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STATE OF NEW HAMPSHIRE

DEPARTMENT OF STATE BUREAU OF SECURITIES REGULATIONS

No. C-2011000036

In the Matter of:

Local Government Center, Inc., et al.

BEFORE DONALD E. MITCHELL, ESQUIRE
PRESIDING OFFICER

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REPORT OF PROCEEDINGS

May 10, 2012

9:10 a.m.

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New Hampshire State Archives and Genealogical

Public Research Room

71 South Fruit Street

Concord, NH 03301

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I N D E X

(Whereupon the following proceedings were held in the presence of the Presiding Officer, counsel, the parties, and the public:)

THE PRESIDING OFFICER: Good morning, Ladies and Gentlemen. This is day nine of the matter captioned -- in the matter of Local Government Center, Inc., et al.

We are in the case in chief of the respondents. And this morning prior to beginning the testimony we have, frankly, as usual and customary, some, quote, housekeeping matters to take on the record.

So I'm going to first recognize Mr. Tilsley. Mr. Tilsley, please.

MR. TILSLEY: Thank you, sir. In follow-up to our discussion yesterday morning regarding the potential inaccuracies in Exhibits 5 and 6 from Mr. Coutu's testimony last week, Mr. Saturley and I spent a few minutes at the end of the day yesterday, and I think we have confirmed that the errors which they discussed are, in fact, errors, and we made some changes to the exhibits to address it.

What we've done on Exhibit 5, and I'll have Mr. LaRochelle substitute these into the books, is on the PLT 2002 column, the bottom half of that column beginning with "Income statement," the LGC was correct that those are 2001 numbers.

So what we've basically done is to black out the lower portion of that column so that those -- those are actually from my book. Sorry. I wanted to make sure you saw it. So we've blacked those out so they're no longer on the form. Those numbers do not carry over to any of the other charts. So that's the only change we need to make.

On Exhibit 6, the number in question was 2006 property trust increase, decrease, and net assets, which is represented as a positive 963. The LGC was right, that calculation should have been a negative 963. So the change we've made is simply to put the parentheses around the number to indicate in accounting terminology that it's a negative number.

I believe there's an agreement we can substitute these in. Thank you.

THE PRESIDING OFFICER: Thank you, Mr. Tilsley. No objection, Mr. Saturley?

MR. SATURLEY: No objection to the representations and the substitutions offered by Mr. Tilsley.

THE PRESIDING OFFICER: Thank you. Mr. Saturley, do I understand, therefore, that the issue of Exhibits 1 through 9 have now been appropriately addressed?

MR. SATURLEY: Appropriately addressed, as long as you understand the objection that I filed or made orally yesterday, that I still maintain it. What you called my general objection, I believe is what you called it.

THE PRESIDING OFFICER: Well, I may have. Can you refresh my recollection?

MR. SATURLEY: Certainly. That I consider that some of the other material, while accurate in the sense that it is pulled accurately from financial statements, nevertheless, when put together in a particular chart that we only received the Friday before testimony started and was not the subject of specific testimony resulted in a misleading chart, and so, therefore, I objected to it being accepted as a full exhibit for that purpose.

For instance, one chart pulls accrued information from one source, compares it to information pulled from another document, another financial summary, and I believe that the comparison is inaccurate. So the numbers are accurate. I accept the numbers. I do not accept the representation.

And I was objecting to the fact that Mr. Coutu did not specifically testify about the information. So it's the accepting that as a full document is what I was objecting to.

THE PRESIDING OFFICER: I understand, and thank you for refreshing my recollection. Do you feel compelled to say anything further, Mr. Volinsky?

MR. VOLINSKY: No, sir.

THE PRESIDING OFFICER: Okay. The objection is denied. And my attention is drawn that there may be that, shall I say, frequent apples and oranges and extrapolations that don't ring true or ring more true to one side than the other. And I'll examine those documents with particular attention. Thank you.

MR. SATURLEY: Yes, sir. Thank you.

THE PRESIDING OFFICER: Okay. The other things we'll -- other administrative matters we'll take care of after our lunch break, I think, so that we can proceed with the witness that we have.

Thank you for your patience, Mr. Murphy. Mr. Ramsdell is going to come forward. While he does that, could I ask you to please stand.

MARTIN MURPHY,

having been first duly sworn,

was examined and testified as follows:

THE PRESIDING OFFICER: Please be seated, sir.

THE WITNESS: Thank you.

THE PRESIDING OFFICER: Would you state your business address.

THE WITNESS: Yes. It's 155 Seaport

Boulevard, Boston, Massachusetts.

THE PRESIDING OFFICER: Mr. Ramsdell.

MR. RAMSDELL: Thank you.

DIRECT EXAMINATION

BY MR. RAMSDELL:

Q. Attorney Murphy, would you identify yourself by name as well.

A. Martin Murphy.

Q. And the address, the business address that you just gave us, that is the business address of what business?

A. It's a law firm, Foley, Hoag.

Q. Attorney Murphy, you are here because you were engaged to analyze the facts regarding the Bureau's allegations that risk pool contracts at issue here are securities and to render an expert opinion whether the risk pool contracts are securities within the meaning of the New Hampshire Uniform Securities Act; is that correct?

A. That's correct.

Q. And have you done that?

A. I have.

Q. What is your opinion?

A. My opinion is that they are not securities within the meaning of the New Hampshire Uniform Securities Act.

Q. Thank you. Could we back up for a minute? Would you describe for Mr. Mitchell your educational background.

A. Yes. I graduated from Pentucket Regional High School in West Newbury, Massachusetts in 1976, from Princeton University in 1980, and from Harvard Law School in 1983.

Q. Would you describe for us your professional experience after graduating from Harvard Law School?

A. Yes. I clerked for a federal district judge in Massachusetts for the first year after graduation. I worked for a firm called -- then called Bingham, Dana & Gould for three years. I worked as the federal prosecutor for almost five years.

I then worked as a state prosecutor for another five years. And for the past 15 years I've been in private practice initially at a firm that was then called Bingham & McCutchen, and for the past eight years at Foley, Hoag.

Q. Let me ask you about when you were a federal prosecutor. Did any of your work include investigation or prosecution of federal securities laws?

A. Yes. I did a number of cases, a number of investigations, and a number of cases that involved allegations that a defendant or the target of an investigation had violated federal securities laws.

Q. And what about when you were the first assistant district attorney at Middlesex County, did that --

A. That was not -- there was not much securities work as a state prosecutor, so for that five years of my professional experience I did not do any securities.

Q. Fair enough. How about at Foley, Hoag, is any part of your practice, does it involve securities?

A. Yes. I'd say that a major focus of my practice currently and probably for the past

15 years has been addressing securities laws matters, and particularly securities enforcement matters representing individuals in businesses in securities investigations, administrative, civil, and on occasion criminal.

Q. Do you have any professional distinctions, Attorney Murphy?

A. I'm a member of the American College of Trial Lawyers.

Q. Are you also listed in the Best Lawyers in America, Massachusetts Super Lawyers, and the Chambers USA for both white-collared crime and governmental investigations?

A. Yes.

Q. Can you tell us what state bars and other courts that you are admitted to?

A. I'm a member of the bar of the State of Massachusetts, a member of the bar of the United States District Court for the District of Massachusetts, and for the First Circuit.

Q. And have you had the professional experience of being admitted on a pro hac vice basis in both the federal court, the

United States District Court here in New Hampshire, and in state superior court as well?

A. Yes, the United States Supreme Court as well.

Q. I'm going to hand you a copy of what's been marked as Local Government Center Exhibit Number 267, and I have additional copies for Mr. Mitchell and his law clerk as well so you don't have to pull them out.

A. Thank you.

Q. Thank you. And is Local Government Center Exhibit Number 267 the expert report that you authored in this case?

A. It is.

MR. RAMSDELL: At this point I'd move to strike the identification from LGC Exhibit Number 267.

THE PRESIDING OFFICER: Mr. Tilsley?

MR. TILSLEY: No objection, Your Honor.

THE PRESIDING OFFICER: Very good. LGC Exhibit 267 is now a full exhibit.

(LGC 267 was entered into evidence.)

Q. BY MR. RAMSDELL: Attorney Murphy, I'm going to ask you about the work that you did in this case. Would you start with -- and I'm going to put this portion of your report up so that it's easy for all to see, but would you describe for us or identify the materials that you reviewed in conducting your analysis in this case?

A. Yes. I looked at the statute, both Chapter 5 and the securities statute Chapter 421. I looked at the bylaws of the Local Government Center. I looked at one sample of a participation agreement, that being the participation agreement from the Town of Belmont.

I was given a series of dividend letters that came from Local Government Center to a number of different political subdivisions from 1999 to 2003.

I looked at a number of past precedents from the New Hampshire Bureau of Securities including, I think I mentioned the flexible mortgage matter, the report on the Local Government Center, and a number of other matters that had been made available to me.

I looked at the petition and the amended petition in this case. I looked at the opinion of Mr. Fryer from Verrill Dana.

And I also read a number of cases from a variety of jurisdictions including the United States Supreme Court, from other state courts, and I looked at a series of SEC no-action letters. There were other things, but I think that was the primary material that I looked at when I did my work.

Q. Thank you. The first thing you mentioned was RSA 5-B, and you noted in your report that you attached some significance to the purpose section of RSA 5-B:1.

Can you explain to us the significance of the purpose section of the statute to your analysis?

A. Yes. I think that one of the main areas that you're looking for in understanding whether something is a securities, you need to understand the background of the institution that would arguably be issuing the security, if it is a security. And you'd say, "Well, what is the purpose of that organization?"

In here you have the benefit of having spelled out directly in the statute what the purpose of the organization is, and the purpose of the organization, as the statute spells it out, is really risk management. In the purpose section, I think, the word or the term "risk management" is used five or six times in a single paragraph describing what the purpose of the organization is.

So I think that that was an important factor for me in understanding what the basic nature of this arrangement was.

Q. You also mentioned the next two sections of RSA 5-B: 5-B:2 regarding risk management, and 5-B:3, the statutory mechanism for the creation of the pooled risk management programs. Can you explain the significance of those sections of 5-B to your analysis?

A. Yes. The second section defined risk management. And, again, since it was referred to so many times in the purpose section of the statute, I thought that that was important. And again, it's describing what I think people commonly think of as a risk management function. You know, the defensive claims in the indemnification of a -- for loss.

So that, really, was an important part in, again, understanding what the basic purpose of the statute was, creating these pooled participation agreements.

With respect to paragraph three I found it significant that there was in the statute a particular provision establishing the ability for an organization, created or adopted as an organization under the statute, to engage in activities that I think when you read the words are consistent with what we commonly think of as operating insurance programs.

