STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE

IN THE MATTER OF:	)	
	)	
Local Government Center, Inc.;	)	
Local Government Center Real Estate, Inc.;	)	
Local Government Center Health Trust, LLC;	)	
Local Government Center Property-Liability Trust, LLC;	)	
Health Trust, Inc.;	)	
New Hampshire Municipal Association Property-Liability Trust, Inc.;	)	Case No: C2011000036
LGC – HT, LLC;	)	
Local Government Center Workers' Compensation Trust, LLC;	)	
And the following individuals:	)	
Maura Carroll;Peter J. Curro; and John Andrews	)	
	)	
RESPONDENTS	)	

BUREAU OF SECURITIES REGULATION'S OMNIBUS OBJECTION
TO RESPONDENTS' DISPOSITIVE MOTIONS

NOW COMES Petitioner, the New Hampshire Bureau of Securities Regulation (the "Bureau" or the "Petitioner"), through counsel Bernstein, Shur, Sawyer & Nelson, P.A., and objects to the Respondents' eleven separate motions to dismiss and one motion for summary judgment filed on March 12, 2012. In support of its Objection, Petitioner states as follows:

Introduction

Respondents John Andrews, Maura Carroll, and Peter Curro (the "Individual Respondents"), and the Local Government Center, Inc. and its affiliated entities ("LGC") (collectively with the Individual Respondents the "Respondents"), filed twelve dispositive motions seeking dismissal of and/or summary judgment on each Count of the Amended

Petition.[1] In response, the Bureau submits this omnibus objection, addressing each of the Respondents' various arguments and demonstrating that neither dismissal nor summary judgment is warranted.

The Bureau's Amended Petition set forth six Counts against the Respondents related to their operation of pooled risk management programs under the auspices of R.S.A. ch. 5-B. Count I of the Amended Petition alleges that LGC has been operating pooled risk management programs with an impermissible corporate structure in violation of the requirements of R.S.A. 5-B:5. Namely, LGC is in violation of R.S.A. 5-B:5's requirement that each pooled risk management program be governed by an independent board of directors and independent written bylaws. Contrary to the statute, LGC adopted an illegal parent-subsidiary structure purporting to govern multiple pooled risk management programs, along with other non-risk management programs, under a single board with a single set of bylaws without appropriate governance

[1] The twelve dispositive motions filed by Respondents, and objected to in this omnibus objection, are:

(1) LGC's Motion to Dismiss Counts I & II of the Amended Petition to the Extent they Allege Conduct Which Occurred Prior to June 14, 2010;
(2) LGC's Motion to Dismiss Count I of the Amended Petition on the Ground that R.S.A. 5-B Does Not Prohibit the Conduct in Which LGC is Alleged to have Engaged;
(3) LGC's Motion to Dismiss Count II of the Amended Petition on the Grounds that the Bureau of Securities Regulation has Improperly Failed to Promulgate Rules Under R.S.A. 5-B, and the Statute Unconstitutionally Delegates Unlimited Legislative Authority to the Bureau and is Unconstitutionally Vague;
(4) LGC's Motion to Dismiss Counts III, IV, and V of the Amended Petition on the Ground that LGC's Risk Pool Contracts are not Securities of are Exempt under New Hampshire Law;
(5) Respondent John Andrews' Motion to Dismiss Him from Counts I and II for Failure to State a Cause of Action;
(6) Respondent John Andrews' Second Motion to Dismiss Counts I and II of the Amended Petition;
(7) Respondent John Andrews' Motion to Dismiss Counts III, IV, and V of the Amended Petition, Securities Claims;
(8) Respondent John Andrews' Motion to Dismiss Count VI of the Amended Petition, Civil Conspiracy;
(9) Respondent Maura Carroll's Motion to Dismiss All Counts of the Amended Petition;
(10) Respondent Maura Carroll's Motion for Summary Judgment as to Counts I, II, and VI, and Partial Summary Judgment as to Counts III, IV, and V;
(11) Motion to Dismiss Count IV of the BSR's Amended Staff Petition (filed by Peter Curro);
(12) Motion to Dismiss Count VI of the BSR's Amended Staff Petition (filed by Peter Curro).

controls, resulting in inherent conflicts of interest. Respondents concede that in a parent-subsidiary model, the parent does not own a fiduciary duty to its subsidiaries; it is the subsidiaries that owe a fiduciary duty to the parent. Deposition of Maura Carroll, excerpts attached as Exhibit A to the Affidavit of Kristina Mann ("Mann Aff."), attached hereto as Exhibit 1. As a result of the improper corporate structure, the Respondents breached their fiduciary duties by approving inappropriate transactions distributing funds contributed by municipal and other political subdivision members for risk management coverages for non-risk management purposes, including subsidization of the LGC Parent's lobbying operations.

Count II of the Bureau's Amended Petition alleges that the Respondents charged Members inflated rates in order to accumulate excessive contingency reserves not required for prudent administration of pooled risk management programs; that the Respondents mischaracterized millions of dollars as administrative expenses; and that the Respondents used surplus Member funds for inappropriate purposes such as to subsidize a failing workers compensation pool. In addition, Count II alleges that the Respondents have adopted an impermissible rate stabilization method that fails to return all surplus Member funds to the Members as mandated by R.S.A. 5-B:5, I(c), and that violates municipal budget laws that prohibit non-lapsing funds without express approval by municipal legislative bodies.

Count III of the Bureau's Amended Petition alleges that the risk pool contracts sold by the Local Government Center, Inc. ("LGC Parent"), HealthTrust, Inc., and New Hampshire Municipal Association Property-Liability Trust, Inc. ("NHMA Prop. Liab. Trust") to municipalities and other governmental entities are securities under R.S.A. 421-B; and the above referenced Respondents' failure to register these risk pool contracts as securities violates R.S.A. 421-B:11. Count III further alleges that LGC Parent failed to register as a broker-dealer; that

LGC HealthTrust, LLC, LGC Prop. Liab. Trust, LLC, and LGC Workers' Comp Trust, LLC failed to register as issuer-dealers; and that Mr. Andrews and Ms. Carroll failed to register as agents, all as required by R.S.A. 421-B:6.

Count IV of the Bureau's Amended Petition alleges Mr. Andrews, Ms. Carroll, and Mr. Curro (among other individual Respondents who have since been dismissed from this action by agreement) knowingly or negligently aided LGC in selling unregistered securities in violation of R.S.A. 421-B:11.

Count V of the Bureau's Amended Petition alleges that all of the above referenced Respondents engaged in fraud, deceit, and material omissions in connection with the offer or sale of securities in violation of R.S.A. 421-B:3 by failing to disclose that risk pool contracts were unregistered securities and that the Respondents were not licensed as required by law to offer or sell securities; and by using Member funds for non-pool purposes without the knowledge or written authorization of the members.

Count VI of the Bureau's Amended Petition alleges that the Respondents conspired together to violate R.S.A. 5-B.

In response, Respondents Andrews and Carroll argue that there is no liability under R.S.A. 5-B for individuals, only for the corporate entities operating pooled risk management programs. Similarly, Ms. Carroll argues that she had no operational competence with respect to the pooled risk management programs and lacked any authority to direct the LGC Board or make any policy decisions on behalf of LGC or its affiliated entities. Ms. Carroll, therefore, disclaims any personal liability for the acts of LGC.

In addition, the Respondents argue that R.S.A. 5-B does not prohibit the conduct complained of by the Bureau, that R.S.A. 5-B may not be retrospectively applied to penalize conduct occurring before the effective date of the Bureau's enforcement powers, that the Bureau seeks to adopt substantive rules through its enforcement action instead of through formal promulgation, and that the Respondents were denied due process by lack of notice of the Bureau's interpretation of the statute.

Further, the Respondents argue that R.S.A. 5-B constitutes an unconstitutional delegation of legislative authority to the Bureau and that R.S.A. 5-B is unconstitutionally vague. The apparent effect of Respondents constitutional arguments is to render R.S.A. 5-B void. Such a result would lead to the inescapable conclusion that LGC and the other entities operating pooled risk management programs in New Hampshire have been operating without a valid exemption from taxation and regulation by the Insurance Department as provided in R.S.A. 5-B:6. The immediate consequences of invalidating the statute would be to subject LGC and the other risk management programs to liability for back taxes and penalties, as well as liability to the Insurance Department for a host of regulatory infractions.

Finally, the Respondents argue that the Presiding Officer lacks jurisdiction over a civil conspiracy claim and that the claim is barred by the intra-corporate conspiracy doctrine.

Standard of Review

"In ruling on a motion to dismiss, the court must determine whether the facts as pled are sufficient under the law to constitute a cause of action . . . . It must rigorously scrutinize the complaint to determine whether, *on its face*, it asserts a cause of action. What is involved is a pre-trial, threshold inquiry that tests the facts in the complaint against the applicable law." Jay Edwards, Inc. v. Baker, 130 N.H. 41, 44-45 (1987) (emphasis in original) (*citations omitted*). The factual allegations in the Petition must be taken as true and all reasonable inferences made in the light most favorable to the Petitioner. See, e.g., J & M Lumber and Const. Co., Inc. v. Smyjunas, 161 N.H. 714, 724 (2011).

By contrast, in order to prevail on summary judgment, the moving party must show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. R.S.A. 491:8-a, III; Wood v. Greaves, 152 N.H. 228, 230 (2005). A fact is "material" if it affects the outcome of the litigation. Horse Pond Fish and Game Club, Inc. v. Cormier, 133 N.H. 648, 653 (1990). In considering a party's motion for summary judgment, the court examines the evidence submitted and makes all necessary inferences from that evidence in the light most favorable to the non-moving party. Gould v. George Brox, Inc., 137 N.H. 85, 87-88 (1993).

Argument

I. The Bureau Has Alleged Sufficient Facts to Establish Violations of R.S.A. 5-B Against Each of the Respondents.

Counts I and II of the Bureau's Amended Petition allege basic violations of the requirements set forth in R.S.A. 5-B for pooled risk management programs to operate in New Hampshire as tax-exempt organizations and free from regulation by the Insurance Department. Specifically, the Bureau has alleged that LGC and its various subsidiaries are operating pooled risk management programs without independent boards of directors, without independent by-laws, and without properly identifying or returning surplus funds to their members. In addition, the Bureau alleges that the individual Respondents have knowingly and/or negligently facilitated and directed LGC to engage in and continue its current course of action in violation of R.S.A. 5-B.

On a motion to dismiss, the Presiding Officer need only find sufficient allegations in the Amended Petition, taking all factual allegations as true and making all inferences in the Bureau's favor, to support the finding of violations of R.S.A. 5-B. Despite the Respondents' best efforts to confuse the issue, they cannot overcome the facts alleged that demonstrate clear and ongoing violations of the statute. Nor do Respondents' constitutional challenges constitute grounds for dismissal. Consequently, the Respondents' various motions to dismiss Counts I and II should be denied.

