Interim Report

to the 85th Texas Legislature

House Committee on Business & Industry

December 2016

HOUSE COMMITTEE ON BUSINESS & INDUSTRY
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2016

A REPORT TO THE
HOUSE OF REPRESENTATIVES
85TH TEXAS LEGISLATURE

RENÉ O. OLIVEIRA
CHAIRMAN

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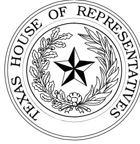


Committee On
Business & Industry

December 5, 2016

René O. Oliveira
Chairman

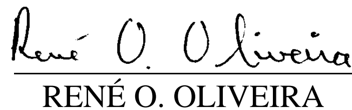
P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Joe Straus
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 Eighty-fourth Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-fifth Legislature.

Respectfully submitted,



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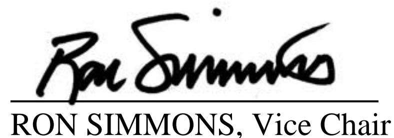

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TEXAS HOUSE OF REPRESENTATIVES
MATT RINALDI
DISTRICT 115

December 20, 2016

Rep. René O. Oliveira, Chairman
House Committee on Business & Industry
P.O. Box 2910 Austin, TX 78768

Dear Chairman Oliveira,

We greatly appreciate the time and energy your and your staff have dedicated to the interim charge work of the Business & Industry Committee. I believe the interim report, with few exceptions, accurately described the manner in which the Legislature should approach each of the issues on which we received testimony. Accordingly, we are signing on to the committee's recommendations, but with the following clarifications.

The interim report appropriately denotes the tremendous success of firms operating in the sharing economy, including Uber, Lyft, Airbnb, and Homeaway. This growth has been driven by the ability of the sharing economy to serve the needs of consumers in a way that older, highly-regulated delivery models cannot. We believe that excessive local regulation of an industry that impacts, or has the potential to impact, the statewide economy, will stifle innovation, competition, and consumer choice. That is why the Legislature must take action to prevent local governments from effectively regulating the sharing economy out of business. A statewide, pro-competition policy on the sharing economy will allow this industry to thrive free from over-regulation and the consumer to choose the balance he or she prefers between safety, privacy, convenience, and other relevant factors.

The committee also examined benefit adequacy in the state's workers' compensation system. The interim report recommends that we consider "permitting all surviving spouses to keep their death benefits upon remarrying," in order to remove a current financial discouragement to the remarriage of beneficiaries. We agree, with one caveat. As the report explains, death benefits were initially a means of monetary support to widows at a time when few women were employed outside the home and depended upon a husband for economic support. This is no longer the case in the 21st Century. Thus, when legislators consider allowing surviving spouses to keep their death benefits upon remarriage, they should also reconsider the permanency of death benefits in the workers' compensation program. We believe death benefits should operate as a time-limited support program to a surviving spouse, regardless of whether or not a remarriage occurs, which expires after allowing the spouse an adequate time for education and training to renter the job market in a position to support themselves financially and economically succeed.

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CARROLLTON, COPPELL, FARMERS BRANCH, IRVING, ADDISON, DALLAS

Again, we thank you for your diligence and attentiveness to our interim charges, and look forward to discussing these issues during the 85th Legislature.

Respectfully,

Matt Rinaldi

Jason Villalba

INTRODUCTION

At the beginning of the 84rd Legislature, the Honorable Joe Straus, Speaker of the Texas House of Representatives, appointed seven members to the House Committee on Business & Industry. The Committee membership included the following appointees: René O. Oliveira, Chairman; Ron Simmons, Vice Chair; Allen Fletcher; Nicole Collier; Jason Villalba; Ramon Romero and Matt Rinaldi.

The Committee was given jurisdiction over all matters pertaining to:

1) Industry and manufacturing;
2) Industrial safety and adequate and safe working conditions, and the regulation and control of those conditions;
3) hours, wages, collective bargaining, and the relationship between employers and employees;
4) the regulation of business transactions and transactions involving property interests;
5) the organization, incorporation, management, and regulation of private corporations and professional associations and the Uniform Commercial Code and the Texas Revised Limited Partnership Act;
6) the protection of consumers, governmental regulations incident thereto, the agencies of government authorized to regulate such activities, and the role of the government in consumer protection;
7) privacy and identity theft;
8) homeowners' associations;
9) oversight and regulation of the construction industry; and
10) the following state agencies: the State Office of Risk Management, the Risk Management Board, the Division of Workers' Compensation of the Texas Department of Insurance, the workers' compensation research and evaluation group in the Texas Department of Insurance, the Office of Injured Employee Counsel, including the ombudsman program of that office, and the Texas Mutual Insurance Company Board of Directors.

In November of 2015, Speaker Joe Straus issued ten interim charges to the Committee on Business & Industry to study and report back with facts, findings, and recommendations. The House Committee held six public hearings on, March 22nd & 23rd, 2016, April 25th & 26th, 2016 and June 8th & 9th, 2016 to study these charges.

The Committee also accepted written testimony and research from the public in the course of compiling this report. And our appreciation is extended to those who testified before the Committee and gave their time and efforts to assist in this process.

BUSINESS & INDUSTRY INTERIM STUDY CHARGES

1) Study Texas businesses' utilization of the Federal Work Opportunity Tax Credit, and the associated state tax refund under Subchapter H, Labor Code, in employing those who are receiving government benefits and/or have consistently faced significant barriers to employment. Conduct a cost/benefit analysis of the tax credit vis-a-vis savings in federal and state public assistance programs.

2) Identify and address potential gaps in Texas businesses’ cybersecurity policies and ensure that Texans’ personal information held by these businesses is secure.

3) Evaluate how Texas can support shared economy growth in the state. Determine how the state can ensure customer security and satisfaction as well as consumer protections without enacting burdensome regulations. Additionally, study the effects of a growing portion of the state's workforce seeking full-time vs. supplemental part-time employment with related technology-based businesses. Analyze recent debate and legal precedent regarding the classification of these employees.

4) Examine the regulatory powers of property owners associations, and the procedures available to home owners when an association restricts individual or property rights. Review current best practices to help clarify the balance of property rights, transparency in governance, and the best interests of property owners in the state.

5) Study the impact of recent Texas cases related to the rights and remedies of shareholders of Texas corporate forms, including the impact of those decisions on the legal rights of both Texas corporations and shareholders and any impact on the Texas business climate.

6) Study the requirement for state agencies and entities to purchase insurance through the State Office of Risk Management (SORM), and the agencies and entities that are exempt from this requirement. Examine the costs and benefits of each approach, and the waiver process by which SORM can allow agencies to purchase insurance on their own.

7) Study the following aspects of the designated doctor process in the Texas workers' compensation system:
   a. the Division of Workers' Compensation's (DWC's) processes for educating, monitoring, and evaluating designated doctors;
   b. whether the DWC requires additional authority to regulate designated doctors or entities providing services for designated doctors; and
   c. any unique issues with "traveling" designated doctors.

8) Examine the adequacy of benefits for injured employees in the Texas workers' compensation system who qualify for Lifetime Income Benefits, and for the beneficiaries of employees who receive Death Benefits. In particular, examine the application of benefit caps for those benefit types and the termination of Death Benefits to surviving spouses on remarriage.

9) Analyze recent data attributing the decline in domestic manufacturing to a consistent trade deficit caused by steady increases in net imports. Study how expanding trade and investing in manufacturing communities' partnerships can grow the state's skilled workforce and production as well as increase net exports and develop a trade balance. *(Joint charge with the House Committee on International Trade & Intergovernmental Affairs)*

10) Conduct legislative oversight and monitoring of the agencies and programs under the committee's jurisdiction and the implementation of relevant legislation passed by the 84th Legislature.

FEDERAL WORK OPPORTUNITY TAX CREDIT

Study Texas businesses' utilization of the Federal Work Opportunity Tax Credit, and the associated state tax refund under Subchapter H, Labor Code, in employing those who are receiving government benefits and/or have consistently faced significant barriers to employment. Conduct a cost/benefit analysis of the tax credit vis-a-vis savings in federal and state public assistance programs.

Background

Both the Work Opportunity Tax Credit (WOTC) and the Tax Refund for Wages Paid to Employee Receiving Aid to Families with Dependent Children (State Refund) share the same goal: to incentivize businesses to hire people who face significant barriers to employment and are currently receiving public assistance benefits. By incentivizing private sector employment, the state and federal government can reduce public assistance expenditures, employers can employ people at a lower cost, and difficult to employ individuals can improve their lives and the lives of their families.

State Refund

In 1991, the Texas Legislature directed the Comptroller of Public Accounts to perform a performance review of state government. In 1993, the comptroller issued a report, *Against the Grain*, which recommended establishing a tax credit for employers who hire people receiving benefits under the Aid to Families with Dependent Children (AFDC, now known as Temporary Assistance for Needy Families). Later that year, the 73rd Legislature passed Senate Bill 82, which, among other things established tax refund program for employers.[i] Today, Texas is the only state to offer a state incentive to employ people on public assistance.

Under the legislation, a business can receive a tax refund voucher equal to 20 percent of the total wages, up to a maximum of $10,000, for newly hired employees who met the eligibility criteria. To be eligible the employee had to be a resident of the state and an AFDC recipient. The employer has to pay at least 80 percent of cost of health insurance coverage for the employee, with a maximum deductible of $300.

Before hiring an employee, the employer has to obtain certification from the state that the potential employee is receiving financial assistance. After the employer has paid wages to an eligible employee, the employer may apply for a tax refund of 20 percent of total wages or $10,000, whichever is less. However, the employer can only apply for the refund between January 1 and April 1 of the year after the wages were paid.[ii]

The timetable and process from certification to hiring to receiving the refund is lengthy, which is a major criticism of the program. Once an employer determines he or she would like to employ a recipient, the employer must ask a state agency to certify the potential employees eligibility. If the tax refund is the determining factor in hiring the potential employee, the employer must wait for the appropriate state agency to certify the employee. Once the employer has the certification, he or she then pays wages and health insurance coverage for the employee. Then, once the calendar year rolls over, the employer can request the tax refund while submitting the appropriate evidence of wages paid as required by the program. Once the state is satisfied that everything is in order, it issues a tax refund voucher. The voucher can be used against any tax paid to the state only for the calendar year for which the voucher is issued.

Some employers might use the voucher against their franchise tax. Many small businesses, however, are exempt from the franchise tax, and thus have no tax to have refunded. They can apply the voucher to their sales taxes or other state taxes. If their state taxes are less than the amount of the voucher, they can only be refunded the amount of the tax they paid. No carry forward is permitted.

(At the time State Refund statute was enacted, only corporations paid the franchise tax. Many businesses began to restructure as partnerships and other business forms to avoid the tax. Subsequently, the franchise tax has been expanded to include other types of businesses, but sole proprietorships are excluded. Additionally, many businesses are exempt by statute because their revenues are very low. Despite the exemptions, many more businesses are paying the state franchise tax today than were paying at the time the legislation was enacted.)

Since the original enactment, eligibility has been expanded to include those who receive government funded medical assistance under Chapter 32 of the Human Resources Code, or receive health benefits through an arrangement under Section 32.0442, Human Resources Code, when part of the cost paid for by the employer.[iii] The provisions of the Affordable Care Act complicated the economics of insurance provisions of the State Refund program, but the statute has remained unchanged. Unknown, but probable, changes to the Affordable Care Act by Congress will make it difficult for the Texas Legislature to update the health insurance provisions of the State Refund program. Because health insurance is a major cost of employment, the Legislature needs to be cautious of federal changes that could make the State Refund program unless or much for costly to the state budget. While the status of the Affordable Care Act is unknown at this time, perhaps Congress will act swiftly so that the Legislature might have a more predictable scenario before the end of the 85th Legislative Session.

The Texas Workforce Commission is now the agency responsible for certifying eligible employees. The agency reports very few applications and certifications under the State Refund program. The table below shows activity for recent years.

Year	Applications	Applications Certified
2012	1,849	32
2013	1,380	92
2014	2,208	304

Given the small number of certifications, some question the overall effectiveness of the program.

Work Opportunity Tax Credit

The WOTC is a federal tax credit for employers who hire people in certain groups, who face barriers to employment. The Department of Labor reports that employers claim over $1 billion in tax credits every year. The WOTC was created in 1996, about three years after Texas created the State Refund.

Employers can earn a tax credit equal to 25 percent of a new employee's wages if the employee works at least 120 hours but fewer than 400 hours in the first year. The tax credit is increased to 40 percent of wages if the employee works more than 400 hours. The tax credit may be used for taxes paid on the previous two years, or carried forward for 5 years if not income taxes are currently due.

The Department of Labor's website lists eligible employees as follows:

Veterans Target Groups
A new hire qualifies for a veterans target group, if the individual is:

- A veteran who is a member of a family that received SNAP benefits (food stamps) for at least a 3-month period during the 15-month period ending on the hiring date;

OR

- A disabled veteran entitled to compensation for a service-connected disability, who has been:
  - Hired within 1 year of discharge or release from active duty, OR
  - Unemployed for at least 6 months in the year ending on the hiring date;

OR

- A veteran who has been unemployed for:
  - At least 4 weeks in the year ending on the hiring date; OR
  - At least 6 months in the year ending on the hiring date.

Please note that to have veteran's status to be eligible for WOTC, an individual must:

- Have served on active duty (not including training) in the U.S. Armed Forces for more than 180 days, OR have been discharged or released from active duty for a service-connected disability; AND
- Not have a period of active duty (not including training) of more than 90 days that ended during the 60-day period ending on the hiring date.

