefits could be materially assisted by vocational rehabilitation or training in returning to employment or returning to employment more nearly approximating the employee's pre-injury employment. The commission shall also notify insurance carriers of the need for vocational rehabilitation or training services." The statute further states that any employee that refuses these services loses entitlement to SIBs.

Several problems have arisen from the implementation of this provision. TWCC field offices are responsible for the initiation of this process by sending the recommendations for services to the worker, the TRC and the carrier. However, instead of being an individual evaluation of the appropriateness of TRC services for an injured worker, TWCC's field offices are automated to send out form letters when the injured worker receives a 15% impairment rating, which would then qualify them for SIBs. In addition, all spinal injuries are immediately referred to TRC.

Many injured workers are not qualified for TRC programs. In order to qualify for vocational training and rehabilitation at the TRC an injured worker must be:

- Injured
- Able to do a job
- Need re-training for that job.

Most injured workers are disqualified over the ability to do a job. Just because a worker has received an impairment rating, does not mean that they have been released to return to work. Even if a worker has been released for modified duty, the TRC may not accept them because the worker has not been released for full duty, and his condition may improve which would qualify him to perform a job for which he does not need re-training. In addition, a worker that is referred immediately upon injury because of a spinal injury is certain to be rejected.

TRC will only give information to TWCC on referral cases on an aggregate basis, which allows TWCC to see how many referrals did not receive services, but not whether the employee refused services or was disqualified. While this information would be useful in determining the effectiveness of this requirement, TWCC does not need it to enforce the second provision of this statute, which that any employee that refuses these services loses entitlement to SIBs. TWCC allows carriers to enforce this section, since it is the carrier who determines SIB amount. However, in talking to carriers, whether an injured worker has received TRC services is never questioned until a dispute on income benefits arises.

In addition to these current requirements, HB 2600 added future return-to-work requirements to the Labor Code.

In §408.0221 of the Labor Code, HB 2600 created an advisory committee to study the feasibility of workers' compensation networks in Texas. As part of the determination of feasibility the committee was to develop evaluation standards and specifications for a report card of the network outcomes to distribute to employers and employees. The statute specified eleven minimum standards including return-to-work outcomes. If feasible, networks will not be implemented until 2003.

Starting August of 2003 TWCC is required by §408.023 of the Labor Code to implement changes in the Approved Doctor List, including the collection of information from treating doctors on patient satisfaction, cost and utilization of health care and return-to-work outcomes.

§ 413.021 of the Labor Code also requires return-to-work coordination services. Although this provision is effective immediately, TWCC is prohibited from enacting rules January 2004. The rule requires carriers to notify and provide the employer return-to-work coordination services as necessary to facilitate an employee's return to employment. While a carrier can provide services to identify needed physical workplace modifications, they are not required to provide these modifications. For TWCC's part, the statute requires TWCC to adopt rules necessary to collect data on return-to-work outcomes to allow full evaluations of successes and of barriers to achieving timely return-to-work after an injury. In addition, TWCC must have their staff training about the coordination of return-to-work services by certified rehabilitation counselors or other appropriately trained or credentialed specialists.

Lastly, TWCC shall report twice annually to the Research and Oversight Council on Workers' Compensation (ROC) regarding the implementation and outcome of the return-to-work initiatives required by this section.

To prepare for this, TWCC has developed a cross-division team to look at all the return-to-work requirements. They have three main focuses: data collection; education; and the coordination services program.

To guarantee collection of all useful return-to-work data, TWCC has surveyed stakeholders about what type of data should be collected, by whom and when. TWCC has initiated contact with TRC and the Texas Workforce Commission about sharing data on return-to-work cases. Staff indicates that their current data collection through EDIs<sup>107</sup> and TWCC 21s<sup>108</sup> is not enough information to develop return-to-work outcomes.

For education, TWCC staff indicated that they would like to expand their current return-to-work program efforts to include healthcare providers. However, the return-to-work administrator indicated that employers, carriers and healthcare providers were all included in the audiences of past presentations.

Since rules for the coordination services program is not required until 2004, TWCC has yet to concentrate on this piece.

To date, the ROC has not received any reports from TWCC on their implementation of return-to-work initiatives. At the time of publication of this report TWCC should have performed two, possibly three reports.

## **SYSTEM PARTICIPANTS**

On April 16, 2002 committee Staff held a stakeholders meeting. Included in the discussion were 21 representatives of labor, employers, carriers, and healthcare providers. While the meeting showed that all system participants felt that return-to-work was important, there was little agreement on any thing else involved in the process.

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<sup>107</sup> Electronic Data Interchange: The format by which carriers report claim information to TWCC

<sup>108</sup> TWCC 21: TWCC form "Payment of Compensation or Notice of Refused or Disputed Claim Interim"

**When asked about their role in return-to-work:**

Doctors:

There seemed to be consensus among doctor groups that they should be responsible for diagnosis, treatment decisions and plans, determining functionality. Doctors seem to disagree slightly on whether they should be determining overall functionality or job-specific functionality. Some doctor groups want to know the specific job requirements before they do a Functional Capacity Exam (FCE), others feel that it is important to do a complete FCE in case the employee is unable to return to his/her current employment. This seems to be a contentious point between doctors and employers. The doctors that want to know the job functions of any modified duty available before a FCE. Employers, on the other hand, want the results of an FCE in order to tailor a modified duty position for the employee. Doctors expressed frustration at releasing an employee to modified duty and having the employer only follow those instructions for a couple of days before making an employee return to full duty functions. They felt that a penalty for this was appropriate.

Employers:

Employers felt that they are required to tell a doctor if there is a modified duty or return-to-work program, let the doctor know of the functions of the job and any modified duty offer. They felt it is not their responsibility to continue to employ an employee if there is not modified duty available. Also, they felt it is not their responsibility to do return-to-work case management for the employee because if the employee can no longer work for them, then the employer ceases to be responsible for the employee's return-to-work. Employer groups expressed that most employers feel that even with the best return-to-work programs that if there is not some way to get a doctor to release an employee to modified duty (maybe after a peer review) that it is useless for the employers to attempt any return-to-work efforts. They felt that there should be stricter penalties if a doctor did not fill out the TWCC-73 (return-to-work assessment).

Carriers:

Carriers felt that it was their responsibility to encourage and educate employers about return-to-work programs before an injury, and after an injury to be the facilitator between the doctor and the employer in the discussions of return-to-work. To make sure that the employee was attending necessary treatments and evaluations; that the doctor is filling out their TWCC-73s fully and the carrier should assist their policyholder (employer) with formulating modified duty opportunities. Other carriers felt that more extensive case management was their responsibility, like educating the doctor about return-to-work, working with the employee on other employment possibilities and training, working with the employer on modified work environments. One carrier said that they felt that employers should be held accountable for adhering to the modified duty agreement because of risk of aggravation of injury to the employee. One carrier agreed with employers that there may be a bona fide offer of employment, but the doctor will not release the employee for any kind of light duty.

**Labor:**

Labor organizations felt that their responsibility was to deal with all parties (carriers, doctors, and employers) with a good faith effort to return-to-work. However, they felt that “our ability as a state to get employees back to work is pathetic.” The keys, in their opinion, are early intervention and communication. One Labor organization mentioned providing incentives for parties to know that it is in their best interest to be diligent about return-to-work. Specifically mentioned was a pilot program at Boeing which has saved millions just through encouraged cooperation between stakeholders. Another Labor organization said that the employee feels like they’ll make more money by staying off work than going back to a modified duty. Further, if they go back their employer will not adhere to the modified duty and will push the employee to perform their full duties which will only aggravate the employee’s condition.

**TWCC:**

Statute requires that TWCC help with the communication between employers and doctors regarding return-to-work. They feel that the TWCC-73 is the first step in communication. They also perform education for stakeholders, particularly employers on return-to-work. But TWCC staff expressed concern by the comments of both doctors and employers. If a doctor is not filling out their TWCC 73 form completely or timely, then that is a Compliance & Practices issue and TWCC can intervene to make that happen. Also, if an employer has an employee come back to work under a modified duty agreement but then expects the employee to perform their full functions, then the employee is not obligated to return-to-work, because there is not a bona fide offer of employment and the carrier should start paying IIBs again.

**A stakeholder asked what percentage of injuries had return-to-work issues.**

The ROC staff responded that approximately 30% of injuries annually exceed return-to-work expectations. Our median return-to-work time is 15-18 weeks, much higher than other states. This was confirmed in ROC studies as well as WCRI<sup>109</sup> studies. A stakeholder asked how many of the return-to-work cases have changed treating doctors. ROC said that data on that issue has not been examined.

**When asked if return-to-work should be the highest goal of the system?**

No stakeholder directly answered the question, but rather expounded on what the problems were with the current system. One Labor organization had met with TWCC staff and was frustrated with the lack of resources that were dedicated to return-to-work. Labor contends that TWCC definitely doesn’t consider return-to-work an important goal of the system.

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<sup>109</sup> Workers’ Compensation Research Institute: A National Policy and Research Institute

**When asked what the legislature should regulate in return-to-work:**

Doctors:

Doctor organizations expressed concern that there are competing statutory compliancy issues for doctors that occur during return-to-work. Employers will call doctors about modified duty and return-to-work and want to know not only what the employee can or can not do, but why they can not. Doctors feel that the diagnoses and detailed medical information are privileged and covered by doctor/patient confidentiality. Employers get very annoyed with doctors and thus a confrontational situation begins.

Employers:

Believe that the overall institutional attitudes are problematic, but that if the legislature could address small problems that it would improve the overall culture. Specific examples of things to address:

- What injuries/employees do you target for early return-to-work efforts and what resources do you devote.
- Expansion of the number of employers with return-to-work and modified duty programs.
- Disagreements between treating doctors and RMEs.
- Employer adherence to modified duties.

Labor:

Agreed that the main problem is the confrontation between employee, employer and carriers.

**When asked the purpose of return-to-work case management and whose responsibility it is:**

Doctors:

One doctor believed that the purpose of case management was to act as a facilitator. To make sure the employee got to treatments on time, that the doctor and employer are communicating. Case managers are looked upon, by doctors, as either a person who wastes a lot of the doctor's time or someone who provides a lot of useful information that the doctor would not get otherwise. He felt that any employee reaching MMI and still unemployed should have a case manager. But, he also said that it should not be mandated for every employee because it is expensive and not needed for all claims.

A Doctors' group felt that it was the doctors responsibility to work with the case manager, but not to be the case manager. He said that already doctors are spending time doing case management, but not getting paid for it. TWCC commented that there was a billing code for case management. Doctors responded that in order to be reimbursed under that code there had to be face-to-face consultation, and most case management for return-to-work happens over the phone. TWCC asked how they currently got paid for these consultations and the doctors responded that they don't.

Carriers:

One carrier group felt the goal of case management is both rehabilitation and return-to-work. He agreed with the doctors on what the duty of a case manager should be.

Employers:

Several employer groups stressed the importance of the fact that while it is beneficial to and the responsibility of the employer to attempt to retain the employee, it is the purpose of case management to return the employee to gainful employment regardless of the employer. Therefore, it can not be the employers responsibility for case management. Further, he stressed that he didn't think that there was enough stress on returning the employee to gainful employment, regardless of the employer. It seemed to him that doctors cater their FCE for the job that the employee currently has rather than one that he might be functionally capable of. If the employee is determined to be unable to return to his current job, penalties designed to encourage return-to-work don't start until they need to qualify for SIB payments. Additionally, there is no actual return-to-work case management.

