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
	)	

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

Respondents Local Government Center, Inc. and affiliated entities ("LGC") submit this motion to dismiss Count II of the Amended Petition on the grounds that (1) the Bureau of Securities Regulation ("BSR") has improperly failed to promulgate rules under the statute it alleges LGC violated; (2) the statute unconstitutionally delegates unlimited legislative authority to BSR; and (3) the statute is unconstitutionally vague.

I. Introduction

1. BSR advances three general allegations in Count II of the Amended Petition. First, BSR alleges that LGC[1] "has used an inappropriate actuarial method for calculating reserves" under R.S.A. 5-B:5, and that LGC's level of reserves "exceeds prudent levels . . . ." Amended Petition ¶ 92. Second, BSR alleges that LGC has "failed to return surplus funds accumulated" as the statute requires. Amended Petition ¶ 94. Third, BSR alleges that LGC has "improperly inflated its administrative costs . . . ." Amended Petition ¶ 95.

2. R.S.A. 5-B does not establish a required method for calculating reserves, returning surplus, or determining what administrative costs are impermissible; it simply provides that pooled risk management programs must "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the

[1] The Amended Petition uses "LGC" to refer to a collection of "individuals and certain entities," presumably encompassing all of the respondents and those entities listed in ¶¶3-21 of the Amended Petition.

participating political subdivisions." R.S.A. 5-B-5, I(c). BSR has promulgated no rules to shed light on how these very general statutory requirements are to be interpreted.

3. Because R.S.A. 5-B provides no hint as to the "appropriate" or "prudent" method of calculating reserves, returning surplus, or determining when administrative costs are "inflated," BSR's effort to penalize LGC for violating its newly decreed position on the meaning of these terms is unfair to LGC and contrary to the New Hampshire Constitution. It must therefore be rejected.

II. BSR Improperly Failed to Promulgate Rules under R.S.A. 5-B:5

4. In its just-issued opinion in *Appeal of Blizzard*, No. 2011-187 (N.H. March 9, 2012), the New Hampshire Supreme Court declared that "'promulgation of a rule pursuant to the [Administrative Procedures Act] . . . is not necessary to carry out what a statute demands on its face.'" *Id*. at 3 (quoting *Nevins v. N.H. Dep't of Resources and Economic Dev*., 147 N.H. 484. 487 (2002) (alterations in original). But "[i]f the statute lacks sufficient detail on its face, then an agency must adopt rules supplying the necessary detail." *Id*. If the agency has not done so, the Court must "determine whether the result [of the agency's failure to adopt rules] was unfair by examining whether the complaining party 'suffered harm as a result of the lack of [required] rules." *Id*. at 3 (quoting *Nevins*, 147 N.H. at 488). Although the statute at issue in *Blizzard* had expressly directed the agency to adopt rules, while R.S.A. 5-B:5 does not, the Court's general analysis in *Blizzard* of when an agency's failure to promulgate rules is unfair to a regulated party applies to BSR's actions against LGC under R.S.A. 5-B:5 with equal force.

5. In *Blizzard*, the failure-to-promulgate-rules argument failed because the party advancing the argument did not "argue that the lack of rules harmed her." *Blizzard* at 3. Here, however, the requirements for a successful challenge to BSR's failure to promulgate regulations are met.

A. The Statute Lacks Sufficient Detail on its Face

6. R.S.A. 5-B:5, I(c) requires that pooled risk management programs "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions." Contrary to what one

would infer from reading Count II, the statute specifies neither an "appropriate" or "prudent" actuarial method for calculating reserves or surplus, nor an appropriate or prudent level of reserves for a risk management pool to maintain. Nor does it offer any guidance as to what constitutes a permissible means of returning surplus. In all of R.S.A. 5-B, the word "reserves" appears just three times.