Long-Term Temporary Assistance for Needy Families (TANF) Recipient
To qualify for this target group, a new hire must be a member of a family that meets one of the following circumstances:

- Has received TANF benefits for at least 18 consecutive months ending on the hiring date; OR
- Has received TANF benefits for at least 18 consecutive or non-consecutive months after August 5, 1997, AND has a hiring date that is not more than 2 years after the end of the earliest 18-month period after August 5, 1997; OR
- Has stopped being eligible for TANF payments during the past 2 years, because a Federal or state law limited the maximum time those payments could be made.

Short-Term TANF Recipient
A new hire qualifies for this target group, if the individual is a member of a family that received TANF benefits for any 9-month period during the 18-month period ending on the hiring date.

Supplemental Nutrition Assistance Program (Food Stamp) Recipient
A new hire qualifies for this target group, if the individual is:

- Age 18 to 39 years old, AND
- A member of a family that received Supplemental Nutrition Assistance Program (SNAP) benefits for:
  - The 6 months ending on the hiring date, OR
  - At least 3 of the 5 months ending on the hiring date.

Designated Community Resident (DCR)
A new hire meets the criteria for this target group, if the individual:

- Is age 18 to 39 years old, AND
- Resides within one of the federally designated:
  - Rural Renewal Counties (RRCs), OR
  - Empowerment Zones (EZs).

Vocational Rehabilitation (VR) Referred Individual
A new hire is a member of this target group, if the individual with a disability has completed, or is completing, rehabilitative services provided by:

- A state-certified agency, OR
- An Employment Network under the Ticket to Work program, OR
- The U.S. Department of Veteran Affairs.

Ex-Felon
A new hire meets the criteria for this target group, if the individual:

- Has been convicted of a felony; AND
- Has a hiring date that is not more than 1 year after the conviction or release from prison.

Supplemental Security Income (SSI) Recipient
A new hire meets the criteria for this target group, if the individual is a recipient of SSI benefits for any month that ends during the 60-day period ending on the hire date.

Summer Youth Employee
A new hire is a member of this target group, if the individual:

- Is a 16 or 17 year old youth, AND
- Works for the employer between May 1 and September 15; and
- Resides in an Empowerment Zone (EZ).

The steps for qualifying an employee are similar to those of the State Refund. On the day of, or before, making a job offer, the employer fills out IRS Form 8850 with information provided by the potential employee, and attests that the employer believes the potential employee is a member of a WOTC target group. The employer also fills out the Department of Labor WOTC form. The employer submits the forms to the Texas Workforce Commission within 28 days of

the employees start date. The Workforce Commission has an electronic system for submitting the forms, though other methods are permissible.

The Workforce Commission reviews the information, and when appropriate certifies the employees eligibility. The Commission then notifies the employer. After receiving certification, and after the employee has worked at least 120 hours, the employer may file for the tax credit with the IRS.

The maximum tax credits for each target group are listed below:

Veteran Target Group	Maximum Tax Credit
Receives SNAP (food stamps) benefits	$2,400
Entitled to compensation for service-connected disability	
Hired one year from leaving service	$4,800
Unemployed at least 6 months	$9,600

Unemployed	
At least 4 weeks	$2,400
At least 6 months	$5,600

Other WOTC Target Groups

Target Group	Maximum Tax Credit
Short-Term TANF Recipient	$2,400
Long-Term TANF Recipient	$9,000 (over 2 yrs)
SNAP (food stamp) Recipient	$2,400
Designated Community Resident	$2,400
Vocational Rehabilitation Referral	$2,400
Ex-Felon	$2,400
SSI Recipient	$2,400
Summer Youth	$1,200

The Texas Workforce Commission testified that the application and use of the WOTC greatly exceeds the State Refund. The chart below shows estimates for the recent activity in Texas.

Year	Applications	Apps Processed	Apps Certified	Value
2014	369,000	366,000	133,000	$321,000,000
2015	433,800	430,000	146,000	$353,600,000
Thru March 2016	238,800	235,000	75,900	$183,000,000

House Bill 3305

In the 84th Legislative Session, Representative René O. Oliveira introduced House Bill 3305 to make improvements to the State Refund program, by:

- Expanding the eligible population to mirror that of the federal WOTC;
- Converting the tax refund to a tax credit, while permitting a five-year carryforward;
- Requiring the Texas Workforce Commission to confirm an employee's eligibility within 60 days;
- Permitting transfer of the tax refund to another entity under limited circumstances; and
- Repealing the state tax refund.[iv]

Supporters of the bill believe that people in the WOTC target groups are "stigmatized," and that many employers will not consider hiring them. As a consequence, these people are likely to remain on public assistance much longer than others. The longer they remain, the greater the cost to the state and federal government. The supporters believed that a state tax credit, running parallel to the federal WOTC credit, would further entice businesses to hire people on public assistance, and reduce government expenditures.

Proponents also stated that tax credits would expand the workforce. About two-thirds of job seekers are already employed, and looking to improve their economic condition. By making people in the WOTC target groups attractive to employers, applicants that would previously go unconsidered now become a viable option. If they get hired, those people can be lifted from a prolonged state of poverty.

A study conducted by Professor Peter Cappella of the Wharton School of Business concluded that the federal government saves about $18,000 for every WOTC employee hired, but pays just $1,300 in a one-time tax credit. The scope of the study was limited to the savings in just four programs; Medicaid, TANF, SNAP (food stamps), and HUD housing subsidies. However, people in the WOTC target groups are often on multiple public assistance programs. The study estimated that the federal WOTC program saves Texas about $154 million per year in Medicaid, TANF, and SNAP costs.

In December of 2015, Congress added a new category to WOTC, the long term unemployed. Rules for this target group have yet to be promulgated, and until they are the credit is unavailable. However, one study projects a $6,000 savings in public assistance for every long term unemployed person who is hired through WOTC.

The value of the federal tax credit has not increased since 1996, when the WOTC program was enacted. Adjusting for inflation, the federal WOTC tax credit is 35 percent less valuable than it was in 1996.

Supporters of the bill could not develop specific savings of a state WOTC tax credit. But they did note that Texas is the only state in the country with a tax incentive for hiring difficult to employ people. Even though the program is relatively small. A state incentive, using the same

administrative procedures as the federal program, would be a tremendous incentive for businesses to create jobs in Texas versus other states, supporters say. Most of the federal WOTC participating businesses are national companies, and often have to choose between multiple states when determining where to locate jobs. A state WOTC incentive could bring those jobs to Texas, and simultaneously reduce the state's costs for public assistance programs.[v]

The Legislative Budget Board determined that the fiscal impact of House Bill 3305 would be a loss to the Property Tax Relief Fund of $36 million in the first year, and $90 million per year after that. Any loss to the Property Tax Relief Fund would have to made up out of money from General Revenue to pay for the Foundation School Program.

The repeal of the current tax credit would add about $300,000 per year to General Revenue.[vi] The LBB only examined the direct impact the legislation would have on the General Revenue Fund and the Property Tax Relief Fund. Secondary impact, such as the savings that would be gained to reductions in the TANF, SNAP, and Medicaid programs were not calculated. Limiting the scope of a Fiscal Note to direct impact is standard policy for the LBB, however, that leaves a significant part of the fiscal impact unexamined. Additionally, HB 3305 was filed just before the filing deadline, so the Legislative Budget Board had little time to gather the appropriate information to examine other impacts.

The Fiscal Note estimated that TWC would certify 1,000 employees per month and that the average credit earned would be $7,500.[vii] Only two WOTC target groups can earn credits of more than $5,600 - disabled veterans and long-term TANF recipients. For most of the WOTC target groups the maximum credit is just $2,400.

The committee requested the Texas Workforce Commission report how many potential employees it is certifying by WOTC target group, in an effort to refine the likely cost of the average tax credit. The following spreadsheet contains those results. The overwhelming majority of certifications are in groups for which the maximum tax credit just capped at $2,400.

Work Opportunity Tax Credit Certifications Issues by Target Group 2014 - April 2016

	Maximum Tax Credit	September 2015 to March 2016	POTENTIAL DOLLAR AMOUNT	September 2014 to August 2015	POTENTIAL DOLLAR AMOUNT	September 2013 to August 2014	POTENTIAL DOLLAR AMOUNT
8850'S RECEIVED		238832		430801		369766	
Non-Veteran Target Group Certifications							
Long-Term Family Assistance recipeitns who are members of a family that has received Temporary Assistance for Needy Families (TANF) benefits for at least 18 consecutive months	$ 9,000.00	426	$ 3,834,000.00	371	$ 3,339,000.00	150	$ 1,350,000.00
TANF Recipients		929	$ 2,229,600.00	1199	$ 2,877,600.00	656	$ 1,574,400.00
Ex-Felons		6314	$ 15,153,600.00	6860	$ 16,464,000.00	2351	$ 5,642,400.00
Designated Community Residents		9977	$ 23,944,800.00	11380	$ 27,312,000.00	8072	$ 19,372,800.00
Vocational Rehabilitation Referrals	$ 2,400.00	4640	$ 11,136,000.00	5340	$ 12,816,000.00	2050	$ 4,920,000.00
Supplemental Nutritional Assistance Program (SNAP) Benefit Recipients		91894	$ 220,545,600.00	115127	$ 276,304,800.00	54246	$ 130,190,400.00
Supplemental Security Income (SSI) Recipients		2485	$ 5,964,000.00	2485	$ 5,964,000.00	786	$ 1,886,400.00
Summer Youth program particpants who are 16 to 17 years old, work between May 1 and September 15 and live in an empowerment zone	$ 1,200.00	220	$ 264,000.00	181	$ 217,200.00	145	$ 174,000.00
Veteran Target Group Certifications							
Disabled Veteran with a service-connected disability who has been unemployed for a least 6 months	$ 9,600.00	509	$ 4,886,400.00	923	$ 8,860,800.00	663	$ 6,364,800.00
Disabled Veteran with a service-connected disability	$ 4,800.00	59	$ 283,200.00	163	$ 782,400.00	87	$ 417,600.00
Veteran who has been unemployed for at least 6	$ 5,600.00	5145	$ 28,812,000.00	8197	$ 45,903,200.00	2623	$ 14,688,800.00
Veteran who has been unemployed for at least 4	$ 2,400.00	2836	$ 12,348,000.00	3339	$ 8,013,600.00	1499	$ 3,597,600.00
Veterans Receiving SNAP Benefits	$ 2,400.00	535	$ 1,284,000.00	634	$ 1,521,600.00	233	$ 559,200.00
TOTAL		125969	$ 330,685,200.00	156199	$ 410,376,200.00	73561	$ 190,738,400.00

At the same time, the number of certifications under the federal program are about 10 times the projections of the LBB. If the programs run parallel, it might be reasonable to expect that most employers would utilize both programs.

Because the federal government pays most of the cost for the TANF, SNAP, and Medicaid programs, the savings to the state could be less than national figures might indicate. If the state's percentage of costs were low, it is possible, though unlikely, that the tax credit might be greater than what the state is spending through the program. Additionally, because some potential employees may be enrolled in multiple programs, calculating the savings is difficult. While a person may be qualified for a WOTC tax credit under the TANF program, but the SNAP program and Medicaid might also see savings. Whether savings can be redirected is also difficult to determine because some money is come in the form of block grants, which require a minimum level of state spending.

The committee is continuing its discussion with state agencies in an effort to better determine the costs and savings. As information becomes available, supporters say they are prepared to adjust tax credit amounts to appropriate levels.

The goal of the current State Refund and WOTC are to help move people off of public assistance and into meaningful employment to reduce public assistance spending. The programs could have a small stimulus effect, if the credits were so great that businesses would create jobs they would not create absent the tax credits. Given that most participants can receive a maximum credit of about $2,400, the stimulus effect seems unlikely. The tax credits, however, would provide an offset to significant barriers some people face when seeking employment.

Recommendation

The Texas Legislature should consider making improvements to the Tax Refund for Wages Paid to Employee Receiving Aid to Families with Dependent Children in an effort to move people off public assistance and into meaningful employment. In evaluating those improvements, the Legislature must be cognizant of the complicated calculations in determining the benefits of any improvements.

TEXAS BUSINESSES' CYBERSECURITY

Identify and address potential gaps in Texas businesses' cybersecurity policies and ensure that Texans' personal information held by these businesses is secure.

Background

The idea of a cyber-attack that is intended to disrupt business operations is no longer a far-fetched scenario. As a result of our increased dependence on the Internet, cybersecurity has emerged as one of the most critical issues facing governments, businesses, and individuals in the 21st century. In 2016, a report by M-Trends, a FireEye company, found that 40 percent of small-and-medium sized businesses (SMBs) do not have adequate security. And 60 percent of SMBs do not consider cyber-attacks as an immediate risk despite the increase in attacks from criminals and hostile foreign governments across all industries.[viii]

The majority of these bad actors whether state sponsored or lone criminals aim to steal credentials, often through spearphishing attacks. E-mail fraud that executes a malicious code or link by "duping" an individual to open or click on a page or link that appears harmless, but ultimately gives the attacker access to that individuals machine.

At the state level, there are certain statutory requirements laid out in Chapter 521 of the Texas Business & Commerce Code (TBCC). TBCC includes a duty to implement reasonable procedures, including taking any appropriate corrective action, to protect the unlawful use or disclosure of any sensitive personal information collected or maintained by a company in the regular course of business. This agreement of this and that applies to information collected or maintained on customers as well as employees. The TBCC also mandates procedures for the destruction of records that contain sensitive personal information, and imposes a number of notification requirements and procedures on a business's security system. Texas also recently expanded the breach notification requirements to include notification to those whose information may have been "potentially" exposed, regardless of that person's residency, be it in Texas or elsewhere.

