STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE
BUREAU OF SECURITIES REGULATION

IN THE MATTER OF:	)	
Local Government Center, Inc., *et al.*	)	Case No: C-2011000036

RESPONDENT JOHN ANDREWS' MOTION TO DISMISS COUNTS III, IV, AND V OF THE AMENDED PETITION, SECURITIES CLAIMS

Respondent John Andrews, by and through his counsel, Orr & Reno, P.A., moves to dismiss Counts III, IV, and V (collectively, the "Securities Counts") of the Amended Petition as follows:

Introduction

The paramount allegation common to the Securities Counts is that the agreements the Respondent business entities share with their members are investment contracts, and therefore, securities regulated by RSA Ch. 421-B. Specifically, the BSR alleges that two agreements are securities: (1) pooled risk participation agreements (the "participation agreements"); and (2) New Hampshire Municipal Association, LLC ("NHMA") membership interests. *See* Amended Petition, ¶¶107, 125. Absent a finding that one or both of the agreements is a security, neither Mr. Andrews nor any other Respondent can be found liable on the Securities Counts (count III – sale of unregistered securities; count IV – knowing or negligent aid in sale of unregistered securities; count V – fraud, deceit and material omissions in connection with offer or sale of securities).

The Securities Counts should be dismissed for failure to state a cause of action upon which relief can be afforded, *see Buckingham v. R. J. Reynolds Tobacco Co.*, 142

N.H. 822 (1998), because neither the participation agreements nor the NHMA membership interests are securities. In short, the participation agreements and the membership interests are not investment contracts under the analysis set forth in S.*E.C. v. Howey*, 328 U.S. 293 (1946), and thus, are not securities within the meaning of RSA Ch. 421-B. Consequently, the Securities Counts, counts III-V, should be dismissed.

The Exhibits

Exhibit A to this motion is a representative participation agreement. Exhibit B is the Respondent Local Government Center (the "LGC") Bylaws. The LGC Bylaws are incorporated by reference into the participation agreement, see Exhibit A, Paragraph 3, and therefore, are part of the agreement.[1] Exhibit C is a set of the copies of letters from a Respondent business entity to a member announcing and enclosing the member's "dividend" check that were produced during the BSR's on-site examination of the LGC.

Argument

I. Participation agreements are not securities.

The New Hampshire Securities Act defines a "security" as follows:

> any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit sharing agreement; membership interest in a limited liability company; partnership interest in a registered limited liability partnership; partnership interest in a limited partnership; collateral trust certificate; preorganization certificate or subscription; transferable shares; investment contract; investment metal contract or investment gem contract; voting trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas

[1] While motions to dismiss generally are decided on the basis of the allegations pled in the complaint, when particular documents are referenced in, or central to, the allegations, it is permissible for the tribunal to consider those documents in deciding a motion to dismiss. *Chasan v. Village District of Eastman*, 128 N.H. 807, 814 (1986) ("consideration of . . . [extrinsic documents] . . . was required in order for the court to render adequate and informed conclusions of law . . . [w]e hold . . . that the trial court did not err in considering documents beyond the pleadings [in granting motion to dismiss]"); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 n. 3 (1st Cir. 1991) (trial court properly considered documents not attached to complaint where complaint alleged documents to be the source of securities fraud).

> or mining right, title or lease or in payments out of production under such a right, title or lease; or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. "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.

RSA 421-B:2, XX(a). According to the BSR, a participation agreement is a security within the meaning of RSA 421-B:2, XX(a) because it is an "investment contract." *See* Amended Petition, ¶107. The BSR's argument is flawed because the participation agreements are not investment contracts under the *Howey* test and therefore, are not securities.

A. Participation agreements allow New Hampshire political subdivisions to pool risk for insurance purposes through LGC's pooled risk management programs.