Q. You mentioned that you reviewed the Local Government Center's bylaws and a participation agreement. Can you describe for Mr. Mitchell the significance to your analysis from the bylaws and the participation agreement that you reviewed?

A. Yes. And, again, I thought it was important to understand what the members of this organization understood the purposes to be and what the legal document describes as the purposes to be.

And again, I looked in particular at the purpose section, which, I think, appears relatively early on in the bylaws. And that, again, spells out that the purpose of the organization is, in essence, to provide an insurance program, or something very much like an insurance program, so as to permit political subdivisions to be allowed to manage their risks but do it in a less cost efficient basis -- a more cost efficient basis so that they don't necessarily have to go out in the market and purchase private insurance.

Q. You specifically noted a couple of matters regarding the bylaws and the participation agreement themselves, and I'd ask you to talk to us a little bit about that.

One is the determination of the amount of a political subdivision's contribution being similar to that being done by an insurance carrier. And the second one being the nontransferability of the -- of the participation agreement. Can you explain why those are significant to you?

A. Sure. Again, if you're thinking about whether something is a security, and in this case in particular whether it's an investment contract, you want to think a little bit about how someone who would be making a payment, whether it's an investment or not, because that's the question, how they determine how much to pay. And if you're thinking about the way people make investments, you think about how much money you have. You think about how much you want to spend.

Here -- but when you're in an insurance program it typically is based on the risks that your organization presents. So it was particularly important to me to understand that the contributions are based on the number of employees that the political subdivision has, what the medical claims experience has been with respect to workers' compensation what the experience modifier is that indicates how safe or how risky that municipality's employees operate.

So these are the kind of factors that typically drive insurance programs, and they're not typically the kind of factors that drive investment decisions. You know, they're very much reflective of the kind of risk assessment that insurance companies use to determine what premiums ought to be for an insurance program rather than what a stockbroker does when he's trying to sell an investment.

Q. Why is it significant that the participation agreements are nontransferable?

A. For a similar reason. Again, you're looking at the overall economic realities of the arrangement. And while not every security is transferrable, certainly under the case law one area that does get focus is whether or not a person can sell or transfer or pledge as a loan a particular kind of financial instrument.

So if you buy shares of Apple, you can sell those shares of Apple. You can, you know, offer them up as collateral for a loan. It's not -- in this instance the participation contracts are not, as I understand it, able to be transferred from one municipality to another or able to be pledged or -- as a loan, as a security for a loan.

Q. You mentioned that you examined the definition of security under the New Hampshire Uniform Securities Act. And I've put the definition, which is stated in your report, up there.

As I look at this, I don't see any phrase like risk pool, participation agreement, or risk pool contract. Aren't we done?

A. No, I don't think we are done, because while there's a long list of particular kinds of contracts and financial interests that are spelled out there, the phrase that I've italicized, "investment contract," the cases interpreting the definition of securities -- which here is very similar to the definition under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The cases that interpret that phrase, "investment contract," you really need to look beyond the particular list of items that are spelled out and look at that phrase to determine whether a particular arrangement or a particular kind of financial instrument is a security or not.

Q. Well, let me ask you how you did that. Did you examine New Hampshire law decisions or the New Hampshire Supreme Court, for example?

A. Yes. And I couldn't find any cases that were decided by the New Hampshire Supreme Court addressing what an investment contract was under New Hampshire law.

Q. When you couldn't find any New Hampshire Supreme Court law that decided the issue for you, did you examine cases in law from outside the State of New Hampshire?

A. Yes. And, you know, it's a fairly common way to go about the analysis here, because this is drawn from the uniform laws, you know, which have been enacted by nearly every state. And the uniform laws definition of security, again, tracks the definition that's in the federal securities laws in the '33 and the '34 Act. And there's really a very large body of case law interpreting what those terms, including the term investment contract, means under the federal securities law.

So I looked in particular at the federal securities laws and some cases from the United States Supreme Court that for many years now have laid out what an investment contract is under federal law since that standard has generally been applied by most states including, as I understand it, by the New Hampshire Bureau of Securities in the past.

Q. And in researching the issue under federal law and looking at other states' law, I don't believe there's any dispute, but I'll ask you: Is the seminal United States Supreme Court, the *Securities Exchange Commission V. Howey*?

A. Yes, it is.

Q. And can you describe for us, as you did in your report, the elements of what I'll refer to as the Howey Test?

A. Yes. There are really four elements to that test. For a particular arrangement to be considered an investment contract and therefore a security, first there needs to be an arrangement or scheme or contract where a person invests money. That's the first test.

The second, it has to be in a common arrangement.

The third, it has to be -- the person has to be led by the expectation of profits.

And the fourth is that the profits are to be derived solely by the work of the promoter or the third party.

That's really the four elements of the classic Howey Test.

Q. And can you put into context for us, we have the specific elements, but can you put into context for us a little bit about the *Howey* case itself and if there's a -- a general way to describe or an overall way to describe how you get to the test?

A. Yes. So the *Howey* case was a case that related to some orange groves in Florida. And the way that the investment was set up was that the company that originally owned the orange groves essentially deeded a very small piece of that orange grove to someone who wanted to participate in the investment.

And then the person who became the owner of this very small part of an orange grove typically entered into a service contract whereby the orange grove -- the company running the orange grove would do all the work that was necessary to manage the orange grove. You know, fertilize, water, take care of the trees, pick the trees, all that stuff. The folks that owned the very small parcel of land didn't really have any role in the ongoing operation of the orange grove.

So if you were to look at the form of the arrangement you'd see something that looked like a -- the sale of a piece of land and something that looked like a contract for the arrangement to take care of that land.

So it's not something that looks like a classic security. But what the supreme court said in the case, what Justice Murphy said, no relation, was that, you know, you have to look past the formal economic -- the formal legal arrangement and look at what's really going on here.

In essence, what the supreme court said is these folks were mostly out-of-state investors. They don't know anything about how to run or manage orange groves. The investment contract -- the service contracts, in fact, prevented them from coming on the land that they owned unless the company running this operation gave them permission.

So what was really happening here was that the people who bought into this arrangement were looking to make an investment in an orange grove and simply by classifying it as a deed of land and classifying it as a service contract.

We're not going to end the analysis there. We're really going to look at what was the overall economic purpose of the arrangement. And it's clear that this was a situation where people wanted to buy what was, in essence, shares of an orange grove company.

Q. You actually included a quote from the Howey Test in your report, and if I can read that, and then I'll ask you. "All the elements of a profit-seeking business venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control, and operate the enterprise. It follows that the arrangements whereby the investors' interests are made manifest involve investment contracts, regardless of the legal terminology in which such contracts are clothed."

Now, can you tell us why you included that quote in your report and what it really means?

A. I think, again, the main focus of the Howey Test is: "What's really going on with this arrangement? What are people really looking to achieve?"

And here what the supreme court held was that the folks from all around the country that were investing in these orange groves, they didn't want oranges, they didn't want the experience of being able to walk among orange groves, they wanted to make money by buying essentially a piece of an orange grove with the expectation that they were going to use their money that they had to make more money. It was, in essence, a profit-making venture. That's why I included that quote in the report.

Q. Now, in essence, are you saying that there aren't magic words that are controlling, if you will? It's a more flexible standard that you have to look at. What's really going on here; is that fair?

A. I think that's exactly the way that the supreme court says you need to approach these issues. You have been given these four particular criteria as a guide to help -- sort of a helpful way of thinking about the process. But I think running through all the cases is the theme that you really have to look at what's the purpose of the underlying economic arrangement.

Q. You just mentioned that that's the theme that the United States Supreme Court has used in analyzing whether something is an investment contract. So let me ask it first: I mean, is the Howey Test still being used today?

A. Absolutely, yes.

Q. You mentioned two other United States Supreme Court decisions in your report. The first one is a case called *Tcherepnin V. Knight*. Would you explain to us that case and why it was important to your analysis?

A. I think that's a case that shows a classic investment contract. There the investors were purchasing shares in a savings and loan. And, you know, they weren't doing that for any other reason than because they expected to use their money to try to make more money, because they expected that the savings and loan would be able to generate profits, and they would be able to share in that profit-making activity. That's, I think, a classic case of an arrangement that from every perspective looks like an investment as we all kind of commonly understand investments.

And the fact that there was no -- there were no sort of magic words that were associated with that, it didn't stop the supreme court. They said that, you know, it looks like an investment. People are using their money to try to make more money by involving themselves not in the operations of a business but allowing the managers of that business to try to run it in a way to generate profits for them. That's really the key to the analysis of that case I thought.

Q. The second case that you mentioned, and I'll tell you there's been some questioning and some testimony, not extensively, but some in this case already about the *United Housing Foundation, Inc. V. Forman*. And you cite and speak about that case in your report.

Would you please explain that case to us and its importance to your analysis.

A. Yes. I think that's, you know, a critical case here, because it's really the flip side of the *Howey* case and the orange groves, because, you know, there it related to those -- that big apartment complex, Co-op City, that's in New York. I think you can see it if you drive into New York on the left. And it's -- the people who bought into Co-op City were actually issued things that were called shares of stock in Co-op City. So that's a term, that's terminology that is often associated with an investment.

But, again, the supreme court didn't let the label control what the result was. What the supreme court did is look at what's going on here, really? What was the purpose of this arrangement? And, you know, they looked, for example, at the fact that a sale of stock was required in order for you to get an apartment in that apartment complex. It really was the representation of your right to occupy an apartment in that complex.

They looked, also, based on the arguments that were made by the plaintiffs at the case at some incidental benefits that that share of stock gave you. The company that ran the -- that ran Co-op City received some subsidized funding from the government but also received rent payments from the tenants. And because it's such a massive complex, they also, for example, operated some offices that were on the premises, and they operated a laundromat, the supreme court mentions.

And all of these, essentially, ancillary businesses that they ran they hoped to use to generate income which would potentially offset the rent payments that the tenants would have to make. And if the -- if the ancillary businesses did well the tenants would actually get a rebate off of their rent.

So arguments were made, well, you know, since they got the benefit of that rebate and since some of the rent money that they paid was put to work for other purposes, that that should turn the arrangement into an investment contract.

And the supreme court said no, because you have to go back and look at what's really going on here. And what's really going on is that that stock certificate is issued to these people because they want to use and enjoy the benefit of living in Co-op City. They wanted to -- you know, they weren't using their rent money to make more money. They were using their rent money to buy something that they needed to have to live, namely, a place to live.

So it sort of, again, goes back to the question of: Are you using your -- are you making an investment by using your money to make more money or are you using your money to buy something that you're going to use or consume like a place to live? And if it's the latter, it's not an investment contract under the *United Housing V. Forman* case or the other cases that follow.