The Committee heard testimony at a public hearing on June 9, 2016 on the issues concerning cybersecurity and the security of Texans' personal information. Joel Lang with CSID, a leading provider of global identity protection and fraud detection technologies for businesses, their employees, and consumers, testified that one of the most common threats to cyber security of small and medium-sized businesses in Texas is spearphishing for credit card data. CSID found that 91 percent of all cyber-attacks actually begin with spearphishing and in 2015, 35 percent of small businesses received spear-phishing messages, and of that 35 percent, there were 23 percent of those malicious messages unknowingly opened by the employees.[ix]

Analysts at Security Metritcs say 61 percent of merchants store credit card Primary Account Number (PAN) data in an unencrypted manner. The high percentage of merchants that keep unencrypted data is alarming and indicates of just how many businesses are vulnerable. SMBs, on average, lose in excess of $200,000 per attack. This magnitude of a financial loss can be devastating.[x]

Once a hacker is into a SMBs data, the vulnerability is not limited to that business. Because the SMB may work with larger companies, the SMB hack may produce a gateway into a larger company. For example, the infamous Target breach was done through a third party vendor. Ultimately, companies are going to store consumer information, and it is important to minimize the risk of exposure for everyone. Because every time a piece of personal identifiable information (PII) is transmitted or stored, the risks inevitably increase. In Texas, PII is defined as a first name and last name in combination with any of the following: social security number, driver's license or government issued ID number, account or credit card number, or health-related information such as the physical or mental condition of the individual.

CSID considers part of the solution for SMBs is to be aware of state regulations in the Texas Business & Commerce Code that govern the breach notification process. CSID also believes SMBs should have a breach response plan that entails keeping an inventory of data assets, securing legal counsel that specializes in privacy matters, establish a relationship with a cyber-forensics provider, preparing for media scrutiny and determining what remedies to victims the SMB will offer. Cyber insurance coverage is also highly encouraged, but just 2 percent of SMBs currently carry some form of cyber liability or data breach insurance.

Lastly, CSID believes Texas business owners would benefit from the creation of a state-level cyber security certification, ensuring at most a minimum viable security standard.
The Committee also invited testimony regarding the vulnerabilities of certain industries that maintain significant amounts of critical data, like banking, health care, utilities and retail.

Banking

Charles G. Cooper, Commissioner of the Texas Department of Banking and, Phillip Hinkle, Director of IT security examinations, testified on how the department has been working with the banking industries to increase awareness. Because banks are high profit targets for cybercrimes, the department has worked to create a multitude of tasks forces, operations and leadership initiatives.

In 2010, the department created the Texas Bankers Electronic Task Force (ECTF) with the U.S. Secret Service. The task force includes members of bank trade associations, approximately two dozen banks, and the U.S. Secret Service. Then from ECTF, the U.S. Secret Service launched "Operation Texas Money Mule," a global undercover operation which is a form of identity theft where cyber thieves gain control of a businesses' bank account, often by stealing user passwords and other valid credentials. Once obtained, thieves initiate fraudulent wire and ACH transactions. ECTF also developed Corporate Account Takeover (CATO) Best Practices which further protect banks but small businesses, and consumers.[xi]

Mr. Cooper, in 2013, also reconvened the Texas Bankers ECTF with banking officials to create the Executive Leadership of Cybersecurity (ELOC) Initiative. The ELOC is currently the single most important transformational element to secure the banking industry from cyber threats.
The Federal Financial Institution Examination Council (FFIEC), in 2013, established the Cybersecurity and Critical Infrastructure Working Group (CCIWG) as a permanent structure and conducts webinars to increase education and awareness. And, in June of 2015, the FFIEC

released a Cybersecurity Assessment Tool (CAT) to assist banks in measuring their cyber risks and preparedness.

The FFIEC directed Texas state-chartered banks to complete a cybersecurity risk assessment and evaluation of controls by the end of 2015. The assessment consists of two parts: Inherent Risk Profile and Cybersecurity Maturity. Upon completion of both parts, management can evaluate whether the institution's inherent risk and preparedness are aligned.

In 2016, the department began evaluating Texas state-chartered banks readiness in meeting the new FFIEC "baseline" cybersecurity level. Early results have indicated that chartered banks are addressing their cybersecurity risks and still working diligently on improvements. Cybersecurity will be a constant ever-growing battle that is here to stay. The Texas Department of Banking is and will continue working to ensure the safety of all industries, businesses and consumers from cybersecurity threats.

Healthcare

The healthcare industry is another high profile target for cyber criminals. Nora Belcher of the Texas e-Health Alliance testified that the industry is seeing a rise in ransomeware that is believed to be driven by the increased value of Protected Health Information (PHI). PHI is defined as any information associated with a patient and his or her health status. There are several ways PHI can be turned into illegal profit, including the following:

- Extortion (blackmail), in which criminals demand money from individuals or health care organizations to prevent exposing private medical information;
- Fraud, in which criminals use a valid health insurance card to obtain health care services or purchase medical equipment or pharmaceuticals that can be resold at a profit;
- Identity theft, in which criminals use a valid Social Security number to open lines of credit or create fake IDs; and
- Data laundering, in which criminals sell stolen data back to legitimate businesses or repackage insurance claims data.[xii]

Ransomware is a type of malware program that infects, locks, or takes control of a system and demands ransom to undo it. Ransomware attacks and infects a computer with the intention of extorting money from its owner. Ransomware may also be referred to as a crypto-virus, crypto-Trojan or crypto-worm.[xiii]

According to Symantec's internet security threat report from April 2015, "Ransomware attacks have more than doubled in 2014, from 4.1 million in 2013, up to 8.8 million." The best, and pretty much only, defense is to keep a separate backup of your files, preferably offline, to restore from. And though there are many ransomware options, no operating system can guarantee immunity.

Just as in any other form of attack, technology is ever changing and keeping up with the latest attack methods is a daily fight. The growing sophistication of these cyber threats does not appear to have an end in sight. Health care providers also often have outdated infrastructure that is

vulnerable to attacks. The only feasible options the Alliance can foresee is regular training for staff and providers start to thinking preventatively so that they may act quickly at first sign of an incident. Like all businesses and industries, the health care system needs to work on keeping software and hardware infrastructure current.

Utilities

Public utilities, such as electricity providers, water and sewer systems and gas systems, face threats to their operational and financial systems. Understandably, all were reluctant to openly discuss the types of threats they are facing, for fear others may mimic or refine attacks. All did inform the Committee that they are keenly aware of, and constantly fighting off, various cyber threats.

Julia Rathgeber with The Texas Cable Association did testify before the committee. TCA member companies, which include, CableOne, Charter, Comcast, Suddenlink, and Vyve Broadbank, work with many federal agencies and cybersecurity initiatives tasked with securing and protecting customer data and company networks. Ms. Rathgeber said the industry sees cybersecurity as a significant threat and has dedicated full-time personnel to ensure security is maintained.[xiv]

George Keleman with the Texas Retailers Association testified combating the sophisticated breaches of today, and will take collaborative efforts from all business industries. Cyberbreaches are not just a retail phenomenon. The industry is motivated to take every step possible to protect and address the financial and privacy risks of these systems, and customers.

Keleman says TRA does not believe in a one-size-fits-all approach, because businesses vary so greatly. For retailers with multistate operations, Texas regulations might add another layer of regulation to existing state and federal regulations, which might complicate compliance.[xv]

Recommendation

The Texas Legislature should continue to monitor data breaches and how businesses and other enterprises prevent and react to cybersecurity threats.

SHARED ECONOMY GROWTH

Evaluate how Texas can support shared economy growth in the state. Determine how the state can ensure customer security and satisfaction as well as consumer protections without enacting burdensome regulations. Additionally, study the effects of a growing portion of the state's workforce seeking full-time vs. supplemental part-time employment with related technology-based businesses. Analyze recent debate and legal precedent regarding the classification of these employees.

Background

The sharing economy has grown rapidly over the last several years. While opinions differ on what types of goods and services are involved in the sharing economy, and the size of the sharing economy, it is clear that tens of thousands, perhaps hundreds of thousands, of Texans are engaged in sharing economy activities, as a full-time job or as supplemental employment.

Economists and academicians struggle to define what constitutes the sharing economy, and even dispute whether the term "sharing economy" accurately describes the commercial activity involved. For the purposes of this report, a broad, general understanding of the sharing economy serves best. Independent entrepreneurs offer their assets for temporary use and/or their skills through a social network or technological platform to consumers. The best known examples include Uber and Lyft for ride sharing; Airbnb and Homeaway for home sharing; TaskRabbit for moving, cleaning, and handyman services, and Favor for delivery services. The spectrum of goods and services in the sharing economy is constantly changing, as are the platforms that connect suppliers and consumers.

In many cases, the ultimate product or service offered is not new. Rather, it is the technology platform that makes it easier for entrepreneurs to find customers and conduct transactions. For example, offering rides is nothing new, and indeed dates back well before the invention of the automobile.

A Case Study in Disruption

Previously, that service was offered by taxi and limousine companies. People made a phone call to a cab company, and, after the passenger waited, a driver would pick up the passenger, and, for a regulated fee, take the passenger to his or her desired location. After the trip, the passenger paid the driver, usually in cash, though in-car credit card processing has now become much more available. The driver is often an licensed independent contractor, who rents a taxi for a certain time period. Fares are set by local governments to try to ensure a driver, with tips, earns enough to cover the cost of the car, gasoline, insurance, his or her wages, and other expenses.

With the advent of the smartphone, tech entrepreneurs realized that they could process a request much faster and more conveniently. Through GPS, the driver's approach could be monitored by the passenger. The platform would also set the rate of the fare, unlike the regulated fares of taxis. The platforms also featured the ability to pay by credit card, including tip, by registering the card with the platform. Thus, the passenger did not have to carry cash, calculate a tip, or spend time on a transaction. He or she simply exited the car at the destination, and the platform handled the transaction, keeping a percentage of the transaction.

The platforms ease of use and regulation avoidance also made it easy for drivers to get started ferrying passengers. If they had a car that met the platform's standards, and they could pass a background check, they were in business. GPS enabled them to move passengers efficiently,

even if they were unfamiliar with an area. The platform also allowed for an efficient transaction system that meant the driver did not need to carry cash, make change, or keep books - the platform would routinely send them a payment for their share of the fare.

Because ride sharing platforms are easy to use for both drivers and passengers and because the cost was often less than taxis, ride sharing companies grew very rapidly. The companies that developed the platforms were able to "disrupt" an established, heavily regulated industry by revolutionizing customer service and avoiding regulation. Considerable debate exists about the propriety of ride sharing companies' avoidance of regulation, but the disruption of the market, whether it is for car rides, a place to stay, deliveries, or other services, is a hallmark of sharing economy companies.

Transportation

In Texas, municipalities have had the authority to regulate taxi service for decades. Cities have established rules regarding the regulation of vehicles, drivers, insurance, dispatch companies, and set fares in accordance with local demands.[xvi] Ride sharing companies came to Texas roughly in 2014. The history of individual ride sharing companies varies in different cities. Some city governments worked immediately to ensure drivers met the regulatory standards of taxi drivers. Others took more of a wait and see attitude. Ride sharing companies often expanded rapidly and became popular while city officials were struggling with the applicability of regulation.

Unlike taxi companies, ride sharing companies, now known as Transportation Network Company, (TNC), do not own and operate a fleet of cars. Instead, drivers use their own vehicles, which gets around a major barrier to entry into the market. Ride sharing companies quickly signed up thousands of drivers and built a customer base. There is a stark difference in how Texas' major cities responded to ride sharing entry into their markets.

Houston

The City of Houston worked with TNCs to develop regulations, and imposed more stringent background checks, including fingerprint checks. While the TNCs do conduct background checks, city officials felt those checks were inadequate. The city applied its longstanding fingerprint policy for cab drivers to TNC drivers. As a result, it does take longer for a driver to be approved and receive a license than it would if the TNCs were allowed to use the background check method they use in other cities and state. Houston and New York are the major U.S. cities where TNCs operate under fingerprinting rules, but Uber has consistently criticized the policy.[xvii]

Uber argues that its background checks, plus its technologies, offer security that the marketplace likes. If the marketplace did not think Uber's checks were sufficient, riders would not use the service. It also points out that its level of security has them operating in 400 cities in 71 countries. However, more cities are making efforts to bring TNCs under greater regulatory control.

Uber also argues that the cost and time involved with fingerprinting keeps entrepreneurial drivers from entering the market place, thus reducing the number of available drivers and making it harder for its customers to book rides. Uber criticizes the fingerprint data bases because it says the data bases often do not include the final disposition of a case. Thus, someone falsely accused is reported as being arrested, but not as having the charges dropped.

Uber also says that of the drivers who apply and are ultimately denied, 90 percent are eliminated by Uber's own background check. Uber also says that dozens of drivers who passed the fingerprint background check and were granted a taxi driver's license, failed Uber's background check. Uber argues that outdated regulations are duplicative, offer little if any additional safety, are anticompetitive, and eliminate employment opportunities.[xviii]

Conversely, the City of Houston believes a fingerprint background check enhances public safety. City officials point to one case where a person passed Uber's background check, but, after fingerprinting, was found to be using one of multiple aliases and social security numbers; and was wanted on an outstanding warrant. Additionally, several applicants who passed Uber's background check were later found to have some criminal background.