7. Simply put, R.S.A. 5-B:5 provides no guidance whatsoever as to the actuarial method to be used to assess and calculate reserves, how surplus is to be returned, or what administrative expenses are not permitted. *See Nevins*, 147 N.H. at 487 ("One purpose for requiring rules is to give persons fair warning as to what standards the agency will rely on when making a decision.")

8. BSR argues as though R.S.A. 5-B established a required method for calculating reserves, stating that pooled risk management programs "must" use an actuarial method "such as the Stochastic Modeling method . . . or an RBC closer to 2.0 or a capital measure close to the State's 5% calculation." Amended Petition ¶93. But the statute says nothing about any of these three methods, either directly or by implication. BSR appears to have plucked the three actuarial methods out of the ether.

9. The three actuarial methods proposed by BSR represent very different points on the spectrum of potential ways to calculate reserves. It is entirely unclear why BSR believes the methods it suggests in the Amended Petition are statutorily permitted, whereas the method chosen by LGC—an RBC of 4.2—is not.

10. Although R.S.A. 5-B:5 provides no instruction or guidance as to how a pooled risk management program is to calculate reserves, BSR claims the actuarial method LGC ought to have used has been clear all along. Per the Amended Petition, that method is the Stochastic Modeling method—unless it's the RBC method . . . but only if the RBC is kept "closer to 2.0." Or perhaps it's the capital measure. BSR is sure that the correct actuarial method is one of those three, but it cannot explain why. Nor can it find any support for any of its positions in the text of the statute.

11. This is not a case where LGC failed to calculate reserves. Rather, LGC obeyed the statutory instructions, selected a means to calculate reserves, and proceeded to calculate reserves accordingly. As required by the statute, LGC has "[p]rovide[d] for an annual actuarial evaluation of the pooled risk management program" that meets the requirements of 5-B:5, I(f) ("[t]he evaluation shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan. The annual actuarial evaluation shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated, shall be filed with the department, and shall be distributed to participants of each pooled risk management program.") Now, after years of accepting LGC's filings without objection, BSR has determined that although LGC did everything the statute required it to do, it ought to have used a different actuarial method. LGC received no direction from either the statute or BSR that certain actuarial methods were acceptable, while others were not. The statute lacked sufficient detail on its face for BSR to enforce it without first promulgating rules to provide LGC with notice of its interpretation of what the statue requires. *See Blizzard*, No. 2011-187 (N.H. March 9, 2012).

12. BSR also decrees that LGC's method of returning surplus through rate credits is somehow prohibited by the statute. Amended Petition ¶99. The statute, however, says nothing about what methods of returning surplus are permitted.

13. BSR further alleges that LGC used pool funds for inflated administrative expenses, non-pool management purposes, and transfers between pools. Amended Petition ¶95. But RSA 5-B does not identify which administrative expenses are permitted and which are not. Rather, RSA 5-B:3, I lists an array of very general purposes for which a risk management program may be administered, including "reducing the risk of its members; safety engineering; distributing, sharing, and pooling risks; acquiring insurance, excess loss insurance, or reinsurance; and processing, paying and defending claims . . . ." Despite this broad statutory authority, BSR now claims that certain administrative expenses are impermissible and that certain methods of pooling and sharing risks are not allowed. Again, the statute lacks sufficient detail on its face for the Bureau to now attempt to enforce it without first having promulgated rules to provide LGC with

notice of its interpretation of what the statue requires. *See Blizzard*, No. 2011-187 (N.H. March 9, 2012).

14. Indeed, the legislature itself appears to have acknowledged that R.S.A. 5-B:5 lacks sufficient detail to indicate what conduct is prohibited. Legislation enacted in 2010 directed "[t]he secretary of state, in consultation with the insurance commissioner and by employing the services of an actuary who has experience with pooled risk management programs and is a qualified member of the American Academy of Actuaries," to "submit a report to the speaker of the house of representatives, the president of the senate, the senate committee and house committee with jurisdiction over matters of commerce, and the governor, containing *specific recommendations concerning the limitation of reserves in pooled risk management programs and the limitation on administrative expenses* as a percentage of claims of pooled risk management programs." Ch. 149:6, Laws of 2010 (emphasis added). The requested report was submitted, but no action has been taken by the legislature. *See* Recommendations Concerning the Limitation of Reserves and the Limitation on Administrative Expenses as a Percentage of Claims of Pooled Risk Management Programs, submitted by BSR on December 30, 2010.

