

**FEDERATION OF REGULATORY COUNSEL, INC.**

**TEXAS BUSINESS ORGANIZATIONS CODE AND INSURANCE  
COMPANIES**

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In Texas, insurance companies have always been organized under various provisions of the Texas Insurance Code. Property and casualty insurance companies are organized under what used to be called "Chapter 2" of the Insurance Code, but which has now been re-codified under Chapter 822 of the Texas Insurance Code. Life insurance companies were incorporated under "Chapter 3" of the Insurance Code, which has now been re-codified under Chapter 841 of the Insurance Code.

Chapter 822 of the Insurance Code, which applies to property and casualty insurers, provides that "[a]n insurance company organized in this state is subject to the Texas Business Corporation Act, the Texas Miscellaneous Corporation Laws Act, and any other law of this state that governs corporations in general to the extent those laws are not inconsistent with this code."<sup>2</sup> Chapter 841, which governs the organization of life insurance companies, has a similar provision: "An insurance company operating under this chapter is subject to the Texas Business Corporation Act, the Texas Miscellaneous Corporation Laws Act, and any other law of this state that governs corporations in general to the extent those laws are not inconsistent with this chapter or another law described by Section 841.002."<sup>3</sup>

Mutual life insurers were organized under the old Chapter 11, which has now been recodified in Chapter 882 of the Insurance Code. Chapter 882 provides: "[e]xcept to the extent of any conflict with this chapter, a law governing a company organized under Chapter 841 applies to a mutual life insurance company organized under this chapter."<sup>4</sup> Mutual property and casualty insurers, which were organized under Chapter 15 of the Insurance Code, are now subject to new Chapter 883 of the Insurance Code, which provides: "[e]xcept to the extent of any conflict with this code, the Texas Non-Profit Corporation Act [citation] applies to a domestic mutual insurance company. The commissioner has each power and duty of, and shall perform each act to be performed by, the secretary of state under that Act with respect to mutual insurance companies."<sup>5</sup>

On January 1, 2006, the new Texas Business Organizations Code ("BOC" or the "Code") became effective for domestic corporations formed in Texas on and after that date. The BOC combines and re-codifies the Texas Business Corporation Act, the Texas Non-Profit Corporation Act, the Texas Miscellaneous Corporation Laws Act and other business related statutes (such as the Texas Limited Liability Company Act and the Texas Revised Partnership Act) into one code, in a "hub-and-spoke" configuration.<sup>6</sup> This means that the "hub" provisions (Title 1 of the BOC, or Chapters 1-12), are generally applicable across all entity forms, while the "spoke" provisions are applicable to only the specific type or types of entities being considered.<sup>7</sup> The stated purpose of the re-codification is: "(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 of the law; (3) eliminating repealed, duplicative, expired, executed, and other ineffective provisions; and (4) restating the law in modern American English to the greatest extent possible."<sup>8</sup> There are transitional provisions that provide that a domestic entity formed prior to January 1, 2006 may voluntarily elect to adopt and become subject to the BOC by following certain procedures set forth in the Code.<sup>9</sup> Foreign entities "registered with the secretary of state to transact business" in Texas may also adopt the BOC.<sup>10</sup> By January 1, 2010, whether they have agreed to adopt the Code or not, all domestic and foreign corporations doing

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business in Texas will be subject to the Code.<sup>11</sup>

Since January 1, 2006, business and corporate lawyers in Texas have had to become accustomed to filing "certificates of formation" signed by the "organizers" of the "organization" with the Texas Secretary of State, rather than "articles of incorporation." They have had to learn to deal with concepts such as "governing authority," in place of "board of directors," and "governing person" instead of a "director."<sup>12</sup> While the Texas Legislature, which directed the codification process, mandated that there be no substantive revisions to the statutes being codified, drafters of the BOC have acknowledged that the Code contains a number of substantive changes in the law.