The city acknowledges that the fingerprinting process does delay the time it takes for a driver to start accepting rides, but that the additional week or two it takes to process an application once the driver has been fingerprinted is a small inconvenience for additional public safety.[xix]

Uber has said that unless some regulations were changed, including the fingerprint requirement, it would stop service in Houston. On November 16, 2016, Uber and the city reached an agreement that would keep Uber in Houston through the Super Bowl in early 2017. The new regulations will reduce the cost of getting a license from nearly $200 to $70, but the fingerprinting requirement will still be in place. The licensing process will be greatly reduced and new Uber drivers could get a license in under 20 minutes.[xx] The city is cutting the physical exam requirement and the requirement that all cars have a fire extinguisher. The city will only require a drug test when there is reasonable cause.[xxi] The specific changes to the regulations and process should come before the city commission in early 2017.

Austin

As it has done in Houston, Uber threatened to leave Austin if the city implemented a fingerprint requirement for TNCs. Lyft, which was also operating in Austin, followed suit. The city had permitted TNCs to operate without fingerprinting drivers, even though cab drivers had to go through that screening process. After an election, the city imposed the fingerprint requirement and both companies terminated service in Austin in May of 2016..

The arguments for and against the fingerprinting requirements are the same in Austin as in Houston.

Several new TNCs which were willing to accept the fingerprinting requirement have since begun operations in Austin. Some expanded delivery operations by adding ride sharing, others were

created solely for the Austin market as a result of Uber and Lyft leaving.[xxii] Companies have been working to secure drivers and market share.

A common complaint among travelers is that they now must learn about multiple smartphone applications that are exclusive to Austin.

City officials are currently re-evaluating regulations for all types of transportation services. The city is trying to achieve a level playing field across several platforms. Cab companies have expressed doubts about deregulating the market, especially lifting the price controls imposed by the city.[xxiii]

San Antonio

San Antonio took a different approach when faced with the balance of public safety and the new ride sharing platforms. The city decided to give riders more consumer choice. San Antonio's taxis and limousines are regulated much like they are in other cities. The city imposed similar regulations to TNCs, and some TNCs terminated service. City officials found that the public wanted the TNCs to return.

In August of 2015, the city implemented new policies through a pilot program. For TNCs, the city removed fare regulations, made criminal background checks optional, offered free fingerprinting checks for drivers, and initiated an education program to let the public know about the program. If a driver wanted to be fingerprinted, he or she would receive a special identity number to let consumers know that the driver had passed a fingerprint background check. Consumers could select those drivers if they wished. The process does take two to three weeks, but drivers are permitted to offer rides through a TNC if the TNC approves them while they are waiting on the fingerprint background check.

On December 8, 2016, the City Council approved a one-year extension of the pilot program through the end of 2017. The agreement permits put three one-year extensions in the future. While cab companies are critical of the extension. San Antonio Mayor Ivy Taylor said, "I don't believe what we developed today was perfect, but I would also say I don't believe it's the job of a city government to protect an industry that may not be adequately responding to consumer demands."

Mothers Against Drunk Driving supported the agreement because it says drunk driving is a greater public safety issue, and more transportation options reduce drunk driving. The San Antonio Police Department cites statistics showing a drop in drunk driving after TNCs began offering rides in San Antonio, but could not say that ride sharing was the sole reason for the decline.

At the same time the city is extending the TNC program, it is reducing regulations on taxis and limos. It is reducing operating fees, accepting annual state vehicle inspections, and allowing advertising and discounted prices, along with other revisions.[xxiv]

Dallas

In Dallas, the city conducted public hearings and meetings. It found the general public liked TNCs and did not want to the companies overregulated. The city knew that it had different regulations for various transportation providers, and wanted to take the opportunity the TNC discussion afforded to level the playing field for all providers. The city also wanted to encourage competition and streamline the licensing process and fees.

Dallas implemented insurance, background checks, and vehicle safety requirements. (The insurance requirement was later superseded by the House Bill 1733, but the requirements were very similar.) The city created an online licensing portal and within one year driver's permits jumped from 11,000 to 46,000, greatly increasing availability and competition.

Fingerprints are not required in the background checks, but the checks must be performed by a company that follows the National Association of Professional Background Screeners guidelines. The city believes that level of scrutiny contains more current information and produces higher quality results than fingerprint checks. The system provides safety and efficiency, and thus far the city is happy with the results. As of mid-2016, the city had only one safety incident, but that involved an individual posing as a TNC driver, not a permitted driver.

The city knew the changes would be disruptive and difficult for entrenched companies. The city felt the increase in competition the public demanded outweighed the difficulty incumbent providers would face. The city reports that TNCs are getting the "lion's share" of the business, but that the change is reflective of a competitive environment.

Other Issues in Transportation

Service for the Disabled

In addition to issues regarding background checks and a level field for competition, there are other areas of concern. By ordinance, taxi companies have been required to have a certain number of vehicles designed to help physically disabled passengers. Because the companies owned fleets of cars, the mandate was easily implemented.

But, as noted earlier, TNCs do not own fleets of vehicles. Cities are adopting rules that TNCs must provide accessible transportation for the disabled. However, some cities are leaving it up to the TNCs to determine how they fulfill the requirement. Some TNCs may purchase vehicles, while others may contract with another provider. Cities do have requirements that rides for disabled passengers be provided within a certain period of time, and they intend to monitor complaints closely.

Discrimination

While no transportation service openly permits discrimination, reports suggest it does happen. Stories of cab drivers refusing to pick up racial minorities persist. Because cab drivers are independent contractors, they are not forced to take the next available customers. They can

select which calls they wish to answer. So, a driver may pass on a call to a less desirable neighborhood, hoping for a later call to a safer area. The result can be longer wait times for the people living in less desirable areas, or perhaps no one showing up at all.

The TNCs' attempt to address the issue by permitting only a few declines to pick up passengers within a certain range of the driver. Additionally, the TNCs feel because they are offering employment opportunities as drivers to people who live in underserved areas, those drivers are more likely to serve areas nearer to home.

Still, using a TNC requires an expensive smartphone, a luxury lower income people cannot afford. Further, TNCs generally require a credit card on file, to which ride charges can be made. Lower income people are less likely to have credit cards, which lessens their opportunities to use the service. While insisting on a smartphone and credit card are not overt actions of discrimination, the requirements do make it harder for lower income people to access the service.

Impact of Regulations Beyond a City

While one city may impose a regulation, the impact can have an effect on communities that are adjacent or nearby. For example, when Austin imposed the fingerprint background check and Uber and Lyft terminated service, a reported 10,000 drivers lost a source of income overnight. While many of these drivers are in Austin and had a vote, undoubtedly many lived in suburban communities and could not vote on the fate of their employment.

Additionally, it is not uncommon for a person in a major metropolitan area to have to traverse several cities as he or she tries to reach a destination. Varying ordinances could have an impact on a driver's ability to service some cities but not others. Houston permits a driver from another city to drop off in Houston a passenger he has picked up outside of Houston, but that driver may not pick up a passenger in Houston.

Employment Status

The TNCs contend that drivers are independent contractors, but there are court cases pending arguing that in some circumstances they are employees. TNCs have settled some cases, so, as of yet, there is not final a ruling on the status of those employees. Most taxi companies use the same structure.

Determining whether a worker is an independent contractor or an employee involves a complicated test of criteria based on which a state or federal labor board can adjudicate a claim. Thus far, there have been no such rulings.

A business's duty to employees is greater than it is to independent contractors. For employees, a business must withhold income and other tax payments, provide social security, cover on-the-job injuries, and, in some cases, provide health insurance or pay a penalty. If TNCs impose sufficient control over workers to make them employees, then the TNCs would gain an economic advantage by misclassifying employees.

It should be noted that this issue is not exclusive to the ride sharing industry. Many people working in the sharing economy could be misclassified, but until the classification is challenged and adjudicated it is impossible to know. If a person is misclassified, he could lose the benefits of income tax withholding, employer payments to social security, Medicare benefits, unemployment insurance, and health insurance.

The Social Safety Net

Most TNC drivers spend only a few hours a week ferrying passengers. While the TNC will file a Form 1099 with the IRS to report wages earned, the TNC does not withhold taxes for income taxes, social security, and Medicare. In the future, sharing economy workers who act as independent contractors may require social services but not have contributed enough to maximize benefits. As the sharing economy grows and the use of independent contractors increases, it may be necessary to modify collection methods to ensure that the social safety net most workers expect will be there for them.

Home Sharing

New technological platforms have also enabled some people to rent out a spare room or an entire house or apartment. Travelers can find these accommodations cheaper than hotel rooms, and often prefer to stay in a place where they can experience more of the local lifestyle. Homeowners can turn unused space into a paying asset.

Through platforms like Airbnb and HomeAway, homeowners can offer unused space and travelers choose from the available options. Using customer rating systems filled in by previous guests, travelers can know what to expect at a particular property. The rating systems provide an incentive to hosts because low ratings mean fewer opportunities to rent and lower prices.

Guests are also rated by hosts. So, guests who are disruptive or exhibit boorish behavior receive low ratings. These guests will have a harder time being accepted as guests, lessening their choices. Unruly guests can also be a problem for neighbors who are not renting property. Some platforms offer the ability for neighbors to report rowdy guests, but in order to do so the neighbor must know the person is a paying guest and which platform the guest has used. Bad actors can be removed from the platform.[xxv]

Some platforms offer all parties verified identifications including profiles and reviews, a secure platform for transactions, and insurance of up to $1 million per night. Others are simply advertising platforms to make the public aware of the availability of space.[xxvi]

In Texas, Airbnb reports that 800,000 Texans used their service when traveling last year. About 14,000 Texans are listed as hosts.[xxvii] HomeAway cited two studies conducted by local host alliances showing the economic impact of the short term rental industry on two Texas cities. In Galveston, a report showed a $237 million economic impact, supporting 3,100 jobs. In Austin another study reported a $234 million impact resulting in 2,500 jobs.[xxviii]

Some cities have passed regulations regarding short term rentals, especially focusing on established residential neighborhoods. Some homeowners and condo owners associations have banned or restricted short-term rentals in their areas or buildings. The platforms do advise hosts to check with the appropriate authority before renting space. The platforms would prefer easy to understand ordinances because they believe such ordinances make it easier for hosts to comply with the regulations. The more onerous a regulation, the more likely it is the host will take rental activity "underground," using different social networks.[xxix]

Traditional hotel operators say the platforms have changed the industry for the better, but they want to ensure that there is a level playing field for everyone. Most large hotels are not affected by the platforms, but smaller bed and breakfasts are. Smaller establishments face regulations including, permitting, payment of taxes, zoning, health and safety requirements, compliance with the Americans with Disabilities Act, commercial insurance, and fire safety permits. Many of these requirements are avoided by people offering a home or empty room as a short term rental. When regulations are loosened to accommodate the platforms, established businesses lose the opportunity to recoup the investment they have made complying with regulations.

Short-term rentals, like all hotel stays under 30 days, are taxable by city and state hotel occupancy taxes. Some hosts evade taxation assuming jurisdictions will not be able to track down their short-term rental. While Airbnb's platform offers a convenient way for guest to pay for their stay, it does not collect and remit hotel occupancy taxes, generally. In Texas, hotels pay the state hotel occupancy tax to the state, but city taxes to the city. (Sales taxes are remitted to the state, then the state sends each local jurisdiction the appropriate amount.)

Airbnb says it could collect the taxes, but would like to make just one payment to the state, then have the state distribute local taxes.[xxx] Varying local tax rates might make that difficult to administer, but the option and its costs should be explored.

Other Sharing Economy

New sharing economy business models and platforms are constantly appearing. Conversely, some models fail to catch on with consumers. While the landscape is constantly changing, some concerns for the State of Texas remain constant: that a level playing field exists for all participants; that everyone abides by the appropriate regulations and licensure; that all participants pay the applicable fees and taxes; that public safety is maintained, and that innovation which results greater competition and customer services is permitted to thrive.

The industries in the sharing economy and the platforms used vary widely. Like the broader economy, conditions that warrant regulation in one sector may not be applicable to all sectors. Some platforms have avoided regulation by splitting the marketing and payment of a service from the actual performance of the service. Still, these platforms have tremendous influence over how a service is provided and at what price.

Texas, like all states, will be challenged by the rapidly changing business practices technology is bringing.

Recommendation

The State should look upon regulating these services in a manner that is best for all citizens across the state. Overregulation will likely stifle innovation, competition, and consumer choice. The Legislature should examine regulations, both at the state and local level, so that regulations are limited, reasonable, fairly and uniformly applied, and in the public interest.

REGULATORY POWERS OF HOMEOWNERS' ASSOCIATIONS

Examine the regulatory powers of property owners associations, and the procedures available to home owners when an association restricts individual or property rights. Review current best practices to help clarify the balance of property rights, transparency in governance, and the best interests of property owners in the state.

Background

Homeowners' associations (HOAs) in Texas are governed by the Texas Property Code, case law, and the contractual agreement signed by property owners. They are formed to provide services for homeowners in exchange for required assessment fees. Most services to homeowners are designed to improve safety, function, and the appealing quality of a neighborhood or subdivision, in order to preserve the property values of the homes within the HOAs' jurisdiction. These services can include anything from providing street lighting and garbage services to the maintenance of common areas like parks, or swimming pools.

HOA boards, which are elected by property owners, pass the rules and ordinances for governing some activities within the HOA. Homeowners are generally obligated to maintain their property in accordance with deed restrictions and HOA rules. A homeowner who buys into an HOA agrees by contract to abide by the rules of the association. Some homeowners believe that some HOA rules might infringe on the homeowners' individual rights and liberties, or cause an unnecessary burden.