15. The fact that the legislature deemed it necessary to obtain an outside expert recommendation on "the limitation of reserves in pooled risk management programs"—that is, the purported statutory requirement LGC is alleged to have violated in Count II—is powerful evidence that the statute, in its current form, lacks sufficient detail, and that additional guidance via rule-making was required.

B. LGC Suffered Harm as a Result of BSR's Failure to Promulgate Rules

16. Unlike the situation in *Blizzard*, where the appellant had never argued that the failure to promulgate rules had harmed her (*see Blizzard* at 3), and *Nevins*, where the appellants could not "explain . . . any specific way in which they were prejudiced as a result of the lack of guidance" (147 N.H. at 488), BSR's failure to promulgate regulations has caused clear and substantial harm to LCG.

17. LGC has for years been operating its business in reliance on its reasonable determination that it was in compliance with the terms of 5-B:5, I(c), which require that LGC

"[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions."

18. Now, based on BSR's sudden discovery that the statute imposes heretofore unidentified, but very precise, requirements that LGC has not met, LGC has been subjected to the enormous disruption and expense caused by BSR's enforcement action against it. If BSR had issued its interpretation of the statutory requirements it claims LGC violated via rule-making *before* it charged LGC with having violated the statute, LGC would of course have complied with BSR's requirements, and would not now be facing the prospect of the massive penalties BSR seeks to impose.

19. The need for BSR to promulgate rules under R.S.A. 5-B:5 is heightened by the unusual history of the statute. As noted by BSR in the Amended Petition, the legislature amended R.S.A. 5-B on June 14, 2010, to include R.S.A. 5-B:4-a, which grants the Secretary of State "the power to investigate pooled risk management programs, issue cease and desist orders, initiate adjudicatory proceedings, impose administrative fines, and order rescission, restitution, or disgorgement." Amended Petition ¶22. Until 2009, R.S.A. 5-B:4 had expressly provided that "[n]othing 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." In other words, when the substantive provisions of the statute at issue in this proceeding were enacted, the statute contained no enforcement mechanism. The non-specific nature of the requirements of R.S.A. 5-B-5, I(c) caused no problems in the absence of an enforcement mechanism; the purpose of the statute then appears to have been simply to endorse the operation of risk management pools within the broad contours of the statute. Now that the legislature has given enforcement power to BSR, however, greater detail and specificity is required.

20. Because R.S.A. 5-B:5 "lacks sufficient detail on its face" to apprise LGC of the standards to which BSR now seeks to hold it, and LGC suffered harm as the result of BSR's failure to promulgate rules that would have provided it with notice of those standards, BSR's failure to adopt rules supplying the necessary detail is fundamentally unfair to LGC. BSR should

not be permitted to hold LGC to standards that are neither spelled out—or indeed even hinted at—in the statute, nor established by BSR via rulemaking.

III. BSR Impermissibly Usurps Legislative Authority in Its Enforcement of R.S.A. 5-B:5

21. Beyond the problem of BSR's failure to promulgate rules under the statute, there is a fundamental flaw in R.S.A. 5-B itself: the statute delegates unlimited legislative authority to BSR, in violation of Part I, Article 37 of the New Hampshire State Constitution (separation of powers). While the legislature can delegate power to promulgate rules to an administrative agency, that delegation of authority cannot be unlimited. *Opinion of Justices,* 121 N.H. 552, 557 (1981).

