Limited Government ◆ Individual Liberty ◆ Free Enterprise ◆ Traditional Values

Texas Conservative Coalition
Research Institute

Free Enterprise & Government Regulation Task Force

FINAL REPORT

January 2025

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Introduction

The Texas Conservative Coalition (TCCRI) views public policy through the lens of its principles of Limited Government, Individual Liberty, Free Enterprise, and Traditional Values. Together, these principles form the "LIFT Principles." Of TCCRI's six public policy Task Forces, only the "Free Enterprise and Government Regulation" task force has one of these principles included in its title. The other half of the title, *government regulation*, should rightly be understood not as government's authority to regulate, but as the LIFT principle of *limited government* applied to government regulation. These ideas go hand-in-hand.

Limiting government and promoting free enterprise are of paramount importance to Texas, its economy, and the prosperity of its citizens. So much of what government engages in impacts free enterprise.

The state requires the government's permission to engage in hundreds of legal activities through the requirements associated with occupational licensing.

The state regulates every aspect of alcohol production, transportation, sale, and consumption.

Artificial Intelligence (AI) and other emerging technologies face efforts to impose expansive new laws and regulations, affecting the ability of innovators to create new products and services.

Housing supply and affordability are universally recognized as important areas of growth and prosperity, yet government regulation prevents them from adapting to address increased need.

The Texas Constitution prohibits gambling, yet authorizes several forms of legal gambling, including a government monopoly in the form of the state lottery. State law also lacks clarity of the topic of fantasy sports.

Financial regulations, including potential laws on earned wage access services, affect how people collect their earnings.

Insurance is heavily regulated by the state. Government requirements related to insurance often distort markets and drive up prices. The same can be said about regulations affecting automobile sales.

Government regulation can be a force for good, as private sector developments in environmental, social, and governance (ESG) work to cause market distortions and impose otherwise unjustifiable business practices.

Over the course of the 88th Legislative Session's Interim, TCCRI held meetings to discuss many of these topics. Those meetings informed the research and policy proposals contained in this report, as did TCCRI's research and work in other areas, including legislative testimony, white papers, and public policy summits. TCCRI hopes that you find the research and policy proposals helpful and informative.

Occupational Licensing Reform

Background

An occupational license is a government-imposed requirement needed in order to work or practice in a regulated profession. These licenses, which include certificates and registrations, often require a certain level of education, training, experience, a government-administered examination, and payment of fees.

According to the Bureau of Labor Statistics' Current Population Survey, in 2023, 21.6 percent of the U.S. civilian labor force, or 34.8 million people, held at least one occupational license. An additional 2.5 percent (4 million) held a certification but no license.[1] In the 1950s, less than 5 percent of the workforce worked in a profession that required a state-issued occupational license.[2] The number of workers needing permission from their state government to work increased fivefold in the past 60 years—going from 1 in 20 workers requiring a license to work, to 1 in 4, according to the National Conference of State Legislatures, the National Governors Organization, and the Council of State Governments.[3]

In the third edition of *License to Work*, a report on occupational licensing, the Institute for Justice found 2,749 occupational licenses required across the 50 states and the District of Columbia within a sample of only 102 lower-income occupations. Professional licensure within these professions requires an average 362 days of education and experience, $295 in fees, and passage of at least one state-administered examination.[4] Demonstrating the inconsistency of licensing throughout the U.S., the Institute for Justice found that of those 102 licensed occupations, *only 12 of them* are required in all 50 states and the District of Columbia, 10 are licensed by 40 to 50 states, and 4 by only one state. These numbers strongly suggest that occupational licensure has less to do with purported protection of consumers and more to do with protecting licensed occupations from new competition. Indeed, most of the occupations identified in *License to Work* are licensed in fewer than 40 states.[5]

The state of Texas licenses 38 of the 102 occupations sampled in *License to Work*, one more (for animal breeders) than it did in 2017 when the Institute for Justice last reviewed them.[6]

As of 2023, Texas administers 858 licenses through 47 different state entities, with the Texas Department of Licensing and Regulation (TDLR) administering the most (204), followed by the Texas Medical Board (66), and the Texas Racing Commission (63).[7] That same year, TDLR's licensed population amounted to 688,206 individual licenses, a 6.8 percent increase from 2021.[8] The Institute for Justice ranks Texas 18th most burdensome state in the nation for occupational licensing (measuring fees, days of education and experience required, and exams needed) and 41st by number of licenses and average burdens (Texas being better ranked here because of fewer occupations licensed than in most other states).[9]

Benefits or Barriers?

Balancing Intent and Effects of Licensing

The stated justification for occupational licensing is typically to protect the health and safety of consumers and to ensure the quality of products and services. The Texas Department of Licensing and Regulation, for example, describes its role, in part, as follows: "We protect the health and safety of Texans and ensure they are served by qualified professionals."[10]

Over the years, however, the number of professions requiring licensure and the requirements to obtain the government's permission for that license to work—training hours, years of experience, fees, reflect less of a health and safety goal and more of an effort to raise barriers to entry, preventing people from earning a living in professions that create little risk for consumers.

In addition to burdensome statutory occupational licensing requirements, Texas has a history of burdensome licensing decisions imposed by state agencies. In *Patel v. Tex. Dep't of Licensing* (2015),[11] for example, TDLR was challenged for imposing the full requirements of cosmetology licensure on

commercial eyebrow threaders. Eyebrow threading is the process of removing facial hair using a piece of string, and it is not covered by any part of the cosmetology license curriculum. Nevertheless, TDLR imposed full licensure on eyebrow threaders who in response sued the state. The Texas Supreme Court ruled in *Patel* that the cosmetology licensing requirement for commercial eyebrow threading imposed by TDLR (750 hours of conventional cosmetology training[12]) "is not just unreasonable or harsh, but it is so oppressive that it violates Article I, § 19 of the Texas Constitution."[1] In the opinion of the Court, Justice Johnson wrote:

> Texans are thus presumptively free, and government must justify its deprivations. So just how nonsensically can government stifle your constitutional right to put your know-how and gumption to use in a gainful trade? ... Laws that impinge your constitutionally protected right to earn an honest living must not be preposterous.[13]

TDLR's mission is to ensure the health and safety of Texans. However, the *Patel* experience suggests that TDLR is willing to view unlicensed occupations as competition for licensed occupations, and, as such, will use the force of government to protect the licensees.

Cost of Licensing

While occupational licensing tends to increase wages for those licensed, this is in part because entry to their profession is limited (by the barrier of licensing), artificially leaving consumers with fewer professionals within these occupations and higher prices as a result. [14] For professionals, limited employment and reduced mobility are also direct consequences of the licensing barrier to entry.

A 2018 Institute for Justice report estimating the economic cost of occupational licensing at the state and national levels found that, at the time, with 19 percent of workers licensed, Texas was losing more than 143,000 jobs and was seeing estimated deadweight losses[2] of more than $431 million, nearly $13 billion in misallocated resources, and a 14 percent increase in earnings for licensees—the latter meaning higher prices for consumers because of licensing.[15] As a Texas Comptroller article put it,

> Licensing thus tilts the economic playing field by steering workers into jobs that are more accessible but lower paying. Workers who can obtain a license benefit from monopoly-like effects, including reduced competition as well as higher wages.[16]

A comprehensive 2015 White House report on occupational licensing found that stricter licensing led to higher prices:

> the evidence on licensing's effects on prices is unequivocal: many studies find that more restrictive licensing laws lead to higher prices for consumers. In 9 of the 11 studies we reviewed ... significantly higher prices accompanied stricter licensing.[17]

Because professions are licensed at the state and sometimes also local levels, it becomes difficult for a professional to move. Research has found that "individuals who move 50 or more miles and reside outside of their state of birth [who are] in state-specific occupations move between states at a 7 percent lower rate compared to members of quasi-national licensed occupations." [18] Under the same conditions, some occupations are also more impacted than others. Johnson and Kleiner found this to be particularly the

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[1] *Patel v. Tex. Dep't of Licensing*, p. 90. Article I, § 19 of the Texas Constitution states that "No citizen of this State shall be deprived of life, liberty, property, privileges or immunities, or in any manner disfranchised, except by the due course of the law of the land" (see Texas Constitution, Article 1, Bill of Rights, https://statutes.capitol.texas.gov/docs/cn/htm/cn.1.htm).

[2] A deadweight loss can be defined as a cost to society resulting from economic or market inefficiencies. This can occur when resources are not appropriately allocated and can result from private decisions or government policies that undermine the market equilibrium, such as price controls, regulations, or taxation. For more, see Tuovila, Alicia, "What Is Deadweight Loss, How It's Created, and Economic Impact," Investopedia, 15 Jun. 2024, https://www.investopedia.com/terms/d/deadweightloss.asp; and Nielsen, Eric, "Deadweight Loss," Econ Focus, Federal Reserve Bank of Richmond, Vol. 9, No. 4, 2005, https://fraser.stlouisfed.org/title/econ-focus-federal-reserve-bank-richmond-3941/fall-2005-476931?page=11.

case for teachers, pest control workers, electricians, pharmacists, and lawyers:

> In sum, the limiting effect of state-specific licensure on interstate migration varies across occupations, and not all such occupations experience such an effect. Pharmacists and pest control workers are the worst affected, with 50-mile movers residing outside their state of birth 16 and 14 percent less likely to move between states relative to quasi-national licensed occupations, respectively.[19]

Finally, according to a study by the Federal Reserve Bank of Minneapolis,[20] workers of color are less likely to be licensed than white workers. Particularly, according to the authors of the study, Latino workers are 11 percentage points less likely to be licensed.

Customer Satisfaction

Unfortunately, licensing does not guarantee quality of service or customer satisfaction.[21]

Grease or Grit? International Case Studies of Occupational Licensing and Its Effects on Efficiency and Quality[22] examines the effects of the regulation of several occupations in different countries, including the U.S. Case studies find no evidence, at best, that the regulation of or additional constraints imposed on the occupations studied improved the quality of service for customers. The two case studies in the United States look at medical scope of practice and the licensing of makeup artists and shampooers.

Regarding expanding scope of practice of health professionals, the authors found that, "there is an emerging consensus [that] allowing medical practitioners the ability to work independently from physicians does not reduce the quality of care. ... If anything, the increase in independent practice appears to improve the quality of care with no measurable influence on prices."[23]

Regarding the licensing of makeup artists and shampooers, the author found that "licensing requirements and the associated intensity do not significantly increase quality through the ratings measure of consumer satisfaction [and] licensing sometimes has a negative effect on quality."[24]

Policy Recommendations

Occupational licensing has been the focus of numerous studies, many of them pointing out the unintended but very real negative consequences for both professionals and consumers of regulating an increasing number of occupations with stricter regulations.

Not all state legislatures have remained blind to the problems caused by licensure, though. A 2021 study found that, starting in 2015, a national trend toward de-licensing has appeared, with 35 occupations being de-licensed between 2015 and 2020, compared to just 9 between 1970 and 2015.[25]

The past few sessions, the Texas Legislature itself took several steps to reduce the burden that occupational licensing had created on certain professionals,[3] but the Lone Star State can take a bolder stance that has the potential to create more opportunities for both Texans and professionals from out of state that we might need here, as well as to positively impact the economy.

In anticipation of the 89th regular legislative session, several bills have been filed that could help alleviate some of the issues caused by occupational licensing. These include:

- House Bill 710,[26] by Representative Harrison, and Senate Bill 100,[27] by Senator Hall, would both provide

[3] In 2017, the 85th Legislature abolished several licenses. In 2019, the 86th Legislature stopped Texas agencies from denying or suspending a license because the professional licensed has defaulted on their student loan and from disqualifying an applicant for a license because of a conviction for an offense unrelated to the occupation for which they are applying for a license. See Halbrook and Wright (2019). The 86th Legislature also passed SB 1200, which allowed for spouses of military service members to have out-of-state licenses recognized. The 88th Legislature extended the later to military service members (SB 422).

universal licensure reciprocity (see Policy Recommendation 1).

- House Bill 794,[28] by Representative Harrison, would require a comprehensive review of existing occupational regulations to determine whether any violate the policy established by the bill that "all occupational regulations must be limited to those demonstrably necessary and carefully tailored to fulfill legitimate public, health, safety, and welfare objectives." If some occupational licenses are found to violate the policy, the bill requires that they be repealed (see Policy Recommendation 3).

- Senate Bill 99,[29] by Senator Hall, would require that a bill introduced to create an occupational license or to expand an existing one come attached with a statement on whether the author of the bill required a review of the legislation by the Legislative Budget Board under Texas Government Code § 325.023.

- House Bill 296,[30] by Representative Harris Davila, would facilitate the licensure of applicants authorized to work in the United States and licensed to practice medicine in a limited number of foreign countries. HB 296 could potentially help alleviate the shortage of physicians.

Policy Recommendation 1

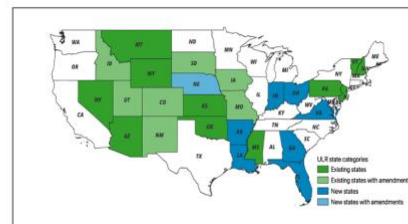
Adopt Universal Licensure Reciprocity

Universal licensure reciprocity would allow for professionals licensed in another state to exercise their occupation in the state of Texas. Universal licensure reciprocity or recognition laws usually still require some criteria to allow for reciprocity, such as relatively similar requirements and scope of practice, good standing in the state where the professional is licensed, and a number of years of experience. Ideally, reciprocity would also allow for professionals from another state where their occupation is not licensed to exercise in Texas if they have a number of years of experience. According to the Knee Center for the Study of Occupational Licensing at West Virginia University, as of 2024, 26 states had passed some form of universal licensure recognition, including 10 states that recognize work experience when the professional's occupation is not licensed in their home state.[31]

Universal recognition or reciprocity is different from interstate compacts that target specific occupations. In a compact, a number of states agree to reciprocity within these states only and usually based on specific requirements. As of 2022, the state of Texas was part of 5 interstate licensure compacts: the Nurse Licensure Compact, the Interstate Medical Licensure Compact, the Physical Therapy Compact, the Emergency Medical Services Compact, and Psychology Interjurisdictional Compact.[32]

Figure 1

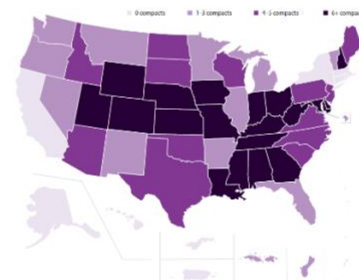
States with Universal Licensure Recognition



Source: Bae and Deyo: "Existing states are the 18 states with universal license recognition reviewed in the last edition of this report, and the eight new states passed the policy since the last edition [2022]. States with amendments refer respectively to the seven existing states and one new state that significantly expanded their initial policy reforms."

Figure 2

States in Interstate Licensure Compacts



Source: National Center for Interstate Compacts

The National Center for Interstate Compacts, within the Council of State Governments, underlines the

importance of including a provision that excludes interstate licensure compacts in universal licensure recognition laws as the requirements agreed upon in a compact could be in conflict with those of universal recognition.[33]

Ahead of the 89th Texas Legislature, House Bill 710 has been filed.[34] HB 710 would allow for universal licensure recognition within the state of Texas if the individual applying for a license fulfills certain conditions, including but not limited to holding a current and valid license or certification in another state, having held it for at least a year, was required a certain level of education and an exam in the other state, is in good standing with the board for the occupation in the other state, has not had their license or certification revoked.

Senate Bill 100,[35] also filed ahead of the 89th Legislature, would provide for a similar universal reciprocity.

Policy Recommendation 2

Pass TCCRI's Occupational Licensing Consumer Choice Act

The Occupational Licensing Consumer Choice Act ("The Act") is model legislation drafted by TCCRI. The Act "provides consumers with the right to choose a worker who best serves their needs irrespective of whether that person holds an occupational license." If a person works in an otherwise legal profession that requires a license, The Act provides that a license is not required so long as the person discloses the fact that they are not licensed by the state to prospective customers. The Act provides requirements for a written disclosure, and production of such a disclosure in any enforcement action for not having a license shall be dismissed. The full text of TCCRI's model bill may be read here.

Where other model licensing bills focus on litigation and methods for striking licensing laws down, The Act takes a different approach. It is self-executing in that it provides a clear framework for working without a license. It focuses on consumer information and consumer choice. The Act's benefits are myriad:

- It does not repeal any licenses but makes them no longer mandatory.
- It allows licenses to remain a market signal of qualification but empowers consumers and other market participants (insurers, for example) to choose for themselves how important the license is.
- It creates more market competition. This is good for workers, consumers, and the larger economy.
- It empowers industry groups, trade organizations, and similar private associations to self-regulate without the participation of government.

Policy Recommendation 3

Ensure That Existing Licenses Are Necessary and Eliminate Those That Are Not

Some occupations are only licensed in a few states, demonstrating that, if those occupations do not require licensure in several states, they probably shouldn't be licensed at all.

Research from the Brookings Institution[36] that looked at the existing literature on occupational licensing reported that a 2011 study found that "licensed florists in Louisiana (the only state to license florists) did not produce better-quality floral arrangements than their unlicensed counterparts in Texas. However, the floral arrangements in Louisiana cost more for the same product and service than those in Texas."[4]

The Legislature should consider requiring the state entities that administer the existing licenses in Texas to review the cost and benefits of each license and to make recommendations for repeal or for making them less burdensome.

[4] As of 2022, Louisiana still is the only state to license the occupation of florist, requiring a $214 fee (see Knepper et al., p. 181.

Ahead of the 89th Texas Legislature, House Bill 794[37] has been filed and would require such a review. The bill would provide that the regulations that violate the policy stated in the bill should be repealed or modified:

> Sec. 2.002. POLICY. It is the policy of this state that all occupational regulations must be limited to those demonstrably necessary and carefully tailored to fulfill legitimate public health, safety, and welfare objectives.

The bill would also allow an individual to petition the licensing authority of a license for repeal or modification if the license violates this policy. It would also provide injunctive relief.

Alcohol Laws and Regulations

With more than 130 distilleries, 400 wineries, and 360 craft breweries, Texas's alcoholic beverage industry is thriving. [38] These domestically-produced beverages, along with non-domestic imports, are transported by a network of distributors and wholesalers to thousands of retailers for off-premise and on-premise consumption. These producers, distributors, and retailers are referred to as the "three-tiers" of the alcoholic beverage industry in Texas and are regulated as such.

Alcohol in Texas is regulated under the Texas Alcoholic Beverage Code, the stated public policy of which is "the protection of the welfare, health, peace, temperance, and safety of the people of this state."[39] The Code is enforced through law enforcement and the Texas Alcoholic Beverage Commission.[40]

The Texas Alcoholic Beverage Code was drafted during the aftermath of Prohibition, and the regulatory structure put in place at that time largely applies today, and many of the laws on alcohol sales thought necessary at the time have since outlived their usefulness. For instance, times and locations of sales for alcohol differ depending on whether the alcohol is sold for on-premise or off-premise consumption, at a grocery store or a liquor store, whether food is served with the alcohol, or whether the alcohol type is beer, wine, or spirits.

Legislation by Volume

New market entrants and new business models often challenge the existing regulatory structure, which can require updating as a result. The Legislature considers a large number of bills to change the laws in the Alcoholic Beverage Code each session. The following table illustrates the number of bills filed, heard, and passed into law over the course of the last seven legislative sessions in Texas:

Session	Bills Files	Bills Heard	Bills Passed
88(R) 2023	70	27 (39%)	13 (19%)
87(R) 2021	91	27 (30%)	16 (18%)
86(R) 2019	93	39 (42%)	19 (20%)
85(R) 2017	92	32 (35%)	16 (17%)
84(R) 2015	84	41 (49%)	22 (26%)
83(R) 2013	85	61 (72%)	22 (26%)
82(R) 2011	60	35 (58%)	17 (28%)

With the expectation that the above trend will continue during the 89th Legislative Session, there is a great opportunity for Texas to promote free market principles by lifting a number of outdated and anticompetitive alcohol regulations.