A. The Respondents' Actions are Prohibited by the Plain Language and Clear Legislative Purpose of R.S.A. 5-B

At the core of Counts I and II of the Amended Petition, and the Respondents' arguments seeking to dismiss these Counts, is the meaning and proper interpretation of the provisions of R.S.A. 5-B. The Respondents take an artificially narrow and overly literal reading of the statute and argue that the statute affords the greatest possible discretion to the Respondents to determine how to operate a pooled risk management program, regardless of the broader context or statutory purpose of chapter 5-B. The Bureau disagrees, and, as required by long-standing principals of statutory interpretation, reads R.S.A. 5-B in the context of its over-arching purpose to benefit participating political subdivisions of the state (the "Members"). Placed in the proper statutory context, it becomes clear that the Respondents' myopic and rigidly literal interpretation runs counter to the core legislative purpose of the statute and that Respondents' actions constitute violations of R.S.A. 5-B, as alleged.

The Presiding Officer in this administrative action is the arbiter of what the statute means, and must follow the well-established standards for statutory interpretation set forth by the New Hampshire courts. As the Supreme Court has recently reiterated:

> In matters of statutory interpretation, we are the final arbiters of the legislature's intent as expressed in the words of the statute considered as a whole. We first look to the language of the statute itself, and, if possible, construe that language according to its plain and ordinary meaning. We interpret legislative intent from the statute as written and will not consider what the legislature might have said

> or add language that the legislature did not see fit to include. *We construe all parts of a statute together to effectuate its overall purpose and avoid an absurd or unjust result. Moreover, we do not consider words and phrases in isolation, but rather within the context of the statute as a whole. This enables us to better discern the legislature's intent and to interpret statutory language in light of the policy or purpose sought to be advanced by the statutory scheme.*

The LLK Trust v. Town of Wolfeboro, 159 N.H. 734, 736 (2010) (*citations omitted*) (emphasis supplied). As stated, statutory interpretation is not a blind reading of isolated words in the statute, but an exercise in discerning how the words effectuate the intent of the legislature. In the instant case, the Respondents have ignored the context and purpose of the statute in reaching their narrow, self-serving interpretation of the requirements under R.S.A. 5-B:5.

The purpose of R.S.A. ch. 5-B was set forth by the General Court at R.S.A. 5-B:1:

> The purpose of this chapter is to provide for the establishment of pooled risk management programs and to affirm the status of such programs *established for the benefit of political subdivisions of the state*. The legislature finds and determines that insurance and risk management is essential to the proper functioning of political subdivisions; that risk management can be achieved through purchase of traditional insurance or by participation in pooled risk management programs *established for the benefit of political subdivisions*; that pooled risk management is an essential governmental function by providing focused public sector loss prevention programs, *accrual of interest and dividend earnings which may be returned to the public benefit* and establishment of costs predicated solely on the actual experience of political subdivisions within the state; that the resources of political subdivisions are presently burdened by the securing of insurance protection through standard carriers; and that pooled risk management programs which meet the standards established by this chapter should not be subject to insurance regulation and taxation by the state.

R.S.A. 5-B:1 (emphasis supplied). The General Court's repetition of the phrase "established for the benefit of political subdivisions" leaves no doubt that the purpose of authorizing pooled risk management programs is to benefit municipalities and other political subdivisions of the state that make up the Members of a risk pool.[2] Moreover, the statute specifically expresses the intent

[2] Indeed, this phrase is repeated two additional times in the statute. *See* R.S.A. 5-B:3, III; R.S.A. 5-B:4.

to reduce costs of obtaining insurance coverage and to return surplus funds to the Members for the public benefit.

The statutory mandate to operate pooled risk management programs "for the benefit of political subdivisions," coupled with the management of Member funds and the mandate to return any surplus funds to the Members, creates a clear fiduciary relationship between LGC and its Members. As the Supreme Court explained in Clark & Lavey Benefits, Inc. v. Education Development Center, Inc., 157 N.H. 220, 227 (2008):

> In this state, "fiduciary relationship" has been defined comprehensively, and exists wherever influence has been acquired and abused or confidence has been reposed and betrayed. A fiduciary relationship exists between two persons when one has gained the confidence of the other and purports to act or advise with the other's interest in mind.

(*citing* Brzica v. Trustees of Dartmouth College, 147 N.H. 443, 447 (2002)) (*internal citations omitted*). Nothing in R.S.A. 5-B suggests a legislative intent to abrogate the common law fiduciary relationship inherent in the position of authority and control held by pooled risk management programs over their Members and their Members' funds. *See* Ettinger v. Town of Madison Planning Board, 162 N.H. 785, 790 (2011) ("We do not, in general, interpret a statute to abrogate the common law absent a clear legislative expression of intent to do so.").

Consequently, it is through the lens of the clear legislative intent and LGC's fiduciary duties that the statutory requirements for valid pooled risk management programs must be interpreted. Doggett v. Town of North Hampton Zoning Bd. of Adjustment, 138 N.H. 744, 746 (1994) (holding statutes must be construed "so as to effectuate their evident purpose"). Interpreted in context and in a way that effectuates the statutory purpose, R.S.A. 5-B prohibits the Respondents' actions as set forth in the Amended Petition.

1. <u>R.S.A. 5-B:5 Requires Each Pooled Risk Management Program to be Governed by an Independent Board of Directors Subject to Independent Bylaws.</u>

R.S.A. 5-B:5 unequivocally states that "each pooled risk management program shall":

> (b) Be governed by a board the majority of which is composed of elected or appointed public official, officers, or employees. . . .
> . . .
> (e) Be governed by written bylaws which shall detail the terms of eligibility for participation by political subdivisions, the governance of the program and other matters necessary to the program's operation.

R.S.A. 5-B:5, I(b) and (e). The Respondents contend that the statute must be interpreted broadly to allow the board and bylaws of a parent corporation to govern multiple pooled risk management programs operated by subsidiary entities, because the statute does not expressly prohibit such an arrangement. However, as set forth in the Amended Petition, a single board simultaneously governing multiple pooled risk management programs from the vantage point of a separate parent corporation, as well as governing the parent corporation and related non-pooled risk management programs, creates inherent conflicts of interest that are contrary to the board's fiduciary duties to the Members and to the statutory purpose of providing coverages for the benefit of the Members. *See* Amended Petition at ¶¶ 78-85. It is undisputed that the LLCs that purportedly operate the pooled risk management programs do not have boards of directors; instead they are allegedly governed by the board of the LGC parent corporation—a separate legal entity with non-pooled risk management interests.

A prime example of the result of this inherently flawed governance structure is the improper transfer of funds out of the HealthTrust and Property-Liability Trust pools to subsidize the floundering Worker's Compensation pool. Even when the impropriety of this transfer was brought to light, and in spite of Ms. Carroll's recommendations, the LGC Board voted in 2011 to characterize the transfer as an unsecured, interest-free loan with little or no hope for repayment.

Carroll Mtn. for Summary J. at 8-9. Directing surplus funds away from the Members who overpaid for their health and property liability coverage was clearly contrary to the purpose (and the clear mandate to return surplus funds) of the statute, and would have raised red flags if presented to an independent board.

The statute cannot reasonably be interpreted, as proposed by Respondents, to allow an outcome in direct conflict with the purpose of the statute. In re Bio Energy Corp., 135 N.H. 517, 521 (1992) ("We construe statutes so as to effectuate their evident purpose."). *See also* R.S.A. 21:1 ("In the construction of all statutes the following rules shall be observed, unless such construction would be inconsistent with the manifest intent of the legislature or repugnant to the context of the same statute."). Nor can Respondents hide behind a strictly literal reading of the statute, because where "a literal construction of the statute does violence to the apparent policy of the Legislature, it will be rejected." In re Justin D., 144 N.H. 450, 453 (1999) (*citations and quotations omitted*).

Respondents point out that the word "independent" does not appear in the statute to qualify the requirement that pooled risk management programs be governed by a board, and argue that words should not be read into the statute. LGC's Mtn. to Dismiss Cnt I at ¶7. Nevertheless, the New Hampshire Supreme Court has ruled that "while we cannot redraft a statute to make it conform to an intention not fairly expressed in its language, when the intention of the Legislature can be ascertained from the statute, words may be modified, altered, or supplied so as to compel conformity of the statute to that intention." Petition of Poulicakos, 160 N.H. 438, 444 (2010) (*quoting* Blanchard v. Blanchard, 133 N.H. 427, 431 (1990) and State Employees Assoc. of N.H. v. N.H. Div. of Personnel, 158 N.H. 338, 346 (2009)). Thus, in order to conform with the clear legislative purpose that pooled risk management programs are governed to benefit their Members and protect Member funds, R.S.A. 5-B:5 may be readily understood to require that each pooled risk management program be governed by an independent board of directors pursuant to individualized written bylaws.

The Respondents' reliance on the "any or all" language contained in R.S.A. 5-B:3, III, is similarly unpersuasive. By the language of the statute, a pooled risk management program may provide multiple areas of coverages. However, in light of the clear purpose of the statute to operate pooled risk management programs for the benefit of the Members, this statutory language implies that each pooled risk management program maintain unity of membership across all offered areas of coverage. To interpret the statute in any other way would create just the types of impermissible conflicts of interest that arose when LGC used funds contributed by Members of its stand-alone HealthTrust risk pool to subsidize the separate and distinct Workers Compensation risk pool. Because there was not unity of membership between the HealthTrust and Workers Compensation risk pools, LGC illegally used HealthTrust Member funds to benefit non-HealthTrust Members. This is an absurd and unreasonable result in conflict with the fundamental purpose of the statute, and the statute should not be interpreted to violate its basic purpose. Petition of Poulicakos, 160 N.H. at 444 (holding statutes must be interpreted "so as to compel conformity" with the legislative purpose of the statute).

In fact, the Respondents have alleged that when R.S.A. 5-B was enacted in 1987, it was drafted to reflect and authorize the structure of LGC's predecessor entities. LGC Answer at 5-6. Then, like today, separate entities ran each pooled risk management program and offered separate categories of coverages. However, unlike today, LGC's predecessor entities were each governed by a separate and independent board of directors pursuant to separate and independent written bylaws. R.S.A. 5-B must be construed to effectuate its evident purpose. In re Bio

Energy Corp., 135 N.H. at 521. Having made this assertion in early phases of the proceeding, Respondents would be precluded by the doctrine of judicial estoppel from taking a conflicting position at this stage. Kelleher v. Marvin Lumber & Cedar Co., 152 N.H. 813, 848 (2005) ("Where a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, it may not thereafter, simply because its interests have changed, assume a contrary position.") (*quotations omitted*).

The Bureau's interpretation of R.S.A. 5-B:5 "harmonizes with the context and the apparent policy and objects of the legislation," In re Justin D., 144 N.H. at 453 (*quoting* State ex rel. Fortin v. Harris, 109 N.H. 394, 396 (1969)), and the Amended Petition therefore sets forth a valid cause of action sufficient to overcome a motion to dismiss. J & M Lumber, 161 N.H. at 724.