A participation agreement is the document by which a New Hampshire political subdivision seeks admission to a risk pool management program administered by LGC. *See* Exhibit A, p. 2, ¶ 1 ("The Applicant applies for participating . . . in the following pooled risk management programs . . ."); Exhibit A, p. 3, ¶ 4 ("upon renewal or initial acceptance as a Participant, the Applicant will be entitled to participate in those benefit programs offered by the applicable Trusts . . . .") A participant can elect to participate in up to four pooled risk management programs offered by LGC, including: (1) HealthTrust (for health and other benefits to employees); (2) Property-Liability Trust ("PLT") (for property and liability risks); (3) PLT d/b/a Workers Compensation Trust ("WCT") (for workers compensation for employees); and (4) PLT d/b/a WCT (for unemployment benefits for employees). Exhibit A, p. 2, ¶ 1.

The purpose of LGC's pooled risk management programs is to enable participating political subdivisions to pool self-insurance reserves, risks, claims, and losses, as well as administrative services and expenses. *See* Exhibit A, p. 1, Preamble (describing HealthTrust as "[a] pool for the management and provision of health and similar welfare benefits to their employees"; describing PLT as "[a] pool for the management and provision of (a) protection against their property and liability risks, known as the Property-Liability Trust; and (b) workers compensation and unemployment benefits to their Employees, known as Workers' Compensation Trust.") The essence of a participation agreement is a commitment by a New Hampshire political subdivision to share and spread risk with other New Hampshire political subdivisions for insurance purposes. *Id.* RSA Ch. 5-B expressly authorizes New Hampshire political subdivisions to enter into such risk-pooling agreements. *See* RSA 5-B:3, I ("A political subdivision . . . may establish and enter into agreements for obtaining or implementing insurance by self-insurance . . . [a]greements made pursuant to this paragraph may provide for pooling of self-insurance reserves, risks, claims, and losses, and of administrative services and expenses associated with them among political subdivisions.")

B. A participation agreement is not an investment contract within the meaning of the New Hampshire Securities Act, and therefore, is not a security.

1. In New Hampshire, the *Howey* test is employed to determine whether an agreement or an instrument is an investment contract, and therefore, a security.

The New Hampshire Securities Act, RSA Ch. 421-B, does not define the term "investment contract." Despite diligent efforts, undersigned counsel's research did not discover a New Hampshire judicial decision defining the term investment contract within

the meaning of the New Hampshire Securities Act.[2] However, while the matter may be one of first impression, existing law provides substantial guidance.

RSA Ch. 421-B is the "*Uniform* Securities Act." RSA 421-B:1 (emphasis added). The Act's stated statutory policy is that it "shall be so construed so as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation of this chapter with the related federal regulation." RSA 421-B:32. Thus, federal decisions construing the term "investment contract" provide guidance for the interpretation of the same term in RSA Ch. 421-B.[3]

The similarity of the definition of securities in the federal Securities Act of 1933 and RSA 421-B:2, XX(a) has been recognized. *Manchester Mfg. Acquisitions, Inc. v. Sears, Roebuck, & Co.*, 909 F. Supp. 47, 52 n.5 (D.N.H. 1995) (definition of "security" under RSA 421-B:2 is "substantially similar to that incorporated into the federal securities laws.") Each provides an ostensive definition of the term that expressly includes investment contracts among the list of instruments deemed securities. *Compare* Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77B(a)(1),[4] *with* RSA 421-B:2, XX(a).

S.E.C. v. Howey, 328 U.S. 293 (1946), is the seminal federal case that defines the term "investment contract" as used in the Securities Act of 1933. In *Howey*, the United

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[2] In *State v. Heneault*, 121 N.H. 497, 499-500 (1981), the term "investment contract" was interpreted in the context of the securities act that was in effect in 1979, a version of the statute that "limit[ed] the definition of securities to those investment contracts 'in the form of a bill of sale.'" *Id.* at 500 (emphasis omitted). Since the Act subsequently was amended to remove this limitation, *Heneault* no longer is good law.

[3] New Hampshire courts often seek guidance from federal courts regarding the interpretation of uniform or similar laws with which the federal law has greater historical development. *See, e.g., Scarborough v. Arnold*, 117 N.H. 803, 807 (1977) ("In considering what constitutes proof of discriminatory failure to hire under our "Law Against Discrimination," RSA 354-A . . . it is helpful to look to the experience of the federal courts in construing the similar provisions of Title VII of the 1964 Civil Rights Act.")

[4] The intent of Section 2(1) of the Act was to define the term "security" to include "the commonly known documents traded for speculation or investment," as well as those " 'securities of a more variable character, designated by such descriptive terms as . . . 'investment contract.'" *Howey*, 328 U.S. at 297.