Policy Recommendations

Policy Recommendation 4

Create Uniformity in Hours of Sale

Conflicting laws on hour of sale should be made uniform for a variety of reasons ranging from the promotion of economic growth, to alleviating anti-competitive effects, to potentially creating more revenue for the state. One proposal is to simply allow alcohol sales of all kinds from 7am until 1am across the board, with an option for a late-hours permit in those jurisdictions that allow it. This will eliminate the anti-competitive system we currently have where certain kinds of businesses may only sell certain kinds of alcohol at variously defined times. Such a reform would simplify the law, free the alcoholic beverage economy, benefit consumers, and make Texas a stronger free market leader.

Policy Recommendation 5

Allow Sunday Liquor Sales

Texas is one of only seven remaining states that prohibits Sunday liquor sales for off-premise consumption.[41] Not only is this practice outdated, but it is anticompetitive in nature. Bars and restaurants are permitted to sell liquor on Sunday, which eliminates any kind of safety or moral argument against such sales. Indeed, purchasing a bottle of liquor and taking it

home for consumption is arguably far safer than allowing a person to drink liquor on a bar or a restaurant and then driving home afterwards.

There is also a strong free market argument to allow Sunday liquor sales as well. Liquor stores sell legal products—including wine, beer, and a variety of products allowed to be sold elsewhere on Sunday. It should be a choice for those stores to open on Sunday and sell their legal products to customers, just like restaurants, grocery stores, and a host of other retailers are allowed to do.

Bills to remedy this anticompetitive law, such as House Bill 1670 (88R, Jetton) are filed every Legislative Session. The 89th Texas Legislature should consider and pass such legislation.

Policy Recommendation 6

Repeal Package Store Restrictions

Section 22.16 of the of the Texas Alcoholic Beverage Code prevents publicly traded corporations from holding liquor permits. Stores such as Costco, Walmart, and many others, can freely sell beer and wine, but are not authorized under law to sell liquor. Costco, as an end-around, has found a way around this unnecessary regulation by leasing a portion of their property to a liquor store where membership is not required to purchase products. In the 88th Legislative Session, Representative Harold Dutton filed House Bill 4920, which would have repealed Section 22.16. The bill was heard in committee, but no further action was taken. The 89th Legislature should pass legislation similar to HB 4920.

Artificial Intelligence (AI)

Background

Artificial intelligence (AI) is the driving force in a current revolutionization of modern life. Its algorithms are designed to emulate human intelligence and it uses a variety of learning models to accomplish that goal, including supervised learning, unsupervised learning, and reinforcement learning.[42] AI systems have a growing list of applications in a diverse and undefined field of industries, including health care, national security, education, and even entertainment, to name a few examples.[43] A more familiar AI company is OpenAI, which offers the now ubiquitous ChatGPT, a generative AI tool allows users to prompt it with inputs and questions that produce human-like responses and work product. It can code computer programs, compose music, draft emails, summarize articles and presentations, reword existing text for clarity, research history and information, and generate art, to name a few examples.[44] OpenAI now has an estimated 300 million weekly users.[45]

Like so many new technologies that came before, the rapid proliferation of AI has prompted calls for government regulation. These calls are driven by a natural desire to protect consumers and the public, but also by a lack of understanding and trust in new technologies and services. People fear that AI will take jobs from humans, that its results will be biased, that it will increase the reach of the surveillance state, or that it will produce harmful fake videos and images, to name only a few concerns.[46] Some of the fears are more warranted than others, but calls for regulation are becoming louder.

Early Efforts to Regulate AI

A number of major players on the world stage have taken preliminary steps to regulate AI. The European Union, for example, recently passed the "AI Act" in 2024, which is the first major comprehensive law on AI regulation in the world. The AI Act regulates based on what it calls "risk" levels, and it applies more stringent rules based on the defined category of risk applied to a particular AI. For example, a "high risk" AI application (e.g. an AI addressing critical infrastructure, educational, and vocational training, safety components of products, credit scoring, certain law enforcement activities, and more) requires the establishment of a "risk management system," and also requires complex data governance, technical documentation, record-keeping, human oversight, and more.[47] Minimal to no-risk AI applications are, for example, AI-enabled video games or spam filters.[48] The stated goal is for the low-risk applications to face very little regulatory red tape and for the high risks applications to face extensive but necessary review and approval. The AI Act faces considerable criticism from free market-oriented advocates. Aswin Prabhakar of the *Center for Data Innovation* warned during debate of the AI Act's passage:

> The EU AI Act, in its current form, risks creating a regulatory environment that is not only burdensome and inappropriate for open-source AI developers but also counterproductive to the broader goals of fostering innovation, transparency, and competition in the AI sector. As the EU's ongoing negotiations over the AI Act continue, particularly around the regulation of foundation models, policymakers need to adequately address these issues. If they do not amend the Act to better accommodate the unique nature and contributions of open-source AI, it could hamper the progress and openness in the AI sector. It is crucial for policymakers to recognize and preserve the distinct advantages that open-source AI brings to the technological landscape, ensuring that regulations are both effective and conducive to the continued growth and dynamism of the AI field.[49]

The United States and Texas would be well advised to follow Mr. Prabhakar's advice. At present, major AI legislation from Congress looks unlikely, though the Biden Administration has taken several steps to create a regulatory framework for AI in the United States, including a major Executive Order that contains all of the hallmarks of the Administration's efforts elsewhere

with respect to emphasizing politically left-leaning priorities (e.g. "*equity*"). Indeed, the Administration describes the order (Executive Order on the Safe, Secure, and Trustworthy Development and Use of Artificial Intelligence[50]) thusly:

> The Executive Order establishes new standards for AI safety and security, protects Americans' privacy, advances equity and civil rights, stands up for consumers and workers, promotes innovation and competition, advances American leadership around the world, and more.[51]

To advance the Biden Administration's goals with respect to private development of AI, the President directed several actions within each of the following categories:

- New Standards for AI Safety and Security;
- Protecting Americans' Privacy;
- Advancing Equity and Civil Rights;
- Standing Up for Consumers, Patients, and Students;
- Supporting Workers;
- Promoting Innovation and Competition;
- Advancing American Leadership Abroad;
- Ensuring the Responsible and Effective Government Use of AI;[52]

There was a time when technological breakthroughs were not viewed by the government as opportunities to be seized upon, but, rather, benefits to society upon which the government should remain neutral. This effort by the Biden Administration has drawn justified criticism. Adam Thierer of *R-Street Institute* explains:

> While some will appreciate the order's whole-of-government approach to AI, unilateral and heavy-handed administrative meddling in AI markets could undermine America's global competitiveness—and even the nation's geopolitical security—if taken too far. AI is a critical new technology with the potential to expand productivity and economic growth fundamentally, with benefits accruing across many sectors and for all consumers. AI has particularly important implications for advancing public health. AI and computational science also have national security ramifications, which is why a strong and secure domestic technology base is essential to countering challenges or threats from China and other nations. Excessive preemptive regulation of AI systems could impede the growth of these technologies or limit their potential in various ways.
>
> . . .
>
> [T]aken together with other recent administration statements, the EO represents a potential sea change in the nation's approach to digital technology markets, as federal policymakers appear ready to shun the open innovation model that made American firms global leaders in almost every computing and digital technology sector. With the United States now facing fierce competition from global AI companies in China and other nations, the danger exists that the country could put algorithmic innovators in a regulatory cage, encumbering them with many layers of bureaucratic permission slips before any new product or service could launch. Biden's new EO could accelerate the move to tie the hands of algorithmic entrepreneurs even if Congress does not pass any new legislation on this front.[53]

Thierer's concerns are not dissimilar to those expressed by Mr. Prabhakar with respect to the EU's AI Act. It would be an historic missed opportunity for America to fall behind in technology innovation because the party in power abandoned the proven

hands-off regulatory approach in order to ensure, among other things, that AI systems are *equitable*.

Cybersecurity and National Security

Two areas in particular where AI can reshape the landscape are cybersecurity and national security. Both of these policy areas are afflicted by what is often termed "the defender's dilemma," the notion that "the bad guys still have the advantage over the defender, as they just need to find one vulnerability or just one misconfiguration, while the defense needs to protect the entire landscape."[54] Put another way, the challenges posed by the defender's dilemma are that:

> Attackers just have to be lucky once, but defenders have to look at all potential risks. The defender's job is to make it too expensive in terms of time, resources, knowledge, and money for the attacker to find that lucky break. That is an expensive proposition for the defender, and is set to get more expensive as security teams are being asked to manage an increasingly diverse set of security technologies.[55]

A recent RAND study projects that over a ten-year period, the effectiveness of cybersecurity countermeasures declines by approximately 65 percent.[56] The implications of this for the security of critical infrastructure, such as the electric grid, banking, and oil and gas pipelines, as well as for national security and international telecommunications are huge. AI, however, has the potential to vastly rebalance this equation and largely nullify the defender's dilemma. Deloitte noted in a recent analysis that, "[u]nlike rule-based systems that struggle to keep pace with the evolving tactics of cybercriminals, AI employs machine learning algorithms to analyze vast datasets in real-time."[57] Because of these capabilities, then, AI "excels at identifying anomalies and potential threats, allowing for lightning-fast detection and swift, proactive responses. This capability is critical in preventing data breaches and minimizing the impact of cyberattacks."[58] Elucidating on this, Google noted in a recent white paper:

> As AI grows more capable, the tasks it can perform will become more useful and complex. This will be transformative for cybersecurity, as defenders struggle both with the amount of tasks that must be performed in a modern environment, and the difficulty of certain tasks. AI can already perform high confidence analysis on complex datasets far faster than humans.[59]

As policymakers seek to build regulatory frameworks for AI, keeping cybersecurity in mind is vitally important. In particular, it is important to let the market work: AI approaches to cybersecurity should not be prohibited.

Considerations for Attempts to Regulate AI in Texas

Texas should not attempt to comprehensively regulate AI in the manner of the European Union or even to the extent that the current Administration in the White House would like it regulated. When engaging in the important business of determining to what extent the State of Texas should regulate AI, TCCRI urges the consideration of the following guiding principles:

- The extent to which AI will shape the future and the manner in which its impact will be felt are currently unknown.
- The private sector should be encouraged to continue developing new technologies.
- There should be a presumption that private sector self-regulation is preferable to government regulation.
- The government is ill-equipped to identify and solve issues emerging from a rapidly changing technological environment.
- Competition within the marketplace will accomplish many, if not most, of the goals regulators seek to attain.

- Government intervention often leads to market distortions and the picking of "winners and losers" in the marketplace.

In this same spirit, the *American Legislative Exchange Council* (ALEC) recently passed a "Resolution in Support of Free Market Solutions and Enforcement of Existing Regulations for Uses of Artificial Intelligence."[60] The resolution and its findings are worth reading:

> WHEREAS, artificial intelligence (AI) represents the next great tool for human flourishing, artistic creativity, increased productivity, and economic growth;
>
> WHEREAS, AI also represents a major area of competition between American innovators and foreign adversaries and cyber criminals;
>
> WHEREAS, the major advancements in AI have been driven by private sector capital, ingenuity, and effort,
>
> WHEREAS, throughout history, major technological advances have been met by hysterical and misguided responses from government regulators;
>
> NOW, THEREFORE LET IT BE RESOLVED, [LEGISLATIVE BODY] supports a permissionless innovation approach to AI, recognizing that the free market is best equipped to advance innovation, mitigate potential harms, safeguard privacy, and ensure robust competition;
>
> BE IT FURTHER RESOLVED, [LEGISLATIVE BODY] supports efforts by state and federal functional regulators to enforce existing anti-discrimination and other laws against regulated entities that use AI;
>
> BE IT FURTHER RESOLVED, [LEGISLATIVE BODY] rejects any attempt by the federal, state, or municipal, governments to ban AI, significantly curtail its advancement by undermining the above principles;
>
> BE IT FURTHER RESOLVED, [LEGISLATIVE BODY] believes that any federal regulations governing the use of AI technology must emerge from the U.S. Congress, and not be promulgated by federal agencies.
>
> WHEREAS, AI innovation is supported by the principles of a market-driven approach to policy creation; competition and technological neutrality; constitutional limits and protections against government overreach; self-governance as the preferred approach to addressing novel challenges, as opposed to increased government regulation; continuous deregulation; and, when absolutely necessary, implementing simple regulations with guardrails;

TCCRI does not reject any attempt to regulate AI, but the Institute echoes the sentiments put forth in the ALEC Resolution. Regulation of AI in Texas should address known concerns that can be clearly identified and defined, for which there is not an existing law that could be applicable. It should not put regulations in place in *anticipation* of issues that may not present themselves in the way that lawmakers predict.

Where Texas does act on AI, it should not create a new regulatory framework where an existing one can be applied. For example, existing anti-discrimination laws have been used to challenge AI personnel and hiring systems that appear to be discriminating on the basis of age and race.[61] AI systems using facial recognition, fingerprinting, iris scanning, voice recognition, and health data analysis, are subject to existing privacy laws.[62]

In 2020, Carlos Ignacio Gutierrez published a paper in *RAND* called "The Unforeseen Consequences of Artificial Intelligence (AI) on Society."[63] This study looked at regulatory gaps between AI applications and instances in which existing regulations were not adequate to address the issues raised by those gaps.[64] Gutierrez found that of all of the regulatory gaps identified, 12 percent were issues novel enough to

justify a new government regulation.[65] He found that roughly 20 percent of the regulatory gaps were instances in which AI made or will make regulations obsolete.[66] Roughly 25 percent of the gaps were caused by "targeting," meaning that existing regulations were not applied appropriately or simply were not applied when they could have been.[67] Importantly, the remaining regulatory gaps were the ones in which issues were so novel that there was a lack of clarity on the applicability of existing regulations.[68]

Though Mr. Gutierrez's study is now four years old, it speaks directly to attempts by lawmakers to create new frameworks where existing ones could be applied. It also makes clear that there is far less need for new laws and regulations than we often believe there is with respect to new technologies.

Policy Recommendations

Policy Recommendation 7

Avoid New Regulation Where Current Law Provides Adequate Oversight

Lawmakers should take extra care to avoid regulation of AI where existing laws and regulations either apply or are adaptable to the changing landscape. Not only is this intuitive, but Gutierrez' *RAND* paper confirms that current laws and regulations are broadly applicable to AI. An example of this is the health care industry, which is heavily regulated across several state agencies, including the Texas Department of Insurance, as well as Texas Health and Human Services. Other states, including Connecticut and Colorado, have recognized this and allowed the existing regulatory framework to address AI issues related to health care.[69] Texas risks stifling innovation and improved services for Texans if it broadly applies a new regulatory structure to AI without regard to the adequacy of existing laws.

Policy Recommendation 8

Provide Adequate Oversight in Government Use of Artificial Intelligence

Government is unique and distinguishable from the private sector in several obvious ways. First, the government is a public entity, funded by taxpayers. Second, government activity lacks the myriad pressures applied to private companies in the private sector marketplace. Indeed, market forces and the broad incentives put in place by competition among those forces drive the private sector to be more efficient and accountable to consumers. Government is answerable only when an issue is identified and outside pressures are effectively applied to impose change. For that process to take place, information must be provided. The Senate Committee on Business and Commerce recognized these issues in its Interim Report to the 89th Legislature, which makes several recommendations with respect to AI use in government.[70] These including creating "an Ethical Code of Conduct for state agencies that promotes accountability and responsible uses of AI systems."[71] It also includes directing "each state agency to publish a biennial report detailing the AI systems deployed by the agency, including the data inputs and decision-making progress."[72] These are reasonable and responsible impositions on government use of AI.

Policy Recommendation 9

Ensure Adequate Power Sources

An underreported aspect of emerging AI technology is the energy it consumes and the state's ability to supply adequate power for AI systems. The size of the global datasphere is expected to more than quintuple from 33 zettabytes in 2018 to 175 zettabytes in 2025. Indeed, A 2023 peer reviewed article in *Joule* estimates that the servers needed to power AI in 2027 under its current growth would be more than it takes to power a small country for a year.[73] The energy needed to power this growth will place an already burdened grid under greater stress than is currently contemplated. Therefore, the legislature must continue its efforts to grow reliable power production in Texas so that AI producers can grow without the artificial restriction of lack of power.

Housing Supply and Affordability

The cost of housing nationally has consistently increased since the financial crisis of 2008. The median sales price of houses sold went from $208,400 in the first quarter of 2009 to $337,900 in the fourth quarter of 2017, to $442, 600 in the fourth quarter of 2022. Prices have slightly decreased since, with the median price being $420,400 in the third quarter of 2024.[74]

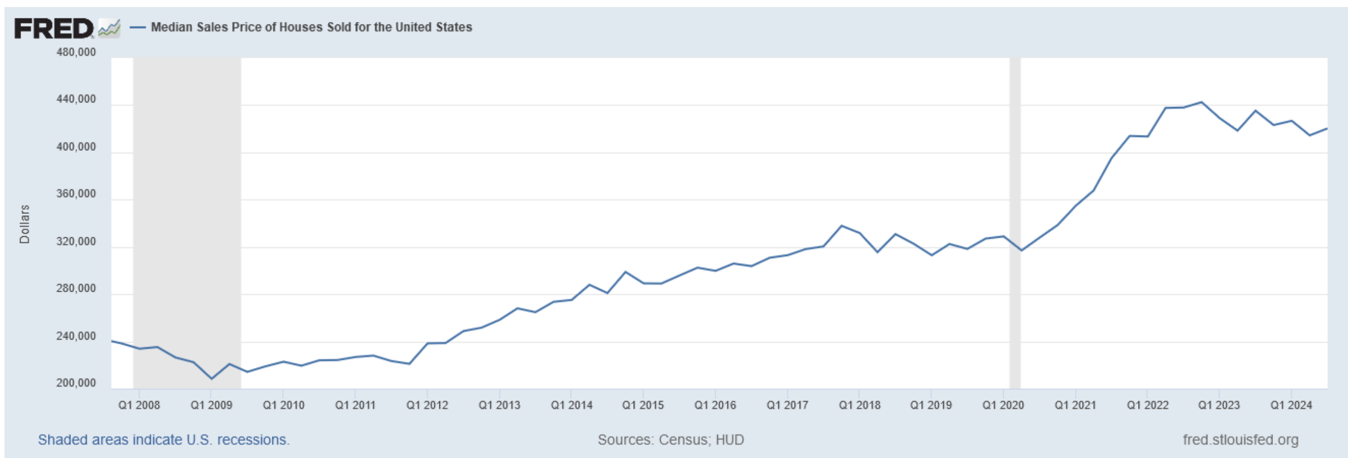
Concretely, that means that a household now needs to earn much more to be able to buy a house. According to the Joint Center for Housing Studies of Harvard University, "In 2022, the median sales price for existing single-family homes rose to 5.1 times the median household income, up from 4.1 in 2019 and the 3.2 price-to-income ratio averaged in the 1990s. ... [T]his ratio dipped slightly to 4.9 in 2023."[75]

The situation was not much better for renters, with the asking rent an estimated 26 percent higher between early 2020 and 2024.

[76]

Figure 3

Median Sales Price of Houses Sold for the United States



Source: FRED, Federal Reserve Bank of St. Louis.[77]

It has become more and more difficult for Americans to become or remain homeowners. An increasing number of households are considered housing cost burdened (spending more than 30 percent of their income on housing costs)[78] and risk being unable to satisfy other basic needs.