2. R.S.A. 5-B:5 Requires Pooled Risk Management Programs to Maintain Adequate, but not Excessive, Contingent Reserves and to Return Any Surplus Directly to Members.

A fundamental tenant of R.S.A. 5-B is the intent to provide political subdivisions of the state with risk management coverages at affordable costs. *See* R.S.A. 5-B:1 (finding that "pooled risk management is an essential governmental function by providing focused public sector loss prevention programs, *accrual of interest and dividend earnings which may be returned to the public benefit* and establishment of costs predicated solely on the actual experience of political subdivisions within the state"). As associations of political subdivisions of the state, pooled risk management programs are inherently non-profit enterprises meant solely to benefit their Members by providing pooled risk programs at cost. Critical to effectuating this fundamental purpose is the concept of returning all surplus funds to program Members.

Consistent with the purpose and mandate of the statute, the Bureau alleges that contingency reserves must be calculated using an actuarially sound method that targets adequate contingency reserves to protect Members from catastrophic losses, but no more. Unlike insurance companies that may need strategic reserves to cover advertising or initiatives to compete in the market place, as well as to pad the corporate bottom-line, by their very nature pooled risk management programs are intended to operate at cost and return any excess reserves (*i.e.* surplus) to their Members.

Contrary to the purpose and stated requirements of the statute, the Respondents contend that they may choose *any* actuarially sound target for contingency reserves. Indeed, while LGC has adopted a contingency reserve target of 4.2 RBC, by its own logic it could permissibly have chosen a target of 10 RBC or even more. To effectuate the clear purpose of R.S.A. 5-B and to satisfy the mandate to return surplus funds to Members, the statue must be interpreted to require pooled risk management programs to establish the minimal actuarially sound contingency reserve that will protect the program's solvency. In re Bio Energy Corp., 135 N.H. at 521 ("We construe statutes so as to effectuate their evident purpose.").

The Respondents' argument that the Bureau is mandating a particular method for calculating contingency reserves misconstrues the Bureau's position. Instead, the Bureau seeks to enforce the purpose and requirements of the statute. The Bureau has outlined a recommended framework for statutorily permissible contingency reserves. The Bureau sets forth three separate examples of methods of calculating a statutorily permissible contingency reserve, but does not mandate use of a specific method under the statute. *See* Amended Petition ¶93.

Accordingly, the Bureau has not adopted detailed ad hoc rules regarding contingency reserve calculations as alleged by the Respondents. Rather, the Bureau has interpreted the statute in the context of its overall purpose, and sought to enforce the plain meaning and intent of the statute.

Similarly, R.S.A. 5-B:5's mandate that pooled risk management programs return "*all* earnings and surplus in excess of any amounts *required* for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions" must be read to effectuate the overall statutory purpose of providing low-cost risk management coverage. As alleged in the Amended Petition, the Respondents' rate-stabilization method of "returning" surplus funds is statutorily inadequate because it fails to return "all" earnings and surplus to Members. *See* Amended Petition at ¶¶61-65, 99-104. By its plain language, the term "return" contemplates the repayment of surplus funds to Members, not a complicated, opaque actuarial estimation that functionally results in LGC retaining a portion or all of annual surplus funds.

Moreover, while rate stabilization may be desirable to some Members, it is not contemplated by the statute, and LGC has not asserted that it obtained approval to retain Member funds by a vote of the Members. Nothing in R.S.A. 5-B authorizes pooled risk management programs to maintain excess reserves for the purpose of stabilizing rates across rate years. Indeed, such an approach improperly penalizes Members for leaving LGC by forfeiting their future recoupment of surplus contributions. Similarly, the Respondents' rate stabilization scheme runs afoul of municipal budget laws, as set forth in the Amended Petition. *See* Amended Petition at ¶¶69-72, 101-104 Facilitating Members unknowing violation of municipal budget law is contrary to R.S.A. 5-B's purpose of benefiting Members.

Maintaining excessive "reserves" and elevating rate stabilization over return of "all" surplus funds to Members constitute violations of the plain meaning and purpose of R.S.A. 5-B. Taking the facts alleged as true, and making all reasonable inferences in favor of the Bureau, Count II of the Amended Petition states a valid claim of violation of the statute and should not be dismissed.

3. Failed Legislative Amendments to R.S.A. ch. 5-B do not Show the Legislative Intent of the Statute.

The Respondents argue that the Legislature's failure to enact certain proposed amendments to R.S.A. 5-B that may have clarified the requirement for separate boards and bylaws and appropriate methods for calculating contingency reserves and returning surplus funds to Members is somehow demonstrative of the Legislature's original intent when enacting R.S.A. 5-B in 1987. This argument is unpersuasive. "The legislature expresses its will by enacting laws, not by failing to do so." Merrill v. Manchester, 114 N.H. 722, 728 (1974). See also Corson v. Thomson, 116 N.H. 344, 350 (1976) ("Defendants' argument that proposed amendments to the section which failed to be enacted are indicative of the legislative intent that the director should be removed by the fish and game commission is not persuasive.").

Indeed, over the years there have been several attempts to amend R.S.A. 5-B, including Respondents' proposed legislation in 2011 that would have, among other things, expressly allowed a parent company to operate risk pools organized as limited liability companies and to return surplus funds over time through rate stabilization. *See* Mann Aff., and Exhibit B, attached thereto (marked LGC-AH012017 – LGC-AH012024). By the Respondents' own logic, the fact that the Legislature declined to adopt Respondents' proposed amendment must demonstrate that the Legislature intended to prohibit these actions under the statute. This example simply demonstrates that the meaning of a legislative body's failure to act provides slim, if any, guidance on the meaning of the statute in question.

In the absence of a clear legislative response to judicial interpretation of a statute, the reasons for the failure of a particular statutory amendment are unknown and unknowable.

Rejection of proposed language could turn as much on a belief that the statute already incorporates the proposed language as on a belief that the proposed language is contrary to the statute's purpose. Consequently, the Respondents' reliance on the content of selectively chosen failed amendments to R.S.A. 5-B provides no support for the Respondents' preferred interpretation of the statute.

In fact, Respondents have made the claim that R.S.A. 5-B was enacted in order to affirm LGC's predecessor entities as valid pooled risk management programs. LGC Answer at 5-6. At the time R.S.A. 5-B was enacted, each of the LGC's pooled risk management programs (health and property-liability) were operated by separate entities with independent boards and independent written bylaws. By the Respondents' own admission, the legislative intent of R.S.A. 5-B was to authorize this existing structure. It is difficult to reconcile this admitted fact with Respondents' current argument that the statue authorizes some other governance structure for pooled risk management programs for the benefit of political subdivisions. *See* Kelleher v. Marvin Lumber & Cedar Co., 152 N.H. at 848-49 (precluding change in position on judicial estoppel grounds). The original intent of the legislature is much more compelling than Respondents' convoluted attempt to discern what the legislature meant when it failed to pass certain amendments to R.S.A. 5-B more than 20 years after the statute was enacted.

4. The Respondents' Contention that R.S.A. ch. 5-B Affords Pooled Risk Management Programs Unfettered Discretion is Unreasonable and Contrary to the Clear Intent of the Statute.

A central theme to many of the Respondents' arguments regarding R.S.A. 5-B is that because the statute does not spell out every conceivable detail of how pooled risk management programs may operate, LGC has unfettered discretion to operate within a literal reading of the statute. In essence, Respondents argue that they are free to take any action that the statute does not expressly forbid, regardless of the reasonableness of the action or whether it is consistent with the statutory purpose of pooled risk management programs.

For example, Respondents argue that the statute does not specify what expenses are properly considered "required for administration" and that this decision is left solely to the business judgment of the LGC Board. Yet this begs the question of how far the LGC Board can go in determining what constitutes an "administrative expense." Could the LGC Board replace all of LGC's computer equipment annually? Purchase a fleet of LGC vehicles for use by LGC employees? Or perhaps send Board members to lavish executive retreats in Hawai'i? The obvious answer is "no," yet Respondents suggest that the statute contains no standards to restrict what the LGC Board classifies as an administrative expense, and that anything goes.[3] The same argument applies to amassing an excessive "contingency reserve" war chest in order to use the "reserve" funds to subsidize other pools or to compete against LGC's perceived competitors. Why stop at an RBC of 4.2 when some insurance companies maintain contingency reserves at the 10.0 RBC level? And if an RBC of 10 is good, would not an RBC of 20 be even better?

With no regulatory oversight, as argued by Respondents, and no independent boards to maintain focus on benefitting the Members, there is no mechanism to restrain bad judgment or self-dealing. The obvious answer is that the context and very purpose of the statute prohibits such excesses. As set forth above, R.S.A. 5-B must be interpreted to effectuate its purpose of benefiting Members and minimizing the cost of coverage to Members.

[3] It should be noted that the statute allows only "required" expenses and reserves. R.S.A. 5-B:5, I(c). This qualifier cabins pooled risk management programs from inflating administrative costs or contingency reserves without a specific justification that the expense or additional reserve is "required" to operate the risk pool for the benefit of political subdivisions. Respondents conveniently overlook the import of the General Court's inclusion of the word "required" in R.S.A. 5-B:5, I(c).

B. Action Against Individual Respondents Is Contemplated by R.S.A. ch. 5-B.

Respondents Andrews and Carroll argue that R.S.A. 5-B does not provide for personal liability and that the Bureau is limited to alleging violations of the statute by the LGC entities. This argument fails because R.S.A. 5-B:4-a specifically authorizes the Secretary of State to investigate and impose penalties for violations of the statute by "any person." *See* R.S.A. 5-B:4-a, V ("In any investigation to determine whether *any person* has violated or is about to violate this chapter or any rule or order under this chapter . . .") (emphasis supplied); R.S.A. 5-B:4-a, VI ("Whenever it appears to the secretary of state that *any person* has engaged or is about to engage in any act or practice constituting a violation of this chapter . . .") (emphasis supplied); R.S.A. 5-B:4-a, VII(a) ("*Any person* who, either knowingly or negligently, violates any provision of this chapter . . .") (emphasis supplied); R.S.A. 5-B:4-a, VII(b) (". . . the secretary of state may enter an order of rescission, restitution, or disgorgement directed to *a person* who has violated this chapter . . .") (emphasis supplied). The General Court's use of the phrase "any person," rather than "any pooled risk management program" demonstrates an intent to create personal liability on individuals for violations of R.S.A. 5-B.

Indeed, there would be little sense in holding only the risk pool entity responsible for statutory violations where the risk pool is no more than an association of political subdivisions. It would be counterproductive for the Bureau to penalize the Members of a risk pool for failing to protect the interests of those same Members. Instead, the statute specifically imposes liability on the individuals, or non-risk pool entities,[4] that "either knowingly or negligently" cause a violation of the statute.

[4] LGC, Inc. is not a pooled risk management program. Rather, it is a parent company whose subsidiaries operate pooled risk management programs.