States Supreme Court enunciated a four-part test for determining whether an interest or instrument is an "investment contract." *Id.* at 298-99 ("an investment contract for purposes of the Securities Act means a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . .").

Importantly, the BSR applies the *Howey* test to determine whether a particular instrument is an investment contract, and therefore, a security under RSA Ch. 421-B. *See* Amended Petition, ¶107 ("the Bureau ha[s] adopted the 'Howey' test"). This has been the BSR's consistent past practice. See Amended Complaint, ¶108 (setting forth elements of *Howey* with citations to *In re Gary Arthur Gahan*, COMO5-028 (N.H. Cur. Sec. Reg., Dec. 30, 2008) and *In re Viatical Investments, Status as Securities*, Into4-003 (N.H. Bur. Sec. Reg., Oct. 10, 2004); *see also In re Good Health Medical Services of New Hampshire, LLC* (N.H. Bur. Sec. Reg., April 8, 1997) (applying *Howey* test); *In re South Beech Street Homeowners' Association, LLC* (N.H. Bur. Sec. Reg., Nov. 29, 2001 (same); *In re The Village at Noble Farm, LLC* (N.H. Bur. Sec. Reg., Feb. 20, 2002) (same); *In re GRQ Investment Club, LLC* (N.H. Bur. Sec. Reg. Jan. 17, 2002) (same); *In re Colliston Yard Condominium Unit Owner's Association* (N.H. Bur. Sec. Reg. Oct. 5, 2005) (same). The BSR's practice of employing the *Howey* test is consistent with the statutory policy of interpreting RSA Ch. 421-B in accordance with federal regulatory precedent. *See* RSA 421-B:32.

Here, the BSR also suggests that the New Hampshire Security Act should be interpreted in accordance with an "alternative" test, the Risk Capital test, which is applied by "[s]ome other state securities agencies and many courts." Amended Petition, ¶107.

The BSR does not explain why its consistent past practice and policy of applying the *Howey* test should be disregarded, or how applying an analysis different from the federal analysis is permitted under RSA 421-B:32.[5] In any event, the BSR's consistent past practice of applying the *Howey* test when interpreting RSA 421-B:2, XX(a) has placed an administrative gloss on the term investment contract in RSA 421-B:2, XX(a). *See DHB Inc. v. Town of Pembroke*, 152 N.H. 314, 321 (2005) ("An "administrative gloss" is placed upon an ambiguous clause when those responsible for its implementation interpret the clause in a consistent manner and apply it to similarly situated applicants over a period of years without legislative interference.") Thus, the BSR may not now change its *de facto* policy of applying the *Howey* test to determine whether a particular instrument is an investment contract within the meaning of RSA 421-B:2, XX(a), in the absence of legislative action, "because to do so would, presumably, violate legislative intent." *Id.*

For the foregoing reasons, the *Howey* test is determinative whether a participation agreement is an investment contract, and therefore, a security.

2. The participation agreements lack the expectation of profit element of the *Howey* test.

As stated in the Amended Petition, "[t]he *Howey* test applies a four-prong analysis to identify an investment contract: (1) investment of money; (2) in a common enterprise; (3) with the expectation of a profit; and (4) to come solely through the efforts of the promoter or some third party." Amended Petition, ¶108. The BSR alleges that the pooled risk participants "have an expectation of a profit in the form of a return of earnings." *Id.* at ¶109. The expectation of profit allegedly arises because "LGC

[5] This assumes the *Howey* test is different from the Risk Capital test – in *dicta*, the United States Supreme Court has suggested they are essentially the same. *See Reves v. Ernst & Young*, 494 U.S. 56, 64 (1990) (Risk Capital approach is "virtually identical to the *Howey* test").

advertises a return on investment to Members, previously in the form of annual dividends paid to Members and currently in the form of rate-stabilization or offsets to future contributions." *Id.*

Even assuming the truth of the BSR's allegations, participants in LGC's pooled risk management programs could not reasonably have expected to share in LGC's investment profits. Moreover, the participation agreements do not satisfy the "expectation of profits" element of *Howey* because the purpose of entering into such an agreement is to acquire insurance coverage, rather than to receive profits from the effort of others. *See United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).

i. The purpose of entering into a participation agreement is to acquire insurance coverage.