**When asked if with a responsibility to deal in good faith, Labor should also incur consequences:**

Labor:

There are already consequences for labor through income benefits. They are already making less than if they were still fully employed.

Carrier:

One carrier brought up the issue of how to keep track of whether an employee is being compliant with doctors instruction for care. Doctors responded that no one is 100% compliant.

**Whose responsibility is it to make sure that ERs are properly educated on RTW issues - Carriers or the State?:**

Carrier:

Carrier chooses to educate employers before there is an injury. However, it should not be mandatory because it is not effective for small employers who can not afford to lose an employee, or for industries that have no opportunities for modified duty (as in construction). Carrier pointed out that TWCC has safety seminars and it would be great if they could incorporate return-to-work in those programs.

TWCC:

They do have a return-to-work education program. Although they did not have funding until April 1st of this year, they have performed 25 educational seminars and produced one return-to-work manual for employers. Since they have received funding, they have scheduled 7 seminars through October of 2002. TWCC staff could not say how much funding had been made available or what the goal was for this funding.

Carrier:

If TWCC's role is education then they should be targeting problem areas for that education either by employers that have poor return-to-work outcomes, or by industries with poor return-to-work outcomes. Another carrier group stated that TWCC and carriers' role should be that of partners in educating employers. Further, they stated that as HB 2600 is implemented and TWCC concentrates more on this education and coordination services, that the system will see an improvement in return-to-work. Carriers need to focus on what coordination services are, and educating employers on its availability so that when an injury happens, the employer will know to ask for the services.

Doctors:

Legislature could provide incentives for employers to do return-to-work programs so that they would understand that its in their best interest to have return-to-work programs. He suggested premium discounts for employers that have return-to-work programs.

Carriers:

One carrier group rebutted that there are incentives to return-to-work programs already. And it is risky to mandate a discount to carriers that may or may not show an impact.

Employer:

A couple of employer groups reiterated that its bad policy to require carriers to mandate a discount for employers that may never use the program (because its too small or because of the nature of the industry). The employer will never recognize the savings and neither will the carrier, even though the carrier have received less premium to cover the expenses of the employer. Further, it takes a long time for an employer to realize the savings of a return-to-work program.

**Should a doctor be penalized for bad RTW outcomes if they have good utilization outcomes and vs. versus?**

Carrier:

Usually not separate. If a doctor has good return-to-work outcomes, they tend to also have good cost utilization outcomes.

Doctors:

When considering whether to penalize a doctor because they don't have good return-to-work outcomes, TWCC must remember that the doctor can only release the employee to go to work. He can not find the employee modified duty, he can not accept the offer of employment for the employee, nor can they retrain that employee.

**If claims themselves are profiled what should happen to outlier claims?**

Doctors:

An automatic FCE, but the problem with that is only so many are reimbursed.

Carriers:

One carrier group ask if TWCC collects data? Another carrier group reiterated that TWCC has the ability to act on bad actors because of HB 2600 and that the system will start to see improvements. The carrier group recommended not having any new legislation in the 78th session to give the new reforms a chance to work and see the results of them. One carrier group commented it seems TWCC places administrative burdens on the whole system rather than on the most egregious abusers.

Doctors:

If the employee returns to work and the employer makes the employee perform their full duties before they should, there is risk of aggravation of the injury and then there is the question of whether the aggravation is an exacerbation or a separate injury, which brings up the issue of the subsequent injury fund. This situation is worse if the employee has changed employers. Also, one doctor organization pointed out that an employee with a serious injury will frequently have flare-ups of their condition, even after years of no problems. Doctors said there is not really a good method for dealing with these situations.

Carrier:

As far as who is responsible for case management, besides the additional reviews through the MQRP and the ADL, there is an opportunity for TWCC to define the role of the treating doctor and to monitor them.

**Is the determination for underemployment appropriate and is there another way to collect this information?**

Labor:

One labor group said that the financial equation to determine underemployment is inappropriate (although they did not say why). Offered that TWCC could exchange information on employees' return-to-work activities with Texas Rehabilitation Commission and Texas Workforce Commission. There needs to be better tracking of employees return-to-work.

TWCC:

TRC won't share information on individual claims but rather will only give information to TWCC in the aggregate.

Carriers:

Carriers will be able to show a change in earnings when an employee gets employment (as long as its within 401 weeks).

Labor:

One labor organization said that if there was a one year guaranteed employment after an injury (with exceptions for functionality and firing for just cause) then it would be really easy to track and employee's return-to-work. He also said that there a lot of incentives to be able to encourage employers to re-employ an employee. When asked why the Florida initiatives failed, neither labor nor NCCI<sup>110</sup> could provide a reason.

**When asked whether stakeholders would prefer a proprietary Return-to-work Guideline that is updated annually that they must purchase or a guideline created by TWCC that is posted on the website for free. Also asked what should the guidelines be used for:**

Doctors:

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<sup>110</sup> National Council on Compensation Institute: A national workers' compensation policy and research institute that was in attendance

There was a lot of discussion about guidelines (sometimes discussion was sidetracked into treatment guidelines). Doctors seemed to agree that the guideline should not be a created by an insurance carrier or insurance group, but rather an evidence based, nationally recognized guideline. Agreed that a guideline was a useful measurement for a trigger but could not and should not be used as a basis for punitive actions. Guidelines are based on a median which means that 50% of the population was above that measurement and there are some medically acceptable reasons why some people take longer to heal than others. Those factors should be considered on a case by case basis for any administrative action.

Carriers:

Carriers did not seem to agree on their views of what the guideline should be. One group recommended Prestley Reed as a nationally accepted guideline, another carrier group said that there was no nationally accepted guideline - that while many states may use Prestly Reed it is not an adopted guideline by which administrative decisions are based- and still another group said that they did not believe that Prestly Reed was evidence based. Further, one carrier did not feel that it was possible for TWCC to post any treatment guideline on the web because they are so voluminous. The one thing that carriers did agree on was that TWCC had to make it transparent what guideline they were using and what they were using it for, so that doctors, carriers and employees could all know the standards by which they are being judged.

Employers:

It was an important part of the HB 2600 negotiations that the return-to-work guidelines (all the guidelines for that matter) be something that doctors in general were familiar with so that doctors that did workers' compensation didn't have to go purchase or be familiar with a completely different set of guidelines depending on whether the injury is compensable or not. National guidelines are more widely known by doctors.

**When asked why the RTW initiatives in Florida (incentives to employers to hire injured workers and penalties for not rehiring) failed?**

Labor:

Asked if TWCC had any incentive programs for employers to rehire injured employees. TWCC responded no. committee staff clarified that there is no statutory requirement or basis for them to make those kinds of incentives.

**What are the stakeholders input on the current educational outreach program? How should outreach programs be targeted at employers?**

Doctors:

Target the 30% that have return-to-work issues.

Employers:

Should focus on where there will be the greatest opportunity for success. Maybe target employers by size or industry first and then employees by skills and disabilities.

### **ROC staff asked about pilot programs**

Employers:

One employer group said that certain industries might benefit from pilots, like construction, but should the system state-wide focus on that? Another employer group said that until treating doctors stop “holding employees hostage” by not releasing them for modified duty, no pilot project or education is useful.

Carriers:

There was some talk during HB 2600 negotiations that there should be more local focus on these industries. Maybe a combined effort of economic development boards, local workforce boards and rehabilitation centers.

### **When asked what return-to-work Coordination Services should be under Article 3 of HB 2600:**

All seemed to agree that Coordination Services should not be offered by TWCC, but rather TWCC staff should be familiar with the services for education and dispute purposes. Felt that carriers should hire someone to provide these services or have them done in-house, but there should not be any certification or licensing requirements. Coordination services should include the following: Job analysis, on site visitations with the employer to determine modified duty opportunities and any environment modifications necessary. Basically the services described earlier as case management.

## **COMMITTEE FINDINGS**

Workers’ compensation is supposed to be a system in which the employer assumes all the risk for premiums and co-pays for unlimited, necessary medical treatment and income benefits in exchange for an emphasis on the return an employee to work as soon as possible. This provides a tremendous

benefit to employees beyond the normal coverage of group health, and helps an employer retain a valued employee.

The system as a whole is supposed to provide the assistance for an employee to return to gainful employment, whether that opportunity is at their pre-injury job or elsewhere. Maintaining an employable workforce decreases taxes by lessening the burden on unemployment taxes, social security disability, and state and local medical and social services. In addition, a large, healthy workforce produces a healthy economy by increasing the productivity, and the gross state product.

However, in Texas we find a system that pays little attention to actually returning employees to work.

The committee found that out of the ten proactive, return-to-work statutory requirements, TWCC can only be said to minimally perform four.

§408.086 of the Labor Code requires TWCC to determine at least annually the extent to which an injured worker receiving either IIBs or SIBs are unemployed or underemployed as a direct result of the employee’s impairment.<sup>111</sup> The purpose of this statute is to determine the outcomes of the system in returning its most injured employees to gainful employment. However, TWCC maintains that they do not know who these employees are unless they dispute their income benefits. However, both of these benefits are received after an employee receives an impairment rating, which is reported to TWCC. Instead of pro-actively designing some means of identification and communication with these workers, TWCC waits on whatever information comes from disputes. Any data that TWCC collects through this manner is useless to the legislature for examining the condition of employment of our most injured workers.

The statute mandates that TWCC would collect this information “at least annually” and authorizes TWCC to require reports, examinations, vocational assessments or other tests at carrier expense to perform this duty. Although this provision has been in statute since 1993, TWCC has not looked at other means for obtaining this data. Further, TWCC claims that if this information was track it would be difficult to determine whether underemployment is directly related to the employee’s injury. However, §408.149 requires them to be able to make just such a determination. The 1993 statute allows an employee or a carrier to request TWCC to determine the employee’s unemployment or underemployment and whether it is a direct result from the compensable injury. TWCC has never created a method for making this determination.

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<sup>111</sup> TWCC defines underemployment where an employee is making 80% less than their pre-injury wage.

Whether an employee is unemployed because of their injury almost a year after their injury is imperative data to judge the effectiveness of the system and the reasons for possible failure. A January 2001 study by the ROC<sup>112</sup> showed that fewer injured workers in Texas (64 %) reported that they were currently working more than two years after their injury, compared with injured workers in other states (75%). For those that said they were currently working, fewer Texas injured workers said they went back to the same employer as before their injury (62% in Texas compared to 79% in other states) and were doing the same kind of work they did before the injury (61% in Texas compared to 76% in other states). Additionally, more Texas injured workers said their current take-home pay was lower than it was before the injury (28% in Texas compared to 13% in other states).

Not only is this information useful for legislators, but it may also be important for TWCC in enforcing prohibited workers' compensation discrimination. It is against the law in Texas to discharge or otherwise discriminate against a worker because he or she has filed a workers' compensation claim.<sup>113</sup> Violation of this law can result in reinstatement of the injured worker and the award of reasonable damages to the injured worker.

A 1998 study done by the ROC<sup>114</sup> showed that 21% of injured workers surveyed reported that they were either fired or laid off after their work-related injuries. 64% of laid-off workers were let go within six months or reporting their injury, 26% of these were let go within one week.