In recent sessions, the Legislature has seen a greater number of bills attempting to preempt an HOA from enforcing some ordinances. The Legislature has greatly restricted HOAs' abilities to regulate political signs, the flying of the American and Texas flag, and use of solar panels and standby electric generators. The Legislature has also considered other bills when homeowners felt their rights had been violated, or regulations were unnecessary.

No state agency regulates HOAs or has the authority to investigate or regulate their internal activities or take any action against an association for undue regulations or compliance with its bylaws or governing documents. When a homeowner believes an HOA has passed an unreasonable or disliked ordinance, an individual homeowner usually has 3 options: elect a new board to repeal the rule; go to court in the hope that the court determines the board acted improperly; or, come to the Legislature to enact a law prohibiting the rule.

Working to elect a new board takes time. Seats generally have specific terms, and only certain seats are up for election each cycle.

Going to court can be extraordinarily expensive. The homeowner must accept the burden of hiring an attorney on his or her own. HOAs that contract with management companies may be paying for legal services through that contract. No matter how strongly the homeowner may feel about the inappropriateness or legality of the ordinance, the outcome is far from certain.

Taking the issues before the Legislature is not an easy task either. The Texas Legislature meets once every two years, so a significant amount of time could lapse before the homeowner gets a chance to appeal to the Legislature. The homeowners will likely have to travel to Austin to testify on the bill, at his or her own expense. HOAs can use assessment funds to send board members to Austin to argue against the bill, and some HOA management companies may even send a lawyer to argue against the bill.

Gregory Cagle, author of *Texas Homeowners Association Law* and an attorney, testified on these issues before the Business and Industry Committee on June 8, 2016. According to Cagle, HOAs are private organizations but, in many ways, are like a fourth branch of government. HOAs are often viewed as bureaucratic in nature, leveling taxes and passing laws. HOAs, however, are not regulated by the U.S. Constitution nor by the Texas Constitution as a sovereign entity would be; their powers and authority derive from the documents that establish them.

HOAs have the ability to enforce restrictive covenants and levy and collect assessments similar to ad valorem taxes. When assessments or penalties for violations go unpaid, the HOA may foreclose on property, forcing a public sale to recoup the money it is owed.

Unlike government elected officials, HOA board members often have a direct or indirect financial interest in the adoption or enforcement of a rule. If a board member believes his or her property value is being negatively impacted by another homeowner's action, the board member can propose and vote directly to regulate the actions of the other homeowner.

Mr. Cagle pointed out that very often board members are unfamiliar with the law, and in some cases, even their own governing documents. Indeed, many homeowners are unfamiliar with their HOA's governance powers. Some have management companies that might help in writing an ordinance, but many management companies do not offer such expertise, or are too small to contract with a management company.

Unlike many other entities, there is no statewide association of HOAs. So, the best practices of HOAs are not generally disseminated among all HOAs.

Mr. Cagle added that many homeowners do not realize that they can contract away a constitutional right. Homeowners are bound by their contract with the HOA, so if the HOA passes an ordinance that they feel is a violation of their individual rights or liberties, they are still obligated to abide by the ordinance.

There is no low-cost method for adjudicating a dispute between a homeowner and the board, other than appealing to the board that implemented the offending rule.

David Kahn, a lawyer who testified at the same hearing, pointed out that a small penalty for violating a rule can explode quickly because no low-cost resolution process exists. If a homeowner violates an HOA rule because the homeowner feels the rule infringes on his or her rights or liberties, the HOA will likely fine the homeowner, say $300 in this example. If the homeowner refuses to pay, late fees of a few hundred dollars might be applied. Some HOAs may even impose a fee of more than $100 for sending out the letter stating the homeowner was late on his or her fine payment.

If the matter escalates, the HOA can refer the matter to its attorney, which can instantly add as much as $3,000 or more to the cost of the homeowner. The huge leap in costs - from a $300 penalty to a $3,500 or more in accumulated fines, penalties and attorney's fees - is incredibly disproportional to the original penalty. But, with no low-cost method for addressing the

ordinance or the fine, costs can escalate.

Mr. Cagle suggested the Legislature consider mandating some form of mediation, and suggested the two parties share the cost. However, the cost of mediation could be greater than the original penalty.

Mr. Kahn suggested taking the matter to a justice of the peace. He believed the matter could be resolved there without attorneys. He felt that fees and fines for late payments escalate, but when an attorney is brought it by the HOA, the costs skyrocket, making it almost impossible for the homeowner to ever get caught up. In some cases, the $300 penalty could even result in foreclosure, a penalty wholly disproportional to the original violation.

Without specialized legal assistance, HOAs' boards will undoubtedly continue to respond to issues within their HOAs with little understanding of the legal implications of their action. Without a low cost method for repealing those actions, homeowners will likely continue to come to the Legislature when they feel an HOA has overstepped its authority or acted capriciously.

Recommendation

The Legislature should continue to evaluate legislation repealing HOA regulatory rules on an individual basis. The circumstances vary too widely to pass an overarching limit that will fit every case.

The Legislature should consider legislation that might develop a low-cost dispute resolution process to keep small fines from becoming unmanageable debt.

MINORITY SHAREHOLDER RIGHTS

Study the impact of recent Texas cases related to the rights and remedies of shareholders of Texas corporate forms, including the impact of those decisions on the legal rights of both Texas corporations and shareholders and any impact on the Texas business climate.

Background

The Texas Business Organizations Code was passed by the Legislature in 2003, did not generally become effective until January 1, 2006. Until then, the Texas Business Corporations Act (TBCA), remained in effect. However, parts of the TBOC did not become effective until January 1, 2010.[xxxi]

Lee C. Ritchie v. Ann Caldwell Rupe, As Trustee for Dallas Gordon Rupe, III

In 2014, the case of Lee C. Ritchie v. Ann Caldwell Rupe, As Trustee For the Dallas Gordon Rupe, III 1995 Family Trust altered the landscape of Texas law governing disputes between majority and minority shareholders of "closely held corporations". Section 21.563, Business Organizations Code, defines closely held corporation as a "corporation that has: (1) fewer than 35 shareholders; and (2) no shares listed on a national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national securities association."

In the case, Ann Caldwell Rupe, a minority shareholder, filed a lawsuit alleging that the majority shareholders & corporation directors engaged in "oppressive" behavior and breached fiduciary duties. Rupe claimed she attempted to get the majority shareholders to purchase her shares or at least assist her in selling them to a third party. The majority shareholders denied Rupe assistance in meeting with prospective third party groups, while also denying her a viable offer to purchase her shares, claiming they were doing what they thought was best for the corporation.

Rupe Investment Corporration (RIC) is made up of three different family trusts that collectively owned approximately 72 percent of RICs voting stock. RICs board of directors had four members, Paula Dennard; who chaired the board, Dallas Gordon Rupe, III (Buddy) who was Dennard's brother; Lee Ritchie; who serves as president of RIC; and Dennis Lutes; attorney whose clients included RIC, Dennard and her family. "Dennard, Ritchie, & Lutes served as trustees of those trusts and thus collectively controlled a majority of RICs voting power." Ritchie and family owned an additional 10 percent of the shares directly, which effectively increased the voting power to 82 percetn. Dallas Gordon Rupe (Buddy) owned the remaining 18 percent directly.

Ann Rupe, the plaintiff, was Buddy's second wife, and they had a child, Guy. Because Guy was born after his grandfather, Gordon, died, Guy was not included in Gordon's trust. Rupe and Buddy wanted him included like Gordon's other grandchildren, but were refused Sadly, during the process, Buddy passed way in 2002, which left his 18 percent interest in RIC in trust, known as "Buddy's trust," for the benefit of Rupe and Guy with Rupe as trustee. RIC board members offered Rupe Buddy's seat on the RIC board of directors, on the condition that she not file a lawsuit against Gordon's trust to have Guy included.

Rupe declined and asked if RIC would be interested in buying her shares for fair value or help her meet with prospective outside buyers. Ritchie declined her offer claiming RIC could not do purchase the shares at that time due to a financial crisis that one of their subsidiaries. Either personally or through her attorneys, Rupe then requested to review and copy RICs corporate

documents. RIC provided some documentation and/or access in response. However, Rupes attorneys claimed that RIC was not as forthcoming with its corporate books, which is required under the Texas Business Organizations Code.

In July 2006, Rupe filed suit against Dennard, Ritchie, Lutes & RIC; alleging they had engaged in "oppressive" conduct and breached fiduciary duties. Rupe requested an accounting and valuation along with an order requiring RIC to purchase her shares at fair market value or, instead, appoint receivership to liquidate RIC.

The former Article 7.05 of the Texas Business Corporation Act, and it's now successor, Section 11.404, Business Organizations Code, authorizes Texas courts to appoint a receiver to rehabilitate a domestic corporation under certain circumstances.

Courts are to appoint a rehabilitative receivership when it is "necessary" to do so "to conserve the assets and business of the corporation and to avoid damage to parties at interest," but only if "all other requirements of law are complied with" and "all other remedies available either at law or in equity, including the appointment of a receiver for specific assets of the corporation, are determined by the court to be inadequate."[xxxii]

Section 11.404(b)(1), Business Organizations Code, provides that in an action brought by an owner of the corporation, before placing a corporation in rehabilitative receivership it must be established that:

> (A) The entity is insolvent or in imminent danger of insolvency;
> (B) The governing persons of the entity are deadlocked in the management of the entity's affairs, the owners or members of the entity are unable to break the deadlock, and irreparable injury to the entity is being suffered or is threatened because of the deadlock;
> (C) The actions of the governing persons of the entity are illegal, oppressive, or fraudulent;
> (D) The property of the entity is being misapplied or wasted; or
> (E) With respect to a for-profit corporation, the shareholders of the entity are deadlocked in voting power and have failed, for a period of at least two years, to elect successors to the governing persons of the entity whose terms have expired or would have expired on the election and qualification of their successors….

Rupe filed a lawsuit alleging oppression under Subsection (c). In that statute, the Legislature did not define the term "oppressive," and in the absence of a statutory definition, court give words their common meaning.

The trial court sided with Rupe and ordered the corporation to buyout her shares at $7.3 million. They held that Rupe was victim to shareholder oppression when the majority shareholders refused to work with prospective third parties who had potential to buy out her shares. The court of appeals agreed and upheld the buy-out order as well. The court rendered that "the most equitability remedy for this oppression was to require RIC to redeem Rupe's shares, and that this remedy was "less drastic" than liquidating the company or appointing a receiver. An appeals

court upheld the trial court's decision.

The case was appealed to the Texas Supreme Court on June 20, 2014. In a 6-3 decision, the court found that the actions of RIC's directors did not constitute oppressive behavior under the "common meaning" meaning standard. Because the court did not find oppressive behavior, it did not have to take up the question of the appropriate remedy. While the lower court ordered a buyout of Rupe's stock, the Supreme Court made it clear that the statute only permits a rehabilitative receivership remedy.

Rupe's pleading and briefs also asserted a "common-law" claim of shareholder oppression. While the court acknowledged such claims, it had never recognized a common-law cause of action for minority shareholder oppression. In this case, the court had to decide whether to recognize such a claim. While the court has the prerogative to recognize a common-law claim in addition to the statutory foundation, it does so only with great caution. In the Rupe case, for a variety of reasons, the court declined to recognize a common-law claim.[xxxiii]

To address the remedy issues raised by the court, Representative Ron Simmons, Vice-Chairman of the House Business and Industry Committee, proposed new remedies for cases when a board of directors is found to have oppressed a minority shareholder. House Bill 3168, 84th Legislature, proposed that:

> the court may order, in addition to any remedy authorized by this code, any legal or equitable remedy the court determines appropriate under the circumstances, including:
>
> (1) The appointment of a fiscal agent to periodically report to the court;
> (2) The retention of jurisdiction by the court;
> (3) An accounting of allegedly misappropriated funds;
> (4) An injunction against the oppressive conduct;
> (5) Payment of a dividend;
> (6) A buyout of the minority shareholder's shares;
> (7) Authorization for the minority shareholder to purchase additional stock; and
> (8) Payment of damages caused by the oppressive conduct.

The House Business and Industry Committee heard the bill, and after considerable debate, it was left pending.

Testimony

Mr. Byron Egan testified before the committee as a corporate lawyer and on behalf of the Texas Business Law Foundation. Mr. Egan expressed concern over any changes to the Texas Business Organizations Code (TBOC) or any other current business entity statutes that he believes already provide "adequate rights and remedies to the owners of equity interests in Texas corporations, limited liability companies and partnerships, and should not be amended to add additional remedies for minority owners in Texas business entities." Echoing the court, he also states, "any such statutory change would add undesirable uncertainty in the law and discourage businesses from organizing under Texas law."

Legislation to overturn Ritchie v Rupe would be inconsistent with the Texas Business Law Foundation's objective of facilitating the enactment of entity laws that make Texas an attractive jurisdiction in which to organize.

Ladd Hirsch, with Diamond McCarthy LLP, says the problem is two-fold. Shareholder oppression under existing Texas case law is too vague, and the remedy for oppression is not clearly set forth in statute.

The remedy imposed by the lower court ordered a buyout not authorized by statute, which created uncertainty during the appeals process for courts and litigants. The Supreme Court dramatically altered the standard for oppression and compounded its dislike of minority shareholder oppression claims by limiting the remedy solely to a receivership.