The basic test for distinguishing a security transaction "from other commercial dealings is 'whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.'" *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975) (*citing Howey, supra*). In *Forman*, the Supreme Court emphasized that "[i]n searching for the meaning and scope of the word security . . . form should be disregarded for substance and the emphasis should be on economic reality." *Id.* at 848 (*citing Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)). Seeking to express the "essential attributes" defining a security, the *Forman* Court explained:

> The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . In such cases the investor is 'attracted solely by the prospects of a return' on his investment . . . ***by contrast, when a purchaser is motivated by a desire to use or consume the item purchased – 'to***

> ***occupy the land or to develop it themselves,' as the Howey Court put it . . . the securities laws do not apply.***

Id. at 853 (internal citations omitted) (emphasis added).

The paramount, indeed the singular, purpose of the participation agreements is to obtain and consume insurance products: namely, one or more of four risk pool management programs administered by LGC. As explained in Section I(a)(i) above and plainly stated in the agreements, political subdivisions engage in LGC's participation agreements for the purpose of pooling their self-insurance reserves, risks, claims, and losses, and administrative services and expenses. Each member applies to enroll in up to four pooled risk management products: HealthTrust exists to manage and provide health and similar welfare benefits to employees; PLT provides for protection of property and liability risks; and PLT workers compensation and PLT unemployment compensation provide workers compensation and unemployment benefits, respectively. See Exhibit A, p. 2, ¶ 1. The plain language, spirit and intent of the participation agreement demonstrate their purpose: for a member to obtain and consume LGC's risk pool products.

In a sizeable body of No-Action Letters, the federal Securities and Exchange Commission ("SEC") has time and again found that instruments that are prerequisites to obtaining insurance coverage, such as the participation agreements, do not satisfy *Howey's* expectation of profit element and thus are not investment contracts within the meaning of the federal securities laws. *See, e.g.*, Pan-American Life Insurance Company, SEC No-Action Letter, 2006 WL 3909364, at *10 (December 28, 2006); Fidelity Life Association, SEC No-Action Letter, 2006 WL 3007366 (October 18, 2006); The Dentists Insurance Company, SEC No-Action Letter, 1987 WL 108357, at *3 (August 10, 1987); Attorneys' Liability Protection Society, SEC No-Action Letter, 1987 WL 107882, at *5

(April 27, 1987); Cal Accountants Mutual Insurance Company, SEC No-Action Letter, 1988 WL 235171, at *4 (November 16, 1988). SEC No-Action Letters are owed considerable deference in New Hampshire. *See* RSA 421-B:32 ("This chapter shall be so construed so as to effectuate its general purpose to make uniform the law of those states which enact it ***and to coordinate the interpretation of this chapter with the related federal regulation.***") (emphasis added).

ii. Similar to mutual insurance dividends, any dividend paid to a pooled risk participant is a return of excess premium paid in to the pool by the member, rather than a share of LGC's investment profits.

The BSR alleges that the expectation of profit arises because "LGC advertises a return on investment to Members, previously in the form of annual dividends paid to Members and currently in the form of rate-stabilization or offsets to future contributions." Amended Petition, ¶ 109. However, the participation agreements do not mention any return of earnings or dividends. *See* Exhibit A. The closest the participation agreement comes to referencing any return of funds to a member is the seemingly unrelated statement that the applicant "agrees to be bound by the provisions of [LGC's] Bylaws." *Id.* at p. 2, ¶ 3. It strains credulity to consider that this single reference to the applicant's obligation is meant to acknowledge the reference in Article V of the Bylaws that addresses a return of "net income" to eligible members under limited circumstances. Exhibit B, p. 13.