The Bureau has alleged violations of R.S.A. 5-B by the LGC entities under the direction of the Individual Respondents. In light of the express liability of "any person who, either knowingly or negligently, violates any provision of" R.S.A. 5-B, the Bureau has set forth a cognizable cause of action against the Individual Respondents. To the extent that the Individual Respondents wish to dispute the facts of their involvement in violations of the statute, such factual determinations must wait for the evidentiary hearing and credibility determinations made by the Presiding Officer.

C. The Bureau Does Not Seek Retroactive Application of R.S.A. 5-B.

As a preliminary matter, there is no dispute that the Bureau is empowered to hold the Respondents responsible for current violations of R.S.A. 5-B, and may impose fines or order rescission, restitution, or disgorgement for current violations of any provision of the statute. R.S.A. 5-B:4-a, I(b) & VII. Instead, the Respondents argue that penalizing them for conduct occurring before the effective date of the enforcement provisions of R.S.A. 5-B:4-a would constitute an unconstitutional retrospective application of the statute. Respondents, however, misconstrue the nature of the action taken by the Bureau and misconceive the scope of the constitutional prohibition on retrospective application of laws set forth at Part I, Article 23 of the New Hampshire Constitution.

Respondents overlook the fundamental distinction between retrospective application of new substantive laws and enforcement of violations of existing statutory requirements. The 2009 and 2010 amendments to R.S.A. 5-B that granted the Bureau regulatory power to enforce violations of the statute did not create new obligations or requirements for the operation of a pooled risk management program. Here, the Bureau merely seeks to enforce violations of R.S.A.

5-B:5, a provision that has been in effect since 1987. Thus, there is no retrospective application of substantive law at issue.

The Respondents' attempt to characterize the enforcement provisions of R.S.A. 5-B:4-a as violative of their substantive vested rights is misplaced. In essence, the Respondents argue that because there was no express regulatory oversight in the statue prior to 2009, they were free to brazenly violate the statute without consequence. Even if this may practically have been the case, the Respondents had no vested right to operate statutorily authorized pooled risk management programs in violation of the statute's substantive requirements while also claiming the tax and regulatory benefits of the statute. The Respondents "have no general right to the continuance even of prior substantive law," In re Goldman, 151 N.H. 770, 774 (2005), and cannot argue with a straight face that they have a vested right to continue to violate the statute without consequence.

Nevertheless, even if the current enforcement action is deemed to affect the Respondents' vested rights, the public purpose and remedial nature of the enforcement provision takes R.S.A. 5-B:4-a outside the scope of Article 23 protections. Pepin v. Beaulieu, 102 N.H. 84, 89-90 (1959) ("[A] retrospective statute does not contravene the provisions of Art. 23rd, Bill of Rights, N.H. Constitution, if it affects the remedy only and is not oppressive or unjust.").

There is no dispute that R.S.A. 5-B serves an important public purpose by authorizing political subdivisions of the state to obtain needed insurance coverages at below-market costs. *See* R.S.A. 5-B:1 (declaring that "pooled risk management is an essential governmental function"). Indeed, the purpose of the Bureau's enforcement action is to compel the return of Member funds improperly retained by Respondents in violation of R.S.A. 5-B. The remedies of rescission, restitution, and disgorgement clearly serve a legitimate government interest in protecting risk pool Members and the public citizens who fund Member participation through their property taxes from violations of R.S.A. 5-B, and are neither oppressive nor unjust. Accordingly, these remedial provisions may constitutionally be applied to conduct arising before the effective date of the amendment. In re Franklin Lodge of Elks No. 1280 BPOE, 151 N.H. 564, 568 (2004).

Here, the improper corporate structure, lack of adequate protections against conflicts of interest and resultant improper transfers of surplus funds, as well as the inflated contingency reserve and improper rate stabilization scheme to retain Member surplus are all continuing violations of the provisions of R.S.A. 5-B. While the initiation of these programmatic changes may have occurred before the Bureau was granted regulatory authority on June 29, 2009, the continuing effects and violations render the need for retrospective enforcement against the Respondents unnecessary. Even Mr. Andrews, who stepped down as Executive Director in September of 2009, was still directing the LGC entities in their violations of R.S.A. 5-B for over two months after regulatory authority began. Moreover, Mr. Andrews has continued on with LGC pursuant to a lucrative 5-year consulting agreement.

II. The Bureau Is Not Required to Promulgate Rules in Order to Enforce Clear Violations of R.S.A. 5-B.

In this enforcement action pursuant to R.S.A. 5-B:4-a, the Bureau is not seeking to promulgate or enforce administrative rules, nor is it required to under the law. In re Blizzard, No. 2011-187 (N.H. March 9, 2012) ("We have consistently held that promulgation of a rule pursuant to the Administrative Procedures Act is not necessary to carry out what a statute demands on its face.") (citations and quotations omitted). As set forth above, R.S.A. 5-B is sufficiently detailed on its face, when read in context and to effectuate its clear legislative purpose, to be implemented without the need for clarifying rulemaking by the Bureau. *See* Section I.A, *supra*.

Moreover, the Respondents fail to recognize the Bureau's authority to interpret the meaning of R.S.A. 5-B and to develop new policy on a case-by-case basis through adjudicatory actions. It is well established that administrative agencies may act through rule-making *or* adjudication. *See* New Hampshire-Vermont Physician Service v. Durkin, 113 N.H. 717, 722-23 (1973) ("The fact that [the Insurance Commissioner] proceeded in an adjudicatory rather than rule making context is irrelevant to the validity of the order in that the Supreme Court has endorsed an agency's choice of the former ad hoc approach under circumstances where it 'may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule.") (*quoting* SEC v. Chenery Corp., 332 U.S. 194, 202 (1947)). Indeed, the U.S. Supreme Court has stated that in "performing its important functions . . . an administrative agency must be equipped to act either by general rule or by individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity." SEC v. Chenery Corp., 332 U.S. 194, 202 (1947).

In Chenery Corp., the U.S. Supreme Court established unequivocally that:

> [an] agency must retain power to deal with the problems on a case-by-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards. And the choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies *primarily in the informed discretion of the administrative agency*.

Id. at 203 (emphasis supplied). In the context of the Bureau's regulatory authority over R.S.A. 5-B, it is clearly within the Bureau's sound discretion to proceed through an adjudicatory action before engaging in formal rule making.

As a starting point, prior to June 29, 2009, the Bureau was expressly prohibited from promulgating rules with regard to R.S.A. 5-B. R.S.A. 5-B:4 (2008) ("Nothing contained in this chapter shall be construed as enabling the department to exercise any rulemaking, regulatory or enforcement authority over any pooled risk management program formed or affirmed in accordance with this chapter."). By Amendments effective June 29, 2009 and June 14, 2010, the General Court stripped this language from the statute and added section 4-a,[5] which granted the Bureau express enforcement authority. R.S.A. 5-B:4 & 4-a.

Section 4-a authorizes the Secretary of State to conduct investigations, bring administrative actions, issue cease and desist orders, and impose penalties for violations of the statute; it does not authorize rule making. While references to rules in the context of violations of "this chapter or any rule or order under this chapter" implies that the Secretary has rulemaking authority, there is no express mandate to promulgate rules or grant of authority to do so contained in R.S.A. 5-B.

In light of the lack of express rule making authority under the statute, and the short amount of time that the Bureau has had regulatory authority, it was well within the Bureau's sound discretion to address the Respondents' violations of R.S.A. 5-B through adjudication rather than initiate a rule-making process. Chenery Corp., 332 U.S. at 203. The Bureau has identified current and ongoing violations that are depriving municipalities and other political subdivisions of this state of millions of dollars rightfully belonging to them. The Bureau properly took action to remedy the specific behavior of LGC that violates R.S.A. 5-B through the Bureau's express regulatory powers, and may not be forced to rely on rulemaking authority that is not clearly granted under the statute before initiating an enforcement action.

[5] R.S.A. 5-B:4-a is set to expire effective July 1, 2013.

Moreover, that the Bureau's enforcement action "might have a retroactive effect [is] not necessarily fatal to its validity." Id. The Chenery Court held that:

> Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law.

Id. Once again, allowing Respondents to retain millions of dollars of surplus funds that were required to be returned to Members far outweighs any ill effect of retroactive application of a finding against Respondents. Where the Respondents have no right to retain surplus Member funds, there can be no prejudice to enforcing the dictates of the statute and returning the funds to their rightful owners.

Finally, the Respondents' reliance argument is without merit. Respondents could not have reasonably relied on the fact that the Bureau did not promulgate rules to justify their actions when the Bureau was precluded from rulemaking under the statute. The Respondents had more than adequate notice of the requirements under the statute (indeed Mr. Andrews was instrumental in assisting the legislature to draft and enact R.S.A. 5-B), and had no right or reasonable expectation to the continuance of the statute without regulatory oversight. Moreover, had the Respondents felt that rules were necessary to define the scope of the statute, they could have petitioned for rulemaking by the Bureau pursuant to R.S.A. 541-A:4, I ("Any interested person may petition an agency to adopt . . . a rule") or filed a declaratory judgment action to challenge the lack of clarity. Respondents, however, took no such actions.

In summary, the Bureau has neither adopted ad hoc rules nor is it required to promulgate rules in order to enforce the clear standards of R.S.A. 5-B and remedy Respondents' violations of the statute. The Respondents arguments, therefore, fail to establish adequate grounds to dismiss Counts I and II of the Amended Petition.

III. R.S.A. ch. 5-B Is Neither an Unconstitutional Delegation of Legislative Power Nor Unconstitutionally Vague.

The Respondents also attack R.S.A. 5-B on constitutional grounds, arguing that it both constitutes an unconstitutional delegation of legislative authority to the Bureau and is unconstitutionally vague. The Respondents face an exacting standard of review in challenging the constitutionality of R.S.A. 5-B:

> When we interpret statutes already in effect, they are construed to avoid conflict with constitutional rights wherever reasonably possible. . . . [W]hen we review an existing statute, we presume it to be constitutional and will not declare it invalid except upon inescapable grounds. This means that we will not hold the act to be unconstitutional unless a clear and substantial conflict exists between it and the constitution. It also means that when doubts exist as to the constitutionality of a [statute], those doubts must be resolved in favor of its constitutionality.

<u>In re Opinion Of Justices</u>, 162 N.H. 160, 164 (2011) (*citations and quotations omitted*). The Respondents' arguments fail to overcome the presumption of constitutionality. Applying the exacting standard of review to Respondents' constitutional arguments, it is clear that R.S.A. 5-B passes constitutional muster.

It should also be noted that if the Respondents prevail on either constitutional argument, R.S.A. 5-B will be rendered void, eliminating any exemption from taxation or regulation by the Insurance Department provided to pooled risk management programs qualifying under the statute. Such a result would open the Respondents and their Members to liability for back taxes and penalties, which could have a significant adverse effect on municipal budgets.