Q. I just want to make sure that we understand you correctly. So they called it stock?

A. They did.

Q. And there wasn't any question that there was a potential for income from, I think you said parking lots and below-market rent and even laundromat services that the owners of the stock could actually get the benefit of as well; is that correct?

A. Yes. In the form of a rebate off of their rent.

Q. And yet, the United States Supreme Court found that not to be a security; is that correct?

A. That's correct.

Q. I want to ask you about a quote from that case that you included in your report. "The short of the matter is that the stores and services in question were established not as a means of returning profits to tenants, but for the purpose of making essential services available for the residents of this enormous complex. Undoubtedly they make Co-op City a more attractive housing opportunity, but the possibility of some rental reduction is not an 'expectation of profit' in the sense found necessary in *Howey*."

Please tell us why you included that quote in your report.

A. I think it goes to the point that I was just speaking about that in a -- in *Howey* there was the ability of the people who owned the stock, that is, the people who were the tenants of this complex, to get an incidental benefit from the way the managers used -- put their money to work in the form of rent rebates. But that was not the basic purpose of the underlying transaction. These people weren't looking to try to use their money to make money. They were trying to use their money to -- so they could have a place to live.

Q. You mentioned that you examined other state court decisions interpreting investment contracts under the Uniform Securities Act. Do state courts generally follow the Howey Test as well?

A. Yeah. The overwhelming majority of state courts do.

Q. You mentioned that you examined the Bureau's past statements regarding securities. Can you tell us what significance the Bureau's past statements had for your analysis?

A. Well, I think it was important for me to understand -- and was -- it was important for me in two ways. Number one, I wanted to take a look at what the Bureau's past practice had been and the extent to which they followed the Howey Test. And I concluded based on my research that they do follow the Howey Test.

So while there isn't a New Hampshire Supreme Court case on point, the Bureau has adopted the same test as the supreme court in determining whether something was a security. So I wanted to see whether it was -- would be viewed as an investment contract and whether that was the right test, and I concluded that it was.

Secondly, I thought it was important to look at whether or not there had been a past practice of treating these pool participation agreements as securities. You know, one of the first things that I noticed when I did the research is that there is a New Hampshire Supreme Court case about these pooled participation agreements. It doesn't have anything to do with whether they're a security or not. But it seemed clear to me that the existence of these agreements was not a secret. It's spelled out in the *Professional Firefighters* case decided by the New Hampshire Supreme Court.

So I wanted to know whether there was any history of any effort by the Bureau of Securities to get the folks who were running entities like the Local Government Center to register as broker-dealers under the New Hampshire Securities Act or do any of the other things that would necessarily go along with treating these pool participation interests as securities.

Q. And what did you find out?

A. I couldn't see any indication that there had ever been any enforcement action taken against, you know, what seemed to be a fairly publicly known practice.

Q. Why would the fact that the participation agreements and the operation of the risk pools having been publicly known for a long period of time and no prior enforcement action having been brought, why would that be significant to your analysis?

A. It was significant in a couple of ways. You know, number one, I think that -- you know, this isn't really just an abstract legal question of whether something is a security or not. If it is, the kind of requirements that goes along with being a registered broker-dealer or a -- or an issuer; there's a big overlay. Folks have to be licensed professionals and there's a lot of regulatory requirements.

So it seemed to me that if regulators were aware of these kinds of programs, particularly involving, you know, people -- sort of the use of public funds in a quasi public organization that -- and they believed that they were securities, there likely would have been some enforcement action. That's just sort of my experience doing a lot of defensive enforcement work.

Secondly, I noticed that in a lengthy opinion or statement of policy, I guess it was called, by the Bureau of Securities relating to loans, the Bureau of Securities itself spelled out that in their view in that case the long-standing decision by the Bureau of Securities not to consider notes backed by mortgages as securities was an important factor in their deciding in that case that they weren't going to consider them going forward.

So I thought it was worthwhile that the

fact that the Bureau of Securities believed that its own enforcement history with respect to an issue was relevant. I thought that that made it relevant as well.

Q. I'm going to tell you that you note in your report that you believe that the first time the Bureau identified these as securities was in 2010. During the course of this actual hearing we've now agreed that the first time there was notification of that was August of 2011, just so you understand that. Okay?

A. Okay.

Q. You did not analyze whether these were investment contracts under the risk capital test, and I'll tell you no one else who's testified about securities in this case did either. Why didn't you?

A. Two reasons: Number one, it seemed pretty clear to me that New Hampshire's never applied that test before. It's a very different test than the Howey Test. Courts like Hawaii that have used it, I know enough about it to know that they rejected the Howey Test and used this test instead. So that's number one.

Number two is -- I don't have expertise and practice in any of the states that use that test, so I just don't feel qualified to opine as to whether these things would be considered securities under that test.

Q. Thank you. You included a quote in your report from a federal case out of the District of New Hampshire here, the *Manchester Manufacturing Acquisitions, Inc. V. Sears Roebuck & Company* case from our federal district court. And that quote says that: "The court further finds and rules that the definition of 'security' is substantially similar under both federal and state law, and no principled reason exists for drawing a distinction between the two given their collective protective purpose. Accord RSA 421-B:32," parens, "This chapter shall be construed as to effectuate its general purpose to make uniform the laws of those states which enact it and to coordinate the interpretation of this chapter with the related federal regulations."

Can you tell me why you included that in your report?

A. Sure. In the absence of any cases from the New Hampshire Supreme Court, I just thought that that was additional support for the idea that in New Hampshire the correct test is the -- is to rely on an interpretation of the federal securities law, which takes you to the Howey Test and the United Housing Test.

Q. Thank you. Okay. So you've explained to us the cases and the materials that you examined. You've explained to us that the Howey Test as the appropriate test. Now I'm going to ask you to actually explain your analysis to us.

And if you would, you talked to us about the practical economic reality that was explained in the three United States Supreme Court cases that you described. Can you start with that for us and tell us about the practical economic reality that you find in this case?

A. Sure. When I looked at all of the materials I looked at, the statute, the bylaws, the dividend letters, it seemed very clear to me that the overriding purpose of the activities that are at issue here was for the Local Government Center, Inc. and the related entities to provide, essentially, an insurance program to the participating political subdivisions.

The reason why it seemed to me based on all the information that I used that political subdivisions would enter into this pooled participation agreement was just as the statute says, risk management.

The way that the members' contributions are made is essentially the same way. It's based on their -- the number of lives that they have or the number of employees that they have, the health experience that they have. If -- with workers' compensation, the kind of -- what's called the workers' compensation modification -- modifier that they have.

So it looks in every way to me like an insurance coverage. That's the way that the contributions or what are, in essence, the premiums are determined. It's based on this kind of insurance-related activity that the political subdivisions need.

You know, so smaller towns, as I understand it, with fewer employees, they are going to be contributing based on the risks that they pose. Just as in a pooled insurance program that's run commercially, smaller businesses are gonna be paying premiums based on the risks that they -- that they pose to the group as a whole.

I understand from the statute itself, from the dividend letters I saw that the -- to the extent that there are returns of excess premiums, in essence, you know, which are labeled dividends in the statute and which are commonly called dividends in the insurance world as well, that the experience of the individual political subdivisions play a role in determining how much money is going to go back to them or is to be credited to them if there isn't an actual return of excess premium labeled as a dividend that's gone back to them.

And again, it looked to me very much like an insurance arrangement. You know, typically in workers' compensation, for example, a business going to buy workers' compensation insurance pays what's sometimes called a deposit premium, which is based on an estimate of what their insurance costs are gonna be over time.

Now, that estimate may prove to be wrong because there aren't as many injuries or there are -- or there are more injuries. So eventually over time if the claims work out and as the -- all the injuries for that year are assembled and handled and paid, the insurance carrier's going to know whether they're going to be able to return some of that deposit premium or not. And it's based in large measure on the experience of the individuals contributing to that insurance program.

So it looked very much to me like an insurance program and not like something where the municipalities were trying to use the money that they had to try to make money like they would if they were going to make investments in the stock market.

Q. I just want to make sure we're clear about one part of this, and that is, you described contribution levels. And you're not suggesting that the LGC sits down with every municipality that may have only a handful of employees and individually assess the risks? I mean, you're aware that there's a level, say under 100 employees, where they get grouped together, correct?

A. Yeah. And that's, I think, again, common with respect to insurance. It's part of the general insurance underwriting process.

You know, we have group health insurance at my law firm. They don't come around to ask each of us whether we've been doing our push-ups and sit-ups or checking our blood pressure, but they have a good sense based on the experience of the group as a whole as to the likely costs of insuring the group.

Q. Okay. So you've told us the practical realities, the economic, and statutory reasons why these are not investment contracts. What about if we look at the Howey Test itself and the elements of that, can you explain your analysis that way?

A. Yes. My analysis with respect to the

Howey Test focused principally on the question of whether the payments were made based on the participating entity being led to the expectation of profits.

I think if you look at the cases it seemed fairly clear to me that that was not the case here. This was not a situation like the orange grove case, like the *Howey* case itself, where people were buying into this arrangement because they wanted to use their money to make more money.

This was much more like the *United Housing* case, the Co-op City case, because as I understand it, the political -- the participating subdivisions are paying their money mainly for the purpose of buying insurance, something that they're essentially going to use and consume.

It's not a place to live, but it's just as essential for these political subdivisions to have given the nature of their operations. And so what they're getting for their money is not the opportunity to make more money for the most part. What they're getting for their money principally is participation in an insurance program.

So that fundamental -- that was the fundamental nature of the arrangements that caused me to conclude that the municipalities were not led to make these payments with the expectation of profits as the supreme court uses that terminology.

I did look at some other material with respect to the other aspects of the -- aspects of the case. You know, there's the fourth element of the test, as it's classically stated, requires the returns to be based solely on the efforts of the promoter or another third party here.

And as I understand the facts, at least to some degree the returns -- and certainly, that was the case with the letters that I saw, which span the period from '99, I think, to 2003. The returns that were given, essentially return of deposit premiums which are called dividends, as they are under the statute, was based on the particular experience of those political subdivisions.

So it wasn't solely on the basis of the efforts of the managers that the returns were calculated or the dividends were calculated, but the actual insurance experience of some of the individual entities or pools of entities drove part of the dividends. So that was the fourth test. And I thought that I wouldn't have made my mind up solely on that basis, but it didn't pass the Howey Test on the fourth test either.

With respect to the first element of the test, whether this was an investment of money, again, I think that goes back to what's the purpose of this. And I thought it was particularly important that there were a series of SEC no-action letters where the analysis proceeded on whether or not there was an investment of money.