In 2023, 31.3 percent of American households paid more than 30 percent of their income in housing costs, according to the Pew Research Center, including 27.1 percent of those with a mortgage and 49.7 percent—nearly half—of those renting.[79] To put those numbers into perspective, as of 2024, 65.6 percent of occupied housing units were owned, while 34.4 percent were rented.[80]

Texas is not immune to the housing affordability problem, especially as it has seen its population grow tremendously. Between 2000 and 2022, Texas' population grew by more than 9 million residents (about half from natural increase, or births minus deaths; 29 percent from net domestic migration; and 22 percent from net international migration), or a 43.4 percent increase.[81]

Domestic migration has driven Texas population growth since 2020, with nearly half a million "domestic migrants" becoming Texas residents in 2022 alone.[82] This, of course, increased the demand for housing, even with Texas already being short of more than 306,000 homes.[83]

Figure 4

Increase in Median Selling Prices of Homes in Select Texas Counties, May 2020 – May 2024

County	May 2020	May 2024	Percentage Increase from 2020 to 2024
Bexar	$230, 000	$295,500	28.5%
Dallas	$249,900	$385,000	54.1%
El Paso	$170,000	$265,950	56.4%
Harris	$232,895	$328,120	40.9%
Tarrant	$248,190	$350,000	41%
Travis	$390,000	$553,550	43.2%

Source: "Housing Activity," Texas Real Estate Research Center, Texas A&M University.[84]

The median price of a house in Texas increased by 5.9 percent annually between 2010 and 2020 (more than twice the rate for the previous decade) and by 15.4 percent in 2021 and 13.4 percent in 2022, with the median home price reaching $340,000 in 2022.[85]

Overall, 34 percent of Texas households in 2022 were housing cost burdened, with lower- (especially) and middle-income households affected most.[86]

According to housing policy nonprofit Up for Growth, the national housing shortage continued to be dire in 2022, at 3.85 million homes.[87] It affected middle-income buyers most. Texas was short 320,000 homes in 2022, despite building more homes than any other state.[88]

Without sound policies to provide affordable housing to average families, Texas' cities run the risk of watching their housing markets transform into those of cities like San Francisco. Austin has recently acknowledged the problem, and in May 2024, the city decreased its 80-year-old minimum lot size of 5,750 sq ft to 1,800 sq ft.[89] One of the hoped-for benefits is that homeowners with larger lot will divide their land to either build additional units or sell part of the land for construction.

The Legislature should focus on (a) reducing costs associated with home ownership, and (b) easing regulations that have the effect of constraining housing supply. The latter will require preempting local law. A number of specific recommendations are discussed in detail below.

Note: Because a shortage of affordable housing is an issue in the large, populous cities of Texas, some of the recommendations below should apply only to cities with a population that exceeds a certain threshold (perhaps 400,000 residents). Property taxes and the fixed fees for title insurance, on the other hand, are statewide problems and accordingly the measures that address them should be applied statewide.

Reform the Property Tax Appraisal System

The Legislature enacted key property tax reforms in the 86th, 87th, and 88th legislative sessions. But property tax rates in Texas are still high relative to the rest of the country. According to Bankrate (citing data from ATTOM), in 2023, Texas had an effective property tax rate of 1.2 percent, the 12th highest rate in the country.[90] On the positive side, this is a marked improvement from 2018, when Texas ranked third or fourth highest.

To further limit property taxes, the Legislature should change certain elements of the property tax appraisal system. Many Texas taxpayers are familiar with property tax appraisal process, through which the applicable county appraisal district (CAD) determines the value of their property. The Legislature could improve this process in several respects.

Historically, the board of directors (BOD) of a CAD was appointed by the governing bodies of the local taxing units which fall within the CAD's boundaries. Greater accountability for appraisals could be achieved by having the elected heads of the taxing units within a

CAD serve as the BOD and directly approve appraisals. By making the already-elected taxing entity officials serve as the BOD, real and long overdue accountability and responsiveness would be injected into the administration of the property tax. Since these officials are already elected, voters would not have to educate themselves on another set of candidates but would benefit because the appraisal process would become a subject for debate during election campaigns, with the members of the CAD's BOD having to defend their records.

Policy Recommendation 10

Make the elected leaders of taxing units within a central appraisal district (CAD) serve on the five spots of the CAD's board of directors (BOD) that are currently reserved for their appointees.

Senate Bill 2 (88S2, Bettencourt) provided that, in counties with at least 75,000 people, voters elect three of the nine members of the BOD. The tax collector-assessor serves as an ex-officio member, and the remaining five members are appointed by the taxing units in the CAD. The Legislature could build upon this excellent reform by having the heads of taxing units serve on the BOD, rather than their appointees.

Policy Recommendation 11

Extend the 10 percent cap on year-over-year growth in homestead appraisals to all real estate in Texas

Section 23.23 of the Tax Code provides that homesteads cannot be appraised for an amount that exceeds 110 percent of the previous year's appraisal, although this cap does not apply to improvements to the property made in the last year. But this cap (the "10 percent appraisal cap") does not apply to second homes or to rental properties. Extending the 10 percent appraisal cap to all properties in the state would protect owners of rental properties, many of whom are "mom and pop" investors, from crushing year-over-year property tax increases. In turn, landlords as a whole should pass on at least a portion of those savings to renters, assuming a competitive market. The Legislature should pursue this idea, although a constitutional amendment would be required.

Senate Bill 2 (88S2, Bettencourt) provided some much-needed relief to owners of non-homestead properties by creating a 20 percent appraisal cap for such properties, although this provision will expire at the end of 2026 unless it is extended.

Title Insurance

The pricing of Texas title insurance under current law is anti-competitive and adds unnecessary costs to the purchase of a property. While title insurance itself unquestionably offers significant value, the manner in which the state regulates the price of it ensures that the price exceeds that which would exist in an unregulated market. Reforming title insurance will not solve the problem of unaffordable housing in Texas, but it can contribute to that end.

Title insurance protects homeowners and lenders against the loss of their interests in a property as a result of defects in title to the property. Although title insurance is not required in Texas, lenders as a matter of course require title insurance to be purchased on the property to protect the lender's interest.[91] This title insurance for the benefit of the lender is sometimes referred to as a loan policy. In addition, the homeowner can purchase an owner's policy, which protects him or her from problems arising from defects in the title to the property.[92] In Texas, it is customary for the seller to pay for the owner's policy, and for the buyer to pay for the loan policy, although this custom can be altered through negotiations between the buyer and seller.[93]

The price of title insurance in Texas is tied to the value of the policy purchased, which in turn is generally tied to the purchase price. For any given policy value in Texas, the price is fixed by state law; these "promulgated" rates for title insurance are an outlier compared to other states. According to a 2019 survey by the National Association of Insurance Commissioners, only Florida and New Mexico set their rates in similar ways.[94] In Texas, for policies ranging between $100,001 and $1 million, the premium is calculated according to the following formula:[95]

*[(policy value – $100,000) * 0.00527] + 832*

Thus, for example, a $350,000 policy would cost $2,149.50. Again, there is no variability in this fee: all title insurance companies must charge according to the formulas in law, no more and no less.[5] Title insurance is not a recurring cost, although a purchase of title insurance will effectively be required when the property is sold. Additionally, a new loan policy is likely to be required when a homeowner refinances.

Some discounted rates apply in certain circumstances. For example, the cost of title insurance is discounted if the relevant loan is refinanced within eight years of the loan date; the discount is 50 percent if the refinancing is within four years of the loan date and 25 percent if the loan is five to eight years from the loan date. After eight years, no discount for title insurance in the case of refinancing is available.[96] In addition, if a loan policy and owner's policy are purchased at the same time, the cost of the loan policy is only $100.[97]

Texas government fixing the price of a service provided by the private sector is a rarity. The principle behind the free market is that businesses compete with each other on the basis of price, quality, and other factors in an attempt to attract consumers. Businesses that provide good value and consumers as a whole are the beneficiaries of a well-functioning market system. When companies do not compete on the basis of pricing, it is possible that consumers will be charged more for the relevant good or service than they would be in a market system.[6]

There is indeed considerable evidence that consumers are being overcharged for title insurance in Texas. A 2016 study by the University of Texas at Austin LBJ School of Public Affairs[98] found that, when taking into account the discount for a loan policy and an owner's policy that are purchased simultaneously, the extra costs due to promulgation are $1,079.20. (If only a loan policy is purchased, the extra costs rise to $1,633.) That $1,079.20 represents a surcharge that Texans must pay for title insurance compared to states with non-promulgated prices.[7] A different 2017 study found that Texas had the fifth-highest title insurance costs in the country.[99]

Compared to other types of insurance companies, title insurance companies pay out little in the way of claims. A 2023 TDI report estimated that loss ratios[8] over the preceding 10, 15, and 20 years (up until 2021 each) were 1.9 percent, 2.3 percent, and 2.5 percent, respectively.[100] A 1 percent catastrophe provision is included for rare events that can produce unusually large aggregate losses, which do not occur with consistency, and, according to TDI, "is difficult to find ... in title insurance."[101]

TDI also reported that "the expense ratio has declined from a high of 94% in 2008 to its lowest point since 1998, of 66% in 2021. The loss and loss adjustment expense (LAE) ratio was consistently low, while profit reached its highest point since 1998, of 33% in 2021."[102]

By comparison, in 2021 the loss ratio for Texas homeowners insurance was 104 percent. That year, however, had unusually high claims; the 10-year average loss ratio for the state's homeowners insurance industry through 2022 was 65.1 percent.[103]

TDI has pointed out that much of the cost of title insurance is attributable to research expenditures rather than the paying of claims.[104] In a Milliman, Inc. 2024 analysis of claims and claims-related losses in the land title insurance industry, commissioned by the American Land Title Insurance, the authors explained that

most of the title professional's efforts are focused on reducing or eliminating the likelihood of claims during the initial underwriting process rather than on loss adjustment after a claim is filed. ... This work is called "Curative" work or "Loss Elimination". The significant work expended in these curative efforts results in most of the title insurance premium being spent on

[5] Consumers may choose to pay additional fees to supplement their basic title insurance policies.

[6] Obviously, fixed pricing does not offer the potential of consumers benefitting from below-market prices, because companies would have no incentive to offer the good or service.

[7] It is true that some home purchases are made in cash, rendering a loan policy unnecessary and thus arguably making the figure of $1,079.20 an overestimate. On the other hand, the figure of $1,079.20 excludes commercial properties, which tend to be more valuable than residential properties and accordingly have higher title insurance costs.

[8] A loss ratio is the value of the expected loss and the expenses associated with settling those claims, divided by premium revenue.

underwriting expense (including curative) and a smaller portion being spent on claims. ... As a percentage of the premiums collected during the ten-year period of 2013-2022, title insurers spent 95% on average for expenses related to loss elimination and other operating costs. Due to the curative efforts of the Industry, claims costs average over 4% of the collected premium during that time period.[105]

It is also true that title insurance in Texas may cover some services that policies in some other states do not, [106] thereby making an "apples to apples" comparison difficult. On that point, however, it is worth noting that the 2016 study from the LBJ School of Public Affairs found that title insurance was still more expensive in Texas even when comparing it only to other states whose title insurance fee provided comprehensive services.[107]

While controlling for every variable in a comparison between state title insurance fees is difficult, it is important to focus on a fundamental question: why does the state of Texas fix the price of insurance, in contrast to thousands of other goods and services which are subject to market forces? Phrased differently, why is a title insurance company in Texas prohibited by law from competing with other companies by lowering its prices, thereby enabling consumers to shop for the best price?

Defenses of the current title insurance industry in Texas are unpersuasive. In a statement on its website,[108] the Texas Land Title Association features some words that its then-president made in 2016.[109] Those claims are listed below, with a response to each claim.

First, "Over the past two decades, Texas title insurance rates have decreased by approximately 15 percent, while the costs of other similar goods and services have increased. A $150,000 title policy on a home today costs $1,152, while in 1991 the same policy cost $1,347."

Assuming this claim is true, it still does not justify the current pricing structure of title insurance in Texas. The fact that a service was even more expensive years ago does not mean it is not overpriced today.

Second, "Simplistic comparisons to insurance premiums in other states (like those cited by the Texas Association of Business and Texas Public Policy Foundation) don't show the full picture. In many states, while insurance premium rates may appear lower, other costs such as attorney's fees, abstract fees and higher closing fees drive the cost up, resulting in higher total costs. Having a known, consistent premium rate, as we do in Texas, takes the guesswork out of this part of the real estate transaction."

The response to this claim is that many consumers would gladly accept some fluctuation in the price of title insurance if, on average, it was significantly cheaper. After all, consumers accept some degree of price fluctuation in almost every market where companies compete on price. If the cost for a home inspection fee were fixed by the state at $5,000, that would remove any uncertainty consumers have about what a home inspection would cost, but it would be a very anti-consumer measure, because most home inspections can be obtained at a much lower price.

Third, "Because title claims are much lower in Texas, Texas consumers have the peace of mind knowing they are at much lower risk of someone challenging their right to own and enjoy their home or property. During the first three quarters of 2015, Texas ranked first in the nation in the amount of premiums written, yet ranked 8th in the nation in lowest claims. This can be compared to California, which is second in the nation in premiums but ranks 41st in lowest claims, and Nevada, which ranks 40th in lowest claims."

The above data does not prove or even necessarily support the claim that Texas' price-fixing of title insurance reduces claims (presumably by the extra costs enabling more thorough work by insurance companies when researching titles). The data is not comprehensive, listing only a few states and covering only a nine-month period. Furthermore, there are numerous variables across states that could influence the number of claims filed, such as their relative population density, the degree of commercialization, and the type of properties insured. Even assuming that fixing title insurance rates reduced the number of claims, the magnitude of the reduction would need to be known; it is quite possible that many consumers would find the (alleged) reduction in risk is not worth the tradeoff of the higher cost of insurance. To use the analogy of a home inspection again, the state could mandate that all house inspections must cost $5,000. This inflated fee would permit a home inspector to make extraordinarily thorough inspections of homes,

which might result in detecting more flaws in the homes. But that does not mean consumers would welcome fixed inspection fees of $5,000.

Fourth, "Texas has always put a priority on protecting individual property rights. The Texas title insurance system is part of that important public policy framework. Texans can count on knowing they have access to high quality title insurance services from local companies in their communities all across the state. Most importantly, this is a system that has worked well and served Texan's well for the better part of a century."

Charging people excessive prices for a good or service while eliminating the ability of prospective competitors to offer lower prices is not consistent with respect for property rights. The fixed-price title insurance system in Texas has worked well for title insurance companies, at the expense of Texas consumers. In 2024, there were roughly 330,000 houses sold in Texas.[110] If one assumes, conservatively, that the buyer and seller in the average transaction collectively overpaid by an average of $1,000, the title insurance industry extracted rents of $330 million from consumers in one year alone.[9] As the authors of the 2016 LBJ School of Public Affairs bluntly state:

Our analysis indicates that the promulgation of rates [i.e., fixing prices by law] in Texas is a strong determinant that explains the state's higher title-related charges. By requiring the promulgation of title rates, Texas transfers wealth from property owners directly to title agents and title underwriters, with no additional value to the property owners. The system functions as a 'reverse Robin Hood transfer.' It is unclear why the Texas Legislature requires the Texas Department of Insurance (TDI) to set rates for title policies when it allows competition in all other lines of insurance. The promulgation of title rates provides no known benefits to Texas property owners; it is just an additional cost for title insurance in Texas reflecting the absence of price competition that makes it more expensive and difficult for Texans to purchase land or properties. While it benefits the title insurance industry, there is no benefit to consumers who fare much better in nearly every other state.[111]

Policy Recommendation 12

Eliminate the Fixed Pricing of Title Insurance

Texas should eliminate the fixed pricing of title insurance in Texas and allow the market to work in the same way it does for life, auto, and other types of insurance.

Policy Recommendation 13

Extend the Time Frame in Which Title Insurance Is Discounted When It Is Purchased in Connection with a Refinancing

If fixed pricing cannot be abolished, extend the time frame in which title insurance is discounted when it is purchased in connection with a refinancing; a discount of 50 percent should apply to such title insurance policies if the owner of the property refinances within 30 years of the loan date and obtains title insurance from the original title company again. Of course, this would apply only if there were no intervening owner of the property between the loan date and date the property is refinanced. As current law recognizes, a discount in the case of a refinancing is appropriate because most of the property's title history has already been examined. A 30-year time frame would match the term of most mortgage loans in this country.

Allow Homeowners to Exercise Their Property Rights

Many homeowners at some point consider the construction of a secondary dwelling on their property. The National Association of Home Builders defines an accessory dwelling unit (ADU) as "a second, smaller dwelling on the same site and often attached to a primary single-family house. Each ADU is a self-contained living unit that typically have their own kitchen, bedroom(s), and bathroom space. Examples include an above-garage apartment, a backyard cottage,

[9] Again, while some home purchases are all cash transactions and thereby render a loan policy superfluous, the estimate of $330 million is very likely a gross underestimate of the rents extracted by the title insurance industry annually because it does not include sales of commercial properties.

and a basement apartment. They are also referred to as granny flats, in-law suites, or secondary dwelling units."[112]

ADUs have the potential to create a significant supply of new housing stock. However, many cities have ordinances which limit the ability of homeowners to construct (or if already constructed, to lease) ADUs.

For example, the city of Dallas imposes various requirements on properties with ADUs, such as the size of an ADU, which must have a minimum floor area of 200 square feet and a maximum floor area which is the greater of 700 square feet or 25 percent of the main structure; the maximum height of the structure containing the accessory dwelling unit cannot exceed the height of the main dwelling unit and cannot be more than one story; a minimum of one parking space is required, with a few exceptions.[113]

Policymakers around the country are recognizing the potential of ADUs to ease the housing crunch. In September 2022, Assembly Bill 2221 passed into law in California. Among other things, this bill narrows the ability of cities to impose height limitations on ADUs and requires cities to provide more detailed explanations for rejecting applications for ADUs.[114] In 2021, the Utah Legislature enacted House Bill 82,[115] which permitted "internal" ADUs in residential areas, subject to certain exceptions, and preempted any local law to the contrary. An internal ADU is one within the primary dwelling unit, such as a basement apartment. In November 2022, the San Antonio City Council liberalized the rules regarding ADUs, eliminating a requirement that ADUs have only one bedroom and allowing the construction of ADUs nearer to property boundaries.[116] In 2023, the city of Austin started reforming its zoning regulations in an attempt to make housing more affordable to middle-income Austinites. These reforms included allowing ADUs in more zones within the cities and tiny houses to be classified as ADUs.[117]

Of course, unrestricted use of ADUs would have the potential to dramatically alter the character of neighborhoods, but a balance should be struck, one that recognizes the general right of people to use their property as they see fit and allows homeowners to utilize ADUs without dramatically altering the appearance of a neighborhood.

Policy Recommendation 14

Legislature Should Preempt Local Law

The Texas Legislature should preempt local law and provide for the following:

- ADUs may be constructed at any time on any property where single-family housing is permitted: before, after, or concurrent with the construction of the primary dwelling.
- Density or growth limits do not apply to ADUs.
- ADUs may be used for rentals (although a minimum rental term could be required) or sold as a freestanding unit.
- ADUs and their associated primary dwellings are not contingent on owner-occupancy.
- Additional parking may not be required for an ADU, unless the ADU's construction removes, replaces, or occupies what was formerly space for parking.
- ADUs may have utilities that are either shared with, or separate from, the primary dwelling. On this point, the Mercatus Center notes that "Austin, Texas, requires a rental ADU to have its own water meter and often to upgrade the tap line—and the cost of that reportedly runs to $25,000 there."[118]
- A local government may not charge the owner of a single ADU an impact fee. Alternatively, a fee could be permitted, as long as it is capped at a reasonable amount.

Existing zoning regulations would still apply but could not discriminate against ADUs. For example, height limitations or setback requirements applicable to the primary dwelling unit would apply to ADUs as well. Deed restrictions or HOA rules prohibiting ADUs would remain in force.