Chapter 23 of the BOC is a "spoke" provision applicable to special purpose corporations, such as business development corporations and grand lodges. Under Chapter 23, a corporation created under a special statute outside the BOC (e.g., the Insurance Code), "to the extent not inconsistent with a special statute regarding a particular corporation, is governed by: (1) Title 1 and Chapter 21, if the corporation is organized for profit; and (2) Title 1 and Chapter 22, if the corporation is organized not for profit."<sup>13</sup> "A corporation organized under a special statute other than this code is not considered a 'domestic corporation' formed under this code, although this code may apply to the corporation."<sup>14</sup> The BOC becomes effective for such corporations on and after January 1, 2010; however, the transition clause governing such "non-code organizations"<sup>15</sup> provides that a corporation formed under another statute "may elect for this code to apply to the corporation at any time on or after January 1, 2006, and prior to January 1, 2010, to the extent provided in Subchapter A, Chapter 23, by filing a statement and taking other actions in a manner similar to a domestic filing entity under Section 402.003."<sup>16</sup> Under Section 402.003, a domestic entity may "voluntarily elect to adopt and become subject to this code by: (1) complying with the procedures to amend its governing documents to comply with this code; and . . . filing with the secretary of state in accordance with Chapter 4: (A) a statement that the filing entity is electing to adopt this code; and (B) if necessary, a certificate of amendment that would cause its certificate of formation to comply with this code."<sup>17</sup> It would appear, then, that an insurance company could adopt the BOC by making a filing with the Secretary of State, and not with the Insurance Commissioner. However, it is not clear how the "non-code organization" would amend its "certificate of formation to comply with this code," if its articles of incorporation are governed by the provisions of the Insurance Code. The Texas Secretary of State's website provides forms for common transactions, including early adoption statements.<sup>18</sup> However, the website only includes forms for early adoption of the BOC by domestic entities and foreign filing entities previously registered. There is no form for a non-code organization's early adoption of the BOC as contemplated by Chapter 23, Subsection A of the BOC. Further, if an insurance company did choose to adopt the BOC prior to January 1, 2010, only such provisions in Title 1 and Chapters 21 or 22 of the BOC as are not addressed by or that do not conflict with the Insurance Code would apply to the insurance company after adoption of the BOC.

This article addresses the question: what is the impact of the adoption of the new BOC on insurance companies organized under the Texas Insurance Code and their holding companies?

**1. Formation of Insurers under the Texas Insurance Code.** Because insurers are incorporated in Texas under the Insurance Code, changes in the laws applicable to corporations in general have not always been applied to the organization of insurance corporations, and the Insurance Code has, to some extent, become something of an anachronism. For example, the articles of incorporation of insurers organized under the Insurance Code must still recite the "amount of the company's capital stock" and the "amount of the company's surplus," which is no longer required of general business corporations organized under the old Texas Business Corporation Act. The Insurance Code also retains such concepts as "earned surplus," and allows insurers to pay dividends only out of "surplus profits arising from its business,"<sup>19</sup> a concept that was long ago abandoned in the Texas Business Corporation Act, which allows dividends to be paid out of "surplus," without regard to whether the surplus was the result of earnings, paid-in or contributed surplus, capital reduction surplus, or other sources.<sup>20</sup> Because laws that govern corporations in general apply to

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insurance companies only when "not inconsistent with" the Insurance Code, these old rubrics will still apply when organizing an insurance company in Texas. "Incorporators" will still file and amend "articles of incorporation" with the Texas Department of Insurance. However, insurers organized under Texas law might want to consider some amendments to their articles of incorporation or bylaws to allow them to take advantage of certain substantive changes in the law brought about by the BOC.<sup>21</sup>

**2. Insurance Companies and the BOC.** The BOC creates a new "vocabulary" for business organizations operating in Texas. For example, a "non-code organization" is defined as "an organization other than a domestic entity."<sup>22</sup> One commentator has stated that this would include foreign entities or organizations formed under a Texas law other than the Code, such as banks or insurance companies.<sup>23</sup> While the definition of "domestic entity" in the BOC includes "an organization formed under *or the internal affairs of which are governed by* this code,"<sup>24</sup> a "domestic entity" may not "operate as . . . an insurance company" under the BOC.<sup>25</sup> For purposes of the BOC, "internal affairs" of an entity include: "(1) the rights, powers, and duties of its governing authority, governing persons, officers, owners, and members; and (2) matters relating to its membership or ownership interests."<sup>26</sup> While the internal affairs of insurance companies are, to the extent not governed by the Insurance Code, subject to the laws of the state governing corporations in general, an insurance company is not considered to be a "domestic corporation," and is, therefore, a "non-code organization."<sup>27</sup>

