

SUBJECT: Changing regulation of for-profit legal services contracts

COMMITTEE: Licensing and Administrative Procedures — favorable, with amendment

VOTE: 5 ayes — Flores, Hamilton, Eissler, Goolsby, D. Jones
0 nays
4 absent — Raymond, Driver, Homer, Wise

SENATE VOTE: On final passage, March 26 — voice vote

WITNESSES: For — Kathleen S. Pinson, Prepaid Legal Services
Against — David Finney; Gary P. Monnin, Kellis Richter, and Ray Rische, Texas Legal Protection Plan

BACKGROUND: A prepaid legal services contract enables a consumer to obtain from a company a set amount of certain legal services for a specific time and price. Such contracts cover different types of legal services, such as defense for moving violations and automobile accidents, divorce, estate planning, consumer protection, and document review. Companies provide a variety of services, from a one-time fee for a telephone consultation to more complicated services. Under a common type of plan, a company charges a monthly fee and offers the customer a variety of legal services. The attorneys used are paid a set monthly amount, based on the attorney's number of clients, or a rate based on services rendered.

The Texas Department of Insurance (TDI) has regulated nonprofit and for-profit legal service contract companies since 1975. TDI requires companies selling these contracts to meet certain requirements, such as maintaining a certain level of reserves, testing and licensing requirements for agents, and restrictions on what can be written into a contract. Companies maintain reserves based on their yearly premium intake, which is used to pay claims. Claims are requests for payment for services rendered and can exceed the amount of premiums paid.

DIGEST: SB 597, as amended, would move the regulation of for-profit legal services contract companies from TDI to the Texas Department of Licensing and Regulation (TDLR) under Occupations Code, ch. 953, and would exempt these companies from insurance law. The bill would not affect nonprofit legal services corporations, automobile clubs, some prepaid legal services programs, lawyer referral services, or retainer or contingency fee contracts between attorneys and clients.

An insurer who issued or renewed a prepaid legal service contract would have to send written notice to the insurance commissioner within 60 days of transferring regulation of the contracts from TDI to TDLR. The bill would authorize the TDLR executive director to enforce the new chapter and would require companies to make their records available to the executive director. The executive director could refer a complaint received by TDLR to the State Bar of Texas, an appropriate licensing agency of another jurisdiction, or any person designated by law to receive public complaints concerning the performance of an attorney.

A person would have to register with TDLR to operate as a company or sales representative of legal services contracts sold in Texas. A company's contracts could be sold only by registered people. A person who collected commissions but did not sell or solicit legal services contracts would not have to register. Testing would not be required for registration, but an applicant would have to undergo a background check. The executive director could set registration fees plus a fee based on a company's annual sales. TDLR would have authority to adopt rules regarding registration.

Each regulated company would have to deposit and maintain a form of financial security with the executive director to guarantee that the company would perform its obligations to contract holders. A company with \$300,000 or less in annual gross revenue in Texas would have to deposit at least \$50,000; companies generating between \$300,000 and \$750,000 annually would have to deposit \$75,000; and those generating more than \$750,000 would have to deposit \$100,000. TDLR would have to safeguard the deposit for as long as the company did business in Texas. The executive director could order a change in the amount of financial security for a company under certain circumstances. A company that failed to meet these financial security obligations could have its registration revoked.

SB 597 would require the TDLR executive director to review annually a company's audited financial statements and a certified statement identifying any reserves. The executive director could require a company to maintain certain reserves to obtain or maintain registration.

The state, on behalf of a legal services contract holder injured because of a company's violation of this chapter, could bring suit to require a company to pay from its financial deposit the cost of any legal services the company had failed to provide.

A company could not sell, offer for sale, or issue a legal services contract in Texas unless it gave the contract holder a receipt or other written evidence of the purchase of the contract and a copy of the contract. A contracting attorney would have to be licensed to practice law, be in good standing with the licensing entity, and maintain malpractice insurance with minimum annual limits of \$100,000 for each occurrence and \$300,000 in the aggregate. A company could not interfere with the attorney-client relationship. A company would have to maintain records of all contracts, sales representatives, and complaints for at least two years after terminating a contract.

A legal services contract would have to be filed with the TDLR executive director before it was marketed, sold, offered for sale, administered, or issued in Texas. Contracts would have to be in writing and would have to include the company's name and full address, the price, terms, and restrictions governing cancellation, and the name of the sales representative and contract holder.