A. R.S.A. 5-B Contains Basic Standards and a Definite Policy that Guide Administration of the Statute.

"To avoid the charge of unlawfully delegated legislative power, a statute must lay down basic standards and a reasonably definite policy for the administration of the law." New Hampshire Dept. of Environmental Servs. v. Marino, 155 N.H. 709, 715 (2007). As set forth above, the legislature has stated the clear policies and purpose underlying R.S.A. 5-B. Specifically, R.S.A. 5-B authorizes the establishment of "pooled risk management programs for the benefit of political subdivisions of the state," in order to lessen the burden on the resources of political subdivisions by providing, in part, "accrual of interest and dividend earnings which may be returned to the public benefit." R.S.A. 5-B:1. These public benefit purposes guide the scope of operation of pooled risk management programs and provide a framework for interpreting the statute.

In addition to a definite statement of purpose, the statute further sets forth basic standards for the operation of a pooled risk management program. R.S.A. 5-B:5 lists seven specific standards required to effectuate the statutory purpose, including legal status as a New Hampshire organization; governance by an independent board of directors; return of surplus funds in excess of amounts required to achieve the statutory purpose of low-cost coverage at a prudent level of risk; annual audits; governance by written bylaws; annual actuarial evaluations; and public hearings. In light of the definite policies set forth in Section 1 and the specific standards delimited in Section 5, there is more than ample guidance to restrict the Bureau's discretion in administering and enforcing the statute.

As made clear in prior cases, where there are articulated factors such as these that limit agency discretion, no unconstitutional delegation has taken place. *See, e.g.,* Union School Dist. of Keene v. Comm'r of Labor, 103 N.H. 512, 516-17 (1961) (Finding delegation of implementation and application of minimum wage standards to specific cases not an unconstitutional delegation of authority); In re Blizzard at 4 (characterizing statutory delineation of distinct violations that trigger suspension of operating privileges as "more than basic"). Moreover, "in matters relating to public resources and public health, the standards and policy may of necessity require more general grants of authority." Velishka v. City of Nashua, 99 N.H. 161, 167 (1954). Thus, because R.S.A. 5-B relates to protection of public resources (namely municipal budgets funded by property taxes), there is a reduced standard of specificity required to meet constitutional requirements.

Accordingly, the clear policy of R.S.A. 5-B and the specific standards contained in Section 5 limit the Bureau's discretion and make the legislature's delegation of authority to the Bureau to enforce the statute a permissible, constitutional delegation of authority.

B. R.S.A. 5-B is Not Unconstitutionally Vague.

LGC makes the incongruous argument that R.S.A. 5-B contained adequate specificity for its first 22 years of existence, only to suddenly become unconstitutionally vague upon the addition of regulatory oversight and enforcement powers in 2009. LGC Mtn. to Dismiss Cnt. II, ¶¶19, 31. This argument is both nonsensical and contrary to the law. The essence of Respondents' vagueness argument is simply a recapitulation of its statutory interpretation argument. The Respondents unsurprisingly desire to interpret R.S.A. 5-B as broadly as possible in order to permit maximum discretion in operating pooled risk management programs. As set forth above, however, R.S.A. 5-B, when read in context and interpreted to give effect to its clear purpose, contains more than adequate specificity to avoid constitutional infirmity.

The standard for review of a void for vagueness claim has often been repeated by the Courts:

> Vagueness may invalidate a statute either because it fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits or because it authorizes or even encourages arbitrary and discriminatory enforcement. A party challenging a statute as void for vagueness bears a heavy burden of proof in view of the strong presumption favoring a statute's constitutionality. The specificity required by due process need not be contained in the statute itself, but rather, the statute in question may be read in the context of related statutes, prior decisions, or generally accepted usage.

Marino, 155 N.H. at 716 (*citations and quotations omitted*). The Respondents interpret R.S.A. 5-B to eliminate any reasonable limitation on how Respondents operate pooled risk management programs, including no limit on the amount of contingency reserves they may retain, no limit on expenses they may deem required administrative expenses, and no limit on the methodology by which they purport to return surplus funds to Members. This interpretation of the statute is, simply put, absurd.

The Respondents void for vagueness argument fails because it is premised on an unreasonable interpretation of R.S.A. 5-B that is in conflict with the very purpose of the statute. It is a fundamental principle under New Hampshire law that "whenever possible, a statute will not be construed so as to lead to absurd consequences." In re Poulicakos, 160 N.H. 438, 444 (2010). Here the Respondents contend that a person of ordinary intelligence would not understand that the purpose of the statute, as well as basic concepts of reasonableness, prohibits conduct that is contrary to the interests of the Members, such as transferring surplus Member funds (*i.e.*, funds not required to protect against reasonable contingencies) to an insolvent Worker's Compensation pool with little hope or expectation of repayment. Rather, Respondents infer that the statute can unreasonably be interpreted to allow unfettered discretion by pooled risk management programs. However, "as between a reasonable and unreasonable meaning of the language used, the reasonable meaning is to be adopted." Id.

R.S.A. 5-B includes adequate minimum guidelines governing administrative enforcement of the statute to avoid constitutional infirmity. State v. MacElman, 154 N.H. 304, 309 (2006). The statute affords a person of ordinary intelligence a reasonable opportunity to understand that maintaining excessive contingency reserves, unreasonable administrative expenses, and failing to return all surplus to Members will run afoul of the plain statutory requirements of R.S.A. 5-B. Moreover, the statute does not encourage arbitrary and discriminatory enforcement, as it set out specific requirements and authorizes the Bureau only to enforce the provisions of the statute. The Respondents have failed to satisfy their "heavy burden" to overcome the "strong presumption favoring a statute's constitutionality," Marino, 155 N.H. at 716, and their motions to dismiss on grounds of unconstitutional vagueness should be denied.

IV. Disputed Issues of Material Fact Prohibit an Award of Summary Judgment.

Respondent Carroll moves for summary judgment on a theory that she had no authority to act for LGC and at all times was merely blindly following the direction of the LGC board. In fact, Ms. Carroll even denies having any substantive knowledge of how pooled risk management programs operate, despite being the executive director of LGC, which purportedly governs pooled risk management programs that collected over $400,000 in Member contributions in 2010 alone. Because disputes of material fact persist, Ms. Carroll's motion for summary judgment must be denied. RSA 491:8-a, III; Wood v. Greaves, 152 N.H. 228, 230 (2005).

Ms. Carroll first argues that she is entitled to summary judgment with regard to any conduct occurring prior to her appointment as Interim Executive Director on September 4, 2009. Mr. Carroll disputes that she was legal counsel to the LGC or the pooled risk management programs or that she ever provided legal advice to any of those entities. Carroll Aff. at ¶¶3, 9. Contrary to Ms. Carroll's assertions, however, she was frequently listed as LGC's general counsel in LGC Board minutes, and even in an article in LGC's own Town and City magazine, over which Ms. Carroll has substantial editorial control. *See* Mann Aff., and Exhibits C & D thereto. Despite having ample opportunity, Ms. Carroll never corrected these and other, supposedly misleading characterizations of her role at LGC.

The inconsistencies between Ms. Carroll's assertions made today in the midst of litigation do not comport with characterizations by LGC itself in years past prior to the threat of litigation. In addition, Ms. Carroll's admission that she was part of the senior leadership team that advised the Executive Director further implicates Ms. Carroll in the conduct complained of by the Bureau. *See* Mann Aff., and Exhibit A thereto. Because Ms. Carroll, who is an attorney, denies that she had any operational knowledge about the operation of LGC and its affiliated pooled risk management programs, any advice provided by Ms. Carroll as part of the senior leadership team was likely legal advice. As such, there are disputed issues of material fact as to the scope of Ms. Carroll's role at LGC prior to September 4, 2009 that preclude an entry of summary judgment in her favor.

Ms. Carroll makes the same arguments of lack of authority or involvement with LGC decision making in her role as interim, and then permanent, Executive Director beginning on September 4, 2009. Ms. Carroll contends that her role as Executive Director was simply "to carry out the policies determined by the LGC Board and to oversee the affairs of LGC under the Board's direction and supervision." Carroll Mtn. for Sum. J. at 8. However, as Executive Director, Ms. Carroll wielded considerable power over the daily affairs of LGC and its affiliate entities, and took an active role in continuing the improper corporate structure and policies that violate the requirements of R.S.A. 5-B. Like Mr. Andrews before her, Ms. Carroll's duties as Executive Director included the following:

> As Executive Director of the LGC, the Employee shall (i) conduct the daily affairs of the LGC, including all of its current and future component divisions and services, under the direction and supervision of the LGC Board of Directors, (ii) act as Treasurer of the LGC and be responsible for the disbursement of LGC funds, (iii) act as Secretary of the LGC, and (iv) render an annual account of the activities of the LGC to the President, the Board of Directors, and the membership and otherwise as may be required by the Board. Conduct of the daily affairs shall include, without limitation, recommending to and carrying out policies established by the Board of Directors; recruitment, retention, evaluation, discipline and discharge of all necessary staff; managing the physical facility and offices of the LGC; locating and recommending various contractors; supervising and reporting on contractors' performance; providing financial and accounting reports; and maintaining excess re-insurance or other insurance.

Employment Agreement of John B. Andrews, ¶2.1.[6] *See* Mann Aff., and Exhibit E thereto.

In light of Ms. Carroll's extensive duties as Executive Director, including close contact with and advice to the LGC Board, there is a factual dispute over the extent of Ms. Carroll's involvement in continuing and facilitating the ongoing violations of R.S.A. 5-B. According to LGC's financial audit reports, Ms. Carroll, as part of the LGC management, was responsible for LGC's financial management and audit process as stated on the annual Independent Auditor's Report. *See* Mann Aff., and Exhibit F thereto. Similarly, Ms. Carroll was central to the effort to clean up the LGC's failed 2003 corporate restructuring, including overseeing the revival of the lapsed corporate entities that previously operated the pooled risk management companies and executing LLC operating agreements and Pooled Risk Management Program Agreements. *See* Carroll Mtn. for Sum. J. at 13. Ms. Carroll is hard pressed to claim she had no involvement in the LGC's current corporate structure when she executed the key documents. Moreover, while Ms. Carroll makes a clever technical argument that she is not a corporate officer of LGC pursuant to the Bylaws, there is no doubt that as a key executive employee with extensive

[6] Due to the late production of documents in this matter, the Bureau does not currently have Ms. Carroll's employment agreement, but assumes it is similar, if not identical, to Mr. Andrews employment agreement.

management-level authority over the company, Ms. Carroll has the same fiduciary duties as imposed on corporate officers.

Taken together, the foregoing demonstrates that there remain disputed issues of material fact with regard to Ms. Carroll's role in advising and directing LGC in its continuing violations of R.S.A. 5-B. Therefore, summary judgment is not warranted, and Ms. Carroll's motion should be denied.