There do not appear to be any implications or special obligations for being a non-code organization, other than as found in Chapter 10, which describes mergers, interest exchanges, conversions and sales of assets. Most of the provisions found in Chapter 10 were simply re-codifications of the merger provisions found in the Texas Business Corporation Act. Very few specific references are made to non-code organizations in the BOC and thus, most provisions of the Code, if applicable to insurance companies, will be applicable as "gap fillers" in such instances where the BOC does not conflict with the Insurance Code.

To adopt the BOC early, in addition to the statement that the non-code organization voluntarily elects to adopt the BOC prior to January 1, 2010, a non-code organization would also have to amend its articles of incorporation to conform to the BOC. By way of example, a property and casualty insurance company, under Chapter 822 of the Insurance Code, must include the following in its articles of incorporation to incorporate with the Texas Department of Insurance: (1) the name of the company; (2) the location of the company's principal business office; (3) the kind of insurance business in which the company proposes to engage; (4) the amount of the company's capital stock; and (5) the amount of the company's surplus.<sup>28</sup> In order to conform to the BOC, assuming that a non-code organization could adopt the BOC in this manner, a property and casualty insurance company organized as a for-profit corporation would have to change the name of its articles of incorporation to a "certificate of formation" and add the following: (1) the type of filing entity; (2) the purpose for which the entity was formed, which can be any lawful purpose; (3) the period of duration, if not perpetual; (4) the street address of the initial registered office and the name of the initial registered agent; (5) the name and address of each organizer; (6) the aggregate number of shares the corporation is authorized to issue; (7) the par value of each share or a statement that each share is without par value; (8) the number of directors and the name and address of each director; and (9) if the shareholders are to have preemptive rights or cumulative voting rights, the certificate of formation must so state.<sup>29</sup> Therefore, there is a significant number of items that would have to be added to the articles of incorporation in order to adopt the BOC; however, none of the items is particularly burdensome. Whether the insurance regulators would have any issue with them, however, is another question.<sup>30</sup>

**3. Substantive Changes in the Law.** The BOC effected some substantive changes in the law governing corporations and other business entities. Most notable are changes in requirements for meetings of shareholders and the board of directors ("governing authority") of corporations; changes regarding the indemnification of officers and directors; and changes standardizing the rules for mergers, interest exchanges, conversions and sales of assets ("fundamental business transactions").

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First, the BOC modernized provisions regarding notice of and voting lists for shareholders and board of directors meetings. The Code added a definition of "electronic transmission"<sup>31</sup> and now permits notice of meetings and voting lists to be transmitted by electronic mail or posted on reasonably accessible electronic networks so long as the notice includes the means of accessing the electronic communications system.<sup>32</sup> Meetings may also be held by conference telephone, videoconferencing equipment or the Internet.<sup>33</sup>

Second, Chapter 8 (Indemnification and Insurance) of the BOC effected some changes with respect to director and officer indemnification. Two provisions which were previously only implied in existing law were explicitly added. One provides that a unanimous vote of the shareholders of a corporation can approve a permissive indemnification of a director or former director.<sup>34</sup> Another provides that the shareholders may by resolution approve indemnification of and advancement of expenses to any officer, employee, agent or delegate who is not also a director.<sup>35</sup> The BOC also now allows a determination that the standard for indemnification has been met to be made by a committee of one rather than two disinterested directors.<sup>36</sup> These provisions apply to "domestic entities" after the mandatory application date<sup>37</sup> regardless of whether the events giving rise to indemnification occurred before or after such date, and it is therefore unclear how, or even if, this provision would affect non-code organizations.<sup>38</sup>