With respect to Representative Simmons' bill, Mr. Hirsch had two suggested changes. First, define oppression and creating a statutory definition. He suggested a list of factors the court should consider, including:

1. Whether the majority owner has retained all or most of the company's earnings and refused to issue any distributions/dividends to owners,
2. Whether the majority owner has failed to hold regular, periodic meetings of the shareholders to report on the finances and operations of the business;
3. Whether the majority owner has increased his compensation and bonuses without increasing or distributing any of the company's profits to shareholders;
4. Whether the majority owner has issued written reports regarding the finances and operations of the company to the shareholders on at least an annual basis; and
5. Whether the majority owner has misused company funds for his or her own personal benefit rather than for legitimate business purposes.

His second suggestion is that a court-ordered buyout should be included as a remedy in the statute.

> The bill needs to address how the minority shareholder's shares will be valued, and this is critical. In valuing minority-held ownership interests on a fair market value basis, business valuation experts typically assign what are called "minority discounts" to this interest because of its lack of marketability and lack of control. These discounts are steep and can be in the range of 40-60% of the total value of the shares. Providing minority owners with a buyout of their shares is not an equitable remedy when it subjects them to significant discounts in value . The standard for value in oppression cases should be "fair value," not "fair market value", because fair value provides what is known as enterprise value, ie., no minority discounts are applied to the value of the minority shareholder's stock in the company.

Recommendation

After carefully reviewing the history of Rupe v Ritchie, the committee acknowledges the difficulty the court faced both in applying the common meaning of the word oppression, and the complications that come with creating a common-law cause of action. Further, the committee wishes to thank Representative Simmons for his work to develop appropriate remedies for

minority shareholder oppression cases. The committee recognizes the need for adequate protection of minority shareholders and some members believe the Ritchie v. Rupe majority decision exposes minority shareholders to potential abuse.

Having received just one list of factors to consider in developing a statutory definition of oppression and additional appropriate remedies, the committee feels it has insufficient information and viewpoints to make a recommendation at this time. Should a member of the Legislature propose a bill with more specific details to address the issues, the committee believes the legislation should receive all due consideration.

INSURANCE PURCHASES THROUGH SORM

Study the requirement for state agencies and entities to purchase insurance through the State Office of Risk Management (SORM), and the agencies and entities that are exempt from this requirement. Examine the costs and benefits of each approach, and the waiver process by which SORM can allow agencies to purchase insurance on their own.

Background

The State Office of Risk Management (SORM) administers multiple lines of insurance for most state agencies, including workers' compensation insurance, property insurance, and automobile insurance. The Office does not receive a general appropriation from the state budget. SORM charges participating state agencies an "assessment," similar to a premium, to cover the cost of losses, insurance, and administration.

SORM's board of directors determines each agency's assessment based on a variety of factors. State law mandates that most state agencies purchase coverage through SORM, but some agencies are exempt and there is a waiver process for agencies that acquire coverage at a lower cost. SORM can generally acquire coverage at a lower cost than an individual agency due to economies of scale.

Historically, SORM has offered coverage through five programs:

- Workers' compensation;
- Automobile insurance;
- Property insurance;
- Directors' and officers' insurance; and
- Volunteer insurance.

In late 2015, the board added five additional lines of coverage:

- Extra-territorial workers' compensation insurance;
- Builder's risk insurance;
- Fine arts insurance;
- Privacy and network security (cyber) liability insurance; and
- Commercial crime insurance.

SORM’s operations are not limited to covering losses incurred by agencies. The agency’s Strategic Programs Division contains four departments, but three are most relevant to this study: Risk Management, Claims Operations, and Document Processing.

The Risk Management Department helps client agencies with risk management, insurance and continuity of operations services. The various client agencies consult with SORM’s risk managers in developing plans to protect the agencies’ employees and assets. The risk managers also support agencies in dealing with insurance, continuity of operations and workers’ comp programs.

Within the department, SORM also has insurance managers who "develop and administer insurance programs to transfer the financial risk of the state, and provide consultative insurance service" to state agencies.

The Claims Operation Department conduct workers' compensation claim investigations and determine eligibility for benefits. Claims examiners within the department handle all the details of most claims.

The Document Processing Department is the initial intake point for injury claims, and maintains all inactive claim files.[xxxiv]

For workers' compensation, the Legislature has placed most of the responsibility for dealing with claims at SORM rather than at each agency. Because the claims are handled at one central agency, each client agency is not required to have expert personnel on the payroll to handle what may be only a handful of cases each year.

The workers' compensation system is complicated, especially when trying to determine how much of an injury is attributable to a work accident and which treatment and medication is appropriate. Additionally, reviewing medical bills submitted by treating physicians and hospitals also requires extensive knowledge of workers' compensation regulations.

SORM's examiners provide independent review of injury claims, separate from the agency that employs an injured worker. Additionally, SORM's examiners and risk managers can detect and design the best injury prevention practices at various agencies, and encourage and instruct other agencies on how to adopt those best practices.

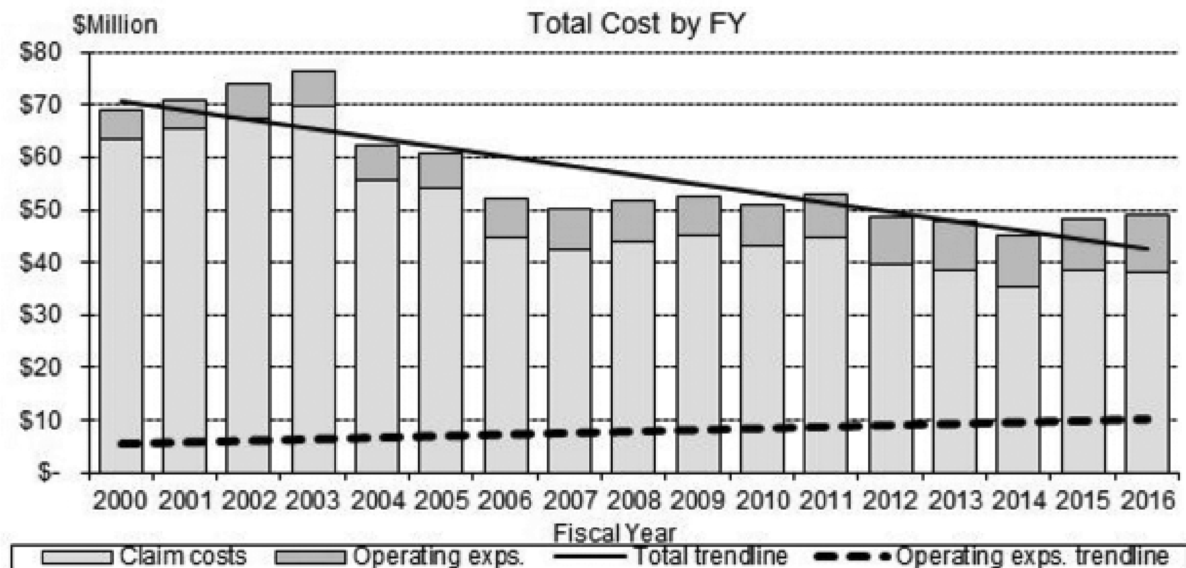
Risk managers also assist agencies in managing safety and property damage risk. While it is hard to assess the value of an injury that never occurs, or property damage this is mitigated, the benefits of prevention should not be undervalued.

The Legal Services Division defends SORM in dispute resolution processes. At some proceedings, the Tort Litigation of the Office of the Attorney General will represent the state, with assistance from SORM. The division also handles cases when injured employees are overcompensated, medical costs are disputed, and state employees are injured by the negligence of a third party. The division is also responsible for recovering money paid from health care providers who overcharge due to billing errors or fraud. Additionally, SORM uses the division to ensure that SORM and other state agencies are complying with statutory and policy requirements.

The overall cost to operate the State Office of Risk Management has dropped over the years. In Fiscal Year 2000, SORM required just under $70 million. For Fiscal Year 2016, SORM needed just under $50 million. SORM highlights the following successes:

- A 21.5 percent reduction in the injury frequency rate from FY 2002 to FY 2012;
- A 43 percent reduction in annual worker's comp expenditures from FY 2003 to FY 2012;

- A 52 percent reduction in the state agencies' final assessment per $100 of payroll from 2002 to 2012; and
- A 70 percent reduction in medical billing to actual payments in FY 2102.[xxxv]



As noted earlier, SORM takes advantage of economies of scale to provide coverage for state agencies cheaper than the agencies can obtain individually. Additionally, because the assets SORM covers are in various parts of the state, the low risk properties are grouped in with higher risk properties, which lessens the cost of covering the high risk properties.

Occasionally, an individual agency will find comparable or better coverage at a lower cost than SORM is offering. SORM can often take those bids to its insurers and negotiate a better rate for all agencies. When SORM cannot match the offer, the agency can appeal to SORM to waive the requirement that the agency purchase its insurance from SORM. Comparing policies requires some expertise an individual agency may have, so SORM analyzes the offer, and if appropriate, grants a waiver.

SORM provided a committee a list of the requests for waivers it has received since 2003, and the outcome of each request. Fifteen of the 26 requests for waiver were approved by SORM.

As noted earlier, some state agencies are exempt from the statutory requirement to purchase coverage through SORM. These are The University of Texas System, the Texas A&M System, the Texas Tech System, the Texas State University System, and the Texas Department of Transportation. These university systems and TxDOT have large numbers of employees, at various location across the state, and large property holdings. The Legislature has exempted these agencies because they are generally large enough to take advantage of the economies of scale as SORM does. There is a point when the economies of scale reach a diminishing return. SORM believes that adding any of these agencies into SORM would not generate any savings. Additionally, it is possible that SORM would become so large that no insurer or group of insurers could cover the risk

These entities are of sufficient size that they maintain highly qualified staff to operate sophisticated programs to manage their risk. The entities also have large enough budgets and assets to handle all but the most catastrophic losses.[xxxvi] These entities often have specialized insurance needs that SORM is unaccustomed to dealing with, like coverage for a mounted cavalry unit or underwater exploration equipment.[xxxvii]

Just as economies of scale reduces costs to SORM, costs can increase if a substantially sized agency is removed from the pool. Occasionally, an agency or university system requests the Legislature exempt that entity from the statutory requirement to purchase insurance through SORM. Evaluating the impact on the agency and SORM can be difficult, because correctly adjusting for future insurance rates is difficult.

When legislators consider bills to exempt an agency, the Fiscal Note for the bill will likely indicate no significant impact to the state budget. Because the state budget groups SORM's assessments with many other payroll and administrative costs, and appropriates money for the assessments on a formula basis, the budget is going to provide the agency the same amount of money for insurance regardless of whether the agency uses SORM or a private insurance company. The agency may be able to redirect the savings of using an outside insurer to another purpose, but the state budget will remain unaffected.

The Legislative Budget Board only accounts for direct costs on the state budget in its Fiscal Notes. If a large agency were to be removed from SORM's pool, then the economies of scale could be diminished. The result could be a larger assessment on the remaining agencies. This impact is considered a secondary impact, not a primary impact, thus it will not be reflected in a fiscal note.

Nevertheless, state agencies would feel the impact if the assessment was higher than the state budget appropriated. The agencies might have to redirect other money to cover the cost of the assessment. While there is almost no previous experiences go by, it is certainly possible that the savings one agency earns by buying insurance on the private market could be more than offset by the remaining agencies paying higher assessments.

When the Legislature considers removing the requirement that an agency purchase insurance through SORM, it needs to be cognizant of these fiscal impacts that are unlikely to show up in a fiscal note.

All the entities that are exempt from purchasing insurance through SORM, with one exception, testified that they provide their respective boards with reports on their insurance purchases and mitigation efforts. The Texas State University System had not yet prepared a report because it obtained its authority to purchase insurance outside SORM just 7 months before the hearing. Each entity said they would provide the Legislature those reports if directed by law, or requested by any member or committee.

The Legislature needs to be aware of the exposure these entities have and how they anticipate covering major losses. After Hurricane Ike hit Galveston in 2008, the Legislature needs to

appropriate $150 million to help repair buildings at The University of Texas Medical Branch. The concatenation of circumstances around the storm forced everyone to rethink insurance requirements.

Ike was a Category 4 hurricane and hit Galveston at high tide, resulting in massive flooding and wind damage. The University of Texas System had just purchased a $100 million dollar policy for UTMB months before the storm hit. For a few years before 2008, UTMB was self insured. After Tropical Storm Allison in 2001 and the terrorist attacks of September 11, 2001, the insurance market greatly restricted coverage and there was only a limited capacity to buy insurance for such events.

Hurricane Ike caused $400 million to $500 million in insurable losses, but only $100 million was covered by insurance. Using a combination of insurance payments, state appropriations, money from the Federal Emergency Management Agency, and money from private foundations and other sources, UTMB began to rebuild and re-equip the campus. About $1 billion in assets have had some mitigation effort.

Recommendation

The Texas Legislature should consider requiring state agencies that are exempt from purchasing insurance through the Office of Risk Management to forward their annual insurance reports to the chairs of the appropriate committees, or to all members of the Legislature.

The Texas Legislature should consider, perhaps by House and Senate rule, requiring a special impact statement be attached to the committee report of bills exempting agencies from the requirement to purchase coverage through SORM. The statement should assess the impact the legislation will have on the assessments the remaining agencies.

DESIGNATED DOCTORS: TEXAS WORKERS' COMPENSATION

Study the following aspects of the designated doctor process in the Texas workers' compensation system:

a. The Division of Workers' Compensation's (DWC's) processes for educating, monitoring, and evaluating designated doctors;

b. Whether the DWC requires additional authority to regulate designated doctors or entities providing services for designated doctors; and

c. Any unique issues with "traveling" designated doctors.