V. The Risk Pool Contracts are Securities Under New Hampshire Law.

A. Risk Pool Contracts Satisfy the Howey Test

The initial issue raised by the Respondents is whether or not the risk pool contracts sold by the Respondents constitute securities under New Hampshire law. The Bureau has alleged that risk pool contracts, or participation agreements as they are referred to in Andrews' motion, constitute investment contracts and therefore fall within the definition of securities as set out in RSA 421-B:2(XX)(a). In alleging that the risk pool contracts are securities, the Bureau relies on the test established by the United States Supreme Court in SEC v. W.J. Howey Co., 328 U.S. 293 (1946), commonly referred to as the Howey test. The issue presented is whether the Bureau has alleged sufficient facts in the Amended Complaint to meet the requirements set forth in the Howey test. All parties agree that the Howey test is an appropriate test for identifying an investment contract under New Hampshire law.

The Howey test applied a four-prong analysis to identify an investment contract for securities regulation purposes: (1) investment of money; (2) in a common enterprise; (3) with the expectation for profit; and (4) to come solely through the efforts of the promoter or some third party. Howey, 328 U.S. at 301. In *Howey*, the Court found that the offering for sale of small plots in an orange grove, in conjunction with a management contract to manage any plots purchased, constituted an investment contract, and not an ordinary real estate sale and management agreement. In their current motions, the Respondents do not contest the common enterprise element of the Howey test. They do contest whether the risk pool contracts meet the other 3 elements of the Howey test, each of which are addressed in detail below.

1. Investment of Money

LGC contends that there is no investment of money because the municipalities and other political subdivisions that purchase risk pool contracts are purchasing risk coverage, not an investment in the common sense of the word. (LGC Mtn to Dismiss Cnts III, IV & V, at ¶18.) Respondent Carroll expands on this argument based on International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), a case in which an employee's contribution of labor was not found to be investment of money for investment contract purposes. A close review of this case indicates that the court relied specifically on the fact that the employee did not pay money in determining that there was no investment contract. The *Daniel* Court cited to a long list of cases in which an investment contract had been found based on the fact that money had been paid. Id. at 559-60. The list includes cases, including *Howey*, in which money had been paid to purchase something else, such as an orange grove and service contract, and an investment contract was still found to exist. The fact that purchasers of LGC's risk pool contracts pay money and receive risk coverage, does not mean that purchasers have not invested money under the Howey test. There is no dispute that purchasers of risk pool contracts pay money to the Respondents, and the Bureau alleged that these payments include an investment.

As indicated above, none of the Respondents are challenging the second element of the Howey test, the common enterprise element.

2. Expectation of Profit

All of the Respondents contest the third element of the Howey test, whether there is an expectation for profit upon the purchase of a risk pool contract. The Respondents essentially claim that the purpose of the risk pool contracts is the ability to obtain insurance contracts. However, the Bureau's allegations, as set forth in the complaint, include allegations that the Respondents pay dividends, retain member's monies to use for rate stabilization, investments, or offsets to future contributions, and advertises these benefits in seeking to sell these risk pool contracts. These allegations, and all reasonable inferences made in the light most favorable to the Bureau, are sufficient to prove that there is an expectation of profit upon the purchase of the Respondents' risk pool contracts.

While the Respondents cite to a number of cases dealing with different situations than the one presented here, the one case dealing with a similar pooled trust situation specifically denied the argument of the trust that "participating school districts were motivated solely by a desire to provide health benefits, and not by the prospect of a return." Indiana ex rel Naylor v. Indiana State Teachers Association, 2010 WL 1737914 (S.D.Ind.) at *4. In *Naylor*, the Indiana Securities Commissioner brought an action against the Indiana State Teachers Association Insurance Trust alleging that the Trust's Health Insurance Plan constituted a security. Naylor, 2010 WL 1737914, at *1. The Trust's Plan featured a "collaborative surplus reserve" where a school district would be credited with a balance if the payments by the school district to the Trust exceed the amount of claims paid, plus administrative expenses and overhead amounts. Id. The Trust represented to school districts that it could receive a return on their collaborative surplus reserve balance based, in part, on the return earned by the Trust on their investments. Id.

The United States District Court for the Southern District of Indiana denied the Trust's Motion to Dismiss the *Naylor* case on the basis that the Plan did not constitute a security. The Court's analysis, in Footnote 8, notes the following in addressing its ability to resolve this claim on a Motion to Dismiss:

> Ultimately, because the proper evaluation of a securities claim "cannot be accomplished without a thorough examination of the representations made by the defendants as the basis of the sale," we conclude that a final determination of whether the CSR Program in this case actually qualifies as a "security" under the relevant statues is a question of fact that must be left for summary judgment or trial. Aldrich v. McCulloch Properties, Inc., 627 F.2d 1036, 1039 (10th Cir.1980) (citations omitted).

Naylor, 2010 WL 1737914, at *2 n. 8. The Court then turned to a review of the allegations contained in the complaint to determine whether a cause of action had been pled that the Plan constituted a security.

The Court applied the Howey test to the allegations contained in the complaint, focusing first on the expectation of profit prong of the Howey test. Id. The Court looked at two cases which are also cited by the Respondents in their current motions: United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) and the same Court's prior decision in Waldo v. Central Indiana Lutheran Retirement Home et al., 1979 WL 1279 (S.D.Ind. Nov.16, 1979). The *Forman* Court found that a housing cooperative in which tenants could receive a rent rebate, if rent paid exceeded the cooperative's expenses, did not constitute a security as the purchaser was motivated by a desire to use or consume the item purchased, as opposed to a return on his or her investment. Forman, 421 U.S. at 853. In *Waldo*, the Court found that a life membership arrangement with a nursing home where the purchaser received both the right to live in the home and an entitlement to interest on the amounts paid was not a security as the interest provision was merely part of a broader arrangement. Waldo, 1979 WL 1279, at *3.

In *Naylor*, the respondents relied on *Forman* and *Waldo* in arguing that no security existed as purchasers of the Plan were motivated solely by the desire to obtain insurance coverage for its employees, and not by the prospect of a return. Naylor, 2010 WL 1737914, at *4. The Respondents in their current Motion make the exact same argument relying on the exact same cases. The *Naylor* court found that the Plan offered no convincing evidence in support of the proffered motivation, and that the Plan's rationale had not been tied to the allegations in the Complaint as a basis of dismissal. Id.

The Respondents' analysis in the instant case suffers from the same defects. The Respondents have offered no convincing evidence in support of their position that purchasers of risk pool contracts are motivated by their desire to obtain insurance coverage; they have simply made the allegation. Given that one of the express purposes of pooled risk management programs is the "accrual of interest and dividend earnings which may be returned to the public benefit" under RSA 5-B:1, the Respondents cannot argue that the only purpose of pooled risk contracts is the desire to obtain insurance coverage. Nor have they tied the allegations to the Complaint as the basis of dismissal. The Bureau alleges in its petition that purchasers of risk pool contracts have an expectation of profits in the form of a return of earnings, and that LGC advertises a return previously in the form of annual dividends and currently in the form of rate stabilization or offsets to future contributions. Amended Petition ¶109. While the Respondents may dispute this allegation, they have only raised an issue of fact to be resolved by the fact finder after a hearing. A factual dispute cannot be the basis for a Motion to Dismiss.

Having determined that *Forman* and *Waldo* did not apply to the trust at issue, the Naylor Court then looked to the Indiana Securities statute, Indiana Code §23-19-1-2(26)(A) which provides that:

> "a security given or delivered with, or a bonus on account of, a purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value."

Naylor, 2010 WL 1737914, at *4. R.S.A. 421-B:2(XIX)(c) essentially contains the same language as the Indiana Code. As a result of this statutory language, the appropriate inquiry on a Motion to Dismiss is not limited to the motivation of participants in obtaining the underlying coverage arrangement, but also includes the motivation for choosing the plan in issue over other alternatives. In *Naylor*, the Court concluded that it was conceivable that the school district's primary motivation for choosing the Trust over other options was the existence of the investment feature. Id. The same conclusion is conceivable in the instant case, as the primary motivation for purchasers of risk pool contracts in choosing the Respondents over other options was the existence of the investment feature, as advertised by the Respondents, and the benefits this feature offered in terms of dividends, rate stabilization, or premium credits.

The *Naylor* Court found that the allegations in the complaint were sufficient to satisfy all of the elements of the Howey test: the health arrangements were offered to and purchased by school districts, a common enterprise existed, the school districts were promised a return on their investments, which were based on the managerial efforts of others. Id. at *5. Similarly, the allegations contained in ¶109 of the Amended Petition are sufficient to satisfy all of the elements of the Howey test.

3. Efforts of the Promoter or Third Party

The fourth and final element of the Howey test is whether the expectation of profit is to come solely through the efforts of the promoter or some third party. *Naylor*, once again, presents the most closely applicable case law. The Trust in *Naylor* was exposed to the exact same risk factors as the risk pool contracts in this case: claims experience and history. The *Naylor* Court, while not specifically addressing the issue, did find that the promised return on investment in the Trust was based on the managerial efforts of others. Naylor, 2010 WL 1737914, at *5.

The *Howey* case itself provides an instructive analysis of the "efforts of the promoter" portion of the Howey test. In formulating its test for an investment contract, the *Howey* Court relies on existing state case law to the effect that an investment contract arises in situations:

> "where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves."

Howey, 328 U.S. at 298. In determining that the sale of plots and management contracts in the Howey orange grove constituted securities, the *Howey* Court relied on the fact that the promoters manage, control, and operate the enterprise. Id. at 300. In order to constitute an investment contract, under the Howey test, the profits must be generated by the efforts of someone other than the investor, i.e. the promoter or some other third party.

In the instant case, the Respondents argue that the profits generated by the risk pool contracts are not solely dependent on the Respondent's efforts as they are also dependent on claims experience and history. If outside factors such as claims experience and history are sufficient to take an investment contract outside of the Howey test, then Howey would never have been determined to be a security. The profitability of an orange grove is dependent on factors outside of the experience and skill of the operator, such as weather. Nevertheless, the *Howey* Court found that sales of an interest in the orange grove were investment contracts. Id.

The key to the Howey case is that profitability has to be dependent on the efforts of someone other than the investor. In this case, while the Respondents cannot control claims experience and history, the Respondent's efforts, skill, and expertise in managing pooled risk contracts contribute to their profitability. The Respondents cannot seriously maintain that their efforts, skill, and expertise have no significant impact on profitability given the claims history that each pooled trust encounters in any given year. The most important factor in this portion of the Howey test is that the investor does not determine the profitability of the investment contract. Municipalities and other political subdivisions of the state purchase a pooled risk contract in recognition of the fact that they cannot control their potential liability and/or their employee's health care costs. Since the profitability of the Respondents' pooled risk contracts are determined by the managerial efforts of the Respondents, the fourth and final element of the Howey test is met.

B. Risk Pool Contracts Satisfy the Risk Capital Test

In the early 1970's, both the state and federal courts became disenchanted with the restrictive way the Howey test was being interpreted. California, for many years, had recognized that there was an alternative test to the Howey test, called the Risk Capital test. While the California version of the Risk Capital test was first developed in Silver Hills Country Club v. Sobieski, 361 P.2d 906 (Cal. 1961), its roots go back much further. *See, e.g.*, Brownie Oil Co. v. Railroad Comm'n, 240 N.W 827 (Wis. 1932).