Finally, the BOC includes a number of substantive changes to the law governing mergers, interest exchanges, conversions, and sales of assets.<sup>39</sup> The BOC generally standardizes the rules for these "fundamental business transactions" for most entities and simplifies conversions from one form of entity to another. Although prior statutes did, in some cases, provide for the conversions of entities from one form to another, many of these laws were of recent vintage, and it was often easier to dissolve the original entity, form a new entity, and transfer the assets and liabilities of the original entity to the new entity.<sup>40</sup> The Code consolidates the previously fragmented conversion provisions into one location. Chapter 10 of the BOC provides for the conversion of a domestic entity into a different type of domestic entity or a non-code organization.<sup>41</sup> Because the definition of a "non-code organization" could include a foreign corporation, this provision may act both as a redomestication provision, as well as a means of converting a general business corporation into an insurance company. Chapter 10 also provides for the conversion of a non-code organization into a domestic entity.<sup>42</sup> The implications of this are most interesting: perhaps there are insurance companies that would rather not continue in business as insurance companies, but could be converted into general business corporations.

With respect to statutory mergers, Chapter 10 of the BOC provides that if one or more non-code organizations is a party to a merger, each non-code organization must take all action required by the BOC and its own governing documents, the merger must be permitted by the law under which the non-code organization is incorporated (or its governing documents)<sup>43</sup> and each non-code organization must comply with the applicable laws under which it is organized (and its governing documents). The Code further provides that if the surviving organization in a merger is not a domestic entity, it is considered to have appointed the Texas Secretary of State for service of process, and it shall promptly pay to the dissenting owners of each domestic entity that is a party to the merger who have perfected their rights of dissent and appraisal the amount, if any, to which they are entitled.<sup>44</sup> The BOC also supplies a definition of "fair value" for dealing with dissenters.<sup>45</sup> However, it is not clear that dissenters' rights provisions would apply to non-code organizations, because the Code states that it "applies only to a 'domestic entity subject to dissenters' rights,' as defined in Section 1.002."<sup>46</sup> A "domestic entity subject to dissenters' rights" means a domestic entity the owners of which have rights of dissent and appraisal under the BOC or the governing documents of the entity.<sup>47</sup>

**4. Implications for Insurance Holding Companies.** Most stock insurers are members of "holding company systems" in which all of the outstanding shares of stock of the insurer are owned by another entity. In most cases, the "holding company" is a general business corporation; however, other forms of organization, such as limited partnerships and limited liability companies, are sometimes found as "insurance holding companies." If the insurance holding company is a domestic entity, it can choose to adopt the BOC early or it can choose to wait until January 1, 2010, when the BOC will become applicable as a matter of law. As a domestic entity, no

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provisions of the BOC would mandate early adoption and/or a penalty for failure to timely adopt the BOC. In fact, on or after January 1, 2010, a domestic entity formed prior to January 1, 2006 does not even have to conform its articles of incorporation to the BOC until it next amends them.<sup>48</sup>

Chapter 9 of the Code applies to foreign entities and describes when a foreign entity would or would not be required to register under the BOC. If the insurance holding company is a foreign filing entity formed prior to January 1, 2006 and previously registered to transact business in Texas, it may voluntarily elect to adopt the BOC prior to January 1, 2010 by filing the application for registration described in Chapter 9.<sup>49</sup> If the insurance holding company is a foreign filing entity formed on or after January 1, 2006 and/or had not previously registered to transact business in Texas, then it must register to transact business in Texas<sup>50</sup> unless other state law authorizes the entity to transact business in Texas.<sup>51</sup>

The BOC contains a non-exclusive list of activities that do not constitute the transaction of business in Texas, including maintaining or defending an action or suit or an administrative or arbitration proceeding; holding a meeting of its owners or board of directors, or carrying on another activity relating to its internal affairs; maintaining a bank account; securing or collecting a debt; and transacting business in interstate commerce.<sup>52</sup> A foreign filing entity that is required, but fails to, register under the BOC may be liable to the state for a civil penalty and late filing fees.<sup>53</sup>

**5. What Are the Advantages and Disadvantages to "Opting In" to the BOC?** Why would an insurance company or its holding company choose to opt in to the BOC prior to its "mandatory application date" of January 1, 2010? One obvious reason would be that the BOC will apply on January 1, 2010 whether or not an insurance company agrees to adopt it, and companies should not delay in acclimating themselves to this new law. However, there may be reasons to delay adoption until the last minute.