Background

In the worker's compensation system, disputes over appropriate care often arise between treating physicians and insurance companies. When these disputes are appealed, the injured worker is examined by a specially trained "designated doctor," who renders an opinion to the hearing officer adjudicating the case.

Designated doctors are appointed and monitored by the Division of Workers' Compensation (DWC). Section 408.0041, Labor Code, requires the Commissioner of Workers' Compensation to develop a certification process, in rule, to evaluate designated doctor qualifications, including educational experience, previous training, and demonstrated ability to perform specific duties. The Division is required to develop a standard curriculum, course materials, a testing criteria, and implement a procedure to periodically review and update such guidelines.[xxxviii]

Joe McElrath, Deputy Commissioner for Business Process of the Texas Department of Insurance: Division of Workers' Compensation, and Bill Defoyed, Director of the Designated Doctor Education testified before the Business and Industry Committee on the standard curriculum for designated doctors and the requirements laid out in Section 413, Labor Code.[xxxix]

In the dispute process, the injured employee, the employee's representative, the insurance company, or the DWC may request an examination by a designated doctor. The exam is restricted to issues about the work-related injury and the medical necessity of medication, treatment, or therapy. Designated doctors do not provide medical treatment to the injured worker. Designated doctors report to the hearing examiner on the extent to which a worker will recover, known as medical impairment, and what level of impairment the worker may suffer, known as the impairment rating, and the worker's ability to return to work.[xl]

The DWC is required by the Texas Labor Code to review the quality of health care provided. Since 2011, medical advisors from the DWC have investigated complaints regarding the quality of designated doctor reports, aspects of their performance, and the quality of their reports from the exams they have performed.[xli]

DWC reports the following issues regarding designated doctors:

- During fiscal year 2015, injured employees reported that designated doctors missed 641 appointments, which was 1.7 percent of the appointments held.
- During fiscal year 2015, designated doctors rescheduled approximately 17,500 appointments because the designated doctor was unavailable, the doctor lacked the necessary medical records to conduct the exam, or to schedule an interpreter for the exam. Rescheduled appointments were approximately 45 percent of the appointments held.
- If an examination is rescheduled by the designated doctor or the injured employee, the rescheduled examination must occur within than 21 days of originally scheduled examination.

With a larger percentage of scheduled appointments being rescheduled, a review of the assignment of doctors and scheduling practices should be undertaken.

As will be detailed later, designated doctors can take cases in as many as 50 counties. The complexity of scheduling appointments across such a vast area is one of the reasons doctors contract with administrative service companies to handle certain managerial functions of their practice. The designated doctor usually pays the cost of these administrators. Administrative service companies perform a variety of tasks including:

- Examination location management
- Scheduling
- Travel coordination
- Medical records coordination and summaries
- Production of designated doctor reports

By rule, designated doctors can chose up to 50 counties in which to examine injured workers. The designated doctor receives a flat fee from the Division which varies depending on the type of exam. The average fee is around $800 per exam.[xlii]

Designated doctors include chiropractors, medical doctors, and doctors of osteopathic medicine. The DWC determines they type of doctor that is eligible to review each case. The following chart details the type of injury each type of doctor may review.

Designated Doctor Qualifications:

Injuries and diagnoses	License type of qualified doctors
Hand and upper extremities, lower extremities excluding feet spine and torso,	Medical doctor, doctor of osteopathy, or doctor of chiropractic
Feet, including the toes and heel	Medical doctor, doctor of osteopathy, doctor of chiropractic, or doctor of pediatric medicine
Teeth and jaws	Medical doctor, doctor of osteopathy, or doctor of dental surgery
Eyes, including the eye and adnexal structures of the eye	Medical doctor, doctor of osteopathy, or doctor of optometry
Other body areas or systems, including but not limited to internal systems; ear, nose, and throat; head and face; skin; mental and behavioral disorders; tendon lacerations; and dislocations	Medical doctor or doctor of osteopathy
• Traumatic brain injuries • Spinal cord injuries, including spinal Fractures with documented neurological Deficit • Severe burns, including chemical burns, defined as 3rd or 4th degree burns over 9 percent or greater of the body • Complex regional pain syndrome • Multiple bone fractures, excluding spinal fractures • Complicated infectious diseases requiring hospitalization or prolonged intravenous antibiotics, including blood borne pathogens • Chemical exposure, excluding chemical exposure limited to skin exposure • Heart or cardiovascular conditions	Medical doctor or doctor of osteopathy with certain board certifications

Source: Texas Department of Insurance, Division of Workers' Compensation

Dr. Stephen Norwood with the Texas Medical Association (TMA) & Texas Orthopedic Association (TOA) testified that the scheduling of the designated doctor exams for the injured worker needs improvement. DWC rules allow a designated doctor to evaluate and examine multiple injured workers during a single travel assignment when possible. The practice maximizes the physician's time during that travel event, and increases the access of injured workers to more timely exams.

To assign designated doctors, the DWC works from the list of counties doctors have chosen to serve. On a rotating basis, the next doctor on the list serving a county is assigned the next injured worker in that county. For example, if a doctor in Dallas chooses to serve Bexar County, when his name comes up in the rotation he is assigned the injured worker, even though there may be plenty of available designated doctors in Bexar County.

For efficiency, the Dallas doctor would like to wait until he is assigned additional cases before scheduling a trip. Because the selection process of the designated doctor is mandated, the injured worker must wait until the Dallas doctor arrives before being examined. Dr. Norwood testified that he felt a more efficient system could be worked out. [xliii]

The system also raises concerns about the overall cost to the Workers' Compensation System. If doctors can afford to travel, especially between major metropolitan areas where the availability of doctors is higher, then perhaps fees could be lowered if a system using local doctors was adopted. Still, there will always be injured workers in part of the state that are sparsely populated, and doctors will likely have to travel to examine those workers. Because scheduling multiple exams is unlikely in those rural areas, the cost of the travel and time would have to be considered in the development of the fee.

Dr. Jeff Cunningham with the Texas Chiropractic Association (TCA) testified. He represents the chiropractic profession in Texas, which is roughly made up of 5,300 licensed doctors of chiropractic. Dr. Cunningham stated that the educational requirements for chiropractors are among the most stringent of any of the health care professions. Chiropractors are qualified to diagnose and treat both spinal and non-spinal biomechanical conditions of the musculoskeletal system. So, if doctors of chiropractic could practice within the designated doctor program to the full extent of their legal scope of practice they could help the process for the injured workers, and, possibly, create unnecessary delays in worker evaluations.[xliv]

Recommendation

The Texas Legislature should direct and authorize the Division of Workers' Compensation to study the agreements between designated doctors and authorized administrative agents to ensure quality medical care in a timely manner, and effectively control costs.

LIFETIME INCOME BENEFITS AND DEATH BENEFITS

Examine the adequacy of benefits for injured employees in the Texas workers' compensation system who qualify for Lifetime Income Benefits, and for the beneficiaries of employees who receive Death Benefits. In particular, examine the application of benefit caps for those benefit types and the termination of Death Benefits to surviving spouses on remarriage.

Background

The committee was instructed to specifically examine the adequacy of Lifetime Income Benefits (LIBs) along with Death benefits (DBs) in workers' compensation cases, which are both administered by the Texas Department of Insurance, Division of Workers' Compensation (DWC).The Division is responsible for several types of benefits for the injured employees whose employers provide workers' compensation coverage. Historically, there are less than 100 LIBs claims per year.

These types of benefits which were reformed by the Texas Legislature and took effect January 1, 1991 included:

- Income benefits which there are four types; Temporary income benefits, Impairment income benefits, supplemental income benefits and Lifetime income benefits;
- Medical benefits;
- Death benefits; and
- Burial benefits.

And as set out in the Texas Labor Code, sec. 408.161, Subchapter I. LIBs are statutorily defined for specific injuries. These injuries are noted below:

Sec. 408.161. LIFETIME INCOME BENEFITS. (a) Lifetime income benefits are paid until the death of the employee for:

(1) total and permanent loss of sight in both eyes;
(2) loss of both feet at or above the ankle;
(3) loss of both hands at or above the wrist;
(4) loss of one foot at or above the ankle and the loss of one hand at or above the wrist;
(5) an injury to the spine that results in permanent and complete paralysis of both arms, both legs, or one arm and one leg;
(6) a physically traumatic injury to the brain resulting in incurable insanity or imbecility; or
(7) 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.
(b) For purposes of Subsection (a), the total and permanent loss of use of a body part is the loss of that body part.
(c) Subject to Section 408.061, the amount of lifetime income benefits is equal to 75 percent of the employee's average weekly wage. Benefits shall be increased at a rate of 3 percent a year.
(d) An insurance carrier may pay lifetime income benefits through an annuity if the annuity agreement meets the terms and conditions for annuity agreements adopted by the commissioner by rule.

The establishment of an annuity under this subsection does not relieve the insurance carrier of the liability under this title for ensuring that the lifetime income benefits are paid.
There are maximum and minimum weekly amounts for LIBs that are set by state law. Currently, the maximum is at $895 weekly and the minimum is at $134. These rates are based off the state

average weekly wage (SAWW). The statutory maximum does not apply after the first year because of the annual 3 percent cost of living increase. And the 75 percent of their average weekly wages are not taxable.[xlv]

Death Benefits

Death Benefits (DBs) are meant to help families replace the income of a worker who dies from a work related injury or occupational illness. Historically, there are roughly 200-250 death benefit claims a year. And these benefits are usually given to the deceased's family; a spouse, their child/children or grandchildren, as long as they are an eligible beneficiary under the Sec. 408.182, Labor Code. However, if there are no eligible beneficiaries, statute states that a portion of the benefits may be given to non-dependent parents for a duration of 104 weeks. [xlvi]

If there are no eligible beneficiaries the insurance carrier is required to make payments that would have otherwise been given to family to the "Subsequent Injury Fund" for a duration of 364 weeks. This fund is administered by the division and was created by the State Legislature in 1947 to help the employment of the disabled, which at the time of enactment included a large number of disabled WWII veterans. After statutory revisions, the fund is now used to:[xlvii]

- Reimburse carriers for payments made in accordance with DWC decisions/orders that are later reversed or modified resulting in an overpayment of a claim;
- Reimburse carriers for certain benefits that were paid due to a designated doctor opinion that is later reversed or modified resulting in an overpayment of a claim;
- Reimburse carriers in situations where multiple employment causes an increase in benefits; and to
- Reimburse carriers for pharmaceutical costs incurred on claims that are ultimately determined to be non-compensable.

Similar to Lifetime Income Benefits the eligible beneficiaries are given the amount of DBs equal to 75 percent of the employee's average weekly wages and are subject to statutory weekly maximums, currently at $895 a week, but are not subjected to minimums. Unlike LIBs, there is no cost of living adjustment for death benefits.

Family members, depending on their relationship to the deceased worker, receive death benefits for varying amounts of time. A spouse is entitled to receive death benefits for life or until remarriage. Upon remarrying the spouse will continue to receive death benefits for 104 weeks.[xlviii] If, however, the deceased worker was a first responder who died on the job or acting as a volunteer, the spouse will receive death benefits for life, regardless of whether he or she remarries. Children of the deceased generally receive death benefits until they turn 18, unless they are enrolled in college as a full-time student, in which case benefits will cease when they leave college or turn 25.

Again, death benefits do not receive a cost of living adjustment as do lifetime income benefits.

The Joint Select Committee on Workers' Compensation report from 1989 recommending a major overhaul of the workers compensation system, including that both lifetime income and

death benefits be adjusted for increases in the cost of living. Both types of benefits are designed for the same purpose - to mostly replace the wages an injured or deceased worker would have earned. The report recommended a three percent annual increase for both types of benefits. Committee staff could not find anything in the legislative record to indicate why three percent was the amount was decided. It is clear that a cost of living adjustment was deemed necessary, but how legislators came to select the three percent levels could not be determined.

From 1987 through 1990, when the committee was considering the system overhaul, the inflation rate as determined by the Consumer Price Index ranged between 3.66 to 5.39 percent. Some believe that legislators turned to the three percent adjustment as a simple proxy for fluctuating inflation rates. Since the Great Recession beginning in late 2007, inflation rates have generally been well below three percent. As a consequence, the lifetime income benefit adjustment has kept well of inflation in recent years.

While the Joint Select Committee recommended the cost of living adjustment for both types of benefits, the legislation that was filed included the cost of living adjustment only for lifetime income benefits. The legislative record provided no rationale for adjusting only one type of benefit. Some believe that it was simply decision to reduce costs, but no reference to why the change was made could be found.

If the purpose of both benefits is the same - to mostly replace the wages an injured or deceased worker would have earned - and it is likely the worker would have earned more as he or she gained years of experience or through minimum wage increases, then it would seem logical and fair that both types of benefits should be adjusted as the original report recommended. As long an injured worker who is receiving lifetime income benefits is alive, the family's income keep up with inflation. The financial consequences of the worker's death will be severe.

For example, representatives of the State Office of Risk Management testified that it is still paying a worker who was injured in 1991. At the time of his injury, his lifetime income benefits were calculated at $531 per week, or $27,612 per year. After 15 years of 3 percent increases, the injured worker now receives $852 per week, or 44,304 per year. If he died in 2016, the family would immediately begin to receive death benefits, but at $27,612 per year, $16,692 less than it is receiving now.