Those cases are very -- those no-action letters presents situations quite similar to this one. And in that case the argument was made and a no-action letter followed based on the argument that this was not an investment of money. Well, it's clearly a payment of money. Again, the purpose of it was to purchase something, namely insurance, and not to use your money to try to make more money, which is really what an investment is classically under the supreme court's cases.

Q. Why would you look at Securities and Exchange Commission no-action letters? Aren't they fact specific?

A. They are fact specific, but when the facts closely or sufficiently closely resemble an issue at hand, they are precedent that practitioners rely on. They aren't binding statements of law issued by the Securities Exchange Commission.

But when you're advising clients, if you've got a situation where the SEC has issued a no-action letter based on a set of facts that they've been given, in addition, you're persuaded by the legal analysis that was presented as the opinion to the SEC, then they do give you some comfort that you're giving your client good advice.

Q. What about the notion that RSA 5-B, it states in there that interest and dividend earnings could be returned for the public benefit, doesn't it?

A. It does.

Q. And did you look at that language and did that influence your opinion?

A. Yes. And again, I thought that that actually supported the view here.

Q. Why is that?

A. Because, again, it's much like the *United Housing V. Forman*. There are going to be occasions when money is going to come back to these political subdivisions, as I understand it within the meaning of the statute. But those monies like the situation in the *Forman* case, as I understand it, are essentially incidental to the main purpose. The main purpose being insurance. Incidental purpose, if there are monies available to be remitted back to the political subdivisions, then they can go back as classically described as dividends as they are in insurance -- in many insurance policies. And if you go back and take a step at -- go back to the purpose section of the statute, the whole idea here, as I understand it, was to give the municipalities, the political subdivisions, an alternative to going out and buying private insurance.

So the whole hope behind this arrangement was that they were going to be able to achieve some savings as a result of pooling their resources. So it was completely consistent with the original legislative objectives that there would be some dividend returns, just as in insurance programs if people's experience is better than it was predicted to be, they get typically deposit premiums returned to them.

Q. You note in your expert opinion that RSA 5-B:5(f) states that: "Contributions to the program and the reserves necessary to maintain it are to be determined in light of 'an annual actuarial evaluation of the pooled risk program.'"

Why did that statutory provision have significance to you?

A. Again, it goes to, you know, what kind of animal is this, really? If you think about a typical investment that you make, you decide to buy money in the stock market, there's not going to be any kind of actuarial evaluation done of your ability to participate or the realization that you get on that investment. That's, again, an indication to me that this is really about the political subdivisions being able to get insurance for potential claims made against them.

In that actuarial process, just as I was talking about with the workers' compensation or the number of lives covered for health insurance, to me makes this clearly, when you look at the economic reality, basically, a pooled insurance program and not investment where you're looking to use your money to make money.

Q. You mentioned one other case in your report and have a discussion, it's *Dryden V. Sun Life Assurance Company of Canada*, a case out of the Southern District of Indiana.

Can you explain to us a little bit about that case and why it was significant to you?

A. It was significant to me because that was one case where, as the statute here labels the returns dividends, in that case, again, there was the use of this term dividends. And I thought it was important, because the court there said, "The fact that you're calling the returns dividends isn't dispositive." Let me take a step back and talk about the facts of the case.

It was a case relating to the people who owned whole life insurance policies. And the company came up with a program and it says -- it said that, "Going forward we've noticed that when people borrow against their whole life programs that gives us less money to invest. And what we're going to do now is say that if you buy a whole -- by a whole life insurance policy from us and don't borrow against it, you're going to get dividends back to the extent we're able to declare dividends that are better than the dividends that we're going to send to the person who borrowed against it."

So while it's not exactly the situation here, it resembles it in a number of key respects. Number one, it's clear that the insurance company was putting the premiums that it was being paid by the policyholders to work in the stock market, number one.

Number two, it was clear that the insurance company was essentially using their returns they achieved in the stock market to impact the amounts that would go back to particular policyholders or the premium charges that would be associated with the policyholder's payments.

But despite those facts, which, you know, the use of the word dividends and the participation of an insurance company in the stock market with the premiums that they paid, that didn't make the purchase of insurance by the policyholder to the insurance company a security within the meaning of the federal securities law, because the -- what the court said what's really at issue here is that these people are buying insurance. They're not looking to make an investment in the stock market, the policyholders. They're not looking to use their money to make more money.

They're looking -- primarily, they're looking to use their money to buy something that they're going to consume or use, just like in this case, insurance, in the same way that the people in the Co-op City case were looking to use their money not to make more money but principally to get a place to live.

Are they using the money to consume or use something, or are they using this money to try to make more money? That's really what all these cases focused on. Yeah.

Q. So based on all of your research, all of your own professional experience both as a regulator, prosecutor, and as a private practitioner, what is your opinion whether the participation agreements at issue in this case are investment contracts and securities?

A. For the reasons I've described I don't think they are. That's my opinion.

Q. I have just a few last questions for you. You were aware that part of the Local Government Center's funds are invested in mutual funds or stocks or actual securities. Does that change the analysis for you?

A. No, it's not -- it doesn't, because -- and I think that's a case -- that's one area where the *Dryden* case is important, and also it's another case where the *Forman* case is important. In both of those cases the people who were the recipient of the -- the tenants in one case or the policyholders in the other case money, used that money -- put that money to use.

In the *Forman* case they used it to run parking lots and they used it to have office buildings with professional offices in Co-op City. So they didn't use the money solely for the purpose of insurance. They did other things with it.

Same with the *Sun Life, Dryden* case. They invested some of the premiums that they got in the stock market. And the participants in those arrangements, the tenants on the one hand and the policyholders on the other, got a benefit as a result of what the insurance company did in one case and the Co-op City managers did in the other.

But despite that fact, the supreme court in the *Forman* case, the Indiana court in the *Dryden* case looked at the overall arrangement and said, "What's really going on here?" And concluded that they were not investment contracts. They were security -- they were not securities.

Q. During the hearing in this case there's been a suggestion or an argument that all insurance contracts are financial in nature and that, therefore, whether it's in the form of cost savings to municipalities or whether it's in the form of returns to municipalities that, therefore, there must be an investment and profits. Do you agree with that assessment?

A. I don't.

Q. Why not?

A. Well, I think the analysis in the *Dryden* case, for example, would show that that was clearly incorrect under that case of analysis. And, again, the focus of all of these cases is what's the underlying economic reality that's going on here?

And as I understand the basic economics here, the basic purpose of this transaction was for these political subdivisions to be able to get insurance for potential claims against them. It goes back to the purpose of the statute that's spelled out, which is risk management and the ability to achieve risk management in a way without having to pay the prices charged by commercial insurance. That's what I read the New Hampshire legislature was setting up when this statute was enacted, and that's what I see as the fundamental purpose of this program.

The fact that the benefit that is coming from the participation in the agreement is a financial benefit, I think the *Dryden* case makes clear isn't -- doesn't mean that it isn't -- does not mean, I should say, that it is a security, just as in the *Forman* case, the municipalities are using their money to buy something that they're going to use or consume.

In this case it's insurance, but they need it just as much as the people in the *United Housing*, *Forman* case needed a place to live.

Q. Attorney Murphy, you've been an assistant United States attorney, therefore, a regulator and a prosecutor in federal securities law. You've been a private practitioner for a number of years now. A significant portion of your practice is in securities.

RSA 5-B, does it put people on notice that when they read the statute they should be aware this might be a security?

A. In my estimation it doesn't. I think when you look at the statute and you look at the arrangement that is spelled out in the statute, you look at the purpose of the statute, it would be very surprising to me that anyone would think that the people who are running these programs would need to register as broker-dealers under the securities law, take the exams that are necessary to be broker-dealers, participate in the kind of analysis that you need to be to be broker-dealers, talk suitability of the investment, which is the core part of being a registered broker-dealer with the participating entities.

It just would come to me as a big surprise reading it to say, "Boy, this now means we're going to have to go comply with all federal and state securities laws, all the registration requirements, all the recordkeeping requirements." It just does not seem like it would be a natural reading of the statute to me.

MR. RAMSDELL: May I have just a minute, Mr. Mitchell?

THE PRESIDING OFFICER: Surely.

MR. RAMSDELL: I have no further questions.

THE PRESIDING OFFICER: Thank you very much. Mr. Gordon, any?

MR. GORDON: No.

THE PRESIDING OFFICER: Thank you. Mr. Howard?

MR. HOWARD: No, thank you, Mr. Mitchell.

THE PRESIDING OFFICER: Very good. Mr. Tilsley on cross-examination.

MR. TILSLEY: Thank you, sir.

CROSS-EXAMINATION

BY MR. TILSLEY:

Q. Good morning, Mr. Murphy.

A. Good morning.

Q. How are you? You ended your testimony by saying that in your opinion RSA 5-B would not put someone on notice that these participation contracts wouldn't be a security. If a client came to you with one of these participation contracts you would not seek a no-action letter, correct?

A. I don't think that I would -- you know, I don't think that's an issue that I would even have spotted as one that would be -- you know, rise to the level where I would think it would be necessary or appropriate to seek a no-action letter.

Q. And a no-action letter is something that a company and their securities lawyer can seek when they spot an issue and they want to be sure that what they're doing is not going to result in some type of enforcement action, correct?

A. Yes.

Q. No-action letters are sought by the

applicant who applies to the regulator for an opinion, correct?

A. Yes. That's correct.

Q. The regulator doesn't walk around and hand out no-action letters to people or initiate that process?

A. No.

Q. Okay. And in the no-action letters, the ones you referred to in your opinion, most of what's in those letters are the analysis that is prepared by the applicant's attorney; is that correct?

A. That's correct.

Q. The analysis will typically specify in detail how the program works, correct?

A. That's correct.

Q. And then will contain some illegal analysis, applying it to the program by the applicant's attorney, correct?

A. Exactly.

Q. And then the SEC's contribution to those no-action letters is usually five or six lines basically saying, "Based on what you've told us and the facts presented, we will not take any enforcement action"; is that fair?

A. That's exactly correct, yes.

Q. Okay. And a no-action letter is a process that's available in New Hampshire, correct?

A. I understand it to be, yes.

Q. So if somebody wasn't sure if they had a security, they could go to the Bureau and submit a few pages of analysis and facts, and the Bureau would respond some way or another?

A. I understand that, yes, to be the case.

Q. Would you agree with me that insurance contracts are financial by nature?

A. I think that insurance contracts are devised for a number of different purposes, but ultimately they are typically entered into to -- as a way of managing risk.

Q. They cost money, correct?

A. Yes.

Q. And the benefits that they provide ultimately boil down to the payment of money to the insured or on behalf of the insured, correct?