22. The legislature may not "create and delegate duties to an administrative agency if its commands are in such broad terms as to leave the agency with unguided and unrestricted discretion in the assigned field of its activity." *New Hampshire Dep't of Env. Services v. Marino,* 155 N.H. 709, 715 (2007) (quoting *Smith Insurance, Inc. v. Grievance Committee*, 120 N.H. 856, 861 (1980)). A statute is unconstitutional if it does not "lay down basic standards and a reasonably definite policy for the administration of law." *Id.* (quoting *Union School District v. Comm'r of Labor*, 103 N.H. 512, 516 (1961)).

23. Similarly, the United States Constitution demands that when a legislature grants powers to an administrative agency, it must provide "an intelligible principle to which the person or body authorized to [act] is directed to conform." *Smith Insurance, Inc. v. The Grievance Committee,* 120 N.H. 856, 861 (1980) (quoting *Hampton & Co. v. United States*, 276 U.S. 394, 409 (1928)).

24. It is well settled in New Hampshire that an administrative agency may only "fill in the details to effectuate the purpose of the statute," and that agency actions which go beyond filling in the details are invalid. *Opinion of Justices*, 121 N.H. 552, 557 (1981). "Rules adopted by State boards and agencies may not add to, detract from, or in any way modify statutory law." *Id*. (quoting *Kimball v. N.H. Board of Accountancy*, 118 N.H. 567, 568 (1978). The delegating statute cannot "express 'its commands . . . in such broad terms as to leave . . . the agency with unguided and unrestricted discretion in the assigned field of its activity.'" *State Farm Mut. Auto. Ins. Co. v. Whaland*, 121 N.H. 400, 404 (1981) (quoting *Smith Insurance*, 120 N.H. at 861).

25. R.S.A. 5-B:5 does not set any standards for how a risk pool is to calculate reserves, return surplus, or determine what administrative costs are not allowed. It establishes no standards for distinguishing permissible actuarial methods from impermissible ones. To allow BSR simply to decree which actuarial methods and ways of returning surplus are acceptable and which are not would grant it "unguided and unrestricted discretion in the assigned field of its activity," *N.H. Dep't of Env. Services v. Marino*, 155 N.H. at 715, and would therefore be unconstitutional. Such a sweeping delegation of power, even with respect to the narrow questions of actuarial methodology at issue in this case, exceeds constitutional limitations. *See Smith Insurance*, 120 N.H. at 861.

26. R.S.A. 5-B does not lay down *any* standards for how reserves are to be calculated or how to calculate the appropriate surplus to return (or how to return it). Instead, with this proceeding, BSR argues that any of three very different methods of calculating reserves are appropriate under the statute—but that the method LGC employed somehow is not. BSR also claims that certain methods of returning surplus are permitted while others are not. But there is no basis in the statute for the lines BSR has drawn. In announcing standards free of any legislative guidance, BSR has gone far beyond any effort to "fill in the details to effectuate the purpose of the statute." *Opinion of Justices*, 121 N.H. at 557. In effect, BSR is purporting to craft its own statute, seeking to write standards into the statute which simply are not there. This is unconstitutional. *See id*. ("Rules adopted by State boards and agencies may not add to, detract from, or in any way modify statutory law.") (quoting *Kimball v. N.H. Board of Accountancy*, 118 N.H. 567, 568 (1978)). BSR may not exercise legislative power which it does not possess.

27. In the just-issued *Blizzard* decision, the New Hampshire Supreme Court rejected a challenge to a penalty imposed by the Department of Safety ("DOS") on unconstitutional delegation grounds. *Appeal of Blizzard*, No. 2011-187 (N.H. March 9, 2012). The Court's rationale, however, underscores why there *is* a constitutional problem with BSR's action against LGC.