In another example, SORM is still paying death benefits to a surviving spouse of a worker who died on the job in 1974. Like current law, the law at that time did not provide an inflation increase for death benefits. At the time of the death, death benefits were calculated at $77 per week. Now, more than 40 years later, the surviving spouse is receiving just $77 per week.

As noted earlier, thanks to a bill brought forward in the 84th Legislature by Representative Charlie Geren, the spouse of a first responder who dies on the job or acting as a volunteer will continue to receive death benefits under workers' compensation, while all other spouses lose their benefits 104 weeks after they remarry. During consideration of the bill, supporters argued "that a survivor of a first responder who paid the ultimate sacrifice in the line of duty should not be penalized for remarrying." The provision that a surviving spouse lose benefits upon or shortly after remarrying has existed in Texas workers' compensation law since the 1920s. At that time,

it was uncommon for women to be employed outside the home, so deceased workers were almost exclusively males. To avoid social stigma, widows generally would not cohabitate without remarrying. Remarriage replaced the income that was lost due to the death, and so death benefits were revoked.

Today, there is virtually no social stigma attached to cohabitation without marriage. Still, upon remarrying a surviving spouse loses his or her death benefits two years later. Testimony before the committee revealed that some believe surviving spouses who remarry do so without knowing they will lose their benefits or are marrying someone wealthy enough that the loss of death benefits income is of no financial consequence. Other surviving spouses, they believe, simply cohabitate because they cannot afford to lose their benefits. The emotional, social, legal, tax, and health benefits of marriage are well documented. If the termination of death benefits is preventing couples from getting married, those couples could be sacrificing the benefits of marriage in exchange for the death benefits.

A representative of the Texas Association of Business noted that when a surviving spouse remarries, the benefits he or she loses are redirected other eligible beneficiaries if there are any. For example, a child in college would receive the death benefits they had been getting, plus the benefits of the surviving spouse who remarries until the child becomes ineligible.[xlix] If there are no eligible beneficiaries after the surviving spouse remarries, then the insurance carrier makes a payment to the Subsequent Injury Fund, which is generally used to pay insurance carriers for overpayment or incorrect payments to claimants so that claimants do not have to repay their overcompensation.

After the horrific shooting of Dallas and Dallas Area Rapid Transit Police officers in June questions were raised about the effectiveness of the 75 percent of average weekly wage calculation for death and lifetime income benefits. News reports were published stating that injured Dallas Police officers and the families of slain officers were to receive the officers' full pay, while injured DART officers and the families of slain DART officers were only receiving 75 percent of their pay. Subsequent to those reports, DART officials used charitable donations to ensure that the DART officers and their families received the officers full pay, and the committee commends DART for that action.

As noted earlier, 75 percent of average weekly wage is used to calculate benefits because the benefits are tax free. It appears that the major reform bill of 1989 used that calculation believing it would approximate the after tax pay of most employees. After discussing the overall benefits situation with DART representatives, committee staff asked them to calculate officers' after tax income against the 75 percent calculation. DART reports that depending on the wage level, the 75 percent rule yields 92 to 98 percent of after tax income. The lower the income, the poorer the 75 percent rule did in approaching after tax income. Because tax rates are lower at lower income levels, the 75 percent rule underestimates an employee's taxes. At higher income levels, the 75 percent rule more closely matches after tax income. The committee deliberately chose to forgo a public examination of the situation immediately after the event out of respect for those who were dealing with the tragedy. But, the situation has exposed a potential inaccuracy of the 75 percent rule when calculating benefits the purpose of which is to replace lost income. The 75 percent rule mostly replaces lost income, but a more accurate method might be available.

Recommendation

The 85th Legislature should consider providing a cost of living adjustment to death benefits, similar to the adjustment under lifetime income benefit provisions.

The 85th Legislature should consider tying the cost of living adjustment for death and lifetime income benefits to the Consumer Price Index rather than an the three percent calculation.

In an effort to remove the financial disincentive for a surviving spouse to remarry, the 85th Legislature should consider permitting all surviving spouses to keep their death benefits upon remarrying.

COMMITTEE OVERSIGHT

Conduct legislative oversight and monitoring of the agencies and programs under the committee's jurisdiction and the implementation of relevant legislation passed by the 84th Legislature.

Compound Pharmaceuticals

Background

In routine information gathering conducted under the House Committee on Business and Industry's oversight authority, the committee became aware of rapidly increasing usage and costs of compound pharmaceuticals in the workers' compensation system. The committee's primary concern is to keep costs for the workers' comp system down, while still providing the health care injured workers require. Any unnecessary costs are generally passed on to employers by insurance companies in the form of increased rates. Any cost that increases rapidly, either through an increase in usage or an increase in price, demands a prompt inquiry to see if further investigation might be needed.

After informally discussing the issues surrounding compounded pharmaceuticals, the committee determined that a public hearing was necessary to bring forward relevant facts. The committee conducted a hearing on March 22, 2016.

In 2005, Texas authorized a closed formulary for drugs used to treat injured workers in the workers' compensation system. In a closed formulary, only certain drugs in each drug class are covered by insurance reimbursement. A closed formulary offers the ability to contain costs. In the Texas workers' comp system, a doctor treating an injured worker may appeal the use of a non-formulary drug if the doctor determines and documents that the drug is necessary to treat the injured worker's injury. Thus, the use of non-formulary drugs generally requires preauthorization. The closed formulary went into effect September 1, 2011, but injured employees were given until September 1, 2013 to adjust to the new formulary.

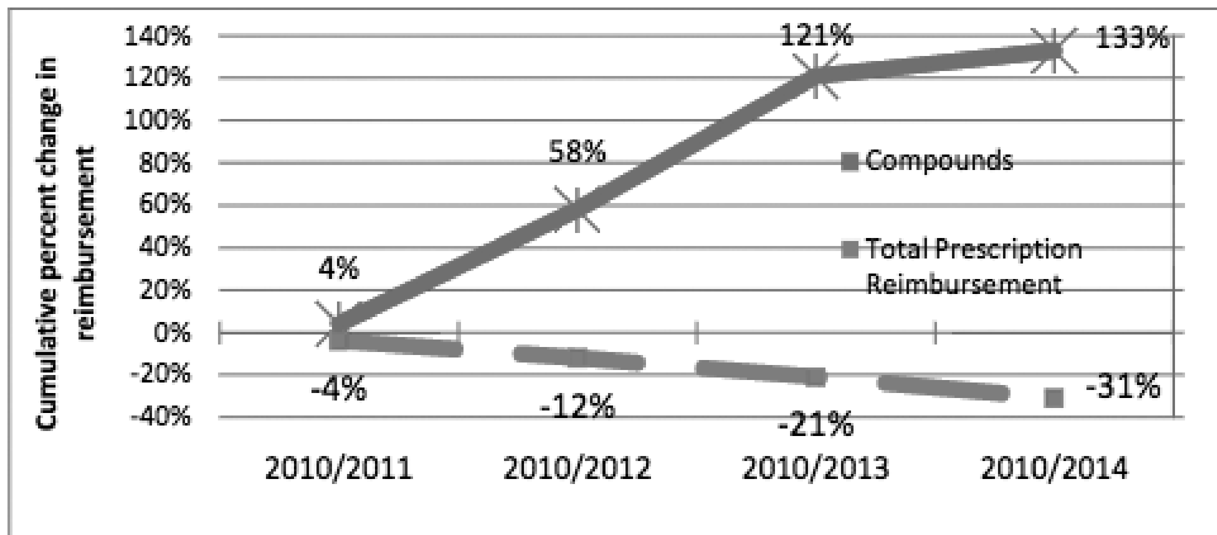
Compounded drugs that use drugs in the closed formulary do not require preauthorization. However, any compounded using a non-formulary drug, including "N" status drugs, generally require preauthorization. "N" status drugs are drugs which are not recommended as a first-line treatment based on the *Official Disability Guidelines* adopted by the Division of Worker's Compensation (DWC).

The closed formulary has resulted in lower costs for prescriptions drugs. While the overall costs were coming down, the cost and usage of compounded pharmaceuticals has been increasing rapidly. The Division of Workers' Compensation (DWC) has grown increasingly concerned about the increase in the number of compounds prescribed and dispensed, the increase in the cost of compounds, a lack of preauthorization's for compounds, and a lack of evidence that compounds are effective.

As a result of these concerns, DWC began an effort to improve data related to compounds in February of 2015. The new rules on data reporting, however, did not take effect until September 1, 2015.[1]

Even before the new data reporting rules went into effect, the DWC was able to develop some data that indicated the growth in the use of compounds. In 2010, compounds accounted for $5.9 million dollars of the $159.6 million in prescription drug reimbursements. By 2014,

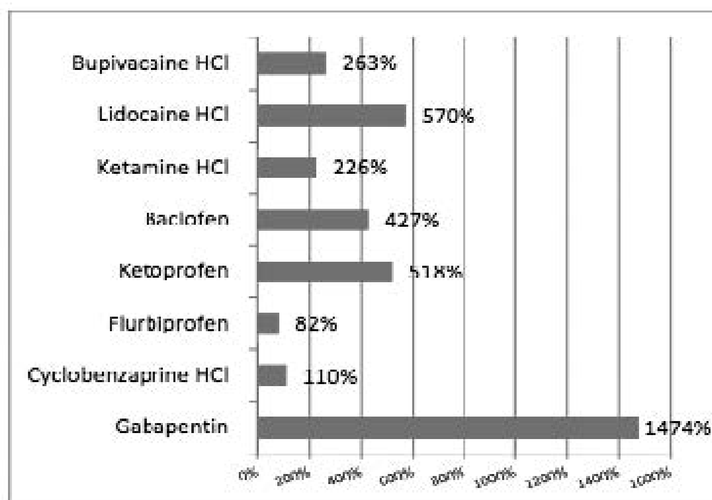
reimbursements for compounds had grown to $13.7 million, an increase of 133 percent. At the same time, overall prescription reimbursements fell to $110.5 million, a decline of about 31 percent. So, while overall drug costs were dropping, the cost of compound pharmaceuticals was increasing rapidly.



The major factor in the increase is the cost per compound, though the increase in usage also contributes. In 2010, 18,535 compounds were reimbursed by insurers. By 2014, that number increased to 21,200, an increase of about 14.5 percent. The average reimbursement per compound, however, grew from $316 in 2010 to $646 in 2014, an increase of 104.5 percent. So, usage of compounds increased 14.5 percent, but the cost per compound jumped 104.5 percent.

Contributing to the problem is that the eight most common ingredients used in compounds all increased in price well above the average wholesale price of drugs in general. For instance, Flurbiprofen saw an 82 percent price increase above the average wholesale price, while Gabapentin's price increased 1,474 percent above the average wholesale price of all drugs.

Examples of Commonly Used Compound Ingredients Price Changes, 2010 to 2015



These drugs were common ingredients in compounds dispensed in FY 2014.

Average wholesale price (AWP) is a commonly used benchmark in pharmacy reimbursement methodologies.

These few examples are a potential factor in the increase of cost for compounds.

Perhaps most disturbing is the concentration of doctors prescribing compounds. In 2014, about 1,000 doctors prescribed compounds for injured workers, writing 24,037 compound prescriptions. Only ten doctors, about one percent of doctors, accounted for 11,614 of those prescriptions, or 48 percent of all workers' compensation related compound prescriptions. The top 50 doctors, or 5 percent of doctors, wrote 17,037 compound prescriptions, or 71 percent of prescriptions. The remaining 95 percent of doctors prescribing compounds, wrote 29 percent of the compound prescriptions.

Not surprisingly, the small concentration of doctors writing a disproportionate number of compound prescriptions resulted in a relatively small number of pharmacies filling most of the prescriptions. In 2014, just 20 pharmacy providers, meaning pharmacies or pharmacy chains, filled more than 80 percent of compound pharmaceutical prescriptions.[li]

These figures are for the prescriptions that were reimbursed. When costs for prescriptions that were not reimbursed are included, the cost per compound prescriptions increases more. The estimated cost of bill for compounded medication nearly tripled from 2009 at $8.11 per prescription, to 2014 at $20.29 per prescription. While specific numbers were not provided, given the difference in costs for billings versus reimbursements, it is clear that a substantial percent of compounded pharmaceuticals were being denied reimbursement.

Those denials cost pharmacies money. Once a patient has left the pharmacy with the drugs, a pharmacy cannot retrieve those drugs if the insurance company refuses to pay. The cost of reimbursement denials is then passed on to other customers whether they are in the workers' compensation system or not. A pharmacy benefit management representative testified that some statutes and regulations seem to be inconsistent with the closed formulary, and that until clearer regulations are implemented, legitimate compounding pharmacies will face the risk of non-payment.[lii]

The patient is often unaware of the denial of reimbursement until he or she attempts to refill a prescription. At that time, the pharmacy informs the patients that the insurance has declined to pay for the drugs, either forcing the patient back to the doctor for another type of prescription or forcing the patient to go without the medication.

After analyzing the preliminary data, the DWC began an audit of the disturbing trends around compound pharmaceutical prescriptions, the doctors prescribing them, the insurance company denials, and reimbursements. The results of the audit are not expected until early in 2017.

Recommendation

When the 85th Legislative Session convenes, the House Committee on Business & Industry should immediately receive and analyze the results of the audit. The Legislature should take appropriate action to ensure that treating physicians prescribe compound pharmaceuticals only when medically necessary, that pharmacies understand which compounds are likely to receive reimbursement, and that insurers are vigilant in accepting or denying payment for compounded drugs. The ultimate goal should be to ensure that the injured worker receives the medication he or she needs to recover from an on-the-job injury.

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