A. In the event that there's a claim or -- you know, it's insurance, so what most of us are hoping for is that nothing happens to us, but we're looking at a certain level for peace of mind that if something does, there will be somebody besides us that will provide the resources to pay it. That's the way I would describe it.

Q. Okay. You talked about the *Dryden* case. That's a mutual life insurance case, correct?

A. Right.

Q. And, in fact, the defendant in that case is Sun Life Assurance Company of Canada, correct?

A. That's correct.

Q. And Sun Life Assurance Company would be subject to comprehensive regulation; is that correct?

A. Yes.

Q. By the Insurance Department?

A. Yes. I don't know -- I wouldn't call myself an expert on Canadian insurance law by any stretch of the imagination, but if they're selling policies in the United States, they're gonna have to comply with the regulations of the various insurance divisions of the states.

Q. Okay. And are you aware of any U.S. Supreme Court cases that rely on a comprehensive regulation by a nonsecurities agency in determining whether a product is not a security?

A. I'm not sure I understood that question, but...

Q. Are you aware of any U.S. Supreme Court cases where the U.S. Supreme Court determined that a particular product was not a security in part based on the fact that it was subject to comprehensive regulation by an Insurance Department?

A. I believe that that concept has been referred to by the United States Supreme Court.

Q. Okay. The *Dryden* case was decided in 1989, correct?

A. Correct.

Q. And it was decided by the U.S. Federal Court for the Southern District of Indiana, correct?

A. Correct.

Q. You do cite in your report one case dealing with similar public entity pool trusts, correct?
A. Yes.
Q. And that's the *Naylor* case?
A. Correct.
Q. And that was decided, I forget -- within the last few years; is that fair?
A. Well, it was -- a motion to dismiss was decided. I know there's -- I looked on the PACER docket last week. There's a motion for summary judgment pending. So it's still a pending case.
Q. Fair enough. But the decision was issued, I believe, in 2011; is that --
A. I think the motion to dismiss was 2010 or 2011.
THE PRESIDING OFFICER: Excuse me. For the record we have it listed as 2010.
MR. TILSLEY: Thank you.
Q. The *Naylor* case, that decision is from the very same court that decided the *Dryden* case, correct?
A. Yes.

Q. You talked about the fact that in your opinion the primary purpose of this statute is insurance coverage. I'm just going to show you to the screen. I'm showing you, sir, RSA 5-B:1. Would you agree with me that that is the purpose provision of New Hampshire RSA 5-B?

A. I would.

Q. And one of the purposes there which we've highlighted, among other things, is the "Accrual of interest and dividend earnings which may be returned to the public benefit"; do you see that?

A. Yes.

Q. Okay. Is there any indication in this statute that that is an incidental purpose as opposed to the other purposes that you've mentioned regarding insurance coverage?

A. There's not that language use, no.

Q. As I understand it you have reviewed dividend letters that LGC issued to its members between 1999 and 2003, correct?

A. Yes.

Q. And that's what you relied on in saying that the dividends are based on claims experience in your testimony, correct?

A. I also was recently given some expert -- excerpts of some of the prior testimony where there was a discussion about whether the calculation of returns was done on a pro rata basis or whether it was based on the experience of the political subdivisions.

Q. When you wrote your report you had not reviewed any information regarding how LGC returns dividends through rate credits, correct?

A. Correct.

Q. In your opinion, the practical economic reality here is that we have an insurance program, correct?

A. Yes.

Q. There are insurance programs that are federal securities, correct?

A. Yes.

Q. Are you familiar with risk retention groups?

A. In some respects, yes.

Q. Okay. You've heard of that before?

A. Yes.

Q. And are you aware that risk retention groups is a type of, sort of private self-insurance?

A. Yes.

Q. Now, are you aware that risk retention groups are securities under federal law?

A. I understand that some are.

Q. You testified that the analysis as to whether or not these participation agreements are securities was not an abstract question; is that correct?

A. Correct.

Q. These are fact-specific analyses?

A. I agree with that, yeah.

Q. Doesn't matter what you call it; what matters is the underlying facts, correct?

A. Correct.

Q. If the facts of a particular product or program change over time, that could affect the analysis of whether or not something is or is not a security, correct?

A. I think that becomes a complicated

question. I wouldn't say it was irrelevant, but I think there would need -- I think that if you take a look at what the overall purpose of the program when it was established, I think I would tend to rely on that more, but I do agree that you can't ignore changes over time.

Q. Okay. So there could be a change over time that would convert a product that say wasn't a security in 1987 into a security in say 2007?

A. Again, I have somewhat of a problem with the idea of converting something from a nonsecurity to a security, but I do think that new participations or new arrangements that someone entered into, if the facts have changed, you would obviously want to take a look at that.

Q. For example, when the SEC issues a no-action letter, it is fact specific, correct?

A. Correct.

Q. And if I have a no-action letter for my investment product and I begin to operate in the way that deviates from the facts in my no-action letter, I may no longer be able to rely on the no-action letter from the SEC, correct?

A. Correct.
Q. In the *Howey* case the purchasers of the orange groves, I think you testified, did not know anything about managing orange groves; is that accurate?
A. Yes.
Q. Do you believe in this case that the municipalities, the school districts that buy -- that become members of these pools know how to run an insurance pool?
A. My assumption is that they aren't experts in that. They are not experts.
Q. And I think you said you've seen or heard some of the testimony on that in this case?
A. I've seen snippets, yes.
Q. Have you seen any testimony from actuaries?
A. No.
Q. Okay. You testified that one of the elements you relied on in determining that these participation agreements are not securities is that they are not transferrable; is that correct?
A. That's correct.

Q. But you did also say that transferability while it is an element of the analysis is not necessarily a determinative element of whether something is a security?

A. Correct.

Q. You can have a security which is nontransferable?

A. Yes.

Q. You testified that the contributions to these programs were based on the number of employees that towns have, correct?

A. That was one element.

Q. One element. Another element was their claims history?

A. Yes, I understand that.

Q. Any other elements?

A. If I can --

Q. Sure. Feel free.

A. I think I was informed that there was, you know, projections on likely health exposures and general underwriting -- other facts that I would view as sort of consistent with underwriting-related facts.

Q. When you testified you did not list that one of the elements of contributions to the programs is the application of surplus produced by the program itself, correct?

A. Correct. I didn't mention that.

THE PRESIDING OFFICER: Excuse me. Just for clarification.

THE WITNESS: Sure.

THE PRESIDING OFFICER: You didn't mention it or you did not consider it?

THE WITNESS: Well, I certainly didn't mention it in my testimony. And I didn't, I think, have the facts relating to that at the time that I did my report is the way I would describe it.

THE PRESIDING OFFICER: Thank you.

THE WITNESS: I learned something about that since, but I didn't know about that at the time of my report.

THE PRESIDING OFFICER: Please continue, Mr. Tilsley.

MR. TILSLEY: Thank you, sir.

Q. You understand that -- I think you

reviewed the bylaws, correct?
A. Yes.
Q. You understand that the net income of this program accrues to the members under the bylaws?
A. I do.
Q. Okay. And that earnings accrue to the members under the bylaws, correct?
A. Yes.
Q. And you understand that 5-B does provide for the return of earnings and surplus to the members?
A. Correct.
Q. You in the beginning of your testimony mentioned that you were rated in Chambers and Best Lawyers for white-collar crimes and federal investigation, correct?
A. Correct.
Q. You did not -- are you rated in those for securities law?
A. No.
Q. Would you agree that the quality of LGC's management is likely to affect the

performance of their risk pools?

A. I think -- I'm inclined to view that as an area outside my expertise. I think as a matter of common sense I would say yes.

Q. Okay. So your expertise does not extend to how the risk pools operate and who contributes to the operation and the success of the risk pools?

A. No. I, you know, took some of what I knew or had been told about in account in reaching my opinion, but I don't profess to be an expert in the operation of risk pools.

Q. Is it fair to say that the purpose of our state's securities law is to provide some protection to potential purchasers of these products?

A. I think investor protection is generally the purpose of most state securities laws, and that's my understanding of the purpose in -- of New Hampshire's.

Q. And if something is a security there's a process for the regulator to look at the product, make a determination as to what types of registrations are necessary; is that correct?

A. In part, yes, that's correct.

Q. And part of that is to make sure that purchasers know what, in fact, they're purchasing, correct?

A. You know, in the securities regulation environment when you've got something that's a security, there's a whole set of overlay about what you have to tell that person about it. You have to make an assessment about whether or not that person's investment objectives are consistent with the instrument that you're offering them. So I guess I would generally agree with what you're saying.

MR. TILSLEY: Okay. I have no further questions, sir. Thank you.

THE WITNESS: Thank you.

THE PRESIDING OFFICER: Any redirect, Mr. Ramsdell? While you consider that, Mr. Gordon, any?

MR. GORDON: No.

THE PRESIDING OFFICER: Mr. Howard?

MR. HOWARD: No, thank you.

MR. RAMSDELL: I do have a couple of questions, I guess.

THE PRESIDING OFFICER: Mr. Ramsdell on redirect.

REDIRECT EXAMINATION

BY MR. RAMSDELL:

Q. You mentioned in response to one of Attorney Tilsley's questions that at the time you wrote your report you weren't aware or you hadn't been made sufficiently aware of any facts regarding potential return of surplus but you've since received some information about that; did I understand your testimony correctly?

A. What I didn't know before which I think I understand now is the surplus on occasion rather than -- or recently, as I understand it, and again, this is just my understanding, rather than being returned as dividends, as I saw in those letters from 1999 to 2003, I've seen some indication that it's been used as a way to reduce premium payments, if I understand the facts correctly.

Q. Okay.

A. I'm not sure if that is correct, that's not something I understood when I wrote the report --

Q. Fine. And I'll represent to you, and I don't believe anyone will disagree, that there, in fact, has been evidence in this case that at some point in more recent years that instead of dividend payments going back to municipalities that, in fact, either rate credits, premium -- or rate stabilization was used. Does that change your opinion or analysis?

A. No. Because, again, just as in the *Forman* case, the operation of these -- the washing machines and the professional offices that were there resulted in rent rebates. I think that the -- and as the supreme court said, contributed to the reduction of rents even without rebates.

I think the same principle would apply here; that if the surplus is being used to reduce premium payments that that wouldn't in any way turn this into a security in my view.

Q. Thank you, Attorney Murphy.

MR. RAMSDELL: Mr. Mitchell, I have no further questions.

THE PRESIDING OFFICER: Thank you, Mr. Ramsdell. Anything further, Mr. Tilsley?

MR. TILSLEY: I'm all set, sir.

THE PRESIDING OFFICER: Okay. Mr. Murphy, I believe you're going to be my last expert, so you bear the burden of helping me clean up the record.