28. The appellant in *Blizzard* had been convicted of negligent homicide in connection with her operation of a boat. Based on the incident that gave rise to her conviction, DOS suspended her boat operating privileges under R.S.A. 270-E:17, "which authorized DOS to

revoke or suspend [boat] operating privileges for any violation of RSA chapters 270, 270-A, 270-B or 270-E." *Blizzard* at 2. In holding that the statute at issue in *Blizzard* met the constitutional requirement that "a statute must lay down basic standards and a reasonably definite policy for the administration of the law," the Court found abundant evidence of "basic standards" and "a reasonably definite policy" in the statute:

> Turning first to the "reasonably definite policy" requirement, the legislature has set forth, in detail, the policies underlying RSA chapter 270, which include: (1) maintaining "public safety," RSA 270:1, I (2010); (2) "protection of property," *id*.; (3) "maintaining the residential, recreational and scenic values which New Hampshire public waters provide," RSA 270:1, II (2010); (4) "maintain[ing] . . . safe and mutual enjoyment of a variety of uses," *id*.; (5) "promotion of our tourist industry," *id*.; (6) "protection of environment and water quality," *id*.; and (7) "nutur[ing] of . . . threatened and endangered species," *id*. We hold that these policies are reasonably definite, and, therefore, satisfy the policy requirement for legislative delegations of authority.
>
> As to "basic standards," the impliedly incorporated chapters specifically define dozens of distinct violations that potentially trigger suspension of operating privileges. These standards are more than basic – they specifically address most aspects of water recreation. In particular, the statute upon which DOS relied when suspending the respondent's operating privilege, RSA 270:29-a, lays down an adequate standard for "[c]areless and [n]egligent [o]peration of [power] [b]oats," which it defines as "operat[ing] a power boat upon any waters of the state in a careless and negligent manner or so that the lives and safety of the public are endangered." These standards, when combined with the reasonably definite policies in RSA 270:1, avoid an unlawful delegation of legislative power.

Blizzard at 5.

29. Based on these detailed and specific statutory provisions, the statute at issue in *Blizzard* was found to have provided "basic standards" and "a reasonably definite policy" to guide the agency in its enforcement action. Here, however, R.S.A. 5-B:5 provides nothing close to the detail and specificity found in *Blizzard*. Because R.S.A. 5-B:5 provides no standards and no policy to guide BSR in the exercise of its enforcement discretion, the statute does not pass constitutional muster.

IV. BSR's Attempt to Enforce R.S.A. 5-B:5 Renders It Unconstitutionally Vague

30. The unusual history of R.S.A. 5-B:5 has led to a situation in which a statute that was well-crafted and adequate for its original purpose now (as amended) provides insufficient guidance as to what conduct it prohibits.

31. From its original enactment in 1987 through 2009, R.S.A. 5-B:4 had expressly provided that "[n]othing 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." In other words, when the substantive provisions of the statute were enacted, the statute contained no enforcement mechanism. Rather, RSA 5-B entities were authorized by the statute to be self-regulating based on the business judgment of their boards of directors. The non-specific nature of the requirements of R.S.A. 5-B-5, I(c) caused no problems in the absence of an enforcement mechanism; the purpose of the statute then appears to have been simply to endorse the operation of risk management pools within the broad contours of the statute. Now that BSR has been given (and is exercising) regulatory and enforcement authority, however, greater detail and specificity are required. A statute that was written (and worked well) for one purpose is now being used for a different purpose. This gives rise to a constitutional problem.

32. Under the "void for vagueness" doctrine, "[a] statute can be impermissibly vague for either of two independent reasons: (1) it fails to provide people of ordinary intelligence a reasonable opportunity to understand the conduct it prohibits; or (2) it authorizes or even encourages arbitrary and discriminatory enforcement." *State v. Hynes*, 159 N.H. 187, 200 (N.H. 2009); *see also State v. LaMarche*, 157 N.H. 337, 340-41 (2008). BSR's imposition of monetary penalties on LGC under R.S.A. 5-B:5 would deprive LGC of its fundamental right to property. *See Hynes*, 159 N.H. at 200 (facial challenge to statute requires claim of violation of fundamental right); *Spengler v. Porter*, 144 N.H. 163, 166 (N.H. 1999) ("The right to use and enjoy one's property is a fundamental right protected by both the State and Federal

Constitutions."). R.S.A. 5-B:5 is unconstitutional, on its face and as applied to LGC, under both prongs of the analysis.[2]

33. As explained *supra*, R.S.A. 5-B:5, I(c) requires that pooled risk management programs "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions," but provides no guidance whatsoever as to how an entity is supposed to calculate reserves, how surplus is to be returned, or what administrative expenses are not permitted. The statute thus fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits, and is therefore unconstitutionally vague. *Hynes*, 159 N.H. at 200.