Yet TWCC makes little effort to identify unemployed and underemployed injured workers, nor do they have any means to judge the reasons for their economic status and whether it is related directly to the injury. In addition, TWCC has not official determination of how long an employee should be off work.

Although § 413.018 of the Labor Code, adopted in 1993 and amended in 1999, requires TWCC to perform "periodic reviews of medical care and specific treatments provided in claims in which exceed return-to-work guidelines and may take appropriate action to ensure that necessary and reasonable care is provided," TWCC has never reviewed medical care because it has never adopted a return-to-work guideline.

Whether TWCC was mandated to do this before 2001 is questionable. The statute did not specifically require TWCC to adopt a return-to-work guideline, but did state that they had to identify claims that exceeded return-to-work guidelines. While, TWCC did not have to adopt a guideline to

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<sup>112</sup> *Striking the Balance: An Analysis of the Cost and Quality of Medical Care in the Texas Workers' Compensation System*, ROC January 2001

<sup>113</sup> Texas Labor Code, Chapter 451, May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>114</sup> *An Analysis of Workers Who Were Fired or Laid off after a Work-related Injury*, ROC August 1998

utilize one to identify an outlier claim, all indication from TWCC staff is that one was never used and these reviews never occurred.

HB 2600 in 2001 allowed TWCC to adopt return-to-work guidelines. After a failed attempt to adopt a proposed guideline was denounce by public testimony as biased, TWCC has made no further attempts to adopt a return-to-work guideline and still has yet to review claims for exceeding accepted guidelines. TWCC staff states that if a claim was identified investigation would be done by the MQRP and the Compliance and Practices Division. However, the question remains how TWCC would identify and defend reviewing a claim if it has no accepted guidelines to which the claim has violated.

The second provision in §413.018 was required by legislation from 1999.<sup>115</sup> This legislation required TWCC to “implement a program to encourage employers and treating doctors to discuss the availability of modified duty to encourage the safe and more timely return-to-work of injured employees.” Instead of creating a program, TWCC developed the Work Status Form (TWCC-73). Reviews from stakeholders of the success or failure of the TWCC-73 is mixed. During the system participant workgroup highlighted in this report, comments showed that this form has not encouraged discussion between doctors and employers. Rather, stakeholders disagree on the information to be included on the form, the purpose for the form and possible conflicts in statutory requirements of confidentiality have arisen because of the use of this form.

The last provision in §413.018 requires TWCC to provide an outreach program to provide information to employers on how to develop an effective return-to-work program. TWCC needs to dedicate more resources to this return-to-work initiative in order to satisfactorily meet their statutory requirement. Although a manual created by the Program Administrator is distributed by TWCC at seminars, an outreach program was never funded. However, because of tremendous stakeholder interest, the Program Administrator traveled across Texas to give 25 presentations on the benefits of and how to implement a return-to-work program. System stakeholders paid for all expenses, including the travel of the Program Administrator, in order to participate in this ‘outreach program.’ Funding was withheld from this program until one month after a meeting with committee staff on this interim charge. However, TWCC could not provide the committee an exact monetary amount or approved expenditures of the budget.

In 1999, the legislature also passed an amended §408.150 to require TWCC to “refer an employee to the Texas Rehabilitation Commission (TRC) with recommendations for appropriate services if the commission determines that an employee entitled to supplemental income benefits could be materially assisted by vocational rehabilitation or training in returning to employment or returning to employment more nearly approximating the employee’s pre-injury employment. The commission

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<sup>115</sup> 76R H.B. 2513

shall also notify insurance carriers of the need for vocational rehabilitation or training services.” The statute further states that any employee that refuses these services loses entitlement to SIBs.

Rather than focusing on the needs of the individual employees and referring employees to the TRC based on need of specific services, TWCC mass mails form letters referring employees that are usually to early in their injury to qualify for TRC services. After the referral, TWCC has no way of knowing whether an employee went to the TRC, was offered or denied services, accepted those services and whether those services were useful in helping the employee find gainful employment. Neither the TRC nor the Texas Workforce Commission (TWC) collaborate in any way with TWCC on returning injured employees to work. In fact, TRC and TWC refuse to share individual specific information and charge TWCC for aggregate data on any referrals from TWCC.

In 2001, HB 2600 mandated several future return-to-work requirements of TWCC. However, the only return-to-work requirement which is currently effective is § 413.021 of the Labor Code, which requires carriers to offer return-to-work coordination services if requested by employers. Although this provision is effective immediately, TWCC is prohibited from enacting rules January 2004. However, TWCC made no efforts to notify carriers of this new requirements or employers of this opportunity.

Lastly § 413.021 of the Labor Code mandates that TWCC shall report twice annually to the Research and Oversight Council on Workers' Compensation (ROC) regarding the implementation and outcome of the return-to-work initiatives required. To date, the ROC has not received any reports from TWCC on their implementation of return-to-work initiatives. At the time of publication, TWCC should have performed two, possibly three reports.

While the committee found that TWCC has a dismal record of implementing their statutory requirements for return-to-work, the committee recognizes that the state has done little to emphasize the importance of return-to-work as a part of TWCC’s mission. TWCC’s funding comes directly from the appropriation process<sup>116</sup> which decides a state agency’s budget on certain agency-specific performance measures. Return-to-work outcomes and data collection are not a performance measure for TWCC. The appropriation process prioritizes a state agency’s allocation of financial and human resources during the rest of the biennium. TWCC has implemented the provision that they felt that they could under their current restraints. However, the committee feels that TWCC has yet to fully investigate how they could change they data collection from other stakeholders to be able to meet some of these requirements. Because of changes in HB 2600, TWCC is beginning this discussions with stakeholders.

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<sup>116</sup> While TWCC does go through the appropriations process, the funds that are used for TWCC’s budget is raised from a tax on insurance carriers’ premiums for workers’ compensation policies.

However, stakeholders themselves are also responsible for the situation of return-to-work in Texas, maybe even more so, since they have a direct ability to influence the outcomes on a case-by-case basis. All stakeholders seem to want better return-to-work outcomes, but none seem to think that they should be the group responsible for the improvement.

Employees are against any penalties for not adhering to prescribed physical therapy and exams. They state that they are already penalized under the current benefit structure by being paid only 70% of regular wages, capped at the state’s average weekly wage.<sup>117</sup> Employee groups point to TWCC or employers for not improving the efforts to rehabilitate and retrain injured workers.

Employers are against being forced to have mandatory return-to-work programs. They argue that small employers and specific industries can not have modified duty opportunities. Small employers have a smaller workforce, and therefore the loss of one employee for a month or longer can be devastating to production. Specific industries that are manual labor intensive (i.e., construction) may not have any job opportunities that someone of limited capabilities can perform. Further, employers are against being responsible for the case management of each injured worker. When an injured worker can no longer return to their pre-injury employment, employers have little to no interaction with injured workers (besides through their carrier). Case management requires intensive contact regardless of who the injured workers’ employer is post-injury.

Both employers and carriers are against mandatory discounts for policyholder that have a return-to-work program. They argue that mandatory discounts limit their ability to provide flexible and competitive pricing, which would only increase premium costs for employers.

Carriers agree that they are the primary stakeholder responsible for case management of an injured worker’s benefits including determining the necessity of care and monitoring an injured worker’s compliancy with therapy and exam appointments. However, carriers disagree on what extent their case management responsibility should extend to return-to-work. Some believe that it is inherent in the goal of the return the injured worker to a pre-injury condition. Others believe that certain rehabilitation, counseling, and retraining are beyond the scope of the workers’ compensation policy. In other lines of insurance, there exists no liability for carriers to provide this type of service.

Doctor groups also disagree on what their role should be in case management. While some doctors feel that they should be intimately involved in discussions with employers, employees and carriers, others argue that their responsibility is returning the employee to maximum medical improvement. While they can and should provide a list of job-related restrictions, it is not the responsibility of the doctor to provide job counseling.

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<sup>117</sup> Workers’ compensation income benefits are not taxable, which is the rationale for only paying an injured worker 70% of their regular pre-tax wages.

All groups feel that TWCC should do more, but when asked specifically what the role of the state should be in encouraging return-to-work stakeholders were reluctant to have state regulation or involvement. In fact, most comments on the state's role were more about how the state should focus their return-to-work efforts (i.e., by industry, by employers with low return-to-work outcomes, by employees with severe injuries), not what type of involvement is necessary.

## **RECOMMENDATIONS**

While a few specific issues did come to light, the main issue that the committee identified was the lack of data. It is difficult to ascertain what recommendations are need when data on the outcomes of the current process are non-existent.

While the committee feels that certain HB 2600 provisions will go a long way to increase the amount and quality of data available, it is concerned that those provisions will either be minimally implemented or not at all like current statutory data collection requirements. Therefore, the committee would recommend making return-to-work data collection a performance measure for TWCC. Eventually, it might be appropriate to make improvements in the outcomes a performance measure as well.

In addition, the committee would recommend that the TRC, TWC, and TWCC inter into a Memorandum of Understanding to be able to exchange data on a case-by-case basis for the purpose of tracking the quality and outcomes of each agency's services.

Through these recommendations and return-to-work mandates in HB 2600 that are scheduled to be implemented over the next biennium, the committee feels that TWCC will improve its data collection and focus on return-to-work. Hopefully, this would provide enough data that when TWCC is subject to review by the Sunset Commission in 2005, stakeholders and the Commission can determine whether more aggressive programs are needed to further return-to-work efforts in Texas.

**SUBCOMMITTEE  
ON THE  
TEXAS  
WORKERS' COMPENSATION  
COMMISSION'S  
SUBSEQUENT INJURY FUND**

## BACKGROUND

In 2001 the Texas Legislature passed House Bill (HB) 2600, an omnibus workers' compensation system reform bill. HB 2600 expanded current reimbursements to carriers from a special fund called the Subsequent Injury Fund (SIF) administered by the Texas Workers' Compensation Commission (TWCC). On the day the bill was considered on the Senate-floor, TWCC released an actuarial study, which showed that these increases in reimbursements would potentially bankrupt the SIF by fiscal year 2003. While HB 2600 passed, concerns about the solvency of the SIF remained. An interim study was assigned to the Committee on Business & Industry to review the fiscal condition of the workers' compensation SIF and to determine whether changes will be needed to keep the fund viable in light of increased demands placed on it by recent legislation.

## WHAT IS A SUBSEQUENT INJURY FUND?

After World War II, veterans found employers were reluctant to assume the increased risk of a compensable injury for an employee with a pre-existing, war-related injury. A previous injury would increase the total disability of the subsequent injury and thus increase the financial liability the employer would pay in workers' compensation benefits. Subsequent Injury Funds (also known as Second Injury Funds) were created by states to encourage employers to hire injured employees by guaranteeing that the employer would only be required to pay for the benefits owed because of a compensable injury. Any benefits that the employee would be eligible for because of the combined impairment of a pre-existing injury and a compensable injury would be paid for or reimbursed from the Subsequent Injury Funds (SIF). Originally 49 states and the District of Columbia had SIFs<sup>118</sup>.