Have you testified before in proceedings, sir?

THE WITNESS: Have I testified before? Yes. Not as an expert, but I have testified.

THE PRESIDING OFFICER: Okay. You understand that I don't have a horse in this race?

THE WITNESS: I do.

THE PRESIDING OFFICER: Very good. I ask these questions, if you will, because I will now assume, bear the responsibility for making certain determinations. And if I am not clear, don't hesitate to ask me to restate it.

THE WITNESS: Okay.

THE PRESIDING OFFICER: In your testimony and in your expert's report you considered our statute, RSA 5-B, correct?

THE WITNESS: Yes, I did. Yes, sir.

THE PRESIDING OFFICER: Okay. In reviewing that statute did you notice that there was an obligation to make certain annual filings?

THE WITNESS: I did.

THE PRESIDING OFFICER: Okay. Did you also notice that there really was no regulatory provision in that statute?

THE WITNESS: I noticed that there was a specific provision that indicated that it was not subject to insurance regulation. That's what I noticed in particular and that there was -- I know that the statute changed over time, but I think originally there was a reporting requirement to the Secretary of State's office.

THE PRESIDING OFFICER: Okay. In your research of other state statutes that you've referenced here this morning and your experience with securities regulation, have you ever seen a statute that does not assign regulatory authority or gave exemption from regulation for such products as these?

THE WITNESS: I'm not really familiar with too many other statutes that essentially lay out products like these.

THE PRESIDING OFFICER: Sure.

THE WITNESS: So I mean, I -- so I think as a preliminary matter I'm not sure that I --

THE PRESIDING OFFICER: All right.

THE WITNESS: -- know of other state statutes that describe these. So I'm not sure I can really answer that.

THE PRESIDING OFFICER: Understood. Can I appeal, then, to, sir, as you referenced, your common sense?

THE WITNESS: Sure. So I think that --

THE PRESIDING OFFICER: Commonsensically?

THE WITNESS: Well, I think commonsensically here it seemed to me -- I thought about that question. And so here it seemed to me you've got an entity that is itself made up of members that are political entities in the State of New Hampshire, and that there is a board of director -- board of directors that's made up of public officials in the State of New Hampshire. If I understand it the members are, you know, public officials.

So I think -- I tried to think of analogies and -- because I noted that, okay, if it's not insurance and reports have to be filed with the Secretary of State, does that mean that there was implicitly some suggestion that they ought to be regulated in some other way?

And I guess my sense was -- again, I'm just relying on common sense here and nothing else, that with the number of political entities and public political subdivisions that were involved here, that there would have been, you know, a lot of opportunities for accountability.

In Massachusetts we have this thing -- this is the closest analogy I can think of -- that's the Massachusetts Water Resources Authority. It is in charge of distributing all the water from the reservoirs to people in eastern Massachusetts. I happen to live in the district. I pay them for my water.

There's boards of directors -- there's people in my town that are on the board of directors. So there's a lot of opportunities for public accountability. They aren't -- the governor can fire the executive director, so it may be a little bit different here, but it's a situation where essentially rate payers have an opportunity to complain about the rates, and they do.

But there's no sort of superstructure of regulation that goes over what the Massachusetts Water Resources Authority can do when I pay for my water. They are building all these projects. You know, they are -- I know that they are investing their -- the money that they get. They aren't leaving it in the bank. You know, they are making what we hope are improvement investments with it. And there's nobody regulating that. So that was the one analogy I thought of.

And on the other side, and you can tell me if I'm going too far in my answer on this --

THE PRESIDING OFFICER: Well, you may be. I understand your answer to this point.

THE WITNESS: Okay.

THE PRESIDING OFFICER: And there has been a change to legislation, as I'm sure you're aware.

THE WITNESS: Yes. Yes.

THE PRESIDING OFFICER: So I have my answer, but if you feel a need to -- that I need to understand something further, go ahead.

THE WITNESS: I think the only other thing that I think I might be able to offer is that, you know, the securities industry is, you know, maybe with the exception of hospitals, probably the most heavily regulated industry that we have in the country. And, you know, there are all different kinds of tests that people have to take to be able to perform very different functions. When I was trying to apply common sense to this analysis, I thought the idea of saying, well, essentially by silence these things are going to be regulated as securities and the folks running these -- the -- it's clearly designed to be run by people who are from local governments.

You know, the idea that there would be some set of broker-dealer regulations that are really very technical in nature to be applied to that, it's sort of, as a matter of common sense that did not make sense to me.

THE PRESIDING OFFICER: Thank you, sir. In reviewing our securities statute, do I understand the sum of your testimony to be that New Hampshire has adopted the Uniform -- the so-called Uniform Securities Act, and that for purposes of application to these set of facts, as you understand them, it does not differ in any substantial way from the Federal Securities Act?

THE WITNESS: With respect to the definition of what a security is.

THE PRESIDING OFFICER: Okay. You recall your testimony in the elements of *Howey?*

THE WITNESS: Yes.

THE PRESIDING OFFICER: Okay. In balancing the black letter of *Howey* with the concept, and it's been -- please accept my representation, it's been variously characterized as economic realities, practical realities of the situation. You recall your response in that regard.

Do I understand you to interpret *Howey* that in writing its decision the U.S. Supreme Court was providing the lower courts and other factfinders with some discretion to look at the facts, these economic realities and practical realities?

THE WITNESS: Yes.

THE PRESIDING OFFICER: Okay. The firm that you presently are employed with, how many attorneys are in that firm?

THE WITNESS: 225, give or take.

THE PRESIDING OFFICER: Okay. Just wanted to get a sense. You know what happens when you cross that border coming north, right? I'll take your smile as an acknowledgment.

I pause because I want to use the most neutral and non-connotative words, and you understand why for record purposes and the impartiality with which I have to apply to this case.

If a, I don't know, an associate, partner -- I don't think the rank in the firm would make a difference. And this is certainly metaphorical or analogous to facts here. You're familiar with the term, quote, issue spotting as an attorney, aren't you?

THE WITNESS: Yes.

THE PRESIDING OFFICER: In fact, you've probably been familiar with that since law school, yes?

THE WITNESS: Exactly, yeah.

THE PRESIDING OFFICER: Okay.

THE WITNESS: I hope I've been better at it, but...

THE PRESIDING OFFICER: Well, it seems like you have, sir. However, in my examination of facts that have been presented and will reveal themselves through the exhibits you see to your right, if an attorney in your firm is presented with a client and the client is presenting a situation or a document that calls upon them or refers specifically -- explicitly to participation agreements, contracts, shares, pooling of interest, and they -- would you expect that someone in your firm as an attorney, that an attorney would spot that and kick it either over to your division in securities or somewhere?

THE WITNESS: Yeah. I think it would depend on the context, so...

THE PRESIDING OFFICER: Yeah.

THE WITNESS: I think certainly there would be some times when you would hope and expect that people would do that, but it would depend on what sort of the overall purpose of -- what the client's business was, I guess is what --

THE PRESIDING OFFICER: Sure. I have to come back just a little bit.

THE WITNESS: Yeah.

THE PRESIDING OFFICER: And this is where I stir things up, and I hope not to. But you certainly would hope that an attorney in your firm would err on the side of caution when those words at least came into play to say, "Well, maybe I ought to walk upstairs across the hall," or whatever the procedure would be; do you not?

THE WITNESS: You certainly hope that they're going to think about all the possibilities, yes.

THE PRESIDING OFFICER: So when you say the people running this thing, that you could see where they might not give it consideration, you know, would not spot anything, if there were four or five attorneys involved, would you consider that they might be more inclined or -- to spot it at least particularly where they have outside counsel?

THE WITNESS: Well, I mean, I can -- I can sort of give you my own reaction, if you don't -- if --

THE PRESIDING OFFICER: And that's what I'm asking you.

THE WITNESS: If that's okay.

THE PRESIDING OFFICER: Uh-huh.

THE WITNESS: And lots -- part of what I do is that, you know, we're asked sometimes to participate in an organization's risk assessments where I'm asked sometimes to weigh in on whether a company has an effective compliance program. And you think of -- you think of the risks that people have in the business that they operate.

You know, I'm only as good as I am, but I can honestly tell you that if I had been asked five years ago to take a look at what I understand to be the operations of the Local Government Center, I would have had a lot of questions about compliance with their bylaws. I would have had a lot of questions about internal controls relating to the way they use their funds. I would have wanted to make sure that, you know, their audits were done properly on an annual basis. But I can honestly tell you that I don't think it would have occurred to me to think that there was a question about whether they ought to be registered as broker-dealers under the New Hampshire Securities Act.

It's just -- again, maybe other people smarter than me would have spotted that issue, but I can honestly tell you, it would not have been something that occurred to me.

THE PRESIDING OFFICER: First, let me

say, as I've said to other experts I've seen, I respect your expertise. Your credentials speak, if you will, to some degree to your expertise and intelligence. And maybe I was too loose with the word issue spotting, but, you know, I was introduced to that in year one of law school. Were you not?

THE WITNESS: Yes, definitely.

THE PRESIDING OFFICER: Okay. So when I'm saying issue spotting, if I'm using it, you understand, I'm not saying everyone should be an expert in securities law, but that when a certain number of terms are involved in the consideration of the establishment of almost any business enterprise that use terms that you find in your now line of expertise that issue spotting would help you identify that?

THE WITNESS: Oh, I agree with that completely.

THE PRESIDING OFFICER: Okay. Thank you. And at the risk of seeming -- or confirming some Massachusetts beliefs about some of us attorneys up in New Hampshire, yesterday I characterized in trying to, if you will, apply *Howey*, understand as it was being presented by the respective sides that I used the old one of: If it looks like a duck and walks like a duck and quacks like a duck.

I understand that's a simplification, but can I not begin my analysis with that with respect to whether or not this is a security?

THE WITNESS: I think that's exactly the right place to start.

THE PRESIDING OFFICER: Thank you very much. Did I stir anything up, gentlemen?

MR. RAMSDELL: I have just one question.

THE PRESIDING OFFICER: Sure, Mr. Ramsdell.

REDIRECT EXAMINATION

BY MR. RAMSDELL:

Q. While RSA 5-B may only have relatively recently added a regulatory component to it, the same would not be true for RSA 421-B, the Uniform Securities Act, correct? Would you agree with me that the regulatory enforcement authority for securities in New Hampshire has existed for a long time?

A. Yes.

Q. Thank you.

THE PRESIDING OFFICER: Thank you, Mr. Ramsdell. Mr. Tilsley, anything further?

MR. TILSLEY: Just one, Your Honor.

THE PRESIDING OFFICER: I'm sorry. Did you say you understand the risk?