34. R.S.A. 5-B:5 is also unconstitutional because it is so vaguely worded that it encourages arbitrary enforcement (such as the enforcement action in which BSR is now engaged). Although the statute itself makes no reference to any particular actuarial method, BSR alleges that LGC ought to have used one of the three actuarial methods proposed in the Amended Petition—but it never explains why its three preferred methods are statutorily acceptable, while the one selected by LGC is not. Instead, BSR simply outlines the different methods and then declares that LGC's choice is in "direct violation of R.S.A. 5-B:5, I(c)." Amended Petition ¶93. It is the essence of arbitrary enforcement for BSR to argue that LGC's method violates the statute, while at the same time arguing that the statute would have permitted any number of other alternatives that happen to be more to BSR's liking. *See* Amended Petition ¶ 93 ("5-B Pools must employ an actuarial method . . . such as the Stochastic Modeling method, . . . or an RBC closer to 2.0 or a capital measure closer to the State's 5% calculation."). For BSR to insist that the three methods favored in the Amended Petition are statutorily mandated, but the method LGC elected to use is not, is an act of arbitrary enforcement that demonstrates why R.S.A. 5-B:5 is an unconstitutional statute. *See Porelle*, 149 N.H. at 423.[3]

[2] In analyzing a void-for-vagueness claim, a "separate federal analysis is unnecessary because the Federal Constitution offers no greater protection than the State Constitution with regard to whether a statute is unconstitutionally vague." *State v. Porelle*, 149 N.H. 420, 423 (2003).

[3] In 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, LGC argues that Count I should be dismissed because the facts as alleged in Count I do not constitute a legal basis for relief under the statute.

V. Conclusion

35. Because (1) BSR has improperly failed to promulgate rules under R.S.A. 5-B, (2) the statute unconstitutionally delegates unlimited legislative authority to BSR, and (3) the statute is unconstitutionally vague, Count II of the Amended Petition must be dismissed.

WHEREFORE, LGC respectfully requests that the Hearing Officer:

A. Dismiss Count II of the Amended Petition against LGC on the grounds that (1) BSR has improperly failed to promulgate rules under R.S.A. 5-B, (2) the statute unconstitutionally delegates unlimited legislative authority to BSR, and (3) the statute is unconstitutionally vague; and

B. Grant any other such relief as may be necessary and proper.

That argument—that nothing in the statute prohibits the conduct in which LGC has engaged—also applies to BSR's claims in Count II. LGC incorporates that argument into this motion by this reference.

Respectfully submitted,
LOCAL GOVERNMENT CENTER, INC.;
LOCAL GOVERNMENT CENTER REAL ESTATE, INC.;
LOCAL GOVERNMENT CENTER HEALTHTRUST, LLC;
LOCAL GOVERNMENT HEALTHTRUST, LLC;
LOCAL GOVERNMENT CENTER PROPERTY-LIABILITY TRUST, LLC;
HEALTHTRUST, INC.;
NEW HAMPSHIRE MUNICIPAL ASSOCIATION PROPERTY-LIABILITY TRUST, INC.;
LGC-HT, LLC; AND
LOCAL GOVERNMENT CENTER WORKERS' COMPENSATION TRUST, LLC,

By Their Attorneys:
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Dated: March 12, 2012

By: */s/ William C. Saturley*

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CERTIFICATE OF SERVICE

I hereby certify that I have this 12th day of March delivered copies of this pleading to all counsel.

/s/William C. Saturley