There are as many variations in funding for SIFs as there are number of SIFs, each state having its own slightly different version. But there is only one funding source - insurance carriers that write workers' compensation. State SIFs generally receive the funding through one or more of the following methods, the first two being the most popular:

- 1) Assessments - The state will assign an assessment based on a percentage of either total losses or total premium dollars received from the previous year. This method applies to both private insurance carriers and self-insured employers.
- 2) Death benefits - The state will either assess a percentage of every death benefit paid as a result of a compensable injury or assess a carrier the total death benefit for claims with no beneficiary.

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118 Wyoming is the only state never to have Subsequent Injury Fund  
❖ *Interim Report to 78th Legislature*

3) Penalties and Fees - The state will receive monies through the penalties assessed for violations of statutes or through fees charged for a license for a carrier or self-insured employer.

4) Appropriations - One state, California, utilizes legislatively appropriated funds only.

States usually assess these funding mechanisms against both carriers and self-insurers; although in Delaware self-insurers are exempt because their employees are not covered by the state's SIF.

## THE ISSUE

Texas' SIF was created in 1947 as "a special fund within the State Treasury."<sup>119</sup> As such, it is a separate and distinct dedicated-account maintained in the State Treasury and administered by TWCC. The daily operations of the SIF are maintained by an Assistant General Counsel for TWCC's Legal Services Department who acts as the Fund Administrator (Administrator) and two administrative assistants. Supervision and maintenance of SIF revenue, expenditures and records are a part-time responsibility for all staff involved.

SIFs original purpose (and still its primary responsibility) was to compensate an employee if the combination of a previous and subsequent injury entitled the employee for Lifetime Income Benefits. The SIF would be responsible for the difference of entitlement between the total disability and the disability if the previous condition had not existed.

Most of the SIF's revenue is provided by the payment of death benefits by insurance carriers for claims in which the deceased employee has no beneficiaries, or those in which all beneficiaries cease to be eligible prior to the payment of 364 weeks (seven years) of benefits.<sup>120</sup> In

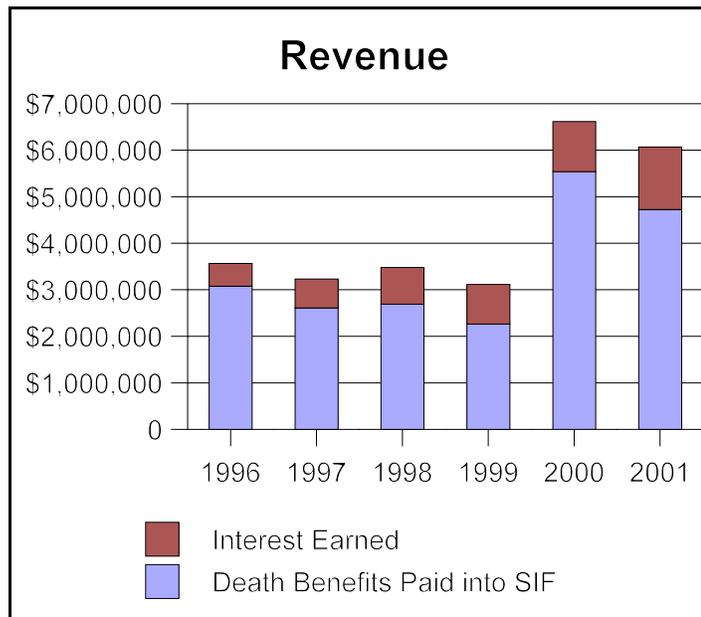


Figure 1: Numbers reconciled by TWCC and ROC staff, 2002

<sup>119</sup> Labor Code §403.006(a), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>120</sup> Labor Code §403.007(a), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<b>Texas TWCC Insurance Maintenance Tax</b>	
2002 Revenue:	\$69,972,903.67
Current Rate:	1.67%
Capped at:	2.0%
1957:	Enacted at a rate of 0.25%
1971:	Self-Insurers added to base
1977:	Rate Increase to 0.45%
1985:	Capped at 0.70%
1989:	Rate set by TWCC, capped at 2.0%
*	Used to fund TWCC
*	Increase has never been due to SIF obligations

**Figure 2:** Comptroller's Office numbers as of June 2002. The amount collected is expected to rise through the end of the fiscal year.

cases in which there is no beneficiary, the insurance carrier is required to pay an amount equal to 364 weeks of death benefits into the SIF. In cases in which the carrier begins to pay benefits to an eligible beneficiary, but that beneficiary subsequently ceases to be eligible (e.g., re-marries, or, in the case of a minor, reaches the applicable statutory age limit) prior to the payment of 364 weeks, TWCC rule stipulates that the carrier is to pay the unpaid amount up to 364 weeks into the SIF.<sup>121</sup> According to TWCC, there are approximately 200 compensable, work-related fatalities a year in Texas, about 16 a month. The SIF has averaged 39 death benefits paid a year over the last six years which represents an average of \$3.5 million in revenue.<sup>5</sup> These death benefits are paid by carriers, certified self-insured employers, the State of Texas and political subdivisions.

The remainder is then paid into the

Subsequent Injury Fund. The carrier may pay weekly or may pay in a lump sum. If payment is made in a lump sum, TWCC will discount the amount owed by the estimated amount of interest that the Commission will earn. Interest made on the account balance and these new revenues is accrued at an annual rate determined by the Comptroller of Public Accounts and was last reported at 2.63%<sup>6</sup> (historically this interest rate has been approximately 5%).

A statutory provision was added in 2001 that allows a back-up form of funding. If TWCC determines that the SIF cannot meet all of its obligations, it is required to increase the rate of assessment for the maintenance tax. The increase shall be an amount not to exceed what would be sufficient funds to cover 120% of unfunded liabilities for the next biennium (as certified by an independent actuary or financial advisor).

<sup>121</sup> Administrative Code §132.10(b), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>5</sup> Letter from TWCC to the committee on March 22, 2002, Attachment C

<sup>6</sup> As reported in a discussion between the committee and Comptroller's staffs on August 14, 2002.

The maintenance tax rate is set annually by the TWCC, not to exceed 2%<sup>7</sup> of the correctly reported gross workers' compensation insurance premiums for the preceding year. In 2001, it was paid by 285 insurance carriers and 53 certified self-insurers.

Death benefits paid into the SIF are made by carriers, certified self-insurers, state agencies and political subdivisions. However, the maintenance tax is only paid by carriers and certified self-insurers. Therefore, an increase on the maintenance tax would impact a select population of the workers' compensation arena.

<b>7 Conditions which will qualify an employee for Lifetime Income Benefits in Texas</b>	
<ul style="list-style-type: none"> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> <li>•</li> </ul>	<ul style="list-style-type: none"> <li>total and permanent loss of sight in both eyes;</li> <li>loss of both feet at or above the ankle;</li> <li>loss of both hands at or above the wrist;</li> <li>loss of one foot at or above the ankle and the loss of one hand at or above the wrist;</li> <li>an injury to the spine that results in permanent and complete paralysis of both arms, both legs, or one arm and one leg;</li> <li>a physically traumatic injury to the brain resulting in incurable insanity or imbecility; or</li> <li>third degree burns that cover at least 40 percent of the body and require grafting or third degree burns covering the majority of either both hands or one hand and the face</li> </ul>

**Figure 3:** Labor Code §408.161(a), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

TWCC is unable to use these funds for any purposes other than those specifically provided for in statute. Therefore, TWCC may not utilize these funds to help with the operational expense of administrating the SIF, nor may it transfer these funds to help with agency operational needs. Originally the only statutorily allowed reason for an expenditure was either to pay for the reimbursement of a death benefit erroneously paid to the SIF or the payment of Lifetime Income Benefits (LIBS) to an eligible employee.

The Texas' SIF is one of the most restrictive in covered benefits. In most states, the SIF covers the a Substantial Change Benefit, which incorporates any benefit, affected by a pre-existing condition called, whereas Texas will only cover LIBs. By statute, LIBs are paid to an employee under seven specific conditions.

The Texas SIF will only cover an employee's LIBs if the employee was eligible because of a pre-existing injury. Since there are only seven very specific instances which will qualify an employee for LIBs in Texas, this is a considerably smaller risk pool than other states. In fact, some states have liabilities up to \$6 billion dollars<sup>8</sup> whereas Texas' current liabilities are only \$8-9 million for LIB cases with annual pay-outs of about \$1.4 million (for LIB and carrier reimbursements). Currently,

<sup>7</sup> Labor Code §403.002(b), May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>8</sup> Steven Bennet, "Second Injury Funds: Moving Into the Past Tense," *Fall 2000 Issues Report*, November 2000, <[http://www.ncci.com/ncci/web/prodsserv/publications/images/11\\_00\\_6.pdf](http://www.ncci.com/ncci/web/prodsserv/publications/images/11_00_6.pdf)> (August 1, 2002) "Connecticut's second injury fund was estimated as having \$6 billion in unfunded liabilities when it was repealed several years ago; Kentucky, over \$2 billion. Florida's is estimated to have over a \$4 billion deficit."

the SIF pays LIB benefits for thirty-seven injured workers, totaling a mean of \$350,000 - \$400,000 in payments a year. While LIBS remain a small portion of expenditures, they show an upward trend in growth of 55% over the last six years, mostly due to statutory changes in 1989, which added a 3% annual escalator to LIBS payments that occurred on or after January 1, 1991.

In 1991, the SIF also became liable for reimbursements to carriers for orders issued by Benefit Review Officers or decisions issued by the Appeals Panel that were eventually overturned. This provision was expanded in 1999 by incorporating decisions made by Hearing Officers at Contested Case Hearings. In addition, the Legislature gave the Executive Director the authority to enter an order for payment of all or part of an employee's medical expenses.

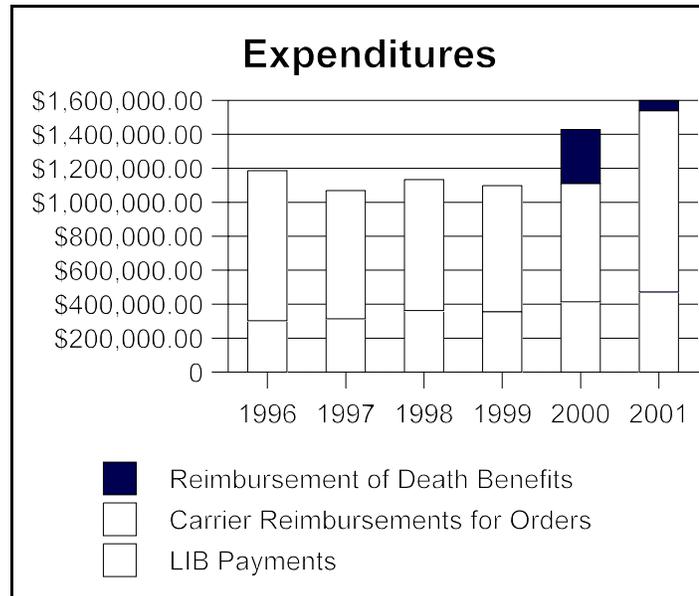


Figure 4: Number reconciled by ROC and TWCC staff, 2002

LIB payments are made to employees and reimbursements are made directly to carriers, certified self-insurers, state agencies and political subdivisions. Carrier reimbursements between 1996 and 2000 averaged around \$700,000, but spiked sharply in 2001 to about \$1 million. This spike is estimated to be due to an expansion in the orders eligible for reimbursement.