Creating more ADUs will not solve the housing affordability problem on its own, but it can play a key role. In 2016, Los Angeles issued 80 permits for

ADUs. In the first 10 months of 2017, that number increased to 1,980.[119] That number can be expected to grow as people learn more about ADUs. Vancouver, British Columbia, a city where awareness of ADUs has long existed, has almost 30,000 ADUs.[120]

Senate Bill 673,[121] introduced in anticipation of the 89th regular legislative session, would preempt the regulation of accessory dwelling units, greatly improving current law.

Minimum Lot Size

Many cities across the country require property lots to be a minimum square footage. In 2023, according to the U.S. Census Bureau and HUD, the median lot size of a new single-family home completed was 8,877 square feet.[122]

The minimum lot size in Dallas ranges between 5,000 and 7,500 square feet.[123] In contrast, the figure in Houston is generally only 1,400 square feet.[124] Thus, 5,750 square feet of land in Houston can accommodate up to four houses, whereas the same area of land in Austin can accommodate only one.

In May 2024, the city of Austin, in an effort to address housing affordability, decreased the 80-year-old minimum lot size of 5,750 sq ft to 1,800 sq ft.[125] One of the hoped-for benefits is that homeowners with larger lot will divide their land to either build additional units or sell part of the land for construction.

The discrepancy between Houston (or recently Austin) and other cities suggests that homeowners in the latter may be paying for a larger lot size than they wish. It is possible that some people in that group, given the option, would have gladly purchased a house on a lot of (for instance) only 3,000 square feet. Not only would these people save money, but more land would be available for housing, leading to an increase in the supply of housing over time. At least two studies[126] have found what common sense would suggest: high minimum lot requirements drive up the cost of housing. Free market principles include a respect for property rights and the general freedom of parties to contract. Just as homeowners should be able to use their property to construct ADUs (subject to reasonable limitations), people should be able to purchase homes that have the characteristics they seek, provided real estate developers are willing to construct them. The case of Houston proves that there are many people in Texas who would happily purchase a lot that is much smaller than the minimum required size in many Texas cities.

Policy Recommendation 15

Preempt Local Law on Minimum Lot Size

The Legislature should preempt local law and provide for a minimum lot size of no more than 1,400 square feet. Once that is in place, the market can take its course, and people will not be forced to purchase houses on lots that are larger than what they seek. Given their smaller size, small lots perhaps (those smaller than 3,000 or 4,000 square feet) should also have less stringent setback and parking requirements than larger lots.

Introduced in anticipation of the 89th regular legislative session, House Bill 878[127] would prevent municipalities with a population of at least 85,000 and wholly or partly located in a county with a population of at least one million from requiring that a residential lot be larger than 2,500 square feet, wider than 16 feet, deeper than 30 feet, or if regulating the density of dwelling units on a residential lot, a ratio of dwelling units per acre that results in fewer than 31.1 units per acre. The bill would also preempt over requirements, including parking and open space regulations, as well as other required features.

Further, the bill would preempt minimum lot sizes in high density residential areas in certain counties, defined as unincorporated areas of a county that have more than two dwelling units per acre.

In addition, the bill would preempt the regulation of accessory dwelling units.

Finally, the bill would provide that,

if the attorney general determines that a political subdivision has violated this chapter, the political subdivision may not adopt an ad valorem tax rate that exceeds the political subdivision's no-new-revenue tax rate for the tax year that begins on or after the date of the determination.

party review of permit requests.[128] But the head of the Dallas Builders Association (DBA) estimated that the

delays by the city from March through November of 2020 resulted in a loss of between 587 and 849 homes, lessening the city's tax base by $264 million to $382 million.[129]

Similarly, the vice president of policy and government affairs for the Real Estate Council of Austin stated in 2020 that "Travis County has the reputation of having one of the most inefficient review processes in Texas." [130] The county acknowledged that it had difficulty keeping up with the flow of applications given its fixed staff, and that third party review should be considered to expedite applications. Notably, Tesla's negotiations with Travis County allowed the company to secure a third-party reviewer to oversee development.[131]

Policy Recommendation 16

Promote Greater Transparency of Development Fees

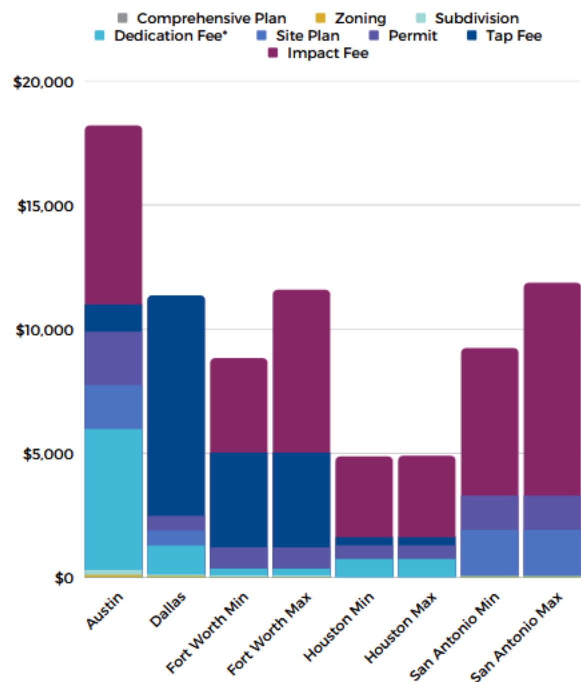
Although many Texans may not realize it, many fees are charged by municipalities during the housing development process. These include site plan application fees, parkland dedication fees, impact fees (these fees are for the construction of infrastructure that is required as a city grows, such as roadways), and building permit fees.[132]

There is, however, a pronounced lack of knowledge about these fees. Of course, that makes it hard for the public to demand, through their legislators, policies to promote transparency and reduce fees. As the Real Estate Research Center at Texas A&M University noted in a June 2022 study, "There is a remarkable lack of comprehensive information on local government's role in Texas' housing development process."[133]

According to a 2022 statement by the Home Builders Association of Greater Austin, "By far, the City of Austin has the highest per-unit development fees ($18,168 per unit) for suburban-style single-family housing developments among the five largest metro areas in Texas."[134]

Figure 5

Estimated Housing Development Fees per Unit in Top 5 Texas Metro Areas, 2022



Reproduced from "Central Texas Housing Development Fees Analysis", Home Builders Association of Greater Austin, p. 3.[135]

According to the analysis of the Home Builders Association of Greater Austin, the average total housing development fees charged per unit across those top 5 metro areas was $10,073. The per-unit development fees estimated for the city of Austin represented 3.4 percent of the 2021 median price for a single-family home in the city. Among the per-unit fees that Austin charged were a $7,200 impact fee, a $5,664 dedication fee for parkland development, and a $2,148 permit fee.

The Legislature can take three steps to address these fees.

First, just as state agencies undergo sunset review every 12 years to ensure they are fulfilling their missions and operating efficiently, local development codes should be scrutinized periodically by a municipality's governing body. All new housing regulations, and all regulations subject to sunset-style review, should carry a fiscal note, similar to those prepared by the Legislature Budget Board for state legislation. Each report should include input by private sector actors as well as an explanation of what has been done, and what could still be done, to lower housing costs.

To prevent a conflict of interest, the fiscal note should be prepared by an entity selected by the state, rather than by the local government. The note should reflect the costs of the regulation, how it affects properties of different sizes, its effect on the overall housing supply, and the extent to which it increases or decreases rent and/or mortgage payments.

Second, the Legislature should require a municipality to publish annually a link on its website that shows an itemized breakdown of all fees charged for common types of developments along with an explanation of the purpose of each fee. Additionally, the link should include the most recent sunset-style report, discussed above.

Third, the 89th Legislature should authorize a task force for the 89th Interim to examine how the state can best encourage local governments to reduce fees in the housing development process. A possible manner of doing so would be to direct grants from the Texas Department of Transportation and/or federal community development block grants to municipalities that show progress in reducing fees. The task force's composition could be modeled on that set forth in House Bill 2674 in Arizona, a 2022 bill that created a bipartisan committee with private sector members to study housing supply shortages in that state.[136]

Policy Recommendation 17

More Accountability in Housing Regulations

All new housing regulations should be accompanied by a fiscal note prepared by an independent party and with input from stakeholders, and all existing housing regulations should be subject to sunset-style review every 12 years.

Policy Recommendation 18

Transparency in Development Fees and Regulations

Municipalities should be required to list on their websites an itemized breakdown of all fees charged for common types of developments, an explanation of the purpose of each fee, and the most recent sunset-style report on housing regulations.

Policy Recommendation 19

Create an interim task force to study housing development fees

The Legislature should create an interim task force to study how best to encourage local governments to reduce or at least freeze government fees currently assessed during the housing development process, perhaps by preferentially allocating grants to local governments that demonstrate progress in this area.

Reform the Valid Petition Process

The valid petition process is a law that allows homeowners to contest and possibly overturn zoning changes made by their city council. Different forms of this process existed in at least 20 states as of 2022, including Texas.[137]

In Texas, 20 percent of owners within 200 feet of the land proposed for rezoning can petition their city council to stop the rezoning project. For the rezoning to go forward, the city council needs a three-fourths majority.[138]

While the intent behind the process is well-intentioned, giving a voice to property owners on how they want their neighborhood to evolve, it can effectively stop zoning changes desired by a majority of the constituents of the city proposing the rezoning. Senior Research Fellow and Director of the Urbanity project at the Mercatus Center Salim Furth explains that "this minority-triggered supermajority requirement is one of several features of the valid petition process which departs from the norms of representative government and is thus ripe for reform." [139] In his testimony to the Texas House Committee on Land & Resource Management, Furth told the story of how a single landowner blocked the rezoning of a commercial area in Plano in order to develop an assisted living retirement home, and despite five other landowners supporting the rezoning.[140]

Policy Recommendation 20

Reform the Valid Petition Process by Increasing the Percentage of Petitioners and Lowering the Majority Needed to Override a Valid Petition

The Texas Legislature should consider reforming the valid petition process by increasing the percentage of landowners necessary to 50 percent, similar to what HB 4637 (88R)[141] would have done. It should also look into reducing the three-fourth majority necessary from the governing body to override the petition to a simple majority as well. House Bill 1742 (89R, Hickland)[142] would enact both reforms. This bill would still allow landowners to protest land use reforms in their neighborhoods, but without turning representative government on its head.

Gambling, Gaming, and Fantasy Sports

Gambling Defined in State Law

Texas generally prohibits gambling. Article 3, Section 47 of the Texas Constitution requires the Legislature to prohibit "lotteries and gift enterprises." And Chapter 47 of the Penal Code governs "Gambling" with a general prohibition on betting, gambling, promoting gambling, operating a gambling place, and engaging in activities related to gambling.[143]

Chapter 47 of the Penal Code defines "gambling" as an offense in which a person:

> (1) makes a bet on the partial or final result of a game or contest or on the performance of a participant in a game or contest;
>
> (2) makes a bet on the result of any political nomination, appointment, or election or on the degree of success of any nominee, appointee, or candidate; or
>
> (3) plays and bets for money or other thing of value at any game played with cards, dice, balls, or any other gambling device.

A key element of gambling is the act of making a "bet," which the Code defines as "an agreement to win or lose something of value solely or partially by chance." However, the statute states that a bet does *not* include:

> (B) an offer of a prize, award, or compensation to the actual contestants in a bona fide contest for the determination of skill, speed, strength, or endurance or to the owners of animals, vehicles, watercraft, or aircraft entered in a contest;

When an illegal bet is placed, the law provides several defenses to prosecution. Under Section 47.02(b) it is a defense to prosecution for gambling if the following elements are met:

> (1) the actor engaged in gambling in a private place;
>
> (2) no person received any economic benefit other than personal winnings; and
>
> (3) except for the advantage of skill or luck, the risks of losing and the chances of winning were the same for all participants.

It is also a defense to prosecution if the actor believed the bet was permitted by law under statutes permitting bingo, raffles, the state lottery, or gambling under the Texas Racing Act, to name a few.[144]

Harm Associated with Gambling

Texas' prohibition on gambling exists with good reason. The negative effects of gambling are well-documented. The *Mayo Clinic* provides a succinct overview:

> Gambling can stimulate the brain's reward system much like drugs or alcohol can, leading to addiction. If you have a problem with compulsive gambling, you may continually chase bets that lead to losses, use up savings and create debt. You may hide your behavior and even turn to theft or fraud to support your addiction.
>
> Compulsive gambling is a serious condition that can destroy lives.

Indeed, research shows that "pathological gambling was associated with a fourfold increase in perpetrating severe physical dating violence and a 20-fold increase for severe physical marital violence."[145]

The state's prohibition on gambling is consistent with a traditional values approach to regulation that purports to prevent this type of harm.

Exceptions to Texas' Gambling Prohibition

Despite the purported illegality of gambling and constitutional and statutory prohibitions on gambling, Texas sanctions a variety of legal gambling operations.

Most notable among these operations is the state-run lottery, a quasi-monopoly granted to the government by the government. The *Lotto Texas* game is a strictly luck-based gambling game that pays out based on how many of six numbers a player can select between 1 and 54 that are pulled out of a random drawing. The overall odds of winning a small amount (e.g. $3 on a $1 bet) are roughly 1 in 71.[146] The odds of winning the *Lotto Texas* jackpot are roughly 1 in 25.8 million.[147] The odds of winning the jackpot in Texas' larger *Powerball* game are 1 in nearly 300 million.[148]

In addition to the state's lottery, Texas law allows gambling on horse and dog races through pari-mutuel wagering.[149] It authorizes gambling in the form of bingo games.[150] It also authorizes gambling in the form of raffles held by charitable organizations.[151] Texas law also makes specific allowance for professional sports teams to hold raffles in which the award to the raffle winner may be up to 50 percent of the proceeds of raffle tickets.[152] These raffles must be conducted by the team's charitable foundation.[153]

These legally operated gambling services are inconsistent with a state policy generally prohibiting gambling.

Texas Law on Gambling is Unclear with Respect to Fantasy Sports

Fantasy sports are ubiquitous, with the global fantasy market having an estimated value of $30.5 billion in 2023 and enjoying growth that puts it on a trajectory towards an estimated $114.7 billion in 2033.[154] In the United States, annual fantasy sports revenue is estimated in excess of $10 billion per year and more than 50 million people in the United States are playing fantasy sports.[155]

Fantasy sports games take many forms, each with their own unique traits, which makes providing blanket definition difficult, but the following definition captures it well:

> Fantasy sports leagues allow individuals to simulate being a sports team owner or manager. Generally, an individual assembles a team, or lineup, often under a salary limit or budget, comprising actual players from the various teams in the particular sports league, i.e., National Football League, National Basketball League, or National Hockey League. Points are garnered for the individual's "team" based on the actual game performance of the selected players, and scoring is based on the selected player's performance in the game where actual performance statistics or measures are converted into fantasy points. Each participant "owner" competes against other owners in the fantasy league. In a traditional fantasy sports league, play takes place over the course of an entire sports season, tracking the performance of selected players for the duration of the season. In contrast, in daily fantasy sports leagues, play tracks players' performances in single games on a weekly basis. With respect to both types of fantasy games, once a participant selects his or her players as the team or "lineup," they have no control over the players' performance in the actual game or the outcome of the actual game. The participant waits for the outcome, and his or her point levels are determined by the performance of the players on game day. Individuals pay a fee to participate in a league, which fees fund the pot of money used to pay out to the participants as their earned points direct. In play on the Internet sites for DraftKings and FanDuel, a portion (ranging from 6% to 14%) of the fees collected are not paid out to the participants but are retained by the gaming site. The "commissioner" running a traditional fantasy sports league may or

> may not retain a portion of participants' entry fees.[156]

The above definition of fantasy sports was written in an opinion by Texas Attorney General, Ken Paxton.[157] The opinion sought to answer two questions: (1) are daily fantasy leagues permissible under Texas law, and (2) is it legal to participate in fantasy sports leagues where the house does not take a "rake" and the participants wager only amongst themselves?[158] General Paxton found that fantasy sports and daily fantasy sports do fall within the state's definition of gambling. His determination fell largely on the definition of "bet" in Texas law, which means "an agreement to win or lose something of value solely or partially by chance."[159] This definition requires only that an *element* of chance be involved, which allows for a great deal of skill to be present with the act still falling within the definition of a bet for legal purposes.

A Game of Skill

The fantasy sports industry disagrees with the Attorney General. The *Fantasy Sports & Gaming Association* defines fantasy sports as follows:

> Fantasy sports leagues are games of skill. Managers must take into account a myriad of statistics, facts and game theory in order to be competitive. There are thousands of websites, magazines and other such publications that seek to synthesize the vast amounts of available fantasy sports information to keep their readers informed and competitive. A manager must know more than simple depth charts and statistics to win; they also must to take into account injuries, coaching styles, weather patterns, prospects, home and away statistics, and many other pieces of information in order to be a successful fantasy sports manager.
>
> The highest level competition of fantasy sports games (such as the National Fantasy Baseball Championship[160]) routinely sees top players win games more frequently than if the contests were random or highly based on chance. It's a pattern that has been repeated with many fantasy sports contests and competitions: the highly skilled fantasy player wins more frequently. A study from the Massachusetts Institute of Technology in 2018 found that based on the win/loss records of thousands of fantasy players over multiple seasons, that the game of fantasy football is inherently a contest that rewards skill.[161]

The result of this disagreement leaves fantasy sports games within a gray area of Texas law.

One place Texas could look to for guidance is federal law, which defines fantasy sports differently, and does so more in line with the view that fantasy sports is a game of skill, not luck. Indeed, 2006 federal legislation (The Unlawful Internet Gambling Enforcement Act) targeted "unlawful internet gambling," which it defined as follows:

> to place, receive, or otherwise knowingly transmit a bet or wager by any means which involves the use, at least in part, of the Internet where such bet or wager is unlawful under any applicable Federal or State law in the State or Tribal lands in which the bet or wager is initiated, received, or otherwise made.[162]

However, the federal law specifically exempted "participation in any fantasy or simulation sports game or educational game or contest in which no fantasy or simulation sports team is based on the current membership of an actual team that is a member of an amateur or professional sports organization[.]"The following conditions must also be met:

> (I) All prizes and awards offered to winning participants are established and made known to the participants in advance of the game or contest and their value is not determined by the number of participants or the amount of any fees paid by those participants.
>
> (II) All winning outcomes reflect the relative knowledge and skill of the

participants and are determined predominantly by accumulated statistical results of the performance of individuals (athletes in the case of sports events) in multiple real-world sporting or other events.

(III) No winning outcome is based—

(aa) on the score, point-spread, or any performance or performances of any single real-world team or any combination of such teams; or

(bb) solely on any single performance of an individual athlete in any single real-world sporting or other event.

The key language included is the passage requiring that all winning outcomes "reflect the relative knowledge and skill of the participants and are determined predominantly by accumulated statistical results of the performance of individuals in multiple real-world sporting or other events." Thus, federal law recognizes fantasy sports games, including daily games, as games of skill, not chance.

Policy Recommendations

Policy Recommendation 21

Clarify the Legality of Fantasy Sports

Legislators have attempted to clarify the legality of fantasy sports in Texas for several sessions. Two bills were filed on this point during the 88th Legislative Session. Both bills would have amended the statutory definition of "bet" by adding an exemption stating that the term does not include "an offer of a prize, award, or compensation to the participants in a fantasy or simulated game or contest." Where the bills differed, however, was in the definition they provided for "fantasy game or simulated contest." House Bill 904 (Moody) required that "participants assemble fictional sports teams composed of actual professional or amateur athletes that compete against the other assembled teams for a prize, award, or compensation[.]" In contrast, House Bill 2142 (Guillen) would have required that "participants assemble or manage fictional rosters composed of actual professional or amateur athletes to compete against other participants or to achieve a preestablished score or other numerical measure of actual performance to win a prize, award, or compensation[.]" Both of these bills resolved the issue of the legal gray area of fantasy sports in Texas, but HB 2142 is worded in a way that allows more competition through a greater variety of contests, which is something legislature should take into account when considering this issue in the 89th Legislative Session.

