

BILL ANALYSIS

H.B. 3768
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Business & Industry
Committee Report (Unamended)

BACKGROUND AND PURPOSE

In order for Texas to remain at the forefront of the innovation economy, it is essential that state laws and policies reflect its commitment to developing technologies. In recent years, Texas has experienced tremendous growth in the blockchain technology and Web3 sectors. Like all Internet industries, the nature of Web3 is designed to be unconstrained by geography, but its primary benefit is the accessibility it allows developers and users. While current law provides for blockchain and Web3 companies and organizations to avail themselves of many existing entity forms, certain aspects of the technology and associations formed around it can result in significant ambiguity in how the law would be applied. This is particularly relevant to unincorporated nonprofit associations that do not have as robust a history of case law around their operations as other entities. H.B. 3768 seeks to support the growth of the blockchain and Web3 sectors and protect the citizens of Texas by establishing regulatory and legal clarity in key areas.

CRIMINAL JUSTICE IMPACT

It is the committee's opinion that this bill does not expressly create a criminal offense, increase the punishment for an existing criminal offense or category of offenses, or change the eligibility of a person for community supervision, parole, or mandatory supervision.

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

H.B. 3768 amends the Business Organizations Code to establish provisions relating to blockchain and distributed ledger technology, the latter of which the bill defines as a distributed ledger protocol that meets the following criteria:

- is a designated regulatory model of software that governs the rules, operations, and communication between intersection and connection points in a telecommunications network and supporting infrastructure;
- includes the computer software or hardware, or collections of computer software or hardware, that use or enable a distributed ledger, including blockchain; and
- uses a distributed, shared, and replicated ledger, which may be public or private, permissioned or permissionless, and include the use of a digital asset as a medium of electronic exchange.

The bill defines "digital asset" as an electronic record in which a person has a right or interest but specifies that the term does not include an underlying asset, unless the asset is itself an electronic record. The bill defines "record" as information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in a perceivable form, including information inscribed on blockchain or distributed ledger technology.

General Provisions

H.B. 3768 establishes the following provisions related to blockchain and distributed ledger technology with respect to the purposes of the Business Organizations Code:

- a requirement for a person's signature is satisfied by the submission of a blockchain that electronically contains the signature or verifies the intent of a person to provide the signature;
- a requirement for a record to be in writing is satisfied by the submission of a blockchain that electronically contains the record; and
- a smart contract, record, or signature may not be excluded as evidence in a proceeding solely because blockchain or distributed ledger technology was used to create, store, or verify the smart contract, record, or signature.

The bill defines "smart contract" as an event-driven computer program that executes on distributed ledger technology used to automate a transaction, including a transaction that takes custody over and instructs transfer of assets on that ledger, creates and transmits digital assets, synchronizes information, or authenticates user rights and conveys access to software applications.

H.B. 3768 includes an electronic data system among the electronic communications systems authorized under current law by which the owners, members, or governing persons of a domestic entity, or a committee of those owners, members, or persons, may hold meetings if the system permits each person participating in the meeting to communicate with all other participants.

Limited Liability Companies

H.B. 3768 provides that a company agreement of a limited liability company may be composed of computer code and maintained in full or in part on blockchain or distributed ledger technology, if the record of the agreement is capable of being retained and accurately reproduced for later reference. For these purposes, a record includes information inscribed on blockchain or distributed ledger technology.

H.B. 3768 gives a limited liability company the option to keep supplemental information relating to the company's membership, taxes, and governing documents on an electronic data system as an alternative to the requirement that such a company keep such information at the company's principal office in the United States or make the information available to a person at that office at the person's written request.

Decentralized Unincorporated Associations

General Provisions

H.B. 3768 provides for the creation and regulation of a decentralized unincorporated association, defined as an unincorporated association that meets the following criteria:

- consists of at least 500 members joined by mutual consent under an agreement, that may be in writing or inferred from conduct, for a common purpose, other than to operate a business for profit;
- has elected to be formed; and
- is not formed under any other law governing the association's organization and operation.