A legal services contract holder could terminate a contract by providing the company with written notice within seven days of receiving the contract. A contract would be void if the holder had not sought legal services before the contract was terminated. If a contract was voided, the company would have to refund the holder or credit the holder's account with the full purchase price of the contract. A company could cancel a contract by mailing a written notice of cancellation to the contract holder before the fifth day of the effective date of cancellation. Under certain circumstances, the company would not have to provide prior notice of cancellation.

SB 597 would prohibit a legal services contract company from using a name that included "insurance," "casualty," "surety," "mutual" or any similar word

descriptive of the insurance, casualty, or surety business. This restriction would not apply to a company that used such a descriptor in its name before September 1, 2003. The bill would prohibit a company or its agent from using false or misleading statements and from deliberately omitting a material statement in the company's contracts or marketing.

The TDLR executive director could impose an administrative sanction, including a penalty, on finding a ground for disciplinary action. In case of an emergency requiring immediate action to protect the public, the executive director could issue a cease-and-desist order to enforce the statute. The executive director also could seek an injunction or other administrative penalties for violations. A person affected by an administrative order, decision, or ruling could appeal to district court in Travis County.

SB 597 would prohibit an insurer from issuing or renewing a prepaid legal service contract under the Insurance Code after March 1, 2004. It would allow TDI and TDLR to enter into a memorandum of understanding for a transition plan to transfer regulation of legal services contracts from TDI to TDLR.

The bill would take effect September 1, 2003. It would apply to legal services contracts that complied with the transition plan or that were entered into on or after March 1, 2004.

**SUPPORTERS
SAY:**

SB 597 would move the regulation of prepaid legal services to TDLR, where it more appropriately belongs. It would follow a national trend to move the regulation of these contracts from the insurance arena to the regulatory arena. Although some aspects of prepaid legal services could be classified as an insurance product, they truly are consumer services and, as such, should be regulated by TDLR rather than by TDI. TDLR has experience in regulating consumer contracts, as the Legislature gave the agency regulatory authority over extended warranty contracts in 1999 and over vehicle protection products in 2001.

Prepaid legal services contracts do not require underwriting, as with insurance products, and claims are not adjusted. These services are more comparable to an extended warranty service contract or a contract with a cellular telephone company for calling minutes. They are similar to insurance contracts only in that the services are capped.

Although SB 597 would change the current regulatory scheme, it would not reduce consumer protections. TDLR would have broad enforcement powers over entities that sell legal services contracts. These entities would have to register with TDLR, post financial security, maintain books and records, and include certain language in their contracts. A company still would have to maintain reserves and would have to post a bond with TDLR. The TDLR executive director could require companies to set aside certain amounts of reserves to pay claims. In the unlikely event that a company was unable to pay claims, the bond could be used to ensure that claims were paid. The executive director also could seek an injunction or another administrative remedy to stop a company from harming or continuing to harm consumers.

OPPONENTS
SAY:

A majority of states regulate prepaid legal contracts as insurance contracts. Although a few companies offer prepaid legal services that are not like insurance, most companies offer insurance-style services. Prepaid legal services essentially are an insurance product, and moving their regulation to TDLR would be detrimental to consumers. When consumers buy prepaid legal services, they consider it an insurance product, similar to health or dental plans. Companies set aside reserve money to pay claims and to cover the risk that a claim may be more than the premiums paid. SB 597 would ease the regulation of these companies and would remove the requirement that every company retain a certain amount in reserves. This could result in attorneys not being paid and consumers not receiving the services they had paid for.

The risks associated with prepaid legal services contracts now offered by insurance companies that are regulated by TDI clearly justify the need for the regulations provided under the Insurance Code, which were designed to ensure adequate protection for consumers. To transfer the regulation of prepaid legal plans to TDLR and maintain adequate consumer protections, SB 597 would need to be amended to adopt the volumes of Texas insurance laws as they now apply to prepaid legal services contracts. Also, TDLR employees would need extensive training in insurance rules and regulations to oversee prepaid legal plans effectively, which might defeat the purpose of the transfer.

SB 597 would cap the financial security requirement at \$100,000, which would not ensure the faithful performance of a company's obligation. Companies licensed for prepaid legal contracts have calculated their reserves based on years of experience, and they can exceed 30 percent of earned

premiums. This means that an insurance company with \$10 million in earned premiums might reserve \$3 million, as compared to the \$100,000 proposed by the bill. Although the committee amendment would allow the TDLR executive director to require “certain reserves,” the language allowing this discretion is too vague.

NOTES:

The committee amendment to the Senate engrossed version of SB 597 would add the requirement for the TDLR executive director to review companies’ audited financial statements and reserves and by allowing the executive director to require a company to maintain certain reserves.