Policy Recommendation 22

Adopt Consistent Policy on Gambling in Texas

Gambling is a difficult policy topic. On the one hand, it falls squarely within a traditional values consideration, which supports the position of outright prohibition. On the other hand, the decision to place a bet is an issue of individual liberty and free enterprise. Furthermore, it is difficult to draw a principled line between permissible gambling and impermissible gambling either in the Texas Constitution or in statute. The state has expressly allowed gambling within games of *pure luck* (lottery, bingo, horse racing, raffles). There is, indeed, an inconsistency in Texas' treatment of gambling. It makes more sense to draw a clear line between gambling that involves pure chance (the lottery) versus games that involve mostly knowledge or skill (like bridge, or fantasy sports) with an element of chance, or to prohibit gambling altogether.

Earned Wage Access Services

Background

Earned wage access (EWA) services are somewhat similar to payday lending[163] but differ in some key respects. Most notably, earned wage access differs from payday lending in that the EWA relates to wages that have already been earned but have not yet been paid by the employer. A person who is paid on the 1st of the month, for example, may face an emergency on the 20th of the month and need money immediately. In such a case, the person may wish to access the wages he or she has earned that month, but which have not yet been paid to him or her. This is the role that EWA services fill. Earned wage access companies (EWACs) work directly with the consumer or through the consumer's employer to provide the employee with access to these earned wages, with the EWAC retaining a corresponding amount of the employee's next paycheck.

Employees can partner with EWACs to offer employees a "perk," even if the employer does not pay any fees to the EWA company. Companies that partner with EWACs to offer EWA services to employees include McDonald's, Uber, and Walmart.[164]

EWA companies often charge fees that are very modest compared to traditional payday loans- often just a few dollars per transaction. Some EWACs charge a small subscription fee in addition to small per-transaction fees, although people with access to EWA through their employers often are not required to pay any fee unless they opt for instant access to the relevant funds, as opposed to waiting a short period of time (e.g., one to three business days). In December 2022, a popular personal finance website provided a list of popular EWA companies and the fees they charge: that list can be viewed here.

The federal Consumer Protection Financial Bureau (CPFB) found that, based on 2021 and 2022 data, the average amount in an EWA transaction is $106.[165] However, because EWA services often allow employees to access their earned wages just a few days or weeks before the date on which they receive their paycheck, their implied annual percentage rates (APRs) can be quite high, reaching more than 100 percent.[166] It should be noted, however, that characterizing EWAs as loans or credit is debatable, especially given that the fees charged are usually flat fees rather than fees varying with the allegedly "borrowed" amount.

EWA services appear to compare very favorably with traditional payday loans, given that the latter— fairly or unfairly— have often been criticized for predatory practices and high fees. There is no evidence of widespread bad actors in this new industry. There are at least two dozen EWACs in the market,[167] more than enough to ensure healthy competition. An EWAC has every incentive to remain on good terms with the employers and/or consumers who are using its services.

The Federal Reserve Bank of Kanas City recently addressed EWA services. Its statement is worth quoting at length.

> A 2022 survey of 200 middle-market companies by Citizens Bank revealed that 71 percent already offer EWA services and another 24 percent expect to do so in the future. According to payroll provider ADP's 2022 survey of 600 employers (300 employers with 151–999 employees and 300 employers with 1,000 or more employees), 96 percent of employers that offer EWA believe it helps with recruitment. For example, as of April 2024, a job search on Indeed.com using EWA as a filter yielded nearly 20,000 results. The same ADP survey shows that 93 percent of employers also believe EWA services help improve employee retention, a belief supported by responses in another 2022 ADP survey of 1,000 employees. About three-quarters of employees surveyed said EWA was important for their employer to offer, with younger employees driving this result (82 percent of Gen Z and 91 percent of millennials stated EWA was important versus 57 percent of Gen X

and boomers). Based on Harris Poll data, U.S. workers age 18–44 expect to have access to EWA or flexible-pay services.[168]

The demand for EWA services is so strong that the industry almost doubled in size from 2021 to 2022.[169] Moreover, the CPFB has found that workers who make use of EWA services do so many times in a year, indicating high satisfaction with the arrangement.[170]

In short, EWA services appear to be a welcome, consumer-friendly innovation to the marketplace. There is no indication that employer and/or consumer reviews will be insufficient to police the market. Nevertheless, some parties, including the CPFB, have called for regulation of EWAs. These calls are puzzling; it is truly difficult to think of an industry that is less in need of regulation than the EWA industry. Despite any evidence of prominent bad actors in the field, any lingering concern about the credibility of EWACs could be addressed by an industry-led process that results in accreditation.

Past Attempted Legislation

House Bill 3827 (88R) would have implemented a regulatory framework for EWACs in Texas; it passed the House but did not proceed in the Senate. The bill would have provided the following:

- An EWAC must obtain a periodically renewable license. An unspecified application fee would apply, as well as a $200 investigation fee. The Office of the Consumer Credit Commissioner (OCCC) could require an applicant to file a surety bond of $10,000. An EWAC would have to file an annual report with the OCCC detailing information about its operations.

- Before entering into a contract with a consumer for EWA services, an EWAC would have to provide a disclosure to the customer that explains the consumer's rights, the fees under the contract, and information about the EWAC's surety bond. The customer would have to sign this disclosure form and the EWAC would have to keep records of it for at least two years.

- The contract between the EWAC and the consumer would have to list certain information in everyday language, including:

  - The EWAC is required to offer the consumer at least one reasonable option to obtain proceeds at no cost to the consumer and clearly explain how to elect that no-cost option. A consumer would be free to pay a donation or gratuity, but no fee, including a subscription fee, could be charged under this option;

  - The consumer's obligations are subject to the bill's significant limitations on compelling or attempting to compel repayment.

  - The consumer may cancel at any time his or her participation without incurring a cancellation fee;

  - The EWAC is required to develop and implement policies and procedures to respond to consumer complaints;

  - If the EWAC seeks repayment from a consumer, it must comply with applicable federal regulations; and

  - The EWAC must reimburse the consumer for any overdraft or non-sufficient funds fees imposed on the consumer by the consumer's financial institution if the EWAC attempts to seek any payment from the consumer on a date before, or in a different amount from, the date or amount disclosed to the consumer for that payment (unless the consumer had acted fraudulently).

An EWAC could not share fees with the consumer's employer; accept repayment from a consumer on a credit card; charge a late fee; report a delinquent consumer to a credit bureau or collections agency; use a third-party collector; require the consumer's credit report to determine eligibility for EWAC services; sell

the consumer's delinquent obligation to a third party; or file suit against the consumer.

Policy Recommendations

Policy Recommendation 23

Oppose any attempt to regulate EWACs as a money service business, as entities providing financing transactions or loans, or as credit access businesses.

While EWA services are not in need of regulation, a strong point in HB 3827 was exempting them from regulation as a "money service business" under Chapter 152 of the Finance Code (e.g., Western Union), or as financing transactions or loans under Title 4 of that code. Subjecting EWACs to these statutes would result in even greater regulation than that proposed by HB 3827. And there is undoubtedly a wish in some parts for such regulation. HB 3827 was actually opposed by some witnesses in committee hearings because it did not go far enough in its regulation of EWACs.

Property & Casualty Insurance

Property and casualty (P&C) insurance comprises the types of insurance that cover the insured against liability and their property. This includes, notably, homeowners', renters', and auto insurance. This insurance is often required (by mortgage lenders and landlords, respectively, for the first two) or by state law (for auto insurance), which means that when its cost skyrockets, consumers are faced with sudden increases in their expenses that they could not necessarily anticipate but that they still have to pay for.

P&C Insurance Rate Increases

Since 2021, consumers have experienced major increases in property & casualty insurance premiums Between 2022 and 2023, the cost of personal motor vehicle insurance increased by 18.9 percent, [171] according to the Congressional Research Service. In its *State of Auto Insurance in 2025*, ValuePenguin, a financial research and analysis subsidiary of LendingTree,[10] reported a 12-percent rate increase in 2023 and 16.5 percent in 2024.[172] According to the latest U.S. Bureau of Labor Statistics data, motor vehicle insurance increased by 11.3 percent year-over-year as of December 2024.[173]

Nationwide, home insurance has increased by nearly 40 percent cumulatively between 2019 and March 2024, according to LendingTree, and by 5.8 percent in 2024 as of May of last year.[174]

Texas was hit harder, with auto insurance increasing 23.8 percent in 2022—compared to just 2.9 percent in 2021—and 25.5 percent in 2023, according to the Texas Department of Insurance (TDI),[175] and 18.8 percent in 2024, according to ValuePenguin, with Texas auto insurance being 4 percent more expensive than the national average.[176] Rates vary by state, with Nevada and Florida having the highest rates—64 percent and 56 percent above the national average, respectively.[177]

Homeowners' insurance average rate in Texas increased by 10.8 percent in 2022, the highest since 2012, and almost double the rate increase for 2021. The rate increase in 2023 was more than twice as much as the previous year's change, at 21.1 percent.[178]

Commercial insurance premiums nationwide have also increased dramatically the past few years—as of the second quarter of 2024, commercial rates had increased for 27 consecutive quarters.[179] However, the conditions for this line of insurance appeared to be improving with a significant deceleration of the rate increase in the second quarter of 2024 compared to the first quarter—5.2 percent compared to 7.7 percent, or a 32 percent decrease.[180]

The rate increases appear to slow down in 2025 for other lines of insurance too. For auto insurance, the *State of Auto Insurance in 2025* predicts a 7.5 percent rate increase national average, and 2.3 percent in Texas.[181]

In a mid-2024 report, the National Association of Insurance Commissioners indicated that "Premium increases and lower claims costs helped the U.S. Property & Casualty (P&C) insurance industry recover from two years of underwriting losses."[182] According to the same report, the two years of low performance were primarily due to "above-average catastrophe losses, higher replacement costs, and inflationary pressures."[183]

Factors Impacting Rate Changes

Several factors have led to those increases, including many that also play a role in the housing affordability crisis, which is reviewed in its dedicated section.

[10] LendingTree is an online lending marketplace that connects borrowers with lenders.

Cost of Materials and Labor, and Supply-Chain Disruptions

The cost of construction, supply-chain disruptions, and an overall insufficient supply of housing all play a role in the increase of homeowners' insurance rates.

Similarly, chip shortages and other supply-chain disruptions that followed the COVID-19 pandemic have made cars more expensive, participating in the increase in insurance rates.

According to the Insurance Council of Texas, as reported by the *Dallas Morning News*, "in 2021, the cost of replacement parts rose 13% and rental car rates rose over 50%" while for housing, "the cost of construction materials rose 25%."[184] More expensive materials and parts result in more expensive houses and cars, making them more expensive to repair or replace.

Mercury Insurance also reported that the cost of construction labor had increased by 11.8 percent between 2020 and 2023.[185]

Years of Losses

The P&C insurance industry also faced several bad years that led to losses. In both 2022 and 2023, the industry saw underwriting losses in excess of $20 billion.[186] Texas was also struck by Winter Storm Uri in February 2021 and the resulting strain on the electric grid. The fallout from the storm cost Texas insurers $11.2 billion.[187]

Homeowners' insurance has been suffering from several years of losses. According to the Insurance Information Institute, homeowners' insurance has faced a net combined ratio above 100 (meaning, losses) since 2020, with the worst year so far being 2023—also the worst since 2011.[188]

The auto insurance industry also saw important losses due to the increase in volume and severity of claims. According to LexisNexis data, as reported by CNN Business, insurance companies faced losses on 27 percent of their collision claims in 2022 (i.e., suffered a total loss of the vehicle), three percentage points more than the previous year.[189]

Extreme Weather Events and Car Fatalities: Increased Number of Claims

The number of homeowners' and car insurance claims and their cost have been climbing with the number of extreme weather events, as well as road accidents and their severity.

Figure 6

Traffic Fatalities in the U.S. and Texas, 2021-2023

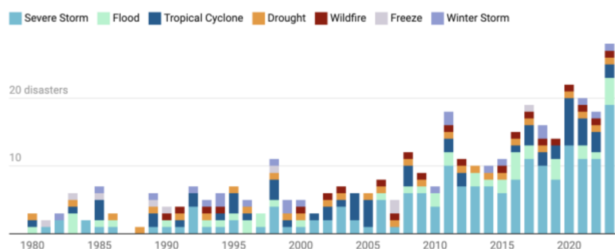
		2020	2021	2022	2023
U.S.	Total	39,007	43,230	42,514	40,990
	Per 100 million miles	1.34	1.38	1.33	1.26
	Per 100,000 people	11.77	13.02	12.76	12.23
	Per day	106	118	116	112
Texas	Total	3,898	4,456	4,407	4,283
	Per 100 million miles	1.50	1.56	1.52	1.45
	Per 100,000 people	15.1	15.1	14.7	14
	Per day	10	12	12	11

Source: National Highway Traffic Safety Administration and Texas Department of Transportation. [190]

Catastrophic losses have increased with the number of extreme weather events such as wildfires, hurricanes,

or floodings. This is compounded by the fact that more people are moving to areas more prone to these weather events, including Texas.[191] According to a report by Mercury Insurance, catastrophe losses increased by 212 percent between 2019 and 2022, from $50 billion to $165 billion. Linked to these events, the cost of temporary lodging has increased 25.8 percent between 2020 and 2023.[192]

Catastrophes inflicting more than $1 billion in damages (inflation-adjusted) have soared in recent years, as the chart below illustrates.



Source[193]

Unfortunately, Texas experiences a disproportionate amount of "heavy weather" events such as strong winds, hailstorms, and tornados. For example, the National Weather Service reports that, as of late May 2024, Texas led the nation in heavy weather events to that point in 2024 with 1,332 (Missouri was second with 871).[194] Although the public understandably focuses on highly visible disasters such as powerful hurricanes that make landfall, much smaller events in the aggregate can be more damaging, at least in some years. In August 2023, *The Wall Street Journal* reported that, according to the prominent reinsurance company Swiss Re, widespread thunderstorms (which often involve strong winds and hail) in the United States accounted for almost 70 percent of global insured natural catastrophe losses in the first half of 2023.[195]

Cost of Reinsurance

Insurance companies buy reinsurance to protect themselves against catastrophic losses. Reinsurers often operate globally and do not have the same geographically concentrated risks that "regular" insurers often have. To a considerable extent, the factors that are driving the rising costs of insurance are the same ones that are driving up reinsurance premiums; if insurers are suffering heavy losses, reinsurers need to price those heavier losses into the premiums they charge insurers.[196] After a difficult 2022, reinsurers at the start of 2023 reduced coverage and charged higher premiums to insurance companies, effectively shifting some risk back to them. That resulted in an outstanding 2023 for the reinsurance industry in terms of profitability.[197]

As mentioned above related to "regular" insurers, a return to profitability seems to be in sight, which should lead to lower rate increases. Of course, other factors are at play, such as the severity of weather events, that neither insurers nor the insured can fully control, but it is likely to temper the situation.

It should be emphasized that P&C insurance is a volatile industry. The Congressional Research Service has pointed out that:

> Cycles in insurance prices and availability are not uncommon, particularly for property and casualty insurance. Periods of high prices and reduced availability are termed hard markets, with soft markets referring to periods of relatively low prices and wider availability. Hard markets can occur when particularly unexpected events occur in claims payouts or in an insurer's asset/investment portfolio or when both sides of an insurer's balance sheet are affected.[198]

Increased Litigation

According to a S&P Global Market Intelligence research analyst, the increased severity of car accidents also mean that litigation is involved more, increasing costs further.[199] The Insurance Information Institute also points out[200] that home insurance claim litigation is increasingly chosen as the first rather than the last resort, leading to abuse of the legal system and higher costs. According to the institute's CEO,

> Another unfortunate factor proliferating the rising costs of insurance is legal system abuse, which basically entails billboard attorneys swaying Americans toward litigation as a first step, rather than one of last resort. This unfortunate

> phenomenon is a problem that needs more attention and fixing. For example, one element, which involves third parties funding litigation for profit has virtually zero transparency. Third-party litigation funding has become a multibillion-dollar global asset class of dark money, in which the likes of foreign governments can even invest and profit from the U.S. legal system.[201]

Third party litigation funding (TPLF) is relatively new in the U.S. It consists of a third-party funder agreeing to provide non-recourse funding to the plaintiff(s) in a lawsuit to which the funder is not a party. Such funding can be consumer or commercial funding—going to individuals or a business or law firm. The funder eventually gets a portion of any proceeds resulting from the litigation. Hence the funding can be considered by the funder as an investment. In addition, non-recourse funding does not require that the plaintiff(s) repay the funder if they lose the lawsuit.[202]

Such funding has pros and cons. Considering the cost of litigation, it can help a plaintiff who is in his right but who do not have the financial means to file suit, to pursue justice. But it can also lead to abuses of the justice system, encouraging bad faith lawsuits, some of which may be settled by the defendant to avoid the greater expenses of trial. Additionally, ethical issues can also arise;[203] for example, the funding party may be in a position to exert over influence over decisions that should be made by the plaintiff. An attorney's duty to his or her client, and even the attorney-client privilege, can be undermined when the attorney is reliant on a third party financer.

Some third-party litigation funders are foreign entities, raising the risk of foreign influence in the U.S. litigation system, as well as the U.S. economy.[204]

Disclosure of TPFL agreements is currently not required in litigation. Interestingly, a defendant's insurance coverage is generally subject to discovery by a plaintiff,[205] which allows the plaintiff and its counsel to better evaluate their legal strategy and settlement negotiations. The logic behind disclosure of the defendant's insurance coverage should apply with equal force to disclosure of the plaintiff's financing by a third party.

TPLF is a factor in what insurers sometimes term "social inflation"— the widespread increase in the size of liability claims independent of economic reasons such as inflation or material prices. Awards of more than $10 million or more by juries against insurers—so-called "nuclear verdicts"[206]—are a growing problem. According to the reinsurance giant Swiss Re, there were 27 cases awarding $100 million or more in the United States in 2023.[207] Such verdicts contribution to social inflation rising 57 percent in the United States in the decade ending with 2023.[208]

Storage Fees

Repair costs for vehicles have increased in recent years. Inflation for repair costs topped 10 percent in 2022, followed by another double-digit increase in 2023.[209] From 2013 to 2023, inflation in these repairs costs was almost 50 percent higher than inflation in the general economy.[210]

One cost encompassed within repair costs that is easy to overlook is storage fees. Auto insurance policies often include coverage for reasonable storage fees. Many body shops charge for each day an automobile is on the premises of the body shop, although exclusions may apply for days on which the body shop performs repairs on the vehicle.[211] During the pandemic and the associated supply chain shortages across the country, there were often long waits at repair facilities. This led to high storage fees, driving up premiums for consumers.[212]

Insurance companies may have a preferred network of body shops with which they have negotiated storage fees. The insured, however, generally has the right under Texas law to select the repair facility.[213]

Texas law caps the storage fees a "vehicle storage facility" (VSF) when the vehicle is stored without the consent of the owner (e.g., the individual's car was towed for illegal parking). A VSF is a garage, parking lot, or other facility that is used to store at least 10 vehicles a year, and is not owned by the government.[214] The cap is adjusted periodically, but currently is $22.85 per day for vehicles up to 25 feet long, and $39.99 a day for longer vehicles.[215] Due to the consent provision, body shops are not subject to these caps on storage fees.