Under Article V of the LGC Bylaws, whether there is "net income," and if so, the manner in which the "net income" is to be distributed to the eligible members, is determined as follows. The LGC Directors have sole discretion to determine "when net

income has been earned", *see* Exhibit B, p. 13, Section 5.1, and to determine how the net income is to be allocated, see Bylaws, Exhibit 2, p. 13, Section 5.2. Moreover,

> [i]n the event LGC shall have net income under Section 5.1 but the Directors do no allocate such net income among eligible members as provided in this Section 5.2, then such net income shall be allocated to eligible Members ***in proportion to the respective payment, during the Fund Year or Pool Year in which the net income is earned, which each eligible Member makes for coverage in connection with programs offered by LGC*** to its Members during said Fund Year or Pool Year.

Id.

The "payment . . . which each eligible Member makes for coverage in connection with programs offered by LGC" serves the same function as an insurance premium paid by a holder of a traditional insurance policy in exchange for insurance coverage. Both payments secure the insurance coverage received by the payor. Hence, the term "net income" in Article V of the LGC Bylaws refers to the portion of premiums paid in by the policyholder that goes unused during the term of the policy.

While risk pools established pursuant to RSA Ch. 5-B are not insurance companies, pooled risk management programs that operate under RSA Ch. 5-B are thus analogous to mutual insurance policies[6] in one key respect: the unused portion of the premium paid by the policyholder, if any, is to be returned to the policyholder at the end of the policy cycle. Courts in other jurisdictions have held that mutual insurance policies that provide for the return of the unused portion of the premium to the policyholder cannot satisfy the "expectation of profits" element of *Howey*.

In *Dryden v. Sun Life Assurance Company of Canada*, 737 F.Supp. 1058 (S.D.Ind. 1989), the federal district court granted a motion to dismiss a complaint against

[6] For a thorough explanation of mutual insurance policies, see *Fidelity and Casualty Company of New York v. Metropolitan Life Insurance Company*, 42 Misc. 2d 616 (Supreme Court, New York County, New York 1963); *Rhine v. New York Life Ins. Co.*, 248 A.D. 120 (Supreme Court, Appellate Division, First Department, New York 1936).

a mutual insurance company alleging, among other things, violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 arising from the sale of a whole life insurance policy. The plaintiff argued that the policy was a security because he expected to share in the company's investment profits based on a policy provision that entitled him to receive a pro-rata share of the premium surplus. *Id.* at 1062-63. The court rejected plaintiff's argument as follows:

> Under a participating life insurance policy issued by a mutual insurance company, the 'dividends' paid are in fact a return of excess premiums paid in by the policyholder, rather than a share of the company's investment profits. . . 'the dividends of a mutual insurance company are not . . . profits as in the case of an ordinary corporation.' . . . 'the policyholder creates his own surplus, by paying more for his insurance in advance than it should actually cost . . . [a]t the end of the year, this surplus, rather than the profits of the company, is paid pro rata to the policyholders.

Id. at 1062-63 (internal citations and quotations omitted). Therefore, according to the *Dryden* court, the plaintiff "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." *Id.* at 1063.

Likewise, in *Collins v. Baylor*, 302 F.Supp. 408 (N.D.Ill. 1969), the court dismissed a complaint on the basis that the mutual insurance policy at issue was not a security under the Securities Exchange Act of 1934. The plaintiff in *Collins* argued that membership in the mutual insurance company constituted "an ownership interest, a share in the profits and losses, a security." *Id.* at 410. The court disagreed, noting that "so-called dividends are, in reality, not dividends, but in a mutual insurance company are merely a return to policyholders of the unearned, that is, unused portion of the premium paid in." *Id.* at 411 (*citing Coons v. Home Life Insurance Co.*, 386 Ill. 231, 236 (1938)). The reason mutual insurance policies are not securities, the *Collins* court reasoned, is that

"[t]here is nothing about reciprocals or mutuals that is at variance with insurance tradition and business custom . . . [i]t is not the expectation of anyone buying these kinds of policies that they are going to be sharing in the profits of a company." *Id.* at 411.

In *Tcherepnin v. Knight*, 371 F.2d 374 (7th.Cir.1967), the Seventh Circuit quoted the following testimony given by SEC Chairman William L. Cary before the U.S. House of Representatives in 1963:

> [W]e did say that mutual insurance companies are not included under this bill because ***the buyers in mutual insurance companies are fundamentally buying insurance and not stock***. Furthermore, because there is no stock, there is no trading in the stock.