In 2001, HB 2600 added four new financial obligations to the SIF. Most are minimal in their expected costs and can be absorbed by the current funding level. HB 2600 increases the eligibility for LIBs by adding severe burns to the list of injuries for which a claimant is eligible for LIBs. HB 2600 also requires that carriers pay for the first 7 days of pharmaceuticals for an injured worker regardless whether there is a dispute over the compensability of the injury. If the injury is later deemed not to be compensable carriers are eligible for reimbursement from the SIF for pharmaceutical benefits paid. In addition, HB 2600 establishes the Health Care Network Advisory Committee to evaluate the feasibility of and advise on the implementation of regional fee-for-service workers' compensation health care delivery network. The Health Care Network Advisory Committee is allowed to dedicate and spend up to \$1.5 million of SIF monies to assess feasibility of, develop and evaluate regional networks.

However, by far the most expensive expansion of liabilities for the SIF is the addition of multiple employment reimbursements. Article 10 of HB 2600 requires carriers to pay income benefits based on all IRS reportable income that a claimant receives and not just the income that is made at the policy holder's work site. Carriers may file for a reimbursement from the SIF for these additional

income benefits which are not covered under the policy premiums. The Research and Oversight Council on Workers' Compensation (ROC) originally estimated total liabilities to the SIF of multiple employment benefit reimbursements at approximately \$11-13 million per fiscal year for injuries that occurred in a given fiscal year. TWCC's May 2001 actuarial study expected Multiple Employment Benefit reimbursements to absorb all of the SIF assets within two years if full reimbursements were made to insurance carriers.

As a counterbalance for these reimbursements, HB 2600 included the following elements designed to assist TWCC with the ongoing management of the SIF:<sup>9</sup>

- A required actuarial analysis of the SIF by TWCC, in an effort to track the viability of the fund, with a report to ROC on the SIF's financial condition required twice a year;
- A provision stipulating that, if the projected liabilities of the SIF are forecasted to exceed its available assets according to the actuarial analysis, TWCC has the authority to trigger an increase in the maintenance tax to provide additional funding.<sup>10</sup> The increase shall be an amount not to exceed what would be sufficient funds to cover 120% of unfunded liabilities for the next biennium (as certified by an independent actuary or financial advisor);
- A provision that allows TWCC to make partial payments of carrier requests for reimbursement of multiple-employment based benefits, also in the case of a projected inadequacy in funding based on the actuarial analysis; and
- A provision allowing TWCC to prioritize the liabilities of SIF.

However, Some concerns existed about the current trends in the SIF liabilities, even before the additional burdens of HB 2600. Overall, expenditures grew by 41% over the period reviewed by the committee. With the multiple employment benefits effective July 1, 2002 this trend is only expected to increase exponentially.

## **THE SOLVENCY OF THE SIF**

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<sup>9</sup> Labor Code §403.006 and 403.007 , May 21, 2002, <<http://www.capitol.state.tx.us/statutes/statutes.html>>

<sup>10</sup> The maintenance tax is a tax on gross workers' compensation insurance premiums in Texas and is paid by all insurance carriers and certified self-insurers operating in the state, except for governmental entities. Governmental entities include the state government as well as other political subdivisions, such as school districts, cities and counties. The current statutory cap on the maintenance tax is two percent of the gross workers' compensation insurance premium in the state.

Interest in the financial status of the SIF began in 1998 when discussions started about expanding the current reimbursements for carriers. The internal audit reported on the SIF as part of their risk assessment. The auditor recognized the expanding SIF obligations and predicted in 1998 the possibility that at some point in the future, the fund balance could be depleted, resulting in the SIF operating on a year-to-year basis, with little or no fund balance remaining at the end of each year. This would mean that with the exception of LIB reserves to LIB payments, the SIF would only be able to pay out in reimbursements, what it received in revenue that same year. The auditor pointed out that should the SIF go to a year-to-year basis, LIB payments would be the first priority with carrier benefits being second. The auditor made five management recommendations.

First, the Auditor recommended that TWCC initiate formal procedures documenting activities related to processing additions to and deductions from the fund should be developed. In addition, cross-training was recommended so that knowledge of fund activities and processing does not rest with one individual. TWCC agreed with these recommendations and stated that in addition to preparing a formal procedure, newly revised Rules will include specific instructions regarding requests for reimbursement. However, when this interim report started it appeared that no cross-training had ever been done, and only internal procedures on the accounting had been completed. Further, rules with specific instructions regarding requests for reimbursements were not adopted until July 24, 2002, four years after it was proposed by the Internal Auditor.

To ensure that deposits into the SIF are accurate, the Auditor recommended the Commission develop a formal procedure to audit the AWWs used by the carrier in calculating death benefits, which the Commission disagreed with in part. The Commission felt that if the AWW used by the carriers are determined at the administrative and judicial dispute levels and resolved, AWW is not subject to modification by the SIF administrator. Whereas if a carrier pays death benefits without issuance of a CCH order, SIF or Hearings or E/EFS may need to implement formal review procedures. The Commission stated that a proposed provision was included in draft new Rules, however to date they have not been adopted.

The Auditor also felt that the SIF administrator and Accounting staff should review the content and format of the SIF information that is currently being distributed to upper management to ensure that the level of detail and volume meets management's needs. Content changes were made to the report.

To reduce the risk of benefit fraud, the Auditor also recommend that the Agency develop a procedure to independently confirm that injured workers receiving LIBs from the SIF actually exist. For example, the Auditor specifically mentioned field office employees visits with the injured workers receiving LIBs to facilitate completion of the statement. Another alternative mentioned was requiring that the annual entitlement statement be notarized. TWCC agreed. They moved the function to the SIF Administration which developed a reply form to be signed and returned by LIBs recipient or immediate relatives. However, it was not required to be notarized. This continues to be an issue and is listed in this reports as a concern.

Lastly the Internal Auditor suggested the fund Administrator should forward copies of the requests for reimbursement to the Hearings Division, to assist the Hearing Division in identifying opportunities for reducing the number of cases involving I/Os that are overturned (and therefore resulting in requests for reimbursements by carriers). TWCC agreed and had those requests forwarded to the Hearings Division.

So out of the five recommendations made in 1998, TWCC addressed three of them. However, of these three, two continue to be issues for the SIF. Of the other two recommendations, Rules suggested in one of the recommendations was finally proposed and adopted during the process of this report and one still awaits action.

An additional internal audit was performed in 2001 at the request of Executive Director Len Riley. Again the internal auditor identified the potential of SIF solvency issues although the SIF seemed to remain a healthy account, liabilities appeared to be on the rise and revenue stagnant. Again, several management changes were suggested by the Internal Auditor.

A recommendation was made to change the terminology and financial data changes in Management reports, with which TWCC complied.

The auditor repeated the recommendation that the Commission should attempt to control the number of carrier reimbursements through training and education. The Auditor also recommended that the Commission adopt a policy regarding application of existing penalties related to payment of benefits under the current statute or adopting new penalty provisions for the SIF. Further investigation into whether cash value or present value is the appropriate method for calculating LIB reserves, was also suggested. At the beginning of the interim report the committee found no evidence that any of these recommendations had been acted on.

A recommendation was made to hire someone with an accounting background to serve as an interface between the Administrator and the Accounting Office. While TWCC did dedicate another staffer to the SIF part-time, the personnel in question did not have an accounting background.

Oddly, the Auditor agreed not to make formal recommendations in the report on LIB Liabilities because of "agreements that the Auditor and the Administrator / Accounting Department came to on issues"<sup>11</sup> of (page 10):

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<sup>11</sup> TWCC Internal Audit, 2001 page 10

- Calculation of LIBS
- types of reports needed to ensure that the liabilities are accurately calculated and reported
- Need for documented accounting procedures detailing the steps necessary to perform these duties.
- Relevant calculations were supposed to be recalculated and accounting records updated to reflect the recalculation by the time of the report's publication.
- Applicable procedures for the Accounting Manual were also supposed to be drafted at the time of the report's publication.

At the beginning of this interim report the only other recommendation which had been acted upon was the contracting of an actuarial study.

TWCC paid \$19,800 for an April 2001 actuarial study of SIF solvency through fiscal year 2005 (the April study). An additional \$4,000 was paid for a May 2001 study focusing solely on the impact of multiple employment benefits (the May study).

The original report stated that the "long-term solvency condition of the SIF is good."<sup>12</sup> with a projected balance in 2005 of \$32,152,000 an increase of more than \$9million from the 2001 starting balance. The May study, which took into account the additional burden of multiple employment benefit reimbursements from the SIF projected that the "implementation of the pending legislation will threaten the financial solvency of the SIF and therefore trigger the need to collect a maintenance tax starting in the year 2003."<sup>13</sup> The second report was released on May 18, 2002, the day HB 2600 was considered on the Senate floor for a vote.

The solvency of SIF became a serious issue for TWCC staff, the ROC<sup>14</sup> and the committee after the passage of HB 2600. Committee and ROC staff began by reviewing the actuarial reports performed in April and May of 2001. Despite Executive Director Richard Reynolds' claim that "Although there was not a written procedure for reviewing the actuarial work performed, all work products were reviewed for accuracy and comprehensibility by the SIF Administrator and the Internal Audit staff. Commission staff worked closely with the contractor to make corrections and clarifications before the final reports were submitted."<sup>15</sup> However, it was determined that TWCC could not verify where certain numbers or measurements came from even though the footnotes of the actuarial report cites material from TWCC. Conversion factors are unexplained and even missing in some areas. Further,

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<sup>12</sup> TWCC Actuarial Report of the Subsequent Injury Fund, April 12, 2001, pg. 2

<sup>13</sup> TWCC Actuarial Review of the Financial Impact of HB 2600 Section 10 on the Subsequent Injury Fund, May 2001, pg. 2

<sup>14</sup> A research project concerning the impact of multiple employment on the SIF was included in the ROC 2002 research agenda. A report is expected in December.

<sup>15</sup> Letter from Mr. Reynolds to the committee on March 7, 2002.

numbers that could be verified by TWCC seemed to be misrepresented in the actuarial report. Further, since TWCC never received any work papers from the actuary there is no way to verify any of his calculations, methodology or changes in trends that have been evident for the past decade. In short, it appears that the actuary under estimated revenues and over estimated liabilities. TWCC staff acknowledges the inaccuracies in both actuary reports and since its original distribution; the actuary reports have not been used for any policy decisions at TWCC.

For the purposes of reconciling the financial data and getting an accurate view of the past and future solvency of the SIF, TWCC, ROC and committee staff agreed that the April actuarial report was unreliable and had little value for predicting future solvency. The May actuarial report evaluating the impact of multiple employment benefits on the SIF was based on data from the April actuarial report. Therefore, the committee disregarded either report in evaluating the financial status of the SIF.

The committee was left with numbers from both internal audits, financial reports from the Accounting Department and the Comptroller's Office. ROC and TWCC staff did a detailed line-by-line reconciliation of all of these materials over the course of four months.

In addition to the reconciliation of the SIF financial numbers, ROC staff spent six months updating the original HB 2600 fiscal note for multiple employment and developing projections of the SIF's expected revenues and liabilities for FY 2002-2007. These updated estimates provide a more accurate and comprehensive understanding of both the expected long-term liabilities and short-term cost of the new multiple employment benefit (Bonnie, do you want to cite the ROC report here and do you want to include it as an appendix?). Although the original fiscal note for HB 2600 provided a rough estimate of the total liabilities associated with the multiple employment provision, two general conclusions could be drawn from the original fiscal note:

- The addition of a new multiple employment provision would add between \$11 and \$13 million a year in system liabilities – not an insignificant amount; and
- The SIF, with an approximate \$25 million balance as of the passage of HB 2600, would likely be a sufficient short-term source for funding the new provision by reimbursing carriers who pay additional benefits based on it, but would not be a sufficient long-term source.

