

SELLING AN INSURANCE AGENCY LICENSED IN TEXAS? ANOTHER LOOK AT THE NEW REQUIREMENTS RESULTING FROM LICENSING REFORM

David D. Knoll, Esq.
(713) 650-2732

When the Texas Legislature adopted legislation reforming its insurance agent licensing system last summer,¹ it added a little noticed provision that would require filing a sworn statement with the Texas Department of Insurance before any person could acquire an ownership interest in or otherwise acquire or exercise “control” over any insurance agency *licensed* in Texas “if the [acquiring] person *is, or after the acquisition would be, directly or in directly, in control*” of the licensed agency.² To our knowledge, this is the first time any state insurance regulator has been given a statutory mandate to review transactions involving investments in or sales of insurance agencies simply licensed in that state, no matter where the licensed entities may be domiciled. It may pose interesting issues (and problems) for insurance agents operating nationally who now have the opportunity to become licensed to do business in Texas.

“Control” is defined as

the power to direct or cause the direction of the management and policies of a license holder, whether directly or indirectly. For the purposes of this subchapter, a person is considered to control:

(A) a corporate license holder if the person, individually or acting with others, directly or indirectly, holds with the power to vote, owns, controls, or holds proxies representing, at least 10 percent of the voting stock or voting rights of the corporate license holder; or

(B) a partnership if the person through a right to vote or through any other right or power exercises rights in the management, direction, or conduct of the business of the partnership.³

“Corporations” included limited liability companies.⁴ Unlike the definition of “control” found in the Texas version of the Texas Insurance Holding Company Regulatory Act (the “Holding Company Act”),⁵ which excludes from the definition persons who have the power to control by reason of “the result of an official position with or corporate office held”⁶ by a person, no such latitude exists for officers or directors of insurance agencies.

The law requires that the following information be filed with the Texas Department of Insurance, under oath, prior to the change of control:

- (1) a biographical form for each person by whom or on whose behalf the acquisition of control is to be effected;
- (2) a statement certifying that no person who is acquiring an ownership interest in or control of the license holder has been the subject of a disciplinary action taken by a financial or insurance regulator of this state, another state, or the United States;
- (3) a statement certifying that, immediately on the change of control, the license holder will be able to satisfy the requirements for the issuance of the license to solicit the line or lines of insurance for which it is licensed; and
- (4) any additional information that the Commissioner may by rule prescribe as necessary or appropriate to the protection of insurance consumers of this state or as in the public interest.⁷

As of the date of this writing, the Commissioner has not proposed any rules implementing the new statute. If the person required to file the information is a partnership, limited partnership, “syndicate” or other group, the Commissioner may require the information from each partner, member and person who controls the partner or member. If the partner, member or person required to file the information is a person, the information needs to be filed regarding the corporation, each individual who is an executive officer or director of the corporation, and each

person who owns, directly or indirectly, more than 10 percent of the outstanding voting securities of the corporation.⁸

The *Department* may disapprove an acquisition of control, if, after notice and hearing, the *Commissioner* determines that:

- (1) immediately upon the change of control the license holder would not be able to satisfy the requirements for the issuance of a license to solicit the line or lines of insurance for which it is presently licensed;
- (2) the competence, trustworthiness, experience, and integrity of the persons who would control the operation of the license holder are such that it would not be in the interest of the insurance consumers of this state to permit the acquisition of control; or
- (3) the acquisition of control would violate this code or another law of this state, another state, or the United States.⁹

The law provides that the acquisition of control will be “considered approved” if the Department has not “proposed to deny the requested change before the 61st day after the date of receipt by the Department of all information required by this section.”¹⁰

The statute appears patterned after the Holding Company Act, but there are some important distinctions between the two. First, under the Holding Company Act, the acquiring person may not acquire or exercise control over the target entity until completing the required “Form A” filing *and* “such acquisition of control has been approved by the Commissioner in the manner hereinafter prescribed.”¹¹ No such language is found in Section 2(n) of Article 21.07. Until the Commissioner “by rule” prescribes additional information that he might require to be filed as “necessary or appropriate to the protection of insurance consumers,” an acquiring person might argue that all he had to do was make the required filing; once that was done, he was free to exercise control over the licensed agency, and take the risk that the Commissioner might later disapprove it.

In fact, while one might think it would be implicit that the Commissioner, if he disapproved of the acquisition, might be able to block or, if it were consummated in violation of the statute or his findings disapproving a change of control, require it to be unwound, the statute, unlike the Holding Company Act, gives him no such authority. In the case of the acquisition of insurers in violation of the Holding Company Act, the Commissioner has the power to set aside, rescind, revoke, reverse, or render null and void the transaction, so that “the parties to such transaction or act shall be returned to the position they would have occupied had not such transaction or act occurred in violation of this article.”¹² The licensing statute is silent on the subject.

The Commissioner, of course, is empowered to take action to revoke the license of the agency if the holder of the license “is found to be in violation of, or to have failed to comply with, this code or a rule of the Commissioner.”¹³ In addition, the Commissioner is empowered to (1) suspend the license of the entity for a specified period of time not to exceed one year; (2) order the holder of the license to cease and desist from (a) the activity determined to be in violation of the code or a rule of the Commissioner, or (b) the failure to comply with the code or the Commissioner’s order; (3) direct the license holder to pay an administrative penalty; (4) direct the license holder to make restitution to each Texas resident and insured harmed by its violation of the code or order; or (5) any combination of the above.¹⁴

Initially, the new requirements will probably have far more reach in connection with domestic Texas insurance agencies licensed only in the state, rather than out-of-state entities now becoming licensed to do business in Texas. However, to the extent that Texas’ new statute attempts to regulate the activities of persons outside the state, we might see lawyers scrambling for the law books to review commerce clause issues raised in *Edgar v. MITE Corp.*¹⁵ and its progeny.

Endnotes

1. Senate Bill 414.

2. Now, article 21.07, Tex. Ins. Code, Sec. 2(n).
3. Article 21.07, Tex. Ins. Code, Sec. 1A(2).
4. Article 21.07, Tex. Ins. Code, Sec. 1A(3).
5. Article 21.49-1, Tex. Ins. Code, Sec. 2(d).
6. *Id.*
7. Article 21.07, Tex. Ins. Code, Sec. 2(n).
8. *Id.*
9. Article 21.07, Tex. Ins. Code, Sec. 2(p).
10. Article 21.07, Tex. Ins. Code, Sec. 2(q).
11. Article 21.49-1, Tex. Ins. Code, Sec. 5(a).
12. Article 21.49-1, Tex. Ins. Code, Sec. 16.
13. Sec. 82.051, Tex. Ins. Code.
14. Sec. 82.052, Tex. Ins. Code.
15. 457 U.S. 624, 102 S.Ct. 2629 (1982).