Id. at 378. As noted by the *Tcherepnin* court, the SEC generally does not claim jurisdiction over mutual insurance policies. *Id.*; *see, e.g.*, Pan-American Life Insurance Company, SEC No-Action Letter, 2006 WL 3909364, at *10 (December 28, 2006); Fidelity Life Association, SEC No-Action Letter, 2006 WL 3007366 (October 18, 2006); The Dentists Insurance Company, SEC No-Action Letter, 1987 WL 108357, at *3 (August 10, 1987); Attorneys' Liability Protection Society, SEC No-Action Letter, 1987 WL 108357, at *5 (April 27, 1987); Cal Accountants Mutual Insurance Company, SEC No-Action Letter, 1988 WL 235171, at *4 (November 16, 1988).

There is no principled difference between (1) a provision in a mutual insurance policy that provides for the pro rata return of excess premium to policyholders and (2) Article V of the LGC Bylaws, which contemplates a pro rata return of excess premium to risk pool participants. The reasoning of *Dryden* and *Collins* therefore apply with equal force to the participation agreements. The agreements cannot reasonably be understood to promise the participant a share of the LGC's investment profits, and thus, are not securities under *Howey*.

3. The participation agreements do not meet *Howey's* "investment" element.

The BSR alleges that the "investment" element of the *Howey* test is satisfied because the participants provide "member contributions" to the pooled risk management programs. Amended Petition, ¶¶109, 111. The BSR's argument fails because member contributions are not investments under the *Howey* test.

Even viewed in the light most favorable to the BSR, the participation agreements do not contain the traditional attributes of an investment. The body of SEC No-Action Letters referenced in Section I(b)(ii)(A) above set forth a number of criteria to determine whether a particular instrument satisfies the "investment" element of *Howey,* including:

- Whether the instrument is interest bearing, *see* The Dentists Insurance Company, SEC No-Action Letter, 1987 WL 108357, at *3 (August 10, 1987);
- Whether the instrument has a fixed maturity date, *see* The Dentists Insurance Company, SEC No-Action Letter, 1987 WL 108357, at *3 (August 10, 1987);
- Whether the instrument is transferrable, *see* Cal Accountants Mutual Insurance Company, SEC No-Action Letter, 1988 WL 235171, at *4 (November 16, 1988);
- Whether specific consideration is given in return for a separable financial interest with the characteristics of a security is paid for the membership, separate from the cost of any insurance provided, *see* Amerisure Mutual Insurance Company, SEC No-Action Letter, 2009 WL 1383743, at *9 fn. 8 (May 13, 2009) (*citing International Bhd. Of Teamsters v. Daniel*, 439 U.S. 551, 559-560 (1979));
- Whether, at the time of issuance of the insurance policy, the membership interest has a value separate and apart from the insurance policies, *see* Fidelity Life Association, SEC No-Action Letter, 2006 WL 3007366 (October 18, 2006); and,
- Whether the company's underwriting practice determines whether an applicant will become a policyholder and will determine the premiums to be paid by the policyholder for the policy, *see* Pan-American Life Insurance Company, SEC No-Action Letter, 2006 WL 3909364, at *10 (December 28, 2006).

All of these factors undermine the BSR's argument that the participation agreements are securities. The participation agreements do not bear interest and they lack

fixed maturity dates. They are non-transferable, are not supported by monetary consideration, and have no discernable value apart from the risk management benefits that flow from each if the applicant is accepted into one of LGC's pooled risk management programs. Finally, the participation agreements expressly provide that LGC's underwriting standards will determine whether an applicant will be accepted to participate in the pooled risk management program for which the prospective member has applied. See Exhibit A, p. 2, ¶ 2.

Because participation agreements do not contain the traditional attributes of an investment, they are not investment contracts within the meaning of RSA Ch. 421-B.

4. In addition to failing the *Howey* tests for investment and expectation of profit, the return of any funds does not "come solely through the efforts of the promoter or some third party."

The BSR concedes that the *Howey* test requires the satisfaction of four elements: "(1) investment of money; (2) in a common enterprise; (3) with the expectation of a profit; and (4) to come solely through the efforts of the promoter or some third party." Amended Petition, ¶108. Here, when LGC returns funds to members, the returns are based on the members' own claims history – a matter exclusively within the control of the member and completely out of the hands of "the promoter or some third party." Consequently, the participation agreements cannot satisfy the *Howey* test.