H.B. 3768 establishes the following regarding an association:

- an association that is formed or operates in Texas is governed by state law;
- provisions regarding decentralized unincorporated associations are supplemented by principles of law and equity and may not be interpreted to repeal or modify a statute or rule for an entity that does not elect to be formed as such an association; and

- an association is an enterprise for purposes of the requirements related to indemnification and advancement of expenses under statutory provisions relating to indemnification and insurance.

H.B. 3768 establishes that a decentralized unincorporated association is a legal entity distinct from the association's members and administrators, and that the association has perpetual duration, unless the association's governing principles otherwise specify, and the power to do all things necessary or convenient to carry on the association's activities or affairs. The bill sets out the following with respect to those governing principles:

- defines "governing principles" as all agreements and any amendment or restatement of those agreements, including any articles of organization, consensus formation algorithms, or enacted governance proposals, that govern the purpose or operation of the association and the rights and obligations of the association's members and administrators, whether contained in a record, implied from the association's established practices, or both; and
- requires the principles to identify the jurisdiction in which the association is formed.

The bill defines "administrator" as a person authorized by the members of a decentralized unincorporated association to fulfill administrative or operational tasks at the direction of the members, "established practices" as the practices used by a decentralized unincorporated association without material change during the most recent five years of the association's existence, or if the association has existed for less than five years, during the association's entire existence, and "member" as a person that, under the governing principles of a decentralized unincorporated association, may participate in the development of the policies and activities of the association and the selection of the association's administrators.

H.B. 3768 establishes the circumstances under which an association may be dissolved, and provides for the continuation of the association in existence until the association's activities are wound up in accordance with the association's governing principles and any administrator appointed and authorized to wind up the association, among other requirements.

H.B. 3768 requires its provisions regarding decentralized unincorporated associations to be applied and construed to make the law with respect to such associations uniform among states enacting it.

Use of Distributed Ledger Technology

H.B. 3768 authorizes a decentralized unincorporated association to provide for the association's governance, in whole or in part, through distributed ledger technology, including through a smart contract that executes on such technology and is used to automate a transaction. The bill sets out the following regarding that authority:

- authorizes the association to adopt a reasonable algorithmic means for establishing consensus for the validation of records, the establishment of requirements, processes, and procedures for conducting operations, and making organizational decisions with respect to the use of distributed ledger technology;
- authorizes the association's governing principles to specify certain information regarding any distributed ledger technology used or enabled by the association and to adopt voting procedures, which may include a smart contract deployed to the technology, that provides for matters of governance or relates to the activities of the association that is within the purpose of the association; and
- authorizes the association, in accordance with such voting procedures and in compliance with requirements of law and the governing principles, to modify or substitute the consensus mechanism and related procedures, requirements, or processes.

Association Membership

H.B. 3768 provides for the admission, suspension, dismissal, expulsion, and resignation of association members, and establishes that a member's interest or a right conferred in the

association is freely transferable to another person through conveyance of the membership interest or other property that confers on a person a voting right in the association. With respect to administration of the association, the bill authorizes the members to select association's administrators with member approval, authorizes but expressly does not require an administrator to be an association member, and sets out further provisions regarding the rights and duties of an administrator. The bill establishes that a member does not owe a fiduciary duty to the association or to any another member of the association solely by virtue of their membership, and requires a member to discharge the applicable duties and obligations and to exercise the member's rights in a manner consistent with the contractual obligation of good faith and fair dealing.

H.B. 3768 entitles a member or administrator to an electronic record of any record maintained by the association of information that is material to the member's or administrator's rights and duties. The bill establishes that an association is not obligated to do the following:

- provide a record for record requests made through distributed ledger technology, including through a smart contract, to a member or administrator who has access to the information in a record made available on such technology; or
- collect and maintain a list of members or member information, including the names or addresses of members.

The bill provides for the association's authority to restrict access to and use of information, and for the authority of a former member or administrator to access information to which the former member or administrator was entitled as a member or administrator.

Powers and Authority

H.B. 3768 authorizes an association to carry on any business activity in which the association may lawfully engage for profit and apply any such profit to the following purposes:

- paying reasonable compensation to or reimbursing reasonable expenses incurred for services rendered to the association, including for the administration and operation of the association and for the provision of collateral for the self-insurance of the association, voting, and participation;
- conferring benefits on the association's members or administrators in conformity with the association's common nonprofit purpose or purposes, if any;
- repurchasing membership interests to the extent authorized by the association's governing principles; and
- making distributions of property to members on winding up and termination.