One advantage to the early adoption of the BOC is the modernization of the law allowing for the use of the Internet or electronic mail for meetings, notice of meetings and voting lists. Although these electronic meetings and notice provisions were not previously available under the Texas Business Corporation Act (the "TBCA"), similar language was added to the TBCA in 2003.<sup>54</sup> Therefore, these provisions are available whether or not a non-code organization opts in early; however, the BOC does flesh out the definition of "electronic transmission" and "similar communications equipment."<sup>55</sup> Where the TBCA allowed for meetings by telephone or similar communications equipment<sup>56</sup> and notices by electronic transmission,<sup>57</sup> the BOC makes clear that communications equipment can include the Internet<sup>58</sup> and that electronic transmission can include a facsimile, an electronic mail transmission, or a posting on an electronic network.<sup>59</sup>

Another advantage, as discussed above, is that some of the indemnification provisions have been amended to provide for simplified determinations that standards for indemnification have been met. These amendments were made only to the BOC, and thus are not available unless a non-code organization opts in early.<sup>60</sup> The BOC also simplifies merger procedures, especially for non-code organizations. The BOC updated many of the provisions with respect to the creation of holding companies<sup>61</sup> as well as clarifying the provisions with respect to conversions of or into non-code organizations.<sup>62</sup>

Most provisions of the BOC that would appear to make early adoption a disadvantage for a non-code organization were merely transferred from prior law and result in no substantive change in the law. The main disadvantage to early adoption is the administrative burden of amending the organization's articles of incorporation to comply with the BOC and filing an early adoption statement. And the main uncertainty for insurance companies is how the Texas Department of Insurance will view amendments to an insurance company's organizational documents to comply with the BOC.

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### Endnotes

1. The authors would like to express their gratitude and acknowledge the contribution of Paige Ingram Castañeda, an associate in Winstead's Austin office, for her assistance in providing research and source checking for this article.
2. Tex. Ins. Code Ann. § 822.002 (Vernon 2006).
3. Section 841.002 provides that "[e]xcept as otherwise expressly provided by this code, each insurance company incorporated or engaging in business in this state as a life insurance company, an accident insurance company, a life and accident insurance company, a health and accident insurance company, or a life, health and accident insurance company is subject to: (1) this chapter; (2) chapter 3; and (3) Title 7." Chapter 3 is the remaining uncodified remnants of the old insurance code; Title 7 regulates life insurance and annuities.
4. Tex. Ins. Code Ann. § 882.001 (Vernon 2006).
5. *Id.* § 883.003. There does not seem to be a similar reference to the Texas Non-Profit Corporation Act in Chapter 882, which governs mutual life insurance companies.
6. See Daryl B. Robertson et. al., *Introduction to Texas Business Organizations Code*, 38 Tex. J. Bus. L. 57 (Fall 2002).
7. *Id.* at 64.
8. Tex. Bus. Orgs. Code Ann. § 1.001 (Vernon 2006).
9. *Id.* § 402.003.
10. *Id.* § 402.004.
11. *Id.* § 401.001(1)(c).
12. All of these terms are defined in Tex. Bus. Orgs. Code Ann. § 1.001 (Vernon 2006).
13. *Id.* § 23.001(a).
14. *Id.* § 23.003.
15. *Id.* § 1.002(56).
16. *Id.* § 402.005(b).
17. *Id.* § 402.003(a).
18. [http://www.sos.state.tx.us/corp/forms\\_boc.shtml](http://www.sos.state.tx.us/corp/forms_boc.shtml) (Last visited January 27, 2007).
19. Tex. Ins. Code Ann. arts. 21.31, 21.32, 21.32A (Vernon 1981). A life insurance company may declare or pay dividends to its shareholders only "from the company's earned surplus, as defined by the commissioner." Tex. Ins. Code Ann. § 841.253(a)(2) (Vernon 2006).
20. See Tex. Bus. Corp. Act Ann. art. 2.38 (Vernon 2003).