In *Sobieski*, the court held that the sale of country club memberships in a for-profit country club to be built was an investment contract. Sobieski, 361 P.2d at 909. The only right the purchaser had was the right to use the club's facilities, if the Club was actually built. Id. at 907. The membership did not grant the purchaser any rights to receive any income from the Club and the purchaser had no claim on the assets of the Club. Id. The problem was that the club had no assets and merely an option to purchase the land on which the Club was to be built. The money raised from the pre-sale of club memberships was going to be used to finance the building of the club. Id. at 908. The court indicated that the club was raising capital. Id. The court reasoned whether this capital was raised through the sale of securities in the form of stocks or bonds, or by pre-selling the memberships should make no difference. Id. Either method involved the sale of securities. Id. at 908-09. California continues to apply the Risk Capital test and the Howey test as alternative tests for identifying an investment contract under California law.

Also in the early 1970's, the Hawaii supreme court was unhappy with the interpretations of the Howey test and combined the best of the Howey test with the best of the Risk Capital test in State v. Hawaii Market Center, Inc., 485 P.2d 105 (Haw. 1971). This test has become known as the combined Howey-Risk Capital test. The combined test has been well-received by the states and has become a well-recognized alternative to the Howey test. Some states, such as Oklahoma, have incorporated the combined test in their statutes as an alternative to the Howey test. *See* 71 Okla. Stat. Section 1-102(32)(d). Others, such as Massachusetts, have adopted the combined test by administrative rule. *See* 950 CMR 14,401. Still others have adopted the combined test by court or administrative decision. *See e.g.*, Smith v. State, 587 S.W.2d 50 (Ct. App. 1979). In total, approximately twenty states have adopted the combined test in one form or another.

The combined Howey-Risk Capital test contains four elements: (1) an investment furnishing initial value to the offeror, (2) a portion of this initial value is subjected to the risks of the enterprise, (3) the furnishing of initial value is induced by the offeror's promise or representation which gives rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise by (4) someone other than the investor. Hawaii Market Center, Inc., 485 P.2d at 109.

The primary difference with the combined Howey-Risk Capital test is that it expands the expectation of profits to include the expectation of a bargained for benefit such as use of country club facilities. To the extent that the Respondents allege that using surplus or earnings to stabilize rates or as a credit toward rates does not involve an expectation of profit, the Risk Capital Test's expanded definition of profits as including bargained for benefit clearly encompasses rate stabilization or credits.

While it is true that the combined test has never been relied on by New Hampshire Courts or the Bureau, it is also true that the combined test has never been rejected by any New Hampshire Court or the Bureau. Further, in light of the fact that R.S.A. 421-B:32 states that our securities act is to be interpreted to make uniform the law of all those states which have adopted the uniform act, and only secondarily consider federal court interpretations of the 1933 Securities Act, the Presiding Officer should consider the combined test in analyzing the sufficiency of the complaint at this preliminary stage of the proceedings.

C. The Governmental Exemption under RSA 421-B:17 Does Not Apply

LGC claims that they are entitled to the registration exemption set forth in R.S.A. 421-B:17(I)(a) for securities issued by the government. The Respondents rely on their status as a quasi-public entity for purposes of the Right to Know Law, R.S.A. 91-A as determined by the

New Hampshire Supreme Court in Professional Firefighters of New Hampshire v. HealthTrust, Inc., 151 N.H. 501 (2004) (hereafter "*PFFNH*"). In recognition of the objectives of R.S.A. 91-A to increase public access to governmental proceedings, the Court determined that one of the Respondent's Trusts fell within the ambit of the Right-to-Know Law. *PFFNH* at 504-05.

The registration exemption for securities issued by the government, as set forth in R.S.A. 421-B:17(I)(a), is not nearly as broad as the definitions of public agency and public body contained in RSA 91-A:1-a. RSA 421-B:17(I)(a) exempts the following securities:

> "Any security, including a revenue obligation, issued or guaranteed by the United States, any state, any political subdivision of a state, or any agency, or corporate or other instrumentality, of one or more of the foregoing, or any certificate of deposit for any of the foregoing, but this exemption shall not include any industrial development bond or any industrial revenue bond;"

In order to be entitled to this exemption as a quasi-public entity, the Respondents would need to be a corporate or other instrumentality of the state or one of its political subdivisions. The three entities that claim the exemption, LGC Parent, HealthTrust, Inc., and NHMA Prop. Liab. Trust are not corporations of the state or any of its political subdivisions. The initial formation documents for all three entities indicate that they were created by individuals and not by the state or one of its political subdivisions. *See* Mann Aff., and Exhibit G thereto. Neither are any of these three entities instrumentalities of the state or any of its political subdivisions. Instrumentalities of the State are state chartered organizations created by the legislature such as the New Hampshire Housing Finance Authority (see R.S.A. 204-C *et seq.* and Union Leader Corp. v. New Hampshire Housing Finance Authority, 142 N.H. 540 (1997)) and the Pease Development Authority (see R.S.A. 12-G *et seq.* and In re Geekie, 157 N.H. 195 (2008)). In *PFFNH*, the Court relied on the New Hampshire Housing Finance Authority case, and compared HealthTrust to the Housing Finance Authority. The Court specifically noted that the Housing

Finance Authority was a public instrumentality, and while it noted that HealthTrust had similar aspects to the Housing Finance Authority, the Court did not indicate that HealthTrust was also a public instrumentality. *PFFNH* at 504. While R.S.A. 5-B authorizes the creation of pooled risk management programs, neither the LGC nor its perceived competitors Primex or SchoolCare, are created by statute and therefore they are not a public instrumentalities. Since the Respondents are not a public corporation or a public instrumentality, they are not entitled to the exemption set forth in R.S.A. 421-B:17(I).

D. The Claimed Insurance Policy Exception Does Not Apply

Respondent Carroll claims that the risk pool contracts are not securities as they are contracts for insurance and therefore do not fall within the definition of a security under R.S.A. 421-B:2(XX)(a), which provides that:

> "Security" does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period."

A close look at this definition indicates that the risk pool contracts in issue meet none of the requirements of the above cited exception to the definition of a security. This exception is not a blanket exception for all contracts that are "fundamentally contracts for insurance" as claimed by Respondent Carroll.

As an initial matter, the risk pool contracts which the Respondents sell are not insurance policies. R.S.A. 5-B:1. Participation in pooled risk management programs were established as an alternative to the purchase of insurance by local governments. Pooled risk management programs, which meet the standards of R.S.A. 5-B, are not subject to insurance regulation by the State. R.S.A. 5-B:6. Since the Respondents maintain that they continue to meet the requirements of R.S.A. 5-B and since the Respondents have not been subject to regulation by the

Insurance Department, they cannot seriously argue that they are an insurance company selling insurance policies, as required for the insurance policy exception of R.S.A. 421-B:2(XX)(a).

The risk pool contracts sold by the Respondents provide health coverage to the purchaser's employees, and coverage to the purchasers for property, liability, and workers compensation. Even if Respondent Carroll was correct that the Respondents are insurance companies selling insurance policies, the so-called policies sold do not promise "to pay money either in a lump sum or periodically for life or for some other specified period" as required by R.S.A. 421-B:2(XX)(a). The "policies" sold by the Respondents provide coverage for certain types of losses or expenses incurred, they do not provide for annuity payments or lump sum payments for a specified period in order to be entitled to the exception contained in R.S.A. 421-B:2(XX)(a). Since the Respondents are not an insurance company, since they do not sell insurance policies, and since they do not sell policies requiring them to pay money either in a lump sum or periodically for life or for some other specified period, the Respondents are not entitled to the exception contained in RSA 421-B:2(XX)(a).

E. Retention of Surplus

As part of its current investigation of the Respondents which led to the current Petition, the Bureau learned that rather than returning surplus to its members on an annual basis, the Respondents have retained surplus and used it for rate stabilization and/or as offsets towards future premium payments. In 2007, the LGC Board amended its bylaws to allow for the "return" of surplus through a "rating formula used to establish rates for each program of coverage." (Amended Petition ¶61.) The surpluses generated annually are retained and invested by the Respondents. This retention and investment of member's funds (LGC bylaws §5.1 and Amended Petition §58)) creates an expectation of profit through the efforts of the promoter that clearly puts these pooled risk contracts squarely within the *Howey* definition of an investment contract. *See* Amended Petition ¶¶58-65.

Respondent Andrews argues that there are no profits paid on these pooled risk contracts as any surplus is a return of premium paid, similar to the dividends of a mutual life insurance company. The Bureau does not dispute that there exists a long line of cases finding that mutual insurance company policies are not investment contracts for securities purposes. The seminal case in this area, Dryden v. Sun Life Assurance Company of Canada, 737 F.Supp. 1058, 1062-63 (S.D.Ind. 1989), found that a life insurance policy was not a security as there was no reasonable expectation of profits under the Howey test. The *Dryden* Court, relying on Rhine v. New York Life Insurance Co., 6 N.E.2d 74 (1936), found that the dividends paid under this whole life policy represented a return of premium:

> "At the end of the year, this surplus, rather than the profits of the company, is paid pro rata to the policyholders. *Id.* Consequently, Dryden could not have expected to share in the profits generated by Sun Life's investment portfolio. All that he could have expected to receive was his pro rata share of the premium surplus."

Dryden at 1063. The Court then concluded that Dryden did not bear the risk of Sun Life's investments or reasonably expect to share in Sun Life's investment profits. As such, the life insurance policy was not a security under the Howey test.

A 1985 No-Action letter from the Massachusetts Securities Division is instructive on this point. (Re: Foot Surgeons Assurance Company, 1985 WL 285139 (Mass.Sec.Div. 1985)). In denying the request for a no-action letter, the Division found that a return in the form of reduced premiums constituted a dividend, creating an expectation of profit. Id. at *1-2. The Division also found that the return of dividends would be the result of the efforts of the Company's management and third party advisors, therefore meeting the Howey tests' efforts of the promoter or third party element. Id. When surpluses are retained and invested by the promoter or third party to be used for subsequent premium reduction, an investment contract exists under the Howey test.

Under the Respondent's new system of retaining surplus, rather than returning it at the end of the year, the Respondents retain and invest the funds. As such, purchasers of risk pool contracts can expect to receive more than their *pro rata* share of any premium surplus. Pooled risk contract purchasers do bear the risk of the Respondents' investments of retained surplus and can reasonably expect to share in the investment profits in the Respondents' retained surplus through additional rate savings. *See, e.g., New Hampshire Town and City*, The Risk Pool Advantage (March 2010) (stating "Pools on the other hand, are not for profit. They take the 'premiums' and invest them as well. However, the 'profits' are used to reduce rates . . ."), attached as Exhibit H to the Mann Aff. The Respondents do not return premium surpluses annually, they retain and invest them, pursuant to their 2007 bylaw amendment. As a result, the Respondents' pooled risk contracts fall squarely within the Howey test as there is a clear expectation of profit from the retained surplus.

