

## **SHARING COMMISSIONS WITH UNLICENSED ENTITIES IN TEXAS: THE WISDOM OF *SOLOMON V. GREENBLATT*<sup>1</sup>**

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By his veto of Senate Bill 956 (“Bill”) on June 20, 1999, Governor George W. Bush delayed agent license reform in Texas for at least another two years.<sup>2</sup> Although the Governor’s action was intended to prevent enactment of a provision unrelated to agent licensing and not to block reform, the effect was to derail much-needed measures for the modernization of the agent licensing system.<sup>3</sup> The Bill would have eliminated restrictions on ownership of corporate insurance agencies including the outdated residency requirement for local recording and managing general agent licenses. Insurance Commissioner Jose Montemayor responded swiftly to the Governor’s action by promulgating, on July 1, 1999, Commissioner’s Bulletin No. B-0037-99 (“Bulletin”) waiving licensing requirements which apply to non-resident agents. Albeit welcome, the waiver falls far short of the reform contemplated by the Legislature. It applies only to holders of local recording agent licenses and ignores corporations and partnerships.

This leaves intact the fiercely protectionist provisions of the Texas Insurance Code which mandate that each officer, director and shareholder of a corporate managing general agency must be individually licensed and reside in Texas, that each officer, director and shareholder of a corporate local recording agency must be individually licensed and that only Texas corporations are eligible to hold either license.<sup>4</sup> These mandates generally apply as well to holders of legal reserve life insurance agent licenses.<sup>5</sup> Thus, foreign corporations remain excluded from participation in the ownership of Texas corporate agencies.

Significantly, foreign business entities are also effectively prohibited from sharing in the revenues of Texas agencies. The Texas Department of Insurance has consistently taken the position that commissions received by a licensed agent may only be shared with other licensees.<sup>6</sup> Therefore, under the Department’s interpretation, a foreign corporation is precluded from being the direct recipient of commission-generated revenue from a Texas agency since it is not eligible to be licensed. It appears that the Bulletin effectively removes the restrictions for individual non-resident holders of local recording agent licenses but non-resident corporations must look elsewhere for relief and managing general agent licenses are unaffected.

*Solomon v. Greenblatt*<sup>7</sup> dealt with a dispute between an insurance agent and his business guru. Walter Greenblatt was not satisfied with his performance in generating revenue and hired Dr. Lillian Solomon to assist him in improving his situation. Dr. Solomon was a psychologist with a business background who advised Greenblatt “about personnel management, time management, and effective selling techniques.”<sup>8</sup> She never met with clients or gave advice regarding insurance. “She concentrated on streamlining management in Greenblatt’s office and on improving his effectiveness as a salesman.”<sup>9</sup> Greenblatt found Dr. Solomon’s services useful and ultimately entered into written agreements with her which defined the terms of their arrangement. The agreements provided, inter alia, that Dr. Solomon would, in return for continuing to render services, receive a fixed annual payment plus a percentage of Greenblatt’s “net insurance income” which exceeded a specified amount. The agreements were to terminate upon the death of either party.

Subsequently, Greenblatt’s situation changed and he determined that he no longer required Dr. Solomon’s services. He stopped paying her and quit consulting with her. Thereafter, Dr. Solomon brought an action to enforce the agreements. Greenblatt responded with a motion for summary judgment in which he asserted that the agreements were unenforceable because they constituted a commission-splitting arrangement with a person who did not possess an insurance agent’s license. The trial court found Greenblatt’s position persuasive and Dr. Solomon appealed.

In making his argument, Greenblatt relied upon several Texas Insurance Code provisions, but the key to his position is language contained in article 21.07:

No insurer or licensed insurance agent doing business in this State shall pay directly or indirectly any commission, or other valuable consideration, to any person or corporation for services as an insurance agent

within this State, unless such person or corporation shall hold a currently valid license to act as an insurance agent as required by the laws of this State....<sup>10</sup>

He reasoned that since Dr. Solomon was not licensed as an insurance agent, the agreements were void.

The Dallas Court of Appeals determined that Greenblatt's application of this provision was too broad focusing on the statutory language "for services as an insurance agent." The court held that it was permissible to enter into a compensation arrangement based upon a percentage of an agent's income so long as the services provided by the unlicensed person were not those of an agent.<sup>11</sup> The court looked for guidance in ascertaining what constituted "services as an insurance agent" to the definition of an agent contained in the Texas Insurance Code.<sup>12</sup> Since Dr. Solomon's services were limited to business consulting, the agreements were enforceable.