Unfortunately, there are reports of some questionable practices by some body shops. Cases of "flipping" have been documented, in which a VSF convinces a consumer that their vehicle needs to be transferred to a body shop. If unsophisticated consumers agree to this, they expose themselves to thousands of dollars in inflated fees by the body shop. [216] The Texas Department of Licensing and Regulation (TDLR) has warned Texans of this danger on multiple occasions.[217] [218] The Texas Department of Insurance (TDI) has warned of a different scam in which a seemingly-friendly tow truck driver will suggest towing a vehicle to a certain repair shop. Again, if an unwary person agrees to this, their vehicle can be taken to a repair facility or body shop that charges thousands of dollars in storage fees and other fees.[219]

There have been news reports in the Austin area in the last several years indicating that some body shops intentionally delay repairs and charge for storage fees resulting from the delays.[220] [221]

While consumers consent to have their vehicles taken to body shops, there are aspects of their dealings with body shops that atypical relative to the typical voluntary transactions between consumers and businesses. First, there is often a third-party payor (i.e., the insurer). Second, unlike the costs incurred in most transactions, a consumer can end up being responsible for storage fees with no advance knowledge of the fee or consent to it, if the insurer declines to cover all or a portion of the alleged storage fee. Third, if the consumer and/or insurer disputes the storage fee, the body shop has tremendous leverage, because it has possession of the vehicle. Fourth, and perhaps most importantly, a body shop is in a position where it can effectively increase storage fees by intentionally working at a slow pace on the vehicle.

Given the foregoing, the Legislature may wish to consider extending the cap on daily storage fees applicable to VSFs to encompass body shops as well.

What Can Texans Do?

There is no "magic bullet" that will bring P&C insurance rates back down to pre-pandemic levels. But there are some steps that policymakers and consumers can take to make insurance more affordable.

Consumers can control some factors that affect their insurance rate. For example, a person's credit score can affect his or her insurance rates. Consumers can have a degree of control with auto insurance, which can be affected by factors such as their automobile's model and year of production.[222]

Consumers should also shop around for the best rates, which encourages insurance companies to be as competitive as they can be— a superior approach to government capping insurers' rates or imposing mandates on them.

A 2020 Deloitte survey found that consumers rarely change insurance companies: "Only 36% had changed auto insurers in the prior three years ... while 20% had not switched in over 10 years and 19% had never changed carriers. Among homeowners, only 30% of US respondents had switched in the prior three years ... while 29% in the United States had never changed insurers."[223] The Deloitte study further explained that one reason for staying with the same insurance company might be that 56 percent of American respondents bundled their auto and home insurance, "making it more challenging for carriers to compete for just one of the paired policies at renewal and discouraging customers from splitting their personal lines coverage."

Even more interesting is that the survey found that despite this apparent reluctance to change insurance company, American respondents were open to innovative, customized policies.

One positive sign is that Americans are starting to shop around to seek relief from high premiums. The LexisNexis Insurance Demand Meter analyzes shopping rates, shopping volumes, and new policy growth of U.S. auto insurance to inform insurance decision makers. Americans increased auto insurance shopping at a rate of 31.2 percent year-over-year in the third quarter of 2024, up from 16.1 percent growth in the second quarter.[224] The growth in volume of new auto policies also increased by 25.9 percent in the third quarter, versus 19.5 percent in the second.[225] And by the end of the third quarter, 45 percent of the policies in force were "shopped" at least once in the preceding 12 months. For both shopping and new policies, Florida and Texas led the way in activity by volume, at 38 percent and 33 percent, respectively.[226]

Figure 7

Monthly Year-Over-Year Change in Shopping and New Policies

Reproduced from "LexisNexis® U.S. Insurance Demand Meter Reaches 'Nuclear.'"[227]

The above graph indicates that American consumers are increasingly acting in a way that will force auto insurance companies to compete more fiercely for their business.

A second step Texans can take to limit their insurance cost concerns the homeowners' insurance context.

Texas Should Keep Its Light Regulatory Regime

A recent Texas Senate Business & Commerce Committee hearing [228] reviewed the problem of insurance rate increases and their effect on Texans. Legislators and witnesses respectively asked for and offered solutions to fix this problem that has become another burden for Texans.

Although it can be frustrating for consumers, and understandable that policymakers would want to help their constituents, more government intervention will likely only make things worse. Insurers must be able to price risk accurately. If they are prevented from doing so by regulation, they cannot attract the capital necessary to provide coverage. In turn, they are likely to either exit the relevant region, or alternatively, charge consumers in one region more to cross-subsidize consumers in a riskier region.

California has tightly regulated insurers for decades. Insurers must go through a cumbersome approval process before increasing their rates, and until very recently were limited in how they can use reinsurance rate and modeling to set rates. This regulatory approach has consequences. As an October 2024 story pointed out, seven of the state's 12 largest insurers had either paused or limited business in the state in the preceding three years. [229] Not coincidentally, the number of dwelling and commercial property policies under the state's insurer of last resort exploded, increasing by 225 percent from September 2022 to September 2024.[230] The solvency of this plan is now in serious doubt; if it fails, policyholders across the state will be on the hook.[231] This is the unfortunate but predictable result when government prohibits insurers from pricing risk accurately. The saying "there is no free lunch" is one that should be kept in mind in the contest of insurance regulation.

Policy Recommendations

Policy Recommendation 24

Keep File and Use and Form Freedom

In the early 2000s, Texas started implementing a file-and-use regulatory system and non-standard forms in order to increase insurance competition in the state, leading to more choices for consumers and, in turn, lower premiums.[232]

The "file and use" system allows insurance companies to start using a new rate as soon as it has been filed with TDI. But TDI subsequently reviews those filings and rate increases to notably ensure they are "not excessive."[233] According to a 2023 *Dallas Morning News* article,[234] TDI "said it reviewed 2,590 rate filings in 2022. Insurers withdrew 229 filings for various reasons and 108 were rejected for technicalities, such as filing under the wrong business line or not providing enough information" but "No filings were disapproved," according to TDI's website. Still according to the article, TDI stated that the agency had "saved consumers over $16 million because

companies withdrew some requests in response to regulators' questions."

Like any major change, for any company, that has been communicated to its customers and implemented, a rate change that needs to be rescinded is costly. Since TDI reviews rates, it is in insurance companies' interest to submit rates that are unlikely to be disapproved.

At the same time, market conditions change all the times, and for an insurance company—any company actually—to be able to react to changes in the market and implement a different rate as necessary and without waiting weeks for it to be approved, let them adapt more quickly and effectively, eventually benefiting both the company and its customers. Businesses are best placed to see evolutions in the market they operate in and to adjust to changing conditions to avoid losses, which would eventually lead to more expensive policies.

In addition, non-standard forms give flexibility to insurance companies to offer a variety of options. Although a lot of choices might seem overwhelming for consumers, it is to their benefit. Standard forms will force insurance to offer the same provisions to all customers. Such a one-size-fits-all might facilitate comparison, but it assumes that all consumers have the exact same needs. In the end, returning to a standard for will not help reduce rates, but it will leave consumers with fewer options to insurance themselves or their property.

It should be emphasized that Texas has a deep and competitive P&C insurance market. TDI reports that there were 79 companies [11] offering homeowners insurance in Texas in 2023.[235]

Policy Recommendation 25

Require Mandatory Disclosure of Third-Party Litigation Funding Agreements

There is an argument that TPFL can help plaintiffs for whom the cost of litigation would otherwise be out of reach. On the other hand, the Legislature should make sure that all parties to a lawsuit that is partially funded by a third party are protected from undue influence and frivolous claims.

In the 86th Legislature, two identical companion bills were filed—Senate Bill 1567 and House Bill 2096[236]—that would have required parties in a civil action to disclose third-party litigation financing agreements. HB 2096 was heard but left pending in the Texas House Judiciary & Civil Jurisprudence Committee.

The 89th Texas Legislature should consider legislation similar to HB 2096.

As mentioned above, the increase in the use of litigation in insurance claims contributes to rising insurance rates for consumers. The states of Indiana, Louisiana, Montana, Wisconsin, and West Virginia have enacted legislation addressing some of the issues existing with third party litigation funding, including transparency.[237] [238] Texas should follow suit.

Improving the Appraisal Process

Homeowners insurance policies frequently contain appraisal clauses. While appraisal is a contractual matter and thus can vary depending on what the parties agree to, appraisal clauses typically allow an insurer or an insured to request appraisal if the amount of the loss is in dispute. For example, if the insurer estimates hail damage to a building is $5,000, but the insured believes it is $25,000, either party can request appraisal. The process will consist of each side utilizing an experienced appraiser. If the two appraisers reach agreement, that settles the amount of the loss. If they cannot agree, they use an agreed-upon umpire; the amount of the loss is settled when two of the three agree upon the amount. The result of an appraisal is binding on the issue of the amount of loss, although litigation can take place on related issues, such as whether the loss is covered under the contract.

The insured and insurer typically pay for their own appraisers and split the cost of any umpire. An important point about appraisal is that it is (or should be) limited to a dispute over the amount of damages.

[11] The actual number of companies was 161, but many of the companies are affiliated with each other. The figure of 79 reflects the sum of companies without affiliates and affiliated groups.

In practice, however, it can be challenging to limit the appraisal to this topic, because other questions (e.g., cause of the loss) can seep into the inquiry.

In a well-functioning system, appraisal offers the parties a simple way to resolve disputes without the expense of litigation. As the Texas supreme court has stated, "Appraisals require no attorneys, no lawsuits, no pleadings, no subpoenas, and no hearings."[239]

Under the system as it works today, however, insureds may be encouraged by third parties (e.g., attorneys, public adjusters, or contractors) to allege inflated damages in the appraisal process. When this tactic is used on a large scale, it drives up insurers' costs and can lead to higher premiums for policyholders. Even if the insured is successful in the appraisal process, he or she may not be made whole once appraisal expenses and fees to third parties (attorneys charging contingency fees of 33 percent or more are common) are taken into account. Thus, both the insured and insurer could benefit from an appraisal process free of third parties. Insurance companies would see fewer inflated claims, and policyholders would keep more of any appraisal award.

The problem is that policyholders who believe they have been "lowballed" by an insurer might not be able to afford the expense of the appraisal process without an attorney or public claims adjuster working on a contingency basis. Steve Badger, a Dallas attorney who has testified before Texas legislative committees on insurance-related issues, has proposed an interesting compromise that the Legislature could explore: a statutory right of appraisal for claims under a certain amount.

Under the envisioned process, an insured would have the right to invoke the appraisal right at any time prior to filing a lawsuit, and an insurer would have the right to invoke it within a certain number of days if and after the insured files a lawsuit. If the insured invokes the statutory appraisal right and proceeds without an attorney or public adjuster, then the insurer would be responsible for paying the costs of both appraisers and the umpire, with the insurer's payment to the policyholder's appraiser being no greater than what the insurer pays its own appraiser (the insured would retain the right to select its appraiser). Otherwise, the insured would pay for its appraiser and its half of the umpire cost. Before an adjuster or attorney could retain a residential policyholder for a claim which is eligible for statutory appraisal, he or she would have to provide the prospective client with written notice (perhaps on a TDI-promulgated form) about the statutory appraisal process and how it allows the prospective client to avoid fees.

To deter bad faith claims by insureds, the appraisal panel (i.e., at least two out of the two appraisers and umpire) could find where applicable that the insured's appraisal request was lacking merit and in bad faith, in which case the insurance company could recover from the insured the costs of the appraisal process it paid on behalf of the insured. Once the appraisal panel issued a decision, it would be binding as to the amount of the loss, and the insurer would have no other liability with respect to issue of the amount of the loss.

The above process would be aimed at resolving typical disputes (e.g., hail damage to a roof) rather than claims of unusually large losses. Claims of losses up to a certain amount (perhaps $50,000) would be eligible for the statutory appraisal process.

Policy Recommendation 26

Create a statutory appraisal process designed to fairly settle disputes over routine storm-related damage to houses to limit the involvement of third parties and resulting higher expenses.

Some additional details would have to be addressed. For example, some attorneys and contractors would likely encourage homeowners to inflate claims to an amount such that the claim is not eligible for the statutory appraisal process, although this concern may be mitigated by the fact that a claim can realistically be inflated only so much before bad faith becomes apparent. More importantly, there might be a need for policyholders to pay a non-trivial amount of the costs of the appraisal process (although still well short of what they pay under the current appraisal process) to ensure that policyholders do not automatically invoke the statutory appraisal right on the assumption that they might gain but can never lose; bad faith can be hard to prove and appraisers may have a natural tendency to "split the baby." But the idea of a statutory appraisal process for relatively small claims is an

intriguing one that deserves legislative consideration. If enacted into law, it could greatly increase the chances of a quick, straightforward settlement of a dispute over the amount of the loss. As a result, inflated claims and expenses to third parties would be reduced, thereby slowing growth in premiums.

Improving Resiliency in Buildings

An obvious consideration in controlling growth in homeowners' insurance premiums is using more resilient materials in constructing homes— materials that are far more likely to withstand wind, storms, and hail.

Unlike many states, Texas has a decentralized building code that is essentially a recommended code. Chapter 214 of the Local Government Code sets forth municipal building codes for both residential and commercial properties; however, counties are not covered and cities can adopt amendments to add, remove, or modify the building code in state statute.[240] [12]

While Texas' decentralized system allows for building codes that are not the most robust, it is important for the public to understand that options are available to homeowners today that can better protect their homes. Using these options should lead to fewer deductibles being paid over time, and lower premiums if policyholders identify insurers that offer discounts when insured homes have been built or renovated to be more resilient. For example, metal roofs are available and are more resilient than asphalt shingles. Similarly, Class 4 shingles are more resistant to hail than Classes 1 through 3. The Class 4 designation signifies that a shingle can withstand a 2-inch steel ball being dropped from a height of 20 feet twice, mimicking the force of large hailstones.[241] [242] Some insurers offer discounted premiums for properties with Class 4 shingles.[243] Protection can be obtained to an even greater extent by making a roof (or an entire house [13]) FORTIFIED, an industry designation developed by the Insurance Institute for Business & Home Safety (IBHS).[244] Details of the outstanding protection afforded by the FORTIFIED certification can be viewed here.

The drawback to more resilient material, of course, is that the material is more expensive. Metal roofs can be twice (or even more) as expensive as asphalt roofs, assuming equal square footage.[245] A 2023 study in *Cityscape* (a publication of the Office of Policy Development and Research of the U.S. Department of Housing and Urban Development (HUD)) found that a FORTIFIED roof would cost slightly more than one percent of an Oklahoma home's sale price, ranging from $3,122 for an 1,806-square foot house to $4,144 for a 2,483-square foot house.[246] Obtaining a FORTIFED designation for an entire residence (not just the roof) could total 2.25 percent of the sale price, or even more for large houses.[247] Insurers, however, offer discounted premiums relating to FORTIFIED residences: between 3 and 42 percent, and typically in the 10 percent to 30 percent range.[248] [14] The study found that, at an assumed interest rate of 5 percent, a homeowner could "break even" on their FORTIFIED investment by Year 13 or 14.[249] However, this analysis assumed a $300 inspection fee of the FORTIFIED components every five years. Much more importantly, the study did not consider the potential savings from the insured not having to make deductible payments; these payments would be more likely if FORTIFIED materials were not used.

A striking finding of the study is that two-thirds of the 27 independent insurance agents interviewed were ignorant of the FORTIFIED program,[250] even though it has existed since 2010[251] and despite Oklahoma having the highest homeowners' insurance rates in the country.[252] This finding suggests that the vast majority of the public is unaware of the program as well.

A December 2024 article in *The Houston Chronicle* reported that FORTIFIED homes in Alabama and

[12] Buildings insured by the Texas Windstorm Association (TWIA) must comply with certain requirements. See Chapter 2210, Subchapter F, Insurance Code.

[13] There are 24 designations under the FORTIFIED program, each of which covers certain components of a residence. https://www.huduser.gov/portal/periodicals/cityscape/vol25num1/ch17.pdf (p. 304).

[14] State Farm, for example, reportedly offers a 24 percent discounts on FORTIFIED homes in Texas' coastal regions. See https://www.houstonchronicle.com/politics/texas/article/home-insurance-fortified-homes-19974218.php.

North Carolina showed a 20 percent reduction in losses relative to non-FORTIFIED homes.[253]

The question for policymakers is: what can be done to increase the use of resilient materials in housing?

One possible option is to make a rigorous building code applicable statewide. The key concern with this approach, however, is that it would exert upward pressure on housing prices. As discussed elsewhere in this Task Force Report, the state must be very conscious of any regulations increasing the cost of housing.

A second option is for the state to disburse grants to homeowners to make their roofs or houses FORTIFIED. Alabama and Louisiana, among others, have adopted this approach, disbursing grants of up to $10,000 per homeowner.[254] [255] The National Council of Insurance Legislators (NCOIL) has drafted a "Strengthen Homes Program Model Act," although it does not specify the amount of the grant.[256] The concern with this approach is the cost to the state; given the population in Texas' coastal areas alone, a significant cost to the state could be anticipated. Of course, a lottery-like system or a "first come, first served" rule could be applied to minimize the cost to the state, but that raises the question of how useful the policy is if it has relatively few beneficiaries.

Yet another option would be to require insurers to offer discounted premiums for houses with FORTIFIED roofs. Louisiana, among other states, has enacted such legislation;[257] the amount of the discount is not specified, but rather must be actuarially justified by the insurer during the rate approval process.[258] The perceived need driving legislation like Louisiana's is that insurers were not readily offering discounts to people who had made their homes resilient.

Interestingly, TWIA is authorized to offer policyholders credits against premiums if the applicable property exceeds building code requirements,[259] and in fact has offered these credits.[260]

But policymakers should be wary of mandating discounts, even if the discount amount is not specified. If consumers become more knowledgeable about options to make their homes more resilient, insurers will respond by offering the appropriate discounts. Moreover, as the HUD study regarding Oklahoma noted, IHBS states that many insurers already provide discounts for FORTIFIED homes. Given that, consumers must be educated so that they shop more wisely and encourage insurers to compete even more.

Given the finding discussed above that most insurance agents in Oklahoma— a disaster-prone state— are unaware of the FORTIFIED program, it is safe to assume that the vast majority of Texans are as well. Ideally, rather than intervening in the marketplace, the government should strive to ensure that Texans have access to the information they need to make well-informed decisions about making their homes more resilient.

Policy Recommendation 27

Develop a standard disclosure through which mortgage lenders can communicate with homebuyers about the importance of resiliency in housing materials and which provides examples of the savings resiliency can generate.

Homeowners' insurance is not required under Texas law, but most homeowners finance their purchase of their homes, and lenders require insurance to be in force. A possible way to better educate Texas consumers about the important potential savings attributable to more resilient homes and the tradeoffs that must be weighed in deciding on the resiliency of their homes is to require mortgage lenders to provide a TDI-promulgated form to homebuyers. This form could discuss the options available to make homes more resilient to hail and storms, provide estimates of resulting premium and deductible savings, and show the expected "break even" point on a resiliency investment based on several different assumptions.

Environmental, Social, & Governance

Overview

The acronym "ESG"- environmental, social, and governance- has become increasingly prevalent in the investing world in recent years. In general, ESG-focused funds deliberately refrain from making investments in certain companies whose policies or operations conflict with ESG goals, and/or make efforts to invest in companies whose policies and operations advance the relevant ESG goals. For example, an ESG investment fund might rule out making investments in any energy company that develops fossil fuels. In fact, traditional energy companies have been targeted by ESG activists, and the Texas has appropriately pushed back.

Although the term ESG is widely used, what principles and policies fall within its scope are not always clear. The term may be used by different people and organizations to mean different things. The table below provides a non-exclusive list of issues which can fall under the nebulous term "ESG."