	FISCAL YEAR					
	2002	2003	2004	2005	2006	2007

Estimated # of workers affected	4,387	4,387	4,387	4,387	4,387	4,387
Average number of weeks workers receive TIBS	11.3	11.3	11.3	11.3	11.3	11.3
<b>System Impact: Estimated additional income benefits paid out by injury year</b>	<b>\$11.4 mil.</b>	<b>\$11.7 mil.</b>	<b>\$12.1 mil.</b>	<b>\$12.6 mil.</b>	<b>\$13 mil.</b>	<b>\$13.2 mil.</b>

Figure 5: ROC

The original fiscal note calculations were based on 1999 national multiple employment estimates from the U.S. Department of Labor, Bureau of Labor Statistics (BLS). The Calculations were then broken down into four major employment groups (based on information from BLS):

- Workers with two full-time jobs
- Workers with two part-time jobs
- Workers with one full-time and one part-time job (injured on full-time job)
- Workers with one full-time and one part-time job (injured on part-time job)

In addition, the ROC calculated Temporary Income benefits (TIBS) based on TIBS duration information from TWCC’s System Data Report (data through the end of fiscal year 2000), whereas Impairment Income Benefits (IIBs) and Supplemental Income Benefits (SIBs) impact were calculated as just a percentage (10%) of the total TIBS impact. No LIBs or Death Benefit calculations were included. In addition, the ROC assumed for their calculations that part-time wages would be half of the full-time wages.

For the new fiscal note several data resources were updated, and variables were both recalculated and additional variables were added. Updated resources included the use of the 2001 multiple employment estimates from the U.S. Department of Labor, Bureau of Labor Statistics (BLS) and the 2001 TWCC System Data Report.

Part-time wages were recalculated based on actual data rather than assuming 50% of full-time wages. IIBs and SIBs impact were calculated using actual data from the System Data report. Because of this, the average TIBS duration increased significantly (from 11.3 weeks to 18.5 weeks). A weighted average of multiple years was used in the new projections to mitigate changes over time.

Three new variables were added to the formula. First, LIBs and Death Benefits were added to the projections using actual data from the System Data Report and actual claims data from TWCC. Secondly, the actual effective date of July 1, 2002 was factored into the calculation. The original fiscal note assumed that the multiple employment provision would be effective when the bill became effective, which was June 17, 2001. However, a delayed effective date was added to the bill after the fiscal note was calculated. Lastly, and most importantly, the ROC included a learning curve for injured workers, employers and carriers to utilize the benefit. The revised fiscal note inserts an approximate 4-year learning curve into the projections and assumes that a maximum of 80% of eligible workers with multiple employment will seek out, prove, and ultimately receive additional income benefits.

TWCC staff informed ROC staff that the SIF would make its first reimbursements of multiple employment-based benefits in October 2003 (early in FY 2004). Any multiple employment-related carrier payments made from the effective date of the provision to this time and properly submitted to the SIF would be reimbursed at this time. TWCC plans for the SIF to continue on this once-a-year reimbursement schedule, paying in October of each year, for the foreseeable future.<sup>16</sup>

Based on this reimbursement plan, ROC staff assumed that additional multiple employment-based benefits paid by carriers in FY 2002 and FY 2003 would be reimbursed in October 2003 (early FY 2004); the benefits paid in FY 2003 would be reimbursed in October 2004 (early FY 2005); and so on. Figure 6 shows the projected SIF balance based on actual multiple employment-based reimbursements made in a given fiscal year, assuming the four-year learning curve for employees and full reimbursement of carriers. Note that no SIF payouts related to multiple employment are shown in FY 2002 or 2003, since TWCC does not plan to make the first SIF reimbursements until early FY 2004.

It should be noted that while multiple employment-related reimbursements from the SIF in Figure 6 are shown on a payment rather than liability basis, SIF LIBs payment are still shown in terms of liability. This is because the payment of LIBs from the SIF is given the highest priority of any SIF obligation, and under no foreseeable scenario would TWCC not reserve for these payments on either a cash or present value basis.

	FISCAL YEAR
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<sup>16</sup> TWCC provided information on this payout plan in late July 2002, just after the adoption of revised TWCC Rules 116.11 and 116.12, related to the SIF. It should be noted that the information provided by TWCC on the planned October payout schedule could alter the ROC's previous projections of the present value liabilities of the SIF for multiple employment-based reimbursements. ROC did not assume as long a lag before reimbursement from the SIF as this payout plan would allow, but the information on the SIF payout schedule came too late to make changes in the report prior to publication. The effect of incorporating longer lags would be to lower the present value liabilities on the SIF and bears consideration in future projections.

	2002	2003	2004	2005	2006	2007
Revenue: SIF death benefits	\$4.5 mill.	\$4.8 mill.	\$4.8 mill.	\$5.0 mill.	\$5.1 mill.	\$5.3 mill.
Revenue: Interest	\$1.0 mill.	\$1.2 mill.	\$1.2 mill.	\$741,211	\$327,287	(\$189,423 )
SIF LIBs liabilities (reserved)	\$9.5 mill.	\$10.2 mill.	\$10.8 mill.	\$11.3 mill.	\$11.8 mill.	\$12.4 mill.
Expenditures: Carrier reimbursement, non multiple employment	\$942,642	\$1.0 mill.	\$1.0 mill.	\$1.0 mill.	\$1.0 mill.	\$1.1 mill.
Expenditures: Multiple employment reimbursements	\$0	\$0	\$3.5 mill.	\$8.8 mill.	\$14.3 mill.	\$16.9 mill.
<b>Estimated year-end available assets (cash value)</b>	<b>\$22.6 mill.</b>	<b>\$25.9 mill.</b>	<b>\$26.2 mill.</b>	<b>\$21.7 mill.</b>	<b>\$11.2 mill.</b>	<b>(\$2.1 mill)</b>
<b>Estimated year-end available assets (present value)</b>	<b>\$23.1 mill.</b>	<b>\$26.9 mill.</b>	<b>\$27.6 mill.</b>	<b>\$23.7 mill.</b>	<b>\$13.7 mill.</b>	<b>\$741,603</b>

Figure 6: ROC

While the revised fiscal note increases the ultimate yearly impact of multiple employment reimbursements when fully utilized from \$3.5 million to \$16.5 million, it includes a learning curve and an expected utilization cap of 80% of eligible employees. The maximum utilization is based on the fact that many employees may only marginally benefit from the multiple employment benefit and may not find it worthwhile to go through the paperwork of proving additional income for so little reimbursement. Conversely, it is also possible some carriers that provide only a small market share of the workers' compensation market in Texas may not find it worthwhile to file for reimbursement from the SIF.

While Figure 6 shows that the year-end assets would be negative in fiscal year 2005, this solely portrays the impact of multiple employment benefits on the SIF under pre-HB 2600 funding mechanisms. The SIF could never actually operate in the negative. To understand this it is important to examine not only the reimbursement schedule for the SIF, but also the additional financial controls that HB 2600 afforded TWCC to prevent insolvency.

First, the SIF reimbursement schedule<sup>17</sup> clearly outlines the obligations for which the SIF is liable and the manner and time in which they will be reimbursed. The SIF is responsible first and foremost for reimbursements to carriers for death benefits erroneously paid into the SIF. These benefits are to be paid to the carrier in full, on a quarterly basis. The second priority is any LIB payment to an injured worker. These benefits must be paid in full either weekly or monthly based on an administrative decision or a court order. Each year the SIF pays out an average of \$350,000 in LIBS payments. In addition, it keeps a cash value reserve for future payments on these claims of \$8 million dollars which is dedicated and not eligible for any other types of payments from the SIF. The third priority for payments from the SIF is benefit overpayments. This includes only the carrier reimbursements authorized before HB 2600. These benefits must be paid in full<sup>18</sup> on a quarterly basis. The last benefits that are reimbursable from the SIF are those liabilities created under HB 2600: multiple employment and pharmaceutical benefit reimbursements. These reimbursements to carriers are paid out at the end of the year, only after all other requests for reimbursements and benefits have been paid. At that time the SIF Administrator will determine whether there are enough funds available to cover them. If there is not, HB 2600 allows for partial payments to carriers. According to the SIF reimbursement schedule the Administrator will divide the amount requested by the amount available to derive a percentage. That percentage will then be applied to the amounts requested for the total amount that will be reimbursed. Further, any unpaid liabilities are not carried over to the next year. Thus, in our projection in Figure 6, it's possible that partial payments will be utilized in fiscal year 2004.

Additionally, as discussed earlier, HB 2600 allows TWCC to increase the maintenance tax rate to cover SIF liabilities. At the end of every biennium<sup>19</sup> an actuarial report of the projected SIF revenues and liabilities for the next biennium is to be done. If after reviewing the actuarial report, TWCC determines that there will be a gap in the coming biennium between revenues and liabilities, TWCC may increase the maintenance tax rate incurred by carriers and certified self-insurers to a level that would generate enough revenue to cover 120% of the expected gap in SIF funding. Thus, in Figure 6 an actuarial study would be done late in fiscal year 2006 to cover the 2007 and 2008 fiscal years' liabilities.

An increase in the maintenance tax can still only raise the tax to its statutory cap of 2% of premiums. Thus, it is possible that if the funding gap exceeds the statutory cap that carriers would be taxed to its mandated limit, the SIF would have to implement large partial payments to carriers in order to maintain adequate funding for their higher priority mandates, and TWCC's operating budget would reach its ceiling as its funding comes from the same tax. While this is not a desirable situation, it is

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<sup>17</sup> TWCC Rule § 116.11- 12, adopted by the TWCC on July 24, 2002.

<sup>18</sup> Carriers are rarely reimbursed the total amount that they requested because expenses are deemed ineligible for reimbursement by the SIF Administrator. These decisions are not appealable except through a lawsuit. Currently there is a lawsuit in which a carrier asserts that the Administrator has no discretionary authority between what is requested and what is reimbursed and also asks for a judicial review of the process that the Administrator uses to decide what is reimbursable. The case is not expected to be decided before the print deadline for this report. The case is Everest National Insurance Co. vs. TWCC, Cause # 03-01-00631-CV in the 201st District Court.

<sup>19</sup> TWCC has contracted for an actuarial report of the SIF, as mandated by HB 2600, due in November 2002.

a more accurate description of a worst case scenario than one that states that the SIF would become insolvent.

Thus, in a partial answer to the committee charge, the SIF cannot go insolvent. However, the worst case scenario for the SIF is not a desirable option and is a possibility by fiscal year 2005.

## **ISSUES**

There have been many issues raised that should be addressed, either internally at TWCC or legislatively. These issues can be broken down into three main categories: Existence, Management and Funding/Liabilities.