MR. TILSLEY: I understand the risk.

MR. RAMSDELL: I thought he said no further questions.

RECROSS-EXAMINATION

BY MR. TILSLEY:

Q. You talked, sir, about the fact that you thought it was nonsensical, I think was the word you used, for the people running LGC to have to register as broker-dealers. If this was a security, for any security, there's a provision to request an exemption from those registration requirements, correct?

A. Yes. I understand that there is.

Q. Thank you.

A. I'm not sure I said -- if I said

nonsensical that might have been strong, but I hope I didn't use that word.

Q. That may be my word. I'm just trying to remember. I didn't write it down. I might be wrong.

THE PRESIDING OFFICER: Thank you very much. I see no other indication of someone -- oh, I'm sorry. Mr. Howard, please come forward. Oh, no, he's consulting with Mr. Ramsdell.

While he's doing that, I'm aware -- I've been informed, Mr. Tilsley -- I'm sorry, Mr. Howard?

MR. HOWARD: I just have one question.

CROSS-EXAMINATION

BY MR. HOWARD:

Q. And I'm only following up on what the hearings officer had just asked you a moment ago, the duck analogy.

If you consider the duck to be a security, does this thing, the participation agreements, look, act, quack, and walk like a duck?

A. I don't think it does.

Q. All right. Thank you.

THE PRESIDING OFFICER: Okay. Any other further questions of this witness? None.

Mr. Murphy, thank you for sharing your knowledge and information with me, and thank you for your candor as to this tribunal. You're excused, sir.

THE WITNESS: Thank you.

THE PRESIDING OFFICER: Okay. I want one housekeeping thing, which is 267. Do we have that in as a full exhibit?

MR. RAMSDELL: Yes. I move to strike it. They agreed, and I believe you struck it.

THE PRESIDING OFFICER: Very good. Just double-checking on that. All right. If I might just take a moment -- or something else, Mr. -- anyone? No? Okay.

Then please let me take a moment before our morning recess. Mr. Ramsdell, you can continue on your mission.

MR. RAMSDELL: Thank you.

THE PRESIDING OFFICER: But I have comments for Mr. Tilsley.

MR. RAMSDELL: Thank you.

THE PRESIDING OFFICER: Okay? Mr. Tilsley, sir. I'm informed that you'll be leaving these proceedings in about 90 seconds.

MR. TILSLEY: More or less.

THE PRESIDING OFFICER: I want to congratulate you on your performance here. I want to commend you for your level of professionalism here.

I want to also thank you for the civility that you have shown to your colleagues and to this tribunal in what has been a unique case, a complex case, and if you'll allow me, at times an emotional case. We've all kind of lived together one way or the other since at least October. I think you joined the proceedings a month or so later. But I wouldn't want it to go unnoticed, frankly, to those in the gallery and to those who are not able to see this type of process play out, because it's a, quote, civil matter.

And so I wish you, again, good luck on your trip and have a safe journey. I hope I don't see you again in this context, but if I do, you'll be welcomed.

MR. TILSLEY: Thank you, sir. I appreciate the nice comments. Thank you to yourself as well as respondents' counsel for accommodating my schedule and letting me get to California for my daughter's graduation. Thank you.

THE PRESIDING OFFICER: Very good. We're at morning recess, then.

(Recess taken.)

THE PRESIDING OFFICER: We have returned from our midmorning recess. And Mr. Saturley, you are calling your next witness.

MR. SATURLEY: I am, sir. I am calling Ms. Jenny Emery.

THE PRESIDING OFFICER: Ms. Emery, good morning.

THE WITNESS: Good morning.

THE PRESIDING OFFICER: Can you raise your right hand?

JENNIFER EMERY,

having been first duly sworn,

was examined and testified as follows:

THE PRESIDING OFFICER: Please be seated. Would you state your name on the record and your business address.

THE WITNESS: My name is Jenny Emery. My business address is my home address: 71 Loomis Street in North Granby, Connecticut.

THE PRESIDING OFFICER: Mr. Saturley.

MR. SATURLEY: Thank you, Mr. Mitchell.

DIRECT EXAMINATION

BY MR. SATURLEY:

Q. Good morning, Ms. Emery.

A. Good morning.

Q. Are you familiar with the Local Government Center?

A. Yes, I am.

Q. Are you familiar with pooling practices, both in New Hampshire and in the nation at large?

A. Yes, I am.

Q. Could you tell me a little bit about how you developed that experience? What was your first familiarity with pooling and how did you get it?

A. The -- when I was a claims adjuster, my first job out of college, I worked for a town and school system in that -- as a risk manager. I did the work as a claims adjuster, became the risk and benefits manager, and then soon faced the lack of insurance and was involved in forming a pool with our local state league association, municipal association --

(Court reporter requests witness to slow down.)

THE WITNESS: Okay.

A. And around that time in the mid '80s pools were forming across the country. I joined what was then Tillinghast, now Towers-Watson, and I was off to the races working with pools for the next 25 to 30 years.

Q. Okay. Could you explain in a little more detail when you mentioned that there was some sort of void or some reason for pools to be developing at that time?

A. Yeah. The -- well, the commercial insurance industry has always found providing products to the public sector challenging in part because the public sector had treated insurance purchasing like a commodity. They tended to move around a lot, which made it very difficult to be profitable. They were a tough risk: Police with guns and people with aging and bad health. And whenever they got into one of their ubiquitous cycles where they were short of capital they would decide that they didn't have the time or interest to write coverage for the public sector anymore.

This happened most dramatically around '86, '85, '86, '87. And the result was that they dramatically increased prices or reduced to even write coverage for municipalities and schools across the country. In fact, there was a Time magazine cover that said, "You're canceled" and it had a picture of city hall on it.

The -- a lot of the -- it started with a lot of state league associations, school board associations, other groups that got together and said, "What do we do?" And they in some cases used existing statutes that were on the books, Joint Powers Authority Act, or they went to the state legislature and got legislation enacted so that they could band together to take control of their own risk management needs.

Q. And your familiarity at first was with regards to being a risk manager for a community?

A. Yes. I was the risk manager -- risk and benefits manager for the school and city of West Hartford, Connecticut. They're done jointly.

Q. And so you had personal experience of this phenomenon?

A. Yeah. We had unacceptable offers with reinsurance. And, of course, the people who sat interestingly on an advisory committee that I reported to were senior executives of the local insurance companies in Hartford: The Travelers, the Aetna, the Hartford. They were the local -- they lived in the community, so they were my advisory council. And I had to go to them and tell them -- and recommend to them that we leave the commercial insurance industry and help launch this new pool, very much like LGC.

And I'll never forget the general counsel of Aetna stood up at the end of the meeting and said the -- said, "I'm going to go tell the CEO that they shot themselves in the foot, because now the public entities have learned -- they're going to learn how to manage their risk themselves, and they're not going to need us anymore." And frankly, that's what's happened with pooling.

Q. Okay. After that experience as a risk manager in a municipality did you then later on become part of the insurance industry?

A. Yes. I was asked to -- I had the opportunity to join what was then Tillinghast, now Towers-Watson, a consulting firm in '87, and spent the rest of my career with them in one form or another.

The -- again, initially all of my work was in the public sector. I worked with individual public entities, small and large, to help them figure out how to manage their risks and how to finance the risk, and then worked with a lot of the groups that would get together to form these pools all across the country.

Q. How long have you worked assisting pools and consulting with pools on this sort of topic and issue you just described?

A. Well, from my entire career at Towers-Watson, which began in '87. I retired a year ago. Although, I've continued to do some work with pools. I worked with pools throughout that entire career. I would say the first five or ten years was -- first five or ten years was pretty exclusively with pools, and the last ten years was exclusively with pools.

In the middle I did some other special projects for the firm. I led their healthcare consulting practice for a little while consulting with health plans and HMOs and led an -- what we call total health management, an integrated benefits practice.

Let me just briefly explain that. While I came out of the property and casualty world, the firm was a very large benefits consultant. And in the early '90s workers' compensation costs were skyrocketing, and workers' compensation is largely a medical program. Sixty to eighty cents of every dollar is a medical dollar. And the doctors are the ones who say whether you can go back to work or not. But there historically has been a wall between workers' compensation and health benefits and STD and LTD employee benefits. One is from one part of the company, the other is from another. One is bought from one kind of insurance company, the other from another.

As a consultant I went over to our benefits people and said, "What can I learn from you about managing medical costs, because they're skyrocketing for workers' compensation?" And they said, "Well, that's interesting. We'd like to learn from you about managing disability, because our employers are starting to say lost productivity is a problem." And that resulted in forming sort of a coalition practice to try to help large self-insured groups -- large self-insured employers or groups develop a more integrated approach to managing the employees' health and welfare. And I did that sort of through the early part of the '90s.

Q. As part of your work at Towers, what's now Towers Perrin, have you worked in the field of risk management?

A. Well, I was considered and am considered a risk management consultant.

Q. And have you worked in the field of workers' compensation?

A. Yes.

Q. And have you worked in the field of healthcare consulting?

A. Yes.

Q. How many risk pools have you consulted with over the period of time that you've been employed in this area?

A. I would say I personally have worked with at least 30 different pools. I also during the last decade led our national practice, which included reinsurance brokerage and actuarial management consulting pool, and I'm sure touched at least 50 pools indirectly through that process.

Q. In your consulting have you worked on a number of different issues with risk pools?

A. Yeah. The industry and I grew up

together, realizing that we're now all grown up. But everything from how do you finance risk to how do you market the program to who do you hire to handle the claims, are they doing a good job, is it time to bring it in-house?

And then so a lot of it was operational and mechanics, which were very heavily insurance focused, because while these were member-owned, member-driven organizations whose business, in my opinion, was much -- it includes the insurance mechanism, but, in fact, it's broader because it's not just about financing risk. It's about changing the risk profile, changing behaviors, and changing the culture of the organization.

Over the last part of my career I was much more involved, personally hands-on with more management and strategic and board-level consulting. Policies, strategies. Things that would take them beyond simply being another source of insurance or risk financing to the things that would really help them help their members bend the cost curve: Operate more safely, be healthier, save taxpayer dollars.

Q. I neglected to ask you about your educational background. Could you give it to us quickly?

A. I graduated from Middlebury College in 1980. Got my master's in business from the University of Connecticut in 1983.

Q. And have you been recognized in your industry for your contributions to the industry?

A. I have a -- what's called an associate in risk management degree. And then most recently, which I'm very proud of when I retired, the Association of Governmental Risk and Insurance Pools, AGRIP, which has been talked about some, which is a national organization that represents several hundred pools across the country, honored me with a resolution.