Figure 8

Examples of ESG Issues

Environmental	*Social*	*Governance*
Climate change and carbon emissions	Gender and diversity policies	Board composition
Air and water pollution	Human rights	Executive compensation
Energy efficiency	Labor standards	Audit committee structure
Waste management	Employee engagement	Bribery and corruption policies
Water scarcity	Customer satisfaction	Lobbying activities
Biodiversity and deforestation	Community relations	Political contributions

Source[261]

While the term ESG is often used in a vague manner, a topic that unquestionably receives a great deal of attention in the ESG context is the first environmental factor listed in the table above: climate change/carbon emissions. The PRI (Principles for Responsible Investing), an international network of financial companies that seeks to promote ESG investing, states that "Climate change is the highest priority ESG issue facing investors."262 This mindset was evident in a 2020 letter to shareholders from BlackRock, the world's largest asset management company:

> A successful low-carbon transition will require a coordinated, international response from governments aligned with the goals of the Paris Agreement [a 2015 treaty regarding climate change], including the adoption of carbon pricing globally, which we continue to endorse. Companies and investors have a meaningful role to play in accelerating the low-carbon transition. BlackRock does not see itself as a passive observer in the low-carbon transition. We believe we have a significant responsibility – as a provider of index funds, as a fiduciary,

> and as a member of society – to play a constructive role in the transition.
>
> Where we have the greatest discretion – in portfolio construction, our active and alternatives platforms, and our approach to risk management – we will employ sustainability across our investment process.[263]

That letter went to on announce BlackRock's plan to exclude from its actively managed funds companies that generate more than 25 percent of their revenue from thermal coal production.[264]

Socially Responsible Investing (SRI) and Impact Investing (IR) became increasingly popular in the 1960s and 70s when religious organizations and their followers wanted to ensure their money was not being used to support what they viewed as objectionable industries such as firearms, tobacco, and gambling. Additionally, Americans and others around the world wanted to divest from the South African apartheid regime and any business involved therein.

Proponents of ESG will claim that their strategy and evaluation is nothing new and simply the newest iteration of SRI and IR. And it is true that, at first glance, ESG has the veneer of the free market at work. Some consumers, the argument goes, want to invest in companies that adhere to a set of socially left values just like many on the right would like to contribute and support companies that reflect their values. Seen in this light, combatting ESG can look like government interfering with people's right to advance their own values. How, then, can anti-ESG policies be justified?

The answer is that ESG poses two problems, each of which stems from how Americans' ownership in stock is typically structured today. The ownership is primarily indirect– owned through giant intermediaries such as Vanguard, Fidelity, and State Street, rather than individuals owning the shares in their own name. Moreover, individuals often indirectly purchase shares in a company through an index fund. An essential right when buying shares of a publicly traded company is the right to "vote your shares," whether that be electing members to the board of directors or making your views known to management on issues which may affect the value of your shares.[265] But with less direct ownership of stock by everyday Americans, more and more voting power is being transferred to a few giant companies. These companies have tremendous market clout due to the amount of assets they manage, and are in a prime position to exert influence over companies. This influence may take the form of advocating ESG policies, even though individual investors holding and purchasing stocks through these companies have not indicated any desire to advance such policies.

Second, ESG is problematic because in many cases it leads to financial companies that mange money for investors adopting policies that actually reduce investors' profits. This runs counter to an asset manager's fiduciary duty, which generally requires the manger to seek the highest risk-adjusted returns possible. The state has a serious stake in this issue, because it hires external managers to manage large portions of its public pension funds, which are listed below.

Texas's state pension systems are listed below. Unless otherwise noted in an endnote, the net assets of each fund below reflect data from the Comptroller's Public Pension Search Tool.[266] The values below are as of August 31, 2023 or December 31, 2023, as applicable:

- The Employees Retirement System of Texas (ERS[15]) ($34.0 billion as of August 31, 2023);
- The Teacher Retirement System of Texas ($187.2 billion as of August 31, 2023);
- The Texas Emergency Services Retirement ($127.4 million as of August 31, 2023);
- The Texas Municipal Retirement System ($39.3 billion as of December 31, 2023[267]);

[15] ERS also administers the Law Enforcement & Custodial Officer Supplemental Retirement Fund, which had just over $1 billion in assets as of August 31, 2023.

- The Texas County and District Retirement System ($46.2 billion, as of December 31, 2023[268]);
- The Judicial Retirement System of Texas Plan Two [16] ($585.6 million as of August 31, 2023[269]); and
- The Permanent School Fund ($52.3 billion as of August 31, 2023[270]), which technically is not a pension system, but rather an endowment.

The returns generated by these funds are used to pay pension benefits to millions of Texans- TRS alone serves 2 million people.[271] Any policy that detracts from the returns of these pension systems should be opposed. Obtaining the best possible return on the invested funds, consistent with proper risk management, is therefore critical. Given that the above funds total approximately $360 billion, the state has powerful leverage when dealing with investment firms.

What does a fiduciary Duty Entail?

A fiduciary duty can exist in many different contexts; to name just a few, partners to their partnerships; spouses to each other; attorneys to their clients; corporations' boards of directors to shareholders; and employees to their employers. The following bullet points list quotes from Texas courts that outline the basics of such a duty:

- "The term 'fiduciary' is derived from the civil law. It is impossible to give a definition of the term that is comprehensive enough to cover all cases. Generally speaking, it applies to any person who occupies a position of peculiar confidence towards another. It refers to integrity and fidelity. It contemplates fair dealing and good faith, rather than legal obligation, as the basis of the transaction. The term includes those informal relations which exist whenever one party trusts and relies upon another, as well as technical fiduciary relations."[272]
- "The agreement to act on behalf of the principal causes the agent to be a fiduciary, that is, a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking. Among the agent's fiduciary duties to the principal is the duty to account for profits arising out of the employment, the duty not to act as, or on account of, an adverse party without the principal's consent, the duty not to compete with the principal on his own account or for another in matters relating to the subject matter of the agency, and the duty to deal fairly with the principal in all transactions between them."[273]
- "The duty of loyalty is the hallmark of a fiduciary relationship. The trustee must at all times place the interests of the beneficiary above his own.[274]

An important aspect of a fiduciary is that he or she must exercise prudent judgement. Prudent judgement necessarily revolves around the reasonableness of the action in question.[275]

In the investment context, a fiduciary focuses on providing the best risk-adjusted returns. As one expert has stated, "Trust law, and ERISA [the federal Employment Retirement Income Security Act of 1974], requires the fiduciary to seek 'the highest return consistent with the preferred level of portfolio risk,' not necessarily the highest available return if the degree of risk is beyond what is acceptable."[276] That principle should apply with equal force to investments by fiduciaries in the non-ERISA context[17] as well.

Texas fights back against ESG

Some financial companies endorsing ESG goals have attempted to use their market clout to penalize entities that oppose those goals by refusing to allocate capital

[16] Administered by ERS.

[17] Retirement plans maintained by governmental entities are generally outside ERISA's scope.

(or limiting their allocation) to such entities, such as energy companies developing fossil fuels and firearms retailers and/or manufacturers. For example, Citigroup announced a "Commercial Firearms Policy" in 2018 under which it required new retail sector clients to adhere to certain policies, including refraining from selling firearms to people under the age of 21 or high-capacity magazines.[277]

Senate Bill 19

In response to ESG activism, the Legislature enacted Senate Bill 19 (87R; Schwertner, et al.) in 2021. That bill, codified in Chapter 2274 of the Government Code, generally prohibits the state or its political subdivisions from entering into a contract with a company for the purchase of goods or services unless the contract contains a written verification from the company that it does not have a policy that discriminates against the firearms industry and will not adopt one during the term of the contract. Under the authority of SB 19, the Attorney General has prohibited Citigroup from underwriting municipal bonds in Texas.[278]

Notably, a December 2022 study found that the state's political subdivisions issued $31.7 billion in municipal bonds from September 2021 through April 2022, and that as a result of the effects of SB 19 on the municipal bond underwriting market in Texas, will pay between $303 to $532 million in additional interest over the life of the bonds, depending on whether the bonds are retired early.[279] The exit of Citigroup and other banks from the municipal bond market in Texas resulted in less competition, which led to higher borrowing costs. Given the enormous sums borrowed through Texas' municipal bond market, even a small increase in the interest rates charged on the bond principal can result in large numbers.

But that does not mean SB 19 has failed in any way. First, banks like Citigroup that promote anti-Second Amendment policies suffer their own loss of revenue. That will cause financial institutions considering similar polices to weigh the risk of adopting them, likely deterring some of them. Second, even if the political subdivisions of the state incur higher underwriting fees, that can be money well spent if it protects constitutional rights.

Senate Bill 13

The Legislature enacted Senate Bill 2013 in 2021 as well (codified as Chapter 809 of the Government Code), a bill that is conceptually related to SB 13. That bill prohibits the state's public pension systems from investing funds with publicly traded financial companies (e.g., banks, investment firms) that "boycott" fossil fuel-based energy companies, or companies that transact with such energy companies. Crucially, the term "boycott" as used in the statute is far broader than its dictionary meaning. The bill targets any company that "without an ordinary business purpose, refus[es] to deal with, terminat[es] business activities with, or otherwise tak[es] any action that is intended to penalize, inflict economic harm on, or limit commercial relations" with a fossil fuel development company that does not commit to environmental standards beyond what the applicable law requires. Generally, state agencies and political subdivisions must include in their contracts for goods and services a provision that the contracting company will not boycott energy companies and will not do so during the term of the contract.

Thus, under the bill, it is possible for a financial company that scales back investments in traditional energy companies but still maintains considerable investment in them to be the subject of divestment by the state.[18] As the Comptroller states, "A financial company may have investments in the Texas oil and gas industry and still be 'boycotting' under the law."[280]

Any investment company engaged in such a boycott is included on a list of companies published by the Comptroller (referred to herein as "the Boycott List"), which state pension systems must consult. If corrective action by a listed company is not promptly taken, state pension systems generally must divest their assets from that company.

[18] In a 2022 letter to the Comptroller, BlackRock disputed the claim that it boycotts fossil fuels and claimed that it had $115 billion invested in Texas energy companies. See https://financialpost.com/pmn/business-pmn/blackrock-tells-texas-it-supports-investments-in-oil-and-gas.

Given the general language in the bill, the Comptroller has faced the challenge of exercising considerable judgement in compiling the Boycott List. A list of frequently asked questions on the Comptroller's site helps explain the analysis of how a company is placed on the list.[281]

The state has followed through on its commitment to protect fossil fuel development companies from ESG activism; as of August 2024, the Boycott List sets forth so-called "boycott energy companies."

AMP LIMITED
BLACKROCK, INC
BNP PARIBAS SA
CREDIT AGRICOLE SA
DANSKE BANK A/S
HSBC HOLDINGS PLC
IMPAX ASSET MANAGEMENT GROUP PLC
JUPITER FUND MANAGEMENT PLC
NATWEST GROUP PLC
NORDEA BANK ABP
RATHBONES GROUP PLC
SCHRODERS PLC
SOCIETE GENERALE SA
SVENSKA HANDELSBANKEN AB
SWEDBANK AB
UBS GROUP AG*
**Acquired Credit Suisse Group AG*

Source: Texas Comptroller[282]

Notably, these entities are all foreign companies, with the exception of BlackRock.[283] In March 2024, the Permanent School Fund withdrew $8.5 billion from BlackRock's management, citing the company's boycotting of energy companies.[284]

On August 29, 2024, the American Sustainable Business Council filed a lawsuit against the Comptroller in federal court, alleging that SB 13 infringes on companies' freedoms of speech and association.[285] That lawsuit has not yet been resolved.

How ESG Interacts with Fiduciary Duties

Do ESG Investments Overperform or Underperform?

The most obvious question to ask about the interplay between ESG and fiduciary duties is whether ESG investing as an empirical matter affects risk-adjusted investment returns, whether adversely or positively. If it has either of those effects, the fiduciary would at a minimum would have to be aware of ESG investing because of its relevance to delivering superior (or inferior) risk-adjusted returns.

The numerous studies that have examined the returns generated by ESG investing are, perhaps surprisingly, mixed. A February 2016 meeting of the TRS Board of Trustees included a presentation from Aon, a UK-based consultancy. That presentation cited multiple studies supporting each of the following claims: ESG leads to inferior risk-adjusted returns; ESG has no meaningful effect on returns; and ESG leads to superior risk-adjusted returns.[286]

More recent evidence is also mixed. A February 2023 analysis by Morningstar stated the following:

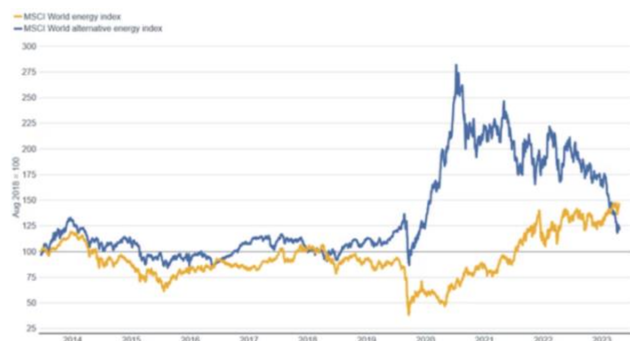
> Over the trailing three- or five-year period, an investor seeking long-term returns would have been better off in a sustainable fund than in one of its conventional peers. Of the 451 U.S. large-blend funds an investor could have chosen in January 2018, 169 survived and beat the Russell 1000 Index, while 282 either closed or underperformed. Nearly 60% of the sustainable options succeeded, while only 35% of their conventional peers did.[287]

It should be emphasized, however, that a 5-year period is a short period over which to evaluate a market sector or even a country's performance. To cite one of many examples, international stocks outperformed U.S.

stocks during the 2000-2007 period, but U.S. stocks have since exhibited vastly stronger performance.[288]

The chart below, from Charles Schwab, shows a narrower comparison: the performance of alternative energy stocks versus traditional energy stocks.

Figure 9 Comparison of Indices for Traditional Energy Stocks Versus Alternative Energy Stocks



Source[289]

As the graph illustrates, alternative energy stocks enjoyed a period of strong outperformance relative to their traditional counterparts for a brief period, especially in 2020, but have since fallen and surrendered all of the outperformance.

Again, results over a period of only several years have to be weighed with a critical eye. For example, alternative energy stocks could have benefitted from government subsides of alternative energy. On the other hand, alternative energy stocks could have felt the adverse effects of rising interest rates from 2022 onward more keenly than traditional companies; a larger portion of their anticipated profits are in the distant future, which means high interest rates, all else being equal, will affect them in a particularly negative way.[290]

A meta-analysis of over 1,000 studies from 2015 to 2020 concluded that over half showed a positive relationship between ESG and financial performance, with the rest being mixed, neutral, or negative.[291]

In contrast, a 2022 study in the *Review of Accounting Studies* found that, between 2010 and 2018 self-styled "ESG funds appear to underperform financially relative to other funds within the same asset manager and year, and to charge higher fees."[292] Interestingly, this study also found that ESG scores are correlated with the number of voluntary ESG-related disclosures, but not with companies' actual levels of carbon emissions.[293]

The varying conclusions of many studies on the performance of ESG investing is a puzzle. One possible explanation is that "ESG" is not only difficult to define, but it is also difficult to discern whether companies touting an ESG philosophy actually invest in strict accordance with ESG principles. A final paper, from February 2023, deserves special mention because its pro-ESG authors were frank in their assessment of the results of ESG-oriented investing when it is actually implemented:

> We find that the more likely a strategy is to deliver real-world change in carbon emissions in line with the 1.5°C goal [i.e., limiting global warming to this level], the more likely it is to give rise to fiduciary concerns [due to failure to maximize investment returns]. Although these fiduciary concerns are unlikely in most cases to give rise to enforceable legal liability, it is likely that many asset managers, when applying an expected standard of fiduciary duty, will conclude that such strategies are not consistent with that duty in the absence of an explicit authorizing mandate from clients.[294]

While the effects of ESG on investment returns is a matter of debate, there is more clarity on a related topic: the flow of investor money in and out of ESG funds. ESG funds enjoyed strong global inflows in 2021; $649 billion.[295] That plummeted to $157 billion in 2022,[296] and to an actual outflow of $13 billion in 2023.[297] Outflows continued in the first quarter of 2024; the trend of outflows may be attributable in part to increased political scrutiny of ESG.[298]

Many observers have noted that funds may style themselves as ESG to gain a competitive advantage in attracting investors' money. Morningstar has noted concerns about this "greenwashing" by ESG funds.[299] [300] Similarly, at least one study has found that

underperforming companies are more likely to invoke ESG as an excuse when explaining underperformance as measured by objective financial criteria.[301]

Considerations Weighing Against ESG

Intuitively, and all else being equal, one would expect that ESG lowers investment returns over a long period of time simply because it restricts the universe of attractive investments. It is axiomatic that global markets are competitive and efficient; thus, finding investment opportunities in any industry or sector that can generate market-beating returns is challenging. Refusing to consider investments that run counter to ESG criteria necessarily reduces the number of those opportunities. For example, a financial company might have the opportunity to invest in a company pursuing a potentially high-returning oil development project, but that opportunity might have to be disregarded if the company has an ESG policy in place.

In the case of Texas, there is another argument against ESG that carries great weight: the importance of the oil and gas industry to the state. In 2021, Texas accounted for 43 percent and 25 percent of the country's crude oil and natural gas production, respectively, and employed over 400,000 Texans.[302] The state's "Rainy Day Fund" is flush with cash; its balance is expected to reach $28.5 billion by the end of 2026-2027 biennium.[303] That expected future balance would be even greater if not for the fund hitting its constitutional limit in 2026, which will result in some money that would normally flow to the fund to stay in general revenue.[304] This savings account of the state, being funded with oil and gas severance taxes, is attributable to fossil fuel development. Given the crucial benefits the oil and gas industry provides to Texans, policymakers are rightfully defensive against attacks on it. When financial companies pursue ESG-focused policies that undermine the ability of critically important industries in Texas to obtain the capital they need to function, it is only rational for the state to re-consider its relationship with such companies.

Fiduciaries Weighing Factors that Touch on ESG

Of course, a company's fiduciary duties to its investors could require it to take into account some considerations that touch on ESG. The most obvious example would be property and casualty insurers weighing the risks and extent of climate change. The Congressional Research Service has noted that "The National Oceanic and Atmospheric Administration (NOAA) tracks 'weather and climate disasters' causing more than a billion dollars (inflation-adjusted) in overall damages/costs since 1980. Such events have increased in number from 33 in the 1980s to 131 in the 2010s and 84 in the 2020s so far."[305] There may be a number of reasons for this increase, but it is clear that large numbers of property and casualty insurance regulators believe that climate change will be highly relevant to the industry.[306] Financial companies investing in insurance companies will obviously take note of this.

A financial company would also have to consider the potential legal liability generated by fossil fuel development. It is not out of the question that traditional energy companies could face carbon or emissions-related lawsuits in the future in certain jurisdictions around the globe, perhaps even a wave of litigation similar to what tobacco companies have faced. This potential liability translates to an investment risk that a prudent fiduciary must weigh.

In the quest for the best risk-adjusted returns, a fiduciary must also weigh the concerns of poor publicity and negative public perception; the negative perception of a company can drive down its stock price. Numerous examples illustrate this principle; perhaps most notably, the iconic beer brand Bud Light recently suffered catastrophic results from an ill-advised marketing campaign.[307] Thus, if evidence emerges that there is growing public sentiment against certain goods or services, a fiduciary could reasonably weigh that in making investment decisions.

Government regulation is yet another consideration for a fiduciary. The attorneys general of 21 "red" states issued an open letter to asset managers on March 30, 2023, criticizing various aspects of the ESG movement.[308] At least 20 states have passed laws to combat ESG activism.[309] On the other end, Maine enacted a statute in 2021 that requires its public employees pension system to divest from fossil fuel investments by 2026.[310] California enacted a law in 2023 requiring large companies to disclose data on their greenhouse gas emissions.[311] The federal Securities and Exchange Commission (SEC) issued a final rule in March 2024 requiring publicly-traded companies to disclose extensive information in their

annual reports on what is termed "climate-related risk." [312] The topics addressed by the required disclosures can range from emissions data to losses incurred from severe weather events to how climate-related risks materially affect the company's business strategy or financial condition.