The issue of the SIF's existence is a serious one for legislators to consider. Although there were originally 49 SIFs in the United States, only 33 SIFs remain. The main reason is the Americans with Disabilities Act (ADA). In 1973, Congress passed the Federal Rehabilitation Act which prohibited organizations which receive federal funds from discriminating against otherwise qualified individuals on the sole basis of a disability. In 1990, Congress enhanced this with the ADA. Among other things, the ADA prohibits an employer from discriminating against an applicant for a disability. Which prompted state legislatures to question the necessity of a SIF. Since disabled employees were protected by the ADA from hiring discrimination, some states decided the original premise of a financial incentive to employers had become obsolete and began repealing their SIFs. To date 16 states have repealed their SIFs.

States which have repealed their SIFs have usually done one of two things to ensure payment of current claims. Either the Fund has existed in a "wind-down" phase, still collecting assessments to an amount that would meet the expected liabilities of current claims only or the Fund has purchased annuities to ensure future payments and administration of liabilities. While the annuities route liberates insurance companies from any future assessments to pay for those current claims, it is, at times, a riskier proposition for the claimant as those funds are susceptible to market influences and while the principle in the annuity may increase, it could also decrease in a tight market.

For future subsequent injury claims filed in states that have repealed their SIFs, insurance companies have borne the cost of the total disability. Thus, for the system, the only impact to eliminating a SIF is on the carrier. They either pay SIF assessments and the cost of subsequent injuries is pooled among all carriers or each carrier accepts the risk of subsequent injuries for its own policyholders. HB 2600 allowed TWCC to purchase annuities for their reserves, but to date TWCC has not fully investigated this option. The committee would recommend that TWCC do a cost analysis study of the utilizing annuities for LIB reserves.

If the SIF is no longer responsible for paying these subsequent injury LIBS, then the question becomes what benefits does the Texas SIF serve? Unlike other states, Texas utilizes its SIF to reimburse carriers for overpayments on benefits that are ordered by TWCC. Some carriers feel this is a counterbalance for the obligation to pay while a dispute is being processed through the administrative dispute resolution process. Again, it's a pooling effect. Every insurance carrier pays into the fund and every carrier gets a benefit out of the SIF.

However, if the SIF had to raise the maintenance tax to subsidize the SIF revenue from death benefits, the benefit would no longer be an even pay-in/pay-out. Carriers, certified self-insurers, state agencies and political subdivisions pay into the SIF through death benefits. However, only carriers and certified self-insurers pay the maintenance tax, and thus be responsible for any increase of the SIF revenue through the maintenance tax. Carriers and certified self-insurers would be taxed more to benefit stakeholders who are not equally providing revenue for the SIF. In addition, if the maintenance tax reaches its cap because of SIF increases, the TWCC operating budget would also be capped as well. Stakeholders may find it a better use of their resources to pay for better services at TWCC than a risk pool for subsequent injuries and overpayments. The committee recommends the Sunset Commission, during its evaluation of TWCC in 2005, examine the continued need for the SIF.

The second major area for concern is general management issues. As mention previously, the SIF is administered by an attorney, a paralegal and an administrative assistant, none of whom are dedicated to the administration of the SIF. The administrator is responsible for both the revenue generation and the determination of payments.

To track incoming revenue, the SIF administrator is responsible for identifying fatality claims where no beneficiary exists or is questionable, tracking those claims and representing the SIF through any dispute resolution process and determining the amount of benefits owed the SIF. All of these tasks present complications. For example, there is no data flag to identify when a death does not have a beneficiary. Additionally, a beneficiary may qualify but will not be eligible for the entirety of the life of the available benefit, i.e., a child who reaches 18 years of age or a spouse who remarries. The remainder of any benefits would also be owed to the SIF. Currently, to confirm that all death benefits owed the SIF are actually collected, TWCC staff must undergo an arduous process of comparing reported deaths with TWCC records of beneficiaries who received benefits. Annual checks would need to be done to confirm continued eligibility of dependant benefits. This is not done. The SIF administrator has done an exhaustive search of this nature twice and each time the revenues for that year increased (1996 and 2000). Currently, TWCC staff is undertaking a project of this nature, but results are not expected until the end of the year.

The committee recommends the Commission investigate several options to assist with SIF data and revenue collection. The first option would be to initiate some sort of data flag for when a carrier identifies a potential SIF claim. The second would address the issue of a payment deadline.

Although death benefits are due to the claimant the day after the fatality, beneficiaries have up to a year to come forward. Many carriers will wait for a year before paying into the SIF. A data flag for identifying beneficiaries or conversely failing to identify a beneficiary would be useful. However, these data points which are useful for the identification of SIF claims do not incentivize a carrier to pay into the SIF. The committee would recommend the initiation of a specific deadline for paying into the SIF and a penalty for not doing so. While TWCC currently has a penalty for not paying a benefit to a beneficiary, this penalty has never been used against a carrier for failing to pay the SIF. It appears that the only penalty for not paying into the SIF is interest that accrues since the benefit was due.

TWCC is further hindered by a lack of standing to dispute the determination of the benefit amount. When a worker dies, the carrier will determine the average weekly wage (AWW) which will then be multiplied over a number of weeks to determine the life of the benefit. The beneficiary may dispute the calculation of the AWW. Although the SIF would be the beneficiary if no dependent can be located, the TWCC does not have standing to dispute the calculation of the AWW. The committee recommends that TWCC should be given legal right to defend the interests of the SIF in any dispute process or benefit negotiation with a carrier. Further, while total benefits to a injured worker may last up to 401 weeks<sup>20</sup>, a SIF benefit is calculated for 364 weeks for no apparent reason. The committee would recommend increasing the number of weeks a SIF benefit is calculated by to 401 weeks.

Finally, the SIF Administrator is responsible for determining, based on an actuarial study, whether expected revenue and current funds will be sufficient to cover expected liabilities. This evaluation triggers the TWCC decision whether to raise the maintenance tax.

In determining payments out of the SIF, the Administrator not only handles payments to LIB recipients, but they also handle payments to carriers. Each of these processes contain their own management issues.

For LIB payments, the Administrator represents TWCC in negotiations with carriers to determine whether a case qualifies as a subsequent injury claim. The Administrator then determines the cash reserves needed to pay for the life of the claim. This is done based the life expectancy of the claimants multiplied by the AWW. These reserves are then dedicated from the SIF. This is currently done on a Cash Value basis, as is the rest of the accounting of the SIF. Cash Value requires that the SIF account for each dollar that they receive and each dollar that they have paid out and for each dollar need to pay off a claim over its entirety. For determining LIB reserves this means that the Administrator earmarks in the first year enough dollars to pay off the life of that claim. Which means it is extremely important that an adequate amount is committed for those claims. The committee is concerned about several issues involving the determination of those reserves.

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<sup>20</sup> Except for Lifetime Income Benefits which could last longer.

The first concern is the use of a mortality table to determine life expectancy. TWCC uses a mortality table adopted by TDI. The current table has not been updated since 1980, further it is a table for healthy individuals. Obviously, a candidate for LIBs has received a critical injury to be eligible. The committee inquired as to whether the staff felt the TDI table was the most appropriate mortality table to use. TWCC staff responded that the agency has never been mandated to use a specific mortality table. The committee found no "industry standard" mortality table for the use of determining income benefits for injured workers. However, TWCC in its contract with the November actuarial report has included a request for verification of the mortality rates being used. The accuracy of determination of life expectancy is extremely important to assure adequate reserves. In the TWCC 2001 Internal Audit, the Auditor found that the Reserve for LIB Liability reported was underestimated by \$966,220.27 (or 14%) because the amount of the liability was never updated. Since the number of years that a person is expected to live increases as they age, the initial life expectancy used in calculating the liability is lower than the "true" expected life of the person. If the liability is not periodically adjusted for changes in life expectancy, the liability for LIBs amount will be understated. Part of the underestimation was also due to a difference of \$507,703.80 between the auditor's cash value calculations and the existing liability for 2 LIB cases. The auditor reported that there was no documentation to support the methodology used when the liability amounts for the New Law LIBs cases were first established. In response to these findings by the auditor, TWCC has reviewed the two LIB cases and established documentation for the LIB calculation, and has initiated a policy of reviewing the life expectancy of each LIB recipient each year. The committee recommends that TWCC continue this new policy and attention to documentation retention and annual re-evaluation of life expectancy.

Another issue involved with determining LIB reserves directly impacts the solvency of the SIF. TWCC's internal auditor suggested in the 2001 audit that the Present Value accounting method be examined for the SIF. Present Value accounting requires that in determining the amount needed for future payoffs, additional revenue sources like investments and interest is accounted for, thus minimizing the initial amount dedicated. Although the SIF monies are not invested, they do earn interest. TWCC has not done an extensive examination into the use of using Present Value, because the Comptroller's Office requires reporting to be submitted in Cash Value. Utilization of Present Value accounting methods would require fewer funds to be committed to reserves in the first year of a claim, thus extending the viability of the SIF. The committee is interested in the outcome of the TWCC November actuarial report which is required to report projections in both cash value and present value. Based on this report the committee would recommend a full examination by the internal auditor's office on the pro and cons of utilizing the Present Value Accounting method for presentation to the Commission.

Finally, in determining the continued eligibility of each claimant receiving LIB benefits, the Administrator receives written verification annually from each claimant. TWCC internal auditors, ROC and committee staff have expressed concerns about the potential for fraud in a system which compares signatures from year to year and requires no other verification. However, the Administrator pointed out that of the 37 claimants that currently receive LIB benefits, many are

home bound which would prevent them from having a statement notarized. Further complicating the matter some claimants live in remote areas or even in foreign countries, which not only complicates any requirement for a notary, but would preclude any visitation from TWCC staff. A check through the Texas Department of Health (TDoH) confirmed that none of the claimants have died, or at least, none had died in Texas. The committee recognizes the difficulties in balancing the interests of preventing fraud and not placing impossible burdens on TWCC or injured workers. The committee would recommend that in addition to their current method of verification, TWCC initiate a memorandum of understanding with TDoH for the purposes of checking for any deaths of current recipients. As the SIF only have 37 active claims, the committee does not feel this is an over burdensome requirement for either state agency. Also, the committee would extend this recommendation to cover other individuals that receive LIB benefits (i.e, attorneys or child support recipients).

For carrier reimbursements, the Administrator must evaluate the validity of a claim against the SIF, understand the reimbursement schedule and make a determination about reimbursement. The SIF pays about \$800,000 annually in carrier reimbursements. This amount could be directly affected if the overturned rulings were used as continuing education for TWCC's current hearing officers so that bad hearing decision that are eventually overturned (and thus cost the SIF a reimbursement) would not be repeated. The committee strongly recommends that TWCC's Hearing Division investigate any way to strengthen current training that focuses on overturned orders provided by the SIF Administrator.

SIF reimbursement rules state that partial payments may be made to those reimbursement requests for multiple employment and pharmaceutical benefits, some interpret this to mean that carrier overpayments are to be paid in full, which rarely happens. The SIF Administrator frequently decided to reimburse a carrier for less than what was requested because not all items that have been asked for were a direct result from the overturned order. Rather the payments were for services presented after the order, but before the order was overturned. In addition about one-third of the requests submitted are never considered because they are incomplete submissions. "...due to pending administrative or judicial proceedings and ... requesters who inquire as to the status of an incomplete request are advised to resubmit a completed request in the future."<sup>21</sup> The SIF Administrator has sole responsibility for determining the requests' compliancy with the Act and rules, including which requests are complete and for complete requests, how much is reimbursed. There is no written procedure for calculating the determination of what is reimbursable other than the statutes that state what is eligible for a reimbursement. There is also no oversight or review of any of the determinations of the SIF Administrator.