The bill prohibits an association from paying dividends or distributing any part of the association's income or profit to the association's members or administrators.

H.B. 3768 authorizes an association to effect a merger or conversion by complying with the applicable statutory provisions and the association's governing principles, including the requirement for member approval of the merger or conversion.

H.B. 3768 provides for the authority of a decentralized unincorporated association to acquire, hold, encumber, or transfer an estate or interest in real or personal property in the name of the association by doing the following:

- authorizing the association to be a beneficiary of a trust or contract, legatee, or devisee;
- requiring the association to execute and record a statement of authority to transfer an estate or interest in real property in the name of the association;
- authorizing such an estate or interest to be transferred by a person so authorized in a statement of authority recorded in the office of the applicable county clerk;
- establishing the required contents of the statement of authority and the manners in which it must be executed and amended;
- authorizing the county clerk to collect a fee in the amount authorized for recording a transfer of real property for recording the statement of authority; and

- establishing the circumstances under which the authority of the person named in a statement of authority is conclusive in favor of a transferee who gives value without notice that the person named in the statement of authority lacks authority.

H.B. 3768 requires a decentralized unincorporated association have the approval of the members in accordance with its governing principles to do the following:

- suspend, select, dismiss, or expel a member or administrator, as applicable;
- adopt, amend, or repeal the governing principles;
- sell, lease, exchange, or otherwise dispose of all, or substantially all, of the association's property outside the ordinary course of the association's activities, regardless of the association's goodwill;
- dissolve the association;
- merge or convert the association;
- undertake any act outside the ordinary course of the association's activities; or
- determine the policy or purpose of the association.

The association must have the approval of the members in accordance with its governing principles to act or exercise a right for which the association's governing principles require member approval. Unless otherwise provided for in the governing principles, association membership interest is calculated in proportion to the person's membership interest or other property that confers onto the person a voting right in the association.

Liability of Members and Administrators

H.B. 3768 establishes that the debts, obligations, and liabilities of a decentralized unincorporated association, whether arising in contract, tort, or otherwise, are solely those of the association. The bill prohibits an association member or administrator from being obligated personally for any debt, obligation, or liability of the association solely by reason of their membership or administration unless the member or administrator agrees to such personal obligation. The bill provides for the liability of an administrator for money damages for an action taken, or for failure to take an action, to be limited or eliminated except for liability for the following:

- the amount of a financial benefit improperly received by an administrator;
- an intentional infliction of harm on the association or the association's members;
- an intentional violation of criminal law;
- a breach of any duty of loyalty, unless the violation of the duty of loyalty is authorized or ratified by the disinterested members; or
- an improper distribution.

Actions and Proceedings

H.B. 3768 authorizes a decentralized unincorporated association, in the association's name, to institute, defend, intervene, or participate in a judicial, administrative, or other governmental proceeding or in any form of alternative dispute resolution. The bill authorizes a claim to be asserted by a member or administrator against the association, and by the association against a member or administrator. The bill sets out the following regarding an action or proceeding against an association:

- a requirement for a summons and complaint or other process in an action or proceeding to be served on an agent authorized by appointment to receive service of process, an appointed administrator of the association, or a member, but only if the agent or administrator cannot be served;
- procedures by which an agent authorized to receive a service of process is to be appointed, including the following:
 - an authorization for the association to file a statement of the appointment in the office of the secretary of state, the requisite contents of which are specified by the bill;

- an authorization for an appointed agent to resign by filing a resignation in the office of the secretary of state;
- a requirement for an amendment to a statement to meet the requirements for execution of an original statement; and
- an authorization for the secretary of state to collect a \$5 filing fee for an original filing, resignation, or amendment;
- a provision establishing that the venue of an action against an association brought in Texas is determined in accordance with the applicable state law of the state in which the association has appointed an agent for service of process; and
- provisions establishing the following:
 - a judgement or order against an association is not by itself a judgment or order against a member or administrator of the association;
 - a claim for relief against an association does not abate merely because of a change in the members or administrators of the association; and
 - an association member is not an agent of the association solely by reason of being a member.

EFFECTIVE DATE

September 1, 2023.