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21. Perhaps subject to "opting in" to the BOC, and resolving the uncertainties as to how a "non-code organization" actually can do this.
22. Tex. Bus. Orgs. Code Ann. § 1.002(56) (Vernon 2006).
23. Daryl B. Robertson, "The New Texas Business Organizations Code," presented at "Understanding and Working with the new Business Organizations Code," sponsored by the University of Texas School of Law and the Business Law Section of the State Bar of Texas, January 25, 2006.
24. Tex. Bus. Orgs. Code Ann. § 1.002(18) (Vernon 2006) (emphasis added).
25. *Id.* § 2.003(2)(D).
26. *Id.* § 1.105.
27. *Id.* § 23.003.
28. Tex. Ins. Code Ann. § 822.052 (Vernon 2006).
29. Tex. Bus. Orgs. Code Ann. §§ 3.005, 3.007 (Vernon 2006).
30. For example, we are not sure how insurance regulators would react to calling the document a "certificate of formation," because the words "articles of incorporation" are specifically used in the Insurance Code.
31. Tex. Bus. Orgs. Code Ann. § 1.002(20-a) (Vernon 2006).
32. *Id.* §§ 6.002, 6.051, 21.3531, 21.354, 21.372, 21.411.
33. *Id.* § 6.002.
34. *Id.* § 8.103(a)(5).
35. *Id.* § 8.105(a)(3).
36. *Id.* § 8.103(a)(2)(B).
37. The "mandatory application date" means: (a) the date a "domestic entity" is formed or the date a "foreign entity" registers with the Secretary of State if on or after January 1, 2006; (b) the date a "domestic entity" or a "foreign filing entity" voluntarily adopts the BOC if the entity was formed prior to January 1, 2006; and (c) January 1, 2010 in all other instances. *See id.* § 401.001(1). Note that an insurance company formed after January 1, 2006 is not a "domestic entity," but a "non-code organization."
38. Tex. Bus. Orgs. Code Ann. § 402.007 (Vernon 2006).
39. *See id.*, Chapter 10.
40. *See* Daryl B. Robertson et. al., *Introduction to Texas Business Organizations Code*, 38 Tex. J. Bus. L. 57, 69 n.19 (Fall 2002).
41. Tex. Bus. Orgs. Code Ann. § 10.101 (Vernon 2006).

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42. *Id.* § 10.102.
43. *Id.* § 10.001(d). "Governing documents" would appear to include both the articles of incorporation and bylaws of a non-code organization. *See* Tex. Bus. Orgs. Code Ann. §1.002(36) (Vernon 2006).
44. *Id.* § 10.008(c).
45. *Id.* § 10.362.
46. *Id.* § 10.351(b).
47. *Id.* § 1.002(19).
48. *Id.* § 402.005(a)(3).
49. *Id.* § 402.004.
50. *Id.* § 9.001.
51. *Id.* § 9.002(c); e.g., the Insurance Code.
52. *Id.* § 9.251.
53. *Id.* §§ 9.052, 9.054.
54. Tex. Bus. Corp. Act Ann. arts. 2.25A, 2.25-1, 9.10C (Vernon 2003 & Supp. 2006).
55. Tex. Bus. Orgs. Code Ann. §§ 6.002(a), 21.3531(b) (Vernon 2006).
56. Tex. Bus. Corp. Act Ann. art. 9.10C (Vernon 2003 & Supp. 2006).
57. *Id.* art. 2.25A, 2.25-1.
58. Tex. Bus. Orgs. Code Ann. § 6.002(a) (Vernon 2006).
59. *Id.* § 21.3531(b).
60. The TBCA and the BOC provide minimum standards for indemnification of current and former officers, directors and "delegates." Through its governing documents, an entity may provide for indemnification and advancement of expenses *greater* than the minimum standards, but may not limit indemnification and advancement of expenses to be *less* than provided in the applicable law. Therefore, the new Code indemnification standards are technically "available" if an entity provides for them in its governing documents, whether or not the entity has opted in early to the BOC. However, if no provision for indemnification or advancement of expenses is contained in its governing documents, or if the indemnification standards are less than those provided for in the BOC, and the entity has not yet adopted the Code, then the statement that these indemnification standards are "not available unless a non-code organization opts in early" would be applicable. The minimum standards provided for in the TBCA, however, would still be applicable.
61. *See id.* § 10.005.

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62. *See id.* §§ 10.101, 10.102.