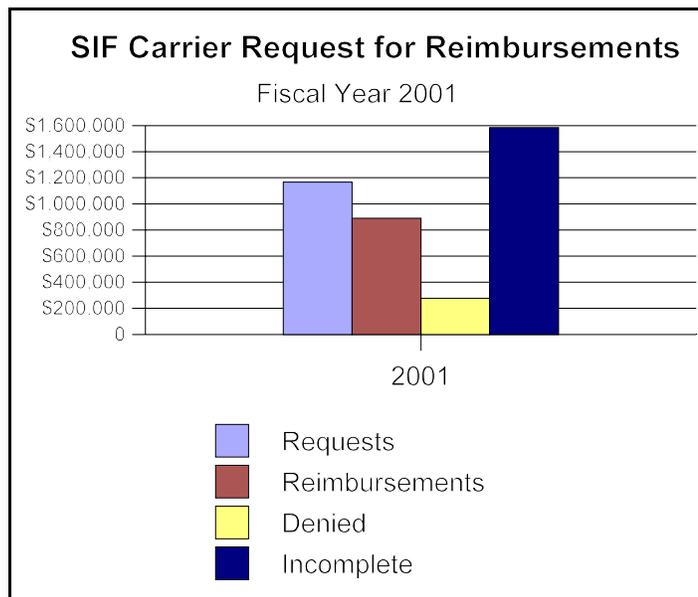
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<sup>21</sup> November 27, 2001 Memorandum from the SIF Administrator to the TWCC Executive Director

Currently, one insurance carrier has taken TWCC to court over this issue<sup>22</sup>. The SIF administrator denied a portion of the requested amount from Everest National Insurance Company because it represented payments made between the hearing officer's decision and the appeals panel decision. Everest moved for summary judgement and requested judicial review of the agency's decisions, asserting that they were arbitrary and capricious or in violation of the law. The District Court case focused on the request for summary judgement, which the court denied because it agreed with the TWCC attorney that the carrier had not exhausted all of its possible administrative appeals.

The Appeals Court disagreed with the district court and found that the carrier had no administrative relief. There is no provision for administrative appeal and further, the Administrator's denial letter says that there is no appeal to the decision. The Appeals Court further stated that the plain language of the statute requires the Fund to reimburse carriers after a modification or reversal and hence the Fund has no discretion to deny a claim for reimbursement.

The Appeals Court remanded the issue back to the 201st District Court. An opinion is not expected before the print deadline of this report. It is still unclear whether a judicial review of the process will occur.



Each year the SIF disperses about \$1.2 million dollars. This amount is expected to increase to \$18.5 million a year. Considering the magnitude of these payments and the importance of revenue generation through searches for eligible death benefits and the recommendations to raise the maintenance tax, the committee recommends changes in the SIF management structure.

Charging one individual with the responsibility for all of these tasks is not only a daunting challenge, but it is also one that elicits criticism and doubt from stakeholders. It is also a structure that vests all institutional knowledge of the process with one individual.

Currently, the TWCC SIF Administrator is an attorney from the Legal Services Department who dedicates 30% of his time to the SIF. He is assisted by an administrative assistant who dedicates 80-100% of her time. In the TWCC 2001 Internal Audit, the Auditor suggested that an additional

<sup>22</sup> Everest National Insurance Co. vs. TWCC Cause # 03-01-00631-CV

personnel be assigned to the SIF. Specifically the Auditor felt that someone with an accounting background would help with dissonance between the Accounting Department (who is responsible for processing all of the payments from the SIF and maintaining accounting ledgers for the SIF) and the SIF Administrator. Although TWCC responded by assigning additional personnel to the SIF Administrator, however this person is only dedicated to the SIF 40% of the time, is a paralegal, and has no accounting background.

While the committee has confidence in the competency of the current SIF Administrator, it would recommend that a full-time administrator be considered and that a multi-tiered structure for determination of reimbursement amounts be implemented to improve the confidence in the SIF payment process. The committee understands that both the current Administrator and an administrative assistant review the payment decisions, but in making decisions to reimburse a potential \$18.5 million it might be more appropriate for the Accounting Department or a Deputy Executive Director to review decisions made by the SIF Administrator. The committee is encouraged that TWCC staff has already taken steps in investigating the need for a full-time SIF Administrator.

The decisions of the SIF Administrator will only become increasingly scrutinized when he or she will need to make recommendations on partial payments and potential maintenance tax increases based on biennial actuarial reports as required by HB 2600. Since the committee found the last two actuarial reports not only lacking in defensible projections but also found that TWCC lacked any supporting work papers from the actuary to explain the methods used, the committee recommends that TWCC work with ROC staff on developing actuarial expectations and contracts. ROC staff has extensive experience with financial research methodologies and what would be necessary to confirm any projections from an actuarial study. In addition, this collaboration would only help to strengthen the biannual reports to ROC on the financial status of the SIF that HB 2600 requires TWCC to provide. The committee understands that TWCC has negotiated a contract for an actuarial review to be completed in November and that ROC and committee input were used to structure the contract. The committee hopes that the ROC and other legislative oversight bodies are continued to be consulted on future actuarial contracts in hopes of producing the most useful product.

Additional data which the committee would recommend TWCC collaborate with ROC to collect is statistical information on multiple employment benefits. At a minimum, TWCC should collect information on how many claims would be eligible, how many claims are filed, whether the injury occurred on a full or part-time job, what was the total expense for all additional income benefits owed because of multiple employment, and how many requests were requested from the SIF due to multiple employment benefits and what were the amounts requested versus the amount refunded.

Obviously, the task of administering the SIF is a complex one. It is also expensive. TWCC estimated that it spent \$75,741.26 in fiscal year 2000 and \$89,516.86 in fiscal year 2001.<sup>23</sup> All of these funds came from TWCC's operating budget. TWCC is unable to utilize SIF monies for the operation of

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<sup>23</sup> March 7, 2002 Letter to the committee from TWCC, Attachment B

SIF. If the Sunset Commission decides that the SIF fund should be continued it should also examine the possibility of allowing SIF monies to be used for its operation.

The Sunset Commission should also evaluate the financial options for the SIF as well if it is to continue. Fiscal projections expect that the SIF will be able to absorb all expenses until at least fiscal year 2006, if not to 2007 before a maintenance tax would need to be evoked. If the SIF is to continue, the Sunset Commission will have to decide whether additional forms of revenue are appropriate and/or whether it is appropriate to minimize exposure to liabilities. But these would be major changes to the structure and purpose of the SIF and would be appropriate for the Sunset Commission's mission.

## **CONCLUSION**

The Fund is a separate fund held in the Treasury and maintained by the Texas Workers' Compensation Commission (TWCC). The daily operations of the Subsequent Injury Fund (SIF) are maintained by an Assistant General Counsel for TWCC's Legal Services Department and two administrative assistants. Supervision and maintenance of SIF revenue, expenditures and records are a part-time responsibility for all staff. All operating expenses come out of TWCC's general operating account and not the SIF itself.

The primary goal of the SIF since 1947 has been to ease the potential risk of employers who hire disabled employees by paying for the difference in Lifetime Income Benefits that would be owed because of a previous disability and a subsequent compensable injury. Since 1991, the SIF has also paid for reimbursements to carriers for benefits they were required to pay because of a TWCC order that was subsequently overturned. Overall expenditures from the SIF has increased 41% over the last six years with an average annual pay out of \$1.2 million.

Currently, the SIF is healthy and has a general trend of asset growth. In the past 6 years the SIF's beginning balance has grown by 221%. Its primary source of income is Death Benefits of injured workers with no beneficiaries. SIF revenue has been consistent over the last decade (about \$3-4 Million a year) with a sharp peak over the last two years of up to \$6.5 million. This revenue is held in an interest-bearing account by the Comptroller. The SIF earns 2.63% interest annually.

HB 2600 added provisions that allow for an increase in the maintenance tax to cover SIF liabilities if there is inadequate funding from Death Benefits. The maintenance tax rate is set annually by TWCC. The current rate is 1.67% . The rate is capped statutorily at 2%. The maintenance tax is paid only by carriers and certified self-insurers, therefore an increase on the maintenance tax would be regressive to a select population of the workers' compensation market participants.

The maintenance tax provision was added in expectation of the costs of the additional carrier reimbursements granted by HB 2600. Of the liabilities that HB 2600 added, the reimbursements for multiple employment benefits will eventually absorb all of the SIF's current resources. When fully utilized around 2006, the multiple employment benefits are expected to create an additional \$18.5 million in reimbursement requests. The SIF does not currently generate enough revenue to meet this demand. In addition to the maintenance tax increase, HB 2600 allows TWCC to make partial payments to carrier for multiple employment benefits. The SIF reimbursement schedule rule forgives the SIF of any debt it cannot meet in a fiscal year. Therefore, the SIF would never actually become insolvent, but rather would operate on a year-to-year basis, depleting all monies not reserved for future LIB payments on current claims.

Since the SIF is not expected to reach the level of needing to make partial payments or evoke the maintenance tax until fiscal year 2006 or later, the committee feel that only slight changes should be made in the financial structure of the SIF for the next legislative session. The committee is also recommending an array of management changes that TWCC should consider. Many of these changes may be directly linked to concerns raised by TWCC's internal audits. These concerns are directly related to maximizing deposits of revenue owed and accurate predictions of the SIF's future liabilities.

Any serious overall change to the SIF structure should not occur in the 2003 legislative session. Rather, TWCC is under Sunset review in 2005 and it would be appropriate for any major financial or structural changes to be part of their overall review of the agency.

## **COMMITTEE RECOMMENDATIONS**

- The Legislature should :
  - Increase the number of weeks of benefits paid into the SIF from 364 weeks to standard 401;
  - Give TWCC legal right to defend the interests of the SIF in any dispute process or benefit negotiation with a carrier over Average Weekly Wage calculations; and
  - Create a memorandum of understanding with TDoH for the purpose of checking for any deaths of current LIB recipients including attorneys or child support recipients, in addition to TWCC's current method of verification.
  
- The Sunset Commission should include in its 2005 review of TWCC the existence, funding and liabilities of the SIF and whether SIF monies could/should be used for SIF operational expenses.

- TWCC should consider the following management changes to:
  - Initiate a data flag for when a carrier identifies a potential SIF claim;
  - Initiate a data flag for identifying beneficiaries, or conversely, failing to identify a beneficiary;
  - Initiate a specific deadline for paying into the SIF and a penalty for not doing so;
  - Act on recommendations from the November actuarial report on mortality tables;
  - Continue the new policy and attention to documentation retention and annual re-evaluation of life expectancy for LIB reserve determination;
  - Conduct an examination by the internal auditor's office on the pro and cons of utilizing the Present Value Accounting method for presentation to the Commission;
  - Strengthen the method of continued education for hearing officers that utilizes the overturned decisions in efforts to decrease carrier reimbursements from the SIF;
  - Consider a full-time administrator and a multi-tiered structure for determination of reimbursement and LIB reserve amounts;
  - Develop, with ROC staff assistance, future actuarial expectations and contracts;
  - Collaborate with ROC to collect statistical information on multiple employment benefits; and Perform a cost analysis study of the utilization of annuities for LIB reserves.