Traditionally, the Texas Department has taken a dim view of arrangements where a third party receives a percentage of an agent's commission income. One method of sharing revenue which developed in response to the Department's concerns takes the form of a service agreement. In the usual case, an agent agrees to compensate a third party for enumerated services which may include information system consulting, claims system development, accounting, lead generation, research and development of new products, new market development, agent recruiting and financing, and human resources consulting. In addition, rent and other charges associated with the use of office space may be addressed in such an agreement. The amount of compensation to which the third party is entitled is tied directly to the value of the service. For this reason, this approach has generally been accepted by the Department. On the other hand, from the standpoint of the third party, this approach is not entirely satisfactory since the amount of compensation is restricted to the value of the services.

When the Texas Department encounters such an arrangement, it will be scrutinized to ensure that the compensation is reasonable in relation to the services rendered. If the agreement does not meet this standard, further inquiry will be made and disciplinary action is a possible result. In the past, an arrangement for payment based upon a percentage of an agent's commission income was deemed, prima facie, to constitute unlawful commission-splitting and would immediately trigger an objection and likely result in the initiation of a disciplinary action for sanctions. *Solomon's* holding contemplates an entirely different standard with no limitation as to what compensation is deemed reasonable by the Texas Department. The Department's staff has been reluctant to recognize the significance of *Solomon* and one may still encounter those at the Department who will dismiss *Solomon* as an anomaly and, therefore, not controlling. Yet the case clearly recognizes that a percentage of commission income may be paid to an unlicensed entity so long as it is not for services as an insurance agent.<sup>13</sup> The Department's aversion to acknowledge *Solomon* may be rooted in the realization that the holding opens the door to arrangements which call for payment to an unlicensed third party without regard for the provision of services of any kind. This is seen as inconsistent with the purposes of regulation since the third party would not be directly subject to the Department's mandate.

The crucial element in creating an arrangement which conforms to the holding in *Solomon* is ensuring that services to be performed clearly do not constitute services as an insurance agent. Article 21.02 provides some assistance in this regard:

Any person who solicits insurance on behalf of any insurance company, whether incorporated under the laws of this or any other state or foreign government, or who takes or transmits other than for himself any application for insurance or any policy of insurance to or from such company, or who advertises or otherwise gives notice that he will receive or transmit the same, or who shall receive or deliver a policy of insurance of any such company, or who shall examine or inspect any risk, or receive, or collect, or transmit any premium of insurance, or make or forward any diagram of any building or buildings, or do or perform any other act or thing in the making or consummating of any contract of insurance for or with any such insurance company other than for himself, or who shall examine into, or adjust, or aid in adjusting, any loss for or on behalf of any such insurance company, whether any of such acts shall be done at the instance or request, or by the employment of such insurance company, or of, or by, any broker or other person, shall be held to be the agent of the company for which the act is done, or the risk is taken, as far as relates to all the liabilities, duties, requirements and penalties set forth in this chapter....<sup>14</sup>

Also, the provisions defining the business of insurance should be carefully reviewed when such an arrangement is

contemplated.<sup>15</sup> One can anticipate that the Department will, at best, very closely scrutinize such an arrangement or, at worst, object to it and commence a disciplinary action. The parties should be prepared to encounter resistance from regulators until such time as the Legislature presents another agent license reform package to the Governor.

*Endnotes*

1. 812 S.W.2d 7 (Tex. App. -- Dallas 1991, no writ).
2. *See generally*, Kimberly Yelkin & Melissa Eason, "Recent Legislative Efforts and Changes to Texas Property and Casualty Agent Licensing Laws," FORC QUARTERLY NEWSLETTER, Vol. II, Ed. 3 (Sept. 4, 1990).
3. *See generally*, "Bomer Proposes Agent License Reforms," TEX. INS. NEWS 1 (Jan. 1999).
4. TEX. INS. CODE ANN. arts. 21.07-3 § 4 (except for those managing general agencies grandfathered under section 5), 21.14 § 3.
5. *Id.* art. 21.07-1 § 4 (Non-residents may be individually licensed under section 7).
6. *See generally, Id.* arts. 21.02 (acts of an agent), 21.07 § 1(b), 21.07-1 § 3 (legal reserve life insurance agent licenses), 21.07-3 §§ 3, 4A (managing general agent licenses), 21.14 § 4 (local recording agent licenses).
7. 812 S.W.2d 7.
8. *Id.* at 9.
9. *Id.*
10. *Id.* at 11 [TEX. INS. CODE ANN. art. 21.07 § 1(b)]. *See also Id.* arts. 21.07-1 § 3(b) (legal reserve life insurance agent license), 21.14 § 4(b) (local recording agent license).
11. 812 S.W.2d at 14.
12. *Id.* at 12-13 [TEX. INS. CODE ANN. art. 21.02].
13. *But see* TEX. INS. CODE ANN. art. 21.49-1 § 4 (transactions with affiliates).
14. *Id.* art. 21.02.
15. *Id.* § 101.051 (formerly art. 1.14-1 § 2).