This wave of government regulation could pose a risk that a fiduciary must recognize- particularly one operating around the country or globally. As one prominent law firm said of the new SEC rule, it "will be costly to implement and will expose reporting companies to increased litigation risk." [313] Perhaps more importantly, the new federal rules and regulations in pro-ESG states may be setting the stage (whether intentionally or otherwise) for future legal assaults and restrictions on the fossil fuels industry.

In summary, it is clear that some ESG-motivated actions are not motivated by financial or risk considerations. For example, Citigroup was quite clear in its public communications that its refusal to take on new clients who sell firearms to people under the age of 21 stemmed from the belief that doing so would combat the social problem of gun violence.[314]

On the other hand, as discussed above, a fiduciary could reasonably weigh a number of risks in the ordinary course of business when determining how to allocate funds among various investment choices, some of which could touch on ESG concepts (e.g., litigation or risks relating to climate change).

Proxy Voting and Proxy Advisory Firms

Proxy voting is the practice of having a designated third party vote on behalf of a person (e.g., a shareholder) who owns an interest in a company; the term is most often used in the context of publicly traded corporations and their annual shareholder meetings. Various issues may be voted on in a shareholder meeting, such as executive compensation, shareholder proposals, election of directors to the corporation's board, and approval (or rejection) of proposed merger and acquisition activity. However, some of these votes are non-binding on the corporation's board of directors.[315]

Proxy voting provides great value by allowing shareholders who cannot attend shareholder meetings to exercise their right to vote and have a say in the corporation's affairs. It is difficult to overstate how much institutional investors rely on proxy voting, given that they may have hundreds of different holdings. The state's Permanent School Fund (PSF), for example, casts 40,000 to 50,000 proxy votes every year.[316] By the same token, in 2021, TRS voted on almost 65,000 ballot measures in 68 countries across the globe.[317] Given the impossibility of having PSF staff attend all shareholder meetings at which these votes are cast, the PSF (as well as the state's pension systems) sensibly make use of proxy voting.

But while proxy voting itself is a useful practice, a closely related practice- the use of proxy advisory firms (PAFs), raises some concerns. Because of the sheer volume of votes that institutional investors' assets give them the right to cast, they rely heavily on PAFs for research, analysis, and sometimes even recommendations on the topics being put to a shareholder vote. In the United States, the PAF market is dominated by two companies, Institutional Shareholder Services (ISS) and Glass Lewis (GL), who collectively control over 90 percent of the market.[318]

There is evidence that PAFs influence voting by institutional investors. For example, in 2016 two scholars showed that a negative recommendation from ISS led to a 25-point reduction in the percentage of voters approving of executive compensation.[319] More strikingly, a 2021 examination found that many institutional investors "robo-vote," a term used to describe voting in lockstep with a PAF's recommendations. This level of influence has led one commentator to label PAFs as akin to "quasi-regulators" of capital markets.[320]

PAFs' analysis of ESG issues can affect returns for shareholders. A 2024 paper provided an illustrative example: "in the 2021 proxy contest between ExxonMobil and [one of its shareholders] Engine No. 1, ISS backed three of the four directors put forward by Engine No. 1 because of their advocacy for ESG concepts, swinging the outcome of a closely run election just before a sharp upturn in traditional energy markets." [321] A 2023 editorial in *The Wall Street Journal* pointed out that ISS offers services to devise "ESG programs to align with company goals, reduce risk, and manage the needs of diverse stakeholders."[322] A PAF rating a company based on traits that the PAF offers consulting services to develop is a clear conflict of interest, a point which others have made before.[323]

Similarly, an investor that retains a PAF for proxy advisory services may submit shareholder proposals that the PAF itself will evaluate, a clear conflict of interest.[324]

Both ISS and GL supported a shareholder proposal from New York City's pension systems to audit Starbuck's labor practices, as well as "a resolution for an independent racial equity audit at McDonald's."[325] The above-mentioned editorial noted that these votes were close (passing with 52 percent and 55 percent, respectively); thus, it is quite possible the PAFs' support for these measures was decisive in them passing. A strong argument can be made that these last two examples were measures that actually financially harm corporations, rather than improving returns. It would be fair to ask whether a PAF is overstepping its proper role when supporting such measures. It is imperative for the institutional investors relying on PAFs to hold them accountable and challenge them when appropriate; the PAFs have no fiduciary duty, but institutional investors typically owe such a duty to their beneficiaries.

In 2022, ERS submitted proxy votes through which it voted in support of shareholder proposals at several large financial institutions which would have limited financing for new fossil fuel projects.[326] Those proposals, championed by climate activists, failed, but they shed light on a key problem, even if the votes by ERS were an inadvertent oversight. The spirit of SB 13 is to prevent the state from using investment firms that target the oil and gas industry. But nothing in SB 13 requires PAFs hired by the state's pension systems to abide by the spirit of that law.

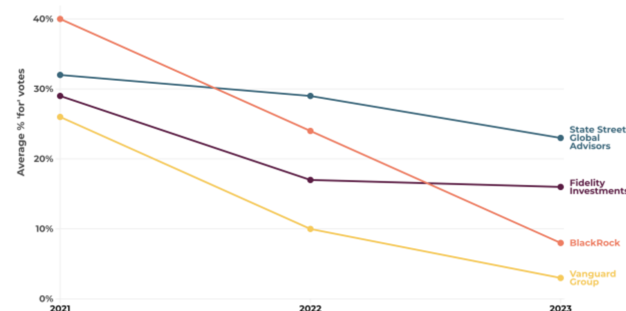
Fortunately, at least some of Texas' pension systems are taking steps to address the problem. In 2022, TRS made plans to modify its proxy voting policy to ensure that it is evaluating climate policies apart from ISS, the PAF it has retained.[327] TRS took some action in light of ISS adopting more stringent voting policies against directors who are resistant to climate disclosure and emission targets.[328] Similarly, the PSF (while not a true pension system) announced in August 2024 that it would adopt a new policy for proxy voting to push back against ESG prevalence.[329]

The principled stance of Texas and other "red" states in pushing back against ESG appears to have led to changes in the private sector as well. A 2024 article noted that Egan-Jones Proxy Services, the third-largest PAF in the country, now offers a proxy policy to investors pursuant to which it will vote against ESG measures like promotion of diversity, inclusion and equity policies and environmental protection.[330] That article also stated that BlackRock plans to add Egan-Jones as a third proxy advisor on its platform.

A report by ShareAction, a pro-ESG organization conducted an analysis of voting on 257 ESG shareholder proposals in 2023 and glumly noted that:

> The four largest asset managers in the world – BlackRock, Fidelity Investments, State Street Global Advisors, and Vanguard – have shown a significant and consistent fall in their support for shareholder resolutions seeking corporate improvements on important environmental and social issues. BlackRock, the largest asset manager in the world, only supported 8% of environmental and social shareholder resolutions in 2023, compared to 40% in 2021. Vanguard, the world's second largest asset manager, showed the weakest performance of the 'big four', supporting only 3% of resolutions in 2023.[331]

The graph below from ShareAction summaries the changing voting record of these four large asset managers:



Source[332]

This trend continued in 2024 to date, with Vanguard rejecting all 400 pro-ESG shareholder proposals (although it also opposed 40 anti-ESG proposals).[333] This trend is heartening, especially considering that the trend runs in the other direction in Europe;

ShareAction reports that, on average, European asset managers voted in favor of a remarkable 88 percent of shareholder proposals in 2023, although it acknowledges that this may be the result of increasing regulation in those countries.[334]

The trend goes well beyond corporate voting. In February 2024, State Street and JPMorgan Chase quit Climate Action 100+, a global coalition focused on climate change. Furthermore, BlackRock transferred its membership to BlackRock International, an international subsidiary,[335] stating that:

> BlackRock International will only conduct issuer engagements and cast proxy votes consistent with decarbonization investment objectives where clients have instructed us to do so. For those clients, Blackrock is creating a new stewardship option, which will be designed over the coming months. For the rest of our clients who have not made this investment choice, we will continue to undertake our responsibilities with a sole focus on advancing their economic interests. This includes continuing to engage with companies and encourage disclosure on how they manage climate risk, where material to their business model and ability to deliver durable long-term financial returns.[336]

Notably, BlackRock introduced "Voting Choice" in 2022, which allows institutional investors to vote their indirectly held shares in a pooled fund.[337] State Street and Vanguard subsequently began to offer this "pass through voting" service to an extent.[338] As one commentator explains, "if the index fund holds 10% of the shares of a portfolio company, and an institutional investor is a 20% participant in the index fund, it [the institutional investor] will be allowed to decide how to vote 2% of the shares of the portfolio company.[339] Vanguard, State Street, and BlackRock are also beginning to offer *individual* investors similar powers.[340] The ability of institutional investors to vote their proportionate interest in a pooled fund is an innovation that can only benefit Texas' pension systems.

The 89th Legislature could take up legislation modeled on Senate Bill 1446 (88R, Hughes), which passed the Senate but did not receive a vote on the House Floor. That bill would have required the governing body of a public retirement system (a "system") to act solely on the basis of financial factors and not use the system's assets to further any social, political, or ideological interests. The same standards would have to appear in contracts through which a proxy adviser or investment manager is hired by the system. This bill would give fund managers the discretion to consider factors which might fall under the vague term "ESG," but only if consideration of such factors were relevant to the risk and return of the investment (e.g., the investment carries a risk of generating legal liability for environmental damages). That approach is consistent with the fiduciary duty pension systems owe to their beneficiaries; the guiding principle in all investments is to maximize risk-adjusted returns for the beneficiaries.

Policy Recommendations

Policy Recommendation 28

Enact legislation modeled on SB 1446 that requires the state's pension systems and their external fund managers and proxy advisors to act solely on financial considerations when taking action with respect to the pension systems

The Comptroller is required under law to update the Boycott List at least annually, but not more than quarterly.[341] Updates may be based on publicly available information and/or information required from the companies on the list. The List was last updated in August 2024.

As noted above, the broad language of SB 13 left the Comptroller with the difficult task of determining what criteria should be weighed in deciding whether to add a company to the Boycott List. The Comptroller has issued "Frequently Asked Questions" concerning the Boycott List. His two-step methodology has been to first identify which companies meet "initial criteria," which is based on industry classification, Morgan Stanley Capital International (MSCI) ESG ratings, and

public pledges to Climate Action 100+ (discussed above) and at least one of the Net Zero Banking Alliance or the Net Zero Asset Managers Initiative;[342] these last two are coalitions of financial industries that aim to influence businesses to reduce greenhouse gases to a net of zero by 2050.[343]

This initial screening identifies companies which may be energy boycott companies The Comptroller then follows up with these companies with a "verification request." In examining companies' responses to these requests, the Comptroller asked questions such as whether the company failed to assert an ordinary business purpose for its policies towards traditional energy companies and whether its proxy voting history demonstrated antagonism towards the fossil fuel development industry.[344] An affirmative response to such questions qualifies the company for inclusion on the Boycott List.

As noted above, the first step in the Comptroller's analysis considers certain public pledges by financial companies regarding "net zero." A further consideration in the second step of the analysis is whether the company "commit[s] to an aggressive reduction in fossil fuel emissions with goals of aligning lending and investment portfolios with 'net zero' prior to 2050?" (emphasis added).[345] But the Comptroller also acknowledges that "A significant number of entities in the financial industry have made public pledges to achieve a net zero approach to carbon emissions by 2050." (emphasis added).[346] Interestingly, it appears that a pledge to comply by 2050 is not sufficient by itself for inclusion on the Boycott List.

Removal from the Boycott List does not hinge on a single factor; the Comptroller has emphasized the holistic review that is required: "Because no single factor caused a financial company to be listed, we cannot identify a specific factor that would need to change for a company to be added to, or removed from, the list."[347] That said, the Comptroller indicated that a financial company no longer being on the Climate Action 100+ and Net Zero Banking Alliance/Net Zero Asset Managers Initiative would no longer meet the initial criteria for the list.[348]

The Comptroller has emphasized that removal from the Boycott List must be the result of substantive action on the part of the relevant company that makes clear it is reversing its policies that target the fossil fuel development industry. As noted above, BlackRock withdrew from Climate Action 100+, but did so by transferring its membership to Blackrock International, a subsidiary. SB 13 made clear that a subsidiary in which a parent company has a majority stake is part of the parent company for purposes of the Boycott List.[349] In February 2024, the Comptroller acknowledged BlackRock's withdrawal from Climate Action 100+, but noted the "shell game" of transferring membership in the coalition to an affiliated entity.[350] As discussed below, Blackrock announced in January 2025 that it was withdrawing from the Net Zero Asset Managers initiative, making clear that Texas and like-minded states are successfully combatting ESG.

To improve the workings of the Boycott List, the Legislature could consider the following amendments to statute, or alternatively the Comptroller could consider updating his guidance on the Boycott List:

- SB 13 speaks of companies that take action against fossil fuel development companies "without an ordinary business purpose." It is clear that some ESG-motivated actions have no ordinary business purpose. For example, Citigroup was quite clear in its public communications that its refusal to take on new clients who sell firearms to people under the age of 21 stemmed from the belief that doing so would combat the social problem of gun violence.[351] On the other hand, as discussed above, a fiduciary could reasonably weigh a number of risks in the ordinary course of business when determining how to allocate funds among various investment choices, some of which could touch on ESG concepts (e.g., litigation or risks relating to climate change). How a financial company with a fiduciary duty to its investors should weigh such considerations could be clarified.

Policy Recommendation 29

Consider amending statute to provide the Comptroller with more detailed guidance on what constitutes the "ordinary course of business."

The Comptroller's guidance states that the answer to the following question is considered in determining inclusion on the Boycott List: "Does the company or its affiliates offer for sale to the public more than 10 U.S.-based funds (e.g., mutual funds, ETFs, other investment company or public security) that include a prohibition, limitation, restriction, or negative screen on oil and gas investments?"[352] The figure of 10 is somewhat arbitrary, although the Comptroller notes that the vast majority of companies examined did not meet that threshold. While taking action against companies that limit their investments in traditional energy companies for ideological reasons is clearly a policy Texas should pursue, a more difficult question is whether Texas should take action against companies that offer investment funds which cater to customers who choose not to invest in traditional energy companies for the *investors'* ideological reasons. Offering targeted investment funds to investors could be viewed as simply responding to consumer demand, provided the investment manager plays no role in steering investors to these particular funds and the decision is solely the investor's.

Policy Recommendation 30

Consider elimination of the "more than 10 funds" rule, if a financial company can show that it does not encourage investors to direct their money to such funds relative to other funds the company offers.

The strong stance taken by Texas and other red states against ESG appears to be having an effect. As the Comptroller aptly stated in a November 2023 release:

We are witnessing tremendous progress. Environmental, Social, and Governance (ESG) funds are experiencing huge outflows and closing faster than they are opening. We are getting real data showing the underperformance of investments that shun fossil fuels. Proxy votes by big fund managers in support of ESG initiatives have dropped precipitously. Even Standard & Poor's reversed course on highlighting its ESG ratings, yet more work is needed.[353]

The fact that BlackRock is the only domestic company on the Comptroller's Boycott List suggests that other financial companies have taken note to curtail their promotion of ESG policies. Notably, in its chairman's 2024 annual letter to investors, BlackRock even conceded that natural gas may have to play a significant role in addressing Texas' future energy needs.[354] The letter further noted that "BlackRock helped convene a summit of investors and policymakers in Houston to help find a solution" to those needs.[355]

Better still, Blackrock announced in January 2025 that it was withdrawing from the Net Zero Asset Managers initiative.[356] The full significance of this exit was apparent several days later, when the initiative announced that it was suspending its activities.[357] As things stand today, Texas policymakers can count their push back against ESG policies as one of their recent great successes.

Automobile Industry Regulations

The Occupations Code contains thousands of pages of regulations covering everything from "Healing Art Practitioners" to "Bingo" games. Quite often these regulations are anticompetitive and protectionist in nature. Take, for example, Section 2301.476, which prevents auto manufacturers from directly selling their products to consumers.[358]

The practical effect of 2301.476 is to set in law the means by which an automobile manufacturer must sell its automobiles in Texas.[359] That has been a successful model for a long time, but successful business models need to be protected in statute from new models that may challenge the status quo.

An Outdated Model

The old model was built around the internal combustion engine. Now, there is a competitor to that model in the form of electric cars that does not have the same needs in terms of engine service and upkeep. The old model does not translate directly to this newer technology. Manufacturers of this newer technology would like to operate under a different business model and there are multiple reasons why it makes sense for them to do so.[360]

Electric cars use a completely different kind of technology from the internal combustion engine, they are sold with a high level of customization, and the costs of maintenance on fully electric vehicles are quite low which is important because traditional dealerships earn most of their revenues through service, which would clearly not be the case for electric cars.[361] Moreover, selling through franchises and dealerships would increase their costs unnecessarily, making it more difficult for manufacturers to turn a profit and would undoubtedly increase the cost for the consumers. In short, the old business model codified in Section 2301.476 of the Occupations Code does not serve the needs of a changing marketplace.

The Ongoing Fight Over Automobile Sales

The fight over maintaining the current statutory dealership franchise model in Texas is well documented. During the 87th Legislative Session House Bill 4379 was introduced which would have provided an exception for electric car manufacturers—like Tesla—would have been carved out of 2301.473.[362] In the 83rd Legislative Session a similar bill was filed and despite neither piece of legislation having a direct impact on the current automobile dealer model, the dealer industry objected loudly. Indeed, of the parties testifying against HB 3351 in its 2013 Business and Industry Committee hearing, five of the six were automobile dealers, and all six had an interest in maintaining the status quo:[363]

- Texas Automobile Dealers Association
- Texas Recreational Vehicle Association
- Dallas Fort Worth New Car Dealers Association
- San Antonio Automobile Dealers Association
- Houston Automobile Dealers Association
- The New Car Dealers of West Texas

Automobile dealers cannot be faulted for protecting their own interests. However, the purpose of government is not to protect the "franchise system" from competition. Other industries across the board are permitted to experiment with different means of distribution. Apple, for instance, sells their products in most retail stores *and* directly through their own stores. It is difficult to imagine any legislator supporting a bill that would prevent Apple from selling iPhones in its own stores, but that is essentially how 2301.476 treats automobile manufacturers. The main difference is that somewhere along the way, automobile dealers' business model became codified in law in a way that protects them from such competition.

Since Texas law prohibits motor vehicle manufacturers from also owning dealerships, Tesla, and companies like it are excluded from the Texas Light-Duty Motor Vehicle Purchase or Lease

Program.[364] There is much debate to be had about whether or not the state should be funneling taxpayer money to subsidize expensive new electric vehicles but if the program is going to operate, it should not unfairly punish the most popular manufacturer of electric vehicles because they simply wish to do business differently.

It is unclear who—besides the automobile dealers—might object to lifting restrictions on direct automobile sales. What is clear, however, is that 2301.476 protects automobile dealerships from new business models. Leaving it in place is government endorsement of a one-size-fits-all distribution method for automobiles. This prevents new companies from innovating, and it restricts choices among consumers. Companies like Tesla may succeed or fail, but that outcome should be the result of the quality of their product, and not because they were restricted from using the business model that they believe gives them the best opportunity to succeed.

Policy Recommendations

Policy Recommendation 31

Repeal restrictive provisions in Section 2301.476 of the Occupations Code or create an exception for electric car manufacturers

Statutorily protecting a specific business model is anti-competitive, and it is not the proper role of government. As the cliché goes, government should not pick winners and losers in the marketplace.

If Tesla and future companies want to try something different, they should be permitted to do so. The 88th Legislature should repeal 2301.476(c) and related provisions to allow automobile manufacturers to sell directly to their customers.[365]

Should the Legislature be unwilling to open the automobile dealership market to free market competition, allowing direct sales by manufacturers of electric cars would be a step in the right direction. This would cause little to no disruption in the existing market and it would show that legislators in Texas are committed to reassessing market restrictions.

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