Exhibit C is a set of the copies of letters from a Respondent business entity to a member announcing and enclosing the member's "dividend" check that were produced during the BSR's on-site examination of the LGC. Each letter states that the Board of Trustees has declared a dividend and the member is receiving a check for "[its] share" of the dividend. *See* Exhibit C. Each letter states the years for which the dividend is being

paid. *Id.* Most importantly, each letter expressly advises the member that *"[its] share is based on [its] actual claim experience in those years."* *Id.* (emphasis added).

While many courts have relaxed the "solely through the efforts of the promoter or some third party" requirement in *Howey*, the inquiry still requires proof that profits were generated "predominantly" from others' efforts. *See United States v. Bowdoin*, 770 F.Supp.2d 142, 151 (D.C. 2011) (*citing Liberty Property Trust v. Republic Props. Corp.*, 577 F.3d 355, 339 (D.C.Cir. 2009). Accordingly, when a party has the ability to substantially impact the "profits" it might receive from an agreement, the agreement fails the *Howey* test. *See Steinhardt Group, Inc. v. Citicorp*, 126 F.3d 144, 155 (3d Cir. 1997) (agreement was not an investment contract under *Howey* where investor had significant control over the management of the investment).

Here, a member's share of any dividend declared by LGC is dependent on its own claim history. *See* Exhibit C. Consequently, the participation agreements are not securities under the *Howey* test.

II. To the extent the Securities Counts are based on an allegation that an NHMA membership interest or contract is a security, the Securities Counts fail to state a cause of action upon which relief could be afforded.

In addition to the participation agreements, the BSR alleges that "membership interests in NHMA, LLC" also constitute securities under the New Hampshire Securities Act. Amended Petition, ¶107. The BSR alternatively refers to this interest as an "NHMA membership contract[]." Amended Petition, ¶125.

Beyond alleging that NHMA membership "interests" or "contracts" exist, Amended Petition, ¶ 107, and concluding that they are securities, *id.* at ¶125, the Amended Petition is entirely devoid of any supporting factual allegations. The BSR

makes no effort to allege, for example, that NHMA members had any expectation of profit by virtue of the "interest" or "contract"; that NHMA members invested money in a common enterprise; or that profits were to come solely though the efforts of a promoter or some third party. In other words, there is no allegation that the NHMA membership "interests" or "contracts" satisfy any of the elements of either the *Howey* test or the Risk Capital test. *Compare with* ¶¶109 and 111 (alleging facts to support the conclusion that a participation agreement meets the four factors of the *Howey* Test and the Risk Capital test and is thus an investment contract).

The Amended Petition fails to provide Mr. Andrews with notice regarding the identity of the alleged NHMA membership "interests" or "contracts," if any,[7] or a factual basis for the BSR legal conclusion they are investment contracts. Because the Amended Petition fails to allege any facts in support of the conclusion that the NHMA membership "interests" or "contracts" are securities, to the extent the Securities Counts are based on the assertion that NHMA membership "interests" or "contracts" are securities, the Securities Counts are not adequately alleged and must be dismissed. *See Proctor v. Bank of New Hampshire*, 123 N.H. 395, 400 (1983) (trial court properly dismissed negligence count where "[the negligence] count fails to adequately allege the defendant's duty, breach, and the resulting harm to the plaintiff.") (internal citation omitted).

Prayer for Relief

Respondent John Andrews respectfully requests that the Presiding Officer dismiss Counts III, IV, and V of the Amended Petition in their entirety.

[7] In fact, it is Mr. Andrews' understanding that there are no NHMA membership agreements or contracts. Rather, Mr. Andrews understands that an NHMA member pays dues to the entity in varying amounts based on their respective membership level. However, it is Mr. Andrews' understanding that no such membership agreement or contract exists, and Mr. Andrews' counsel has not located such an agreement in the tens of thousands of pages of discovery produced to date.

Respectfully submitted,

John Andrews

By and through his attorneys,

March 12, 2012

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was forwarded this day via electronic mail to all counsel of record.

_____
Michael D. Ramsdell, Esq.