This 2007 bylaw amendment also defeats any argument regarding the Bureau's regulatory history with regard to pooled trust contracts and any argument based on administrative gloss. Simply put, there has not been enough time since the Respondent's adoption of the 2007 bylaw amendment for the Bureau to create any regulatory history or a sufficient policy, with regard to the retention of Member surplus for rate stabilization purposes, on which administrative gloss could attach. The Bureau's prior decisions on which the Respondents rely do not involve situations where money is retained and invested on behalf of the members, rather than being returned to them.[7] To the extent that "dividends" such as a premium overpayment are not profits when they are returned in a timely fashion, they become profits when they are retained, invested, and used towards future rate credits. When the Bureau learned through the current investigation that the Respondents had adopted a policy to retain surplus, they moved quickly to file this case alleging securities violations.

Similarly, while the Respondents cite to various no action letters issued by the SEC, none of these letters deal with the same factual situation presented here: the retention and investment of surplus premiums. Moreover, each of these no-action letters are limited in scope to the particular facts presented. No-action letters do not constitute a decision that a certain product is, or is not, a security; rather, they simply indicate the regulator's decision not to take enforcement action on a certain type of product. Finally, SEC no-action letters are based on federal law, whereas state law applies to the instant case. Of utmost importance is the fact that the focus of federal securities acts and state securities acts are different. The federal acts are aimed primarily at regulation of an orderly securities market, and, in recent years, the raising of capital. To the contrary, the sole focus of state securities laws has *always* been to protect investors. <u>See State ex rel. Mays v. Ridenhour</u>, 811 P.2d 1220, 1230 (Kan. 1991). To the extent that the Respondents claim that they are protected by case law, no-action letters, or other authority with regard to mutual insurance companies, any claimed protection was lost when the Respondents amended their bylaws to provide for the retention, rather than the return, of so-called surplus premiums.

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[7] The Associated Pharmacies decision cited on p. 40 of Respondent Carroll's Motion to Dismiss deals with the payment of a dividend, not the retention and reinvestment of it. The Good Health Medical Services case cited on p. 41 of Respondent Carroll's Motion to Dismiss deals with the delivery of medical services to insurers, there is simply no indication that the decision involves the retention of surplus in any fashion.

F. BSR Has Pleaded Securities Fraud With Sufficient Particularity

Count V of the Amended Petition generally alleges that Respondents participated in fraud, deceit and material omissions in connection with the offer or sale of securities in violation of R.S.A. 421-B:3. Pursuant to R.S.A. 421-B:3, it is unlawful for any person, in connection with the offer or sale of a security:

> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

R.S.A. 421-B:3, I.

Respondent Carroll argues that the Bureau has failed to plead securities fraud under R.S.A. 421-B:3 with particularity. Ms. Carroll argues that in order to sufficiently plead a cause of action for securities fraud under RSA 421-B:3, the Bureau must, in connection with its allegations of R.S.A. 421-B:3 violations, sufficiently establish the "who, what, when, where, and how of the alleged fraud." *See* DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir.), *cert. denied*, 498 U.S. 941 (1990). More specifically, Ms. Carroll alleges that the Bureau has failed to "adequately specify the time, place, and content of the relied-upon representations." Manchester Mfg. Acquisitions, Inc. v. Sears, Roebuck & Co., 802 F. Supp. 595, 603 (D.N.H. 1992).

First, it must be noted that the above referenced action is an administrative, not a private civil action. Pursuant to R.S.A. 5-B:4-a, VI, all hearings under RSA 5-B "shall be conducted in accordance with RSA 421-B:26-a." Accordingly, state administrative procedures, as opposed to federal SEC rules or court rules of civil procedure, control. In fact, RSA 421-B:26-a, XX specifically states that "[a]dministrative hearings shall not be bound by common law or statutory rules of evidence, nor by technical or formal rules of procedure." Therefore, civil court pleading standards for fraud do not apply in this administrative hearing under the Bureau's securities rules.

Nonetheless, the Bureau believes it has pleaded securities fraud with sufficient particularity to survive a motion to dismiss even in a civil action. The Bureau has alleged the material omissions giving rise to the fraud claim, including, but not limited to failing to disclose the fact that: 1) "risk pool contracts" are unregistered securities; 2) LGC Parent and its subsidiaries are not licensed as broker-dealers or issuer-dealers as required by law to offer or sell securities; and 3) LGC Parent's officers and employees are not licensed as agents as required by law to offer or sell securities. Id. at ¶124. Further, the Bureau has clearly alleged actions by Respondents that operate a fraud or deceit on members as defined by statute, including, but not limited to: 1) diverting Member funds from the HealthTrust and Prop. Liab. Trust pools to LGC Parent for use to subsidize the Workers Comp Pool; 2) diverting Member funds from the HealthTrust and Prop. Liab. Trust pools to LGC Parent for the benefit of LGC Parent's non-pool administration activities; and 3) investing Member funds in risky investment vehicles not authorized by Municipal Budget laws, all without notice to or approval from its Members. *Id.*

Finally, Ms. Carroll's argument that scienter is required to establish securities fraud is misplaced. Unlike common law fraud, under state securities laws, scienter is not a required element of securities fraud in state enforcement actions. *See* Sec'y of State v. Tretiak, 22 P.3d 1134, 1137, n.11 (Nev. 2001) (collecting cases); State v. First Investor Corp., No. CV-91-373 (Me. Super. Jan 10, 1992). Consequently, no showing of scienter is required to state a valid securities fraud claim, and Ms. Carroll's motion to dismiss should be denied.

VI. The Intracorporate Conspiracy Doctrine Does Not Bar Count VI.

Respondents raise the intracorporate conspiracy doctrine, a doctrine that has not been adopted in New Hampshire, as a defense against Count VI of the Amended Petition. "Under the intracorporate conspiracy doctrine, a corporation's employees, acting as agents of the corporation, are deemed incapable of conspiring among themselves or with the corporation. This doctrine stems from basic agency principles that attribute the acts of agents of a corporation to the corporation, so that all of their acts are considered to be those of a single legal actor." Dickerson v. Alachua County Comm'n, 200 F.3d 761, 767 (11th Cir. 2000) (*citations and quotations omitted*).

The reasoning behind the intracorporate conspiracy doctrine is that it is not possible for a single legal entity consisting of the corporation and its agents to conspire with itself, just as it is not possible for an individual person to conspire with himself. Id. Thus, it is clear that an essential element of the intracorporate conspiracy doctrine is that the alleged conspiracy occurred only between employees, officers, or directors of a single entity, operating within the scope of their employment.

Although LGC presently argues that, under R.S.A. 5-B, the current corporate structure of LGC and its subsidiaries allows the single LGC board to act on behalf of what should be financially and operationally distinct pooled risk management programs, the various entities within this corporate family are separate and distinct. In fact, even LGC claims that "[e]ach of the pools are held by 'a legal entity organized under New Hampshire law', as required by RSA 5-B:5, I(a)." LGC Answer at 10. The fact that LGC views "each" pool as a legal entity indicates that even LGC believes the corporate and company respondents to be separate legal entities. Further, the conspiratorial actions began prior to the "consolidation" of the corporate and company respondents and thus occurred among separate employees, officers, and directors of separate and distinct legal entities. Because LGC, Inc., HealthTrust, Inc., Property-Liability Trust, Inc., HealthTrust, LLC, Property-Liability Trust, LLC, LGC Workers' Compensation Trust, LLC, and LGC-HT, LLC are separate legal entities, the intracorporate conspiracy doctrine's "single entity" requirement is not met, and the doctrine cannot be asserted as a defense to the Bureau's conspiracy claim.

The Respondents further challenge the Presiding Officer's jurisdiction to reach a civil conspiracy claim, and the sufficiency of the Bureau's pleadings. As a preliminary matter, R.S.A. 5-B:4-a specifically grants the Secretary of State with "all powers specifically granted *or reasonably implied*" in order to enforce the provisions of the statute. R.S.A. 5-B:4-a, II (emphasis supplied). As the designee of the Secretary of State, the Bureau is empowered to "bring administrative actions to enforce this chapter." R.S.A. 5-B:4-a, I(a). Because the Bureau is authorized to enforce violations of the statute, and the alleged conspiracy is in furtherance of a knowing or negligent violation of the provisions of R.S.A. 5-B, it is reasonably implied the Bureau has jurisdiction to bring an administrative action encompassing a conspiracy to violate the statute. Any other interpretation of the "reasonably implied" language of R.S.A. 5-B:4-a, II would hamstring the Bureau's ability to enforce the statute and impose fines and penalties on "any person who, either knowingly or negligently, violates any provision of this chapter" in contravention of the clear statutory purpose. R.S.A. 5-B:4-a, VII(a).

Furthermore, the Bureau has adequately plead a civil conspiracy against the Respondents. The Bureau alleges that the Respondents reached an agreement to achieve an unlawful object of violating the requirements of R.S.A. 5-B by placing each of the pooled risk management programs under the control of a single board to facilitate inappropriate transfers of Member funds from and between various pools in violations of their fiduciary duties. The Bureau alleges, and the Respondents admit, that they accomplished the unlawful object of their conspiracy and have acted in furtherance of the conspiratorial acts over the course of several years up to and including the present. Finally, as an administrative arm of the Secretary of State, the Bureau's mission is to protect the public from unlawful acts within its jurisdiction. Thus, the Bureau alleged damages in the form of improperly retained surplus funds that must be returned to Members pursuant to R.S.A. 5-B. Having set forth all of the required elements of a conspiracy, and taking the alleged facts as true as required on a motion to dismiss, the Bureau has pleaded a cognizable conspiracy claim and the Respondents' motions to dismiss should be denied.

VII. Conclusion.

In a flurry of motions the Respondents have attempted to wish away the clear meaning and intent of R.S.A. 5-B in order to rationalize their illegal actions and undermine the very statute that allows them to exist as unregulated, tax exempt organizations They have also challenged the sufficiency of the Bureau's securities and conspiracy claims. Nonetheless, the Bureau has alleged sufficient facts to support cognizable claims that survive the Respondents' motions to dismiss. The Respondents' arguments do not diminish the import of their improper acts, which should be fully explored and debated through the scheduled evidentiary hearing.

WHEREFORE, for the foregoing reasons the Bureau of Security Regulation respectfully requests that the Presiding Officer:

A. Deny each of the Respondents' motions to dismiss;

B. Deny Respondent Carroll's motion for summary judgment; and

C. Grant such further relief as is fair and just.

Respectfully submitted,
The Bureau of Securities Regulations
State of New Hampshire
By its attorneys,
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Dated this 23rd day of March, 2012

/s/ *Andru H. Volinsky*

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I hereby swear that the foregoing motion was provided to counsel of record on the below service list by hand or electronically, this 23rd day of March, 2012.

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