I'm quite sure I'm the only for-profit vendor to the industry that's ever been honored with a resolution thanking me for my contributions in educating pools and their boards and in their development over the last 25 years.

Q. Have you been paying attention to these proceedings as they have developed?

A. Yes, I have.

Q. Have you attended some days and watched the video on other days?

A. Haven't seen every minute, but I've seen a lot of it.

Q. Were you retained and asked by the Local Government Center to serve as an expert in this matter?

A. Yes, I was.

Q. Did you review the petition and the amended petition?

A. Yes.

Q. And some of the experts' reports?

A. Yes.

Q. And have you arrived at any opinions with regards to the operation of risk pools and the operation of LGC as a risk pool and the potential consequences of the Bureau's petition in this matter?

A. Yes, I have.

Q. Would you express them, please, for us briefly?

A. I guess, first I'd like to say that

the -- that public entity pooling, as it's being referred to in this context and certainly in my career, has developed into, in my opinion, the single most successful example of interlocal cooperation that has clearly saved millions and millions of taxpayer dollars, probably thousands of lives.

I've come to learn that very few people that aren't part of that movement understand it, know much about what it does. But it's been a hugely successful, largely self-governed success in local government.

Q. With regards specifically to the operation and history of the Local Government Center, do you have anything --

A. I do. My -- I greatly enjoyed my affiliation with the Local Government Center beginning in 2004, which I'm sure we'll talk more about, but I would say that I have a special -- my -- my -- I didn't want to use the term bias, but in the industry my bias is for member-owned, member-governed pools. Not all of them are. Some of them are vendor driven. But a true pool is member owned and member governed and takes that very seriously.

And from the first day I got involved right through to today I would put LGC right up there at the top of all the pools I've worked with in terms of the engagement of their board, the seriousness and expertise of their management, and all with a focus on what do our members need and want from us and how do we meet their needs?

Q. Given the charges that have been made against LGC by the Bureau and the certain types of relief it seeks, what do you think that -- do you have an opinion whether or not that would have an impact on the municipalities that are served by LGC?

A. I think it would be devastating to pools in New Hampshire, which would clearly cost New Hampshire taxpayers money. The -- and I can -- I can also say that I know pools across the country are watching these proceedings.

They are intentionally -- I think finding in favor of the Bureau of Securities

Regulation would have at best a chilling effect on the public officials throughout the country that are voluntarily serving on these boards, setting policy, and running what has been, as I said, hugely successful programs saving taxpayers millions of dollars.

Q. All right. Let's go through a little bit more detail and determine how and why you arrived at those opinions.

Could you tell us a little bit about your first involvement with the Local Government Center? I think you mentioned that was 2004.

A. Sure. Our firm had been working with the Local Government Center longer than that as their actuary, but I personally had not had that much involvement. I received a call, I think it was early spring of 2004, and asked if I would work with them with a -- with a Long-Range Planning Committee, one of the committees of the board, that wanted to address several issues.

The issues that were originally presented were that they had a still fledgling workers' compensation program that was sustaining operating losses and not growing as they had hoped it would. And they -- the question on the table is -- was: "Should we stay in the business or should we exit the business?"

Second issue was that the -- they were in a very competitive environment here in New Hampshire. The primary competitor was another pool called Primex, which I was also familiar with, and that that pool had recently formed and launched a health program. And the question was was that potentially a threat to the Local Government Center's HealthTrust, which at the time was a very successful program.

The third issue that became apparent very quickly as I got involved was that they -- there was a need to try to operationalize very innovative strategy that they had adopted.

When I started working with them I learned that prior -- in the year prior they had gone through a process. They had had separate boards for the separate product lines and a separate board for the New Hampshire Municipal Association, which had originally been the sponsoring organization. They had individually -- they had worked together -- let me just -- let me just say that's -- that's not uncommon. And often --

Q. What's not uncommon?

A. It's not uncommon for there to be a sponsoring organization with its own board then maybe a -- they start a pool and that pool has a separate board. Sometimes there's interlocking directorships, and they stay very closely aligned. Then if they add another line of coverage sometimes there's a third board. There are also pools that will form with one board and all of the product lines are under that one board. So there's models all over the country.

I had never seen a situation where the separate boards had already formed and got together and said, "Are we doing -- are we serving our members in the best way possible? And if we were to merge our boards and merge the governance together, might we be able to serve them better?" And apparently, they went through a process and independently as separate boards reached a conclusion that it was in their members' best interest for them to integrate.

So I walked into a situation where the governance structure had been integrated into one program, the LGC, with separate product lines, and the -- but some of the opportunities from that integration hadn't yet been, you know, been realized. It's very typical to adopt a strategy, put it in place, but then there's still a lot of work to change how you do business.

So some of the people in the organization -- there were still people who knew healthcare, knew the health business but never talked about the work comp. business. And people who knew the property-liability business -- and two different people from the organization might go out on the same day to visit the same member. And they were here -- they heard from the members. "Can't you make this easier on us? We like one-stop shopping." But they hadn't really organized that yet.

So that became part of -- part of that strategy work as well was: "If we are integrated, how do we begin to operationalize that integration and make it real on the ground for our members so that they will start seeing benefits?"

Q. Now, you say you began work with a Long-Range Planning Committee?

A. Yeah. I don't know whether -- I think it was a standing committee. I don't believe it was an ad hoc committee.

Q. Okay. And did that lead eventually to a presentation to the board of directors?

A. Yeah. We did work throughout the spring. Met probably a month later. Again, my -- my role was to facilitate their process. I'm a strong believer that boards set policy. We would gather information, facts. Did gather from them. I went through a process of interviewing all the board members individually. Got member feedback.

When we interviewed the board members we asked them to play both their roles. We wanted to hear from them as a public official in their own community, and then to take that hat off and put their board hat on. And then we could bring that together confidentially and move together. And that led to the Long-Range Planning Committee making a couple recommendations that we took to a two-day, full board retreat that happened, I believe, in July of 2004.

Q. All right. I'd like to at this point look through some of the documents that reflect what you just said. I'd like to first look at Exhibit 67.

MR. VOLINSKY: Yours?

MR. SATURLEY: Yes, LGC 67.

Q. LGC 67 is a set of minutes from an executive session of the Long-Range Planning Committee meeting. If you look at the list of consultants, which is the third paragraph, you'll see that you are listed as having attended.

A. Okay.

Q. Would you turn to the second page, please. Second page near the top reflects that you were discussing with the Long-Range Planning Committee some actions to be considered. You see there are three bullet points there?

A. Yes.

Q. Are those three bullet points, do they translate to your memory of the three, essentially, initiatives that the Long-Range Planning Committee had invited you to come discuss?

A. Yes.

Q. And they were, again, the governance and operational structures needed to be translated into value; that's more or less the first bullet point?

A. Yes.

Q. The second bullet point is we need to make some decisions about the workers' compensation program?

A. Right.

Q. And the third bullet point is that there are serious competitive threats, and we need to know what to do about them?

A. Yes.

Q. This was a meeting on April 19th, 2004. Did I hear you say that there was more than one meeting with the Long-Range Planning Committee

before you got to the board?
A. Yeah. I believe we probably met monthly. I can't swear to that, but I --
Q. Let me see if I can demonstrate that to you.
A. Okay.
Q. If we look at 70, LGC 70, please. LGC 70 appears to be minutes from May 11th, 2004, another Long-Range Planning Committee meeting; do you see that?
A. Right.
Q. Do you see that under the consultants present it mentions that you are there? Do you see under the bolded text, there's a comment from Dr. Weiss who says there's only one agenda item for today. And what was the agenda item as reflected in the minutes? It was you, wasn't it?
A. Right.
Q. And it was a working session to continue thoughts with regards to thinking on the issues that had been brought up. And if I represent that the minutes of this one agenda item are 11 pages, does that comport with your copy?

A. Yes, it does.

Q. And was that meeting and these minutes, are they representative of the sort of length and discussion and depth and scope of discussion that the members of the Long-Range Planning Committee went through with you on these topics that you've mentioned?

A. Absolutely. These were -- and all the committees and the board as a whole at the LGC, it's a very hands-on board. That doesn't -- that's not to say that they are technical insurance experts nor should they be.

I would offer to you the opinion that one of the things that has made public entity pooling so successful is the fact that they have been governed by noninsurance professionals so that they are not stuck in the traditional thinking of a commercial insurer but instead are focused on helping their members, run their members' business better. And this was a very good example of that.

Q. Okay. I'd like to look next at LGC Exhibit 72. LGC Exhibit 72 appears to be minutes

from a board of directors' meeting of June 18. Now, this is not the full-board retreat that you mentioned, is it?
A. That's right, it's not.
Q. It's sort of an interim report to the board from you on the topic?
A. Right.
Q. And if I look under the consultants present, it says that you're there. And if I look at the last paragraph on the first page, do I see a record that you were advising the board about the status of the work to date?
A. Right.
Q. And a recitation that the objectives of the strategy development process now underway are to address WC. That's workers' comp., right?
A. Yeah.
Q. Consider competitive threats and to translate integration into value for their members. So, again, the three themes that you were addressing you are reporting to the board at this point?
A. Right. And this is -- it's a very

process-oriented organization. You know, it was important to bring people along because at the end it's their policy and they need to own it and understand it. And we would meet regularly as they developed their consensus and their decisions.

Q. I'd like to look at LGC Exhibit 74 next, please. The board of directors' minutes we just looked at was June 18th. This is June 21st. This is back at the Long-Range Planning Committee meeting.

A. Okay.

Q. Again, lengthy set of minutes. Fourteen pages this time. What was the topic of this particular Long-Range Planning Committee meeting as far as you know?

A. It looks like I developed a PowerPoint deck on developing a strategic plan for the Local Government Center's risk services program.

Q. And the committee spent a long time discussing this topic one more time?

A. Yes.

Q. Fair to say that by the time you got to the board of directors' retreat in July of 2004 that a significant amount of discussion, a significant amount of research, a significant amount of thought and energy had gone into the topics that you had been asked to work through with the board?

A. Absolutely.

Q. Exhibit LGC 76, please. Are these minutes from the annual retreat in July of 2004?

A. Yes, they are.

Q. This is the one at which you presented on the topics that had been assigned to you and on which you were consulting with the board?

A. Yes. I facilitated both days. The Long-Range Planning Committee was also very active because they were effectively presenting their recommendations to the board.

Q. And so when you say you were facilitating and they were also presenting, explain a little bit more about what you envisioned and what you understood your role to be in this process.

A. Well, as I said, in something like this where they're making policy decisions, there's no right or wrong policy decision. That's what business judgment and their fiduciary duties are about. I can give them perspective about what other pools across the country do and what their strengths and weaknesses have been, what worked and why, what didn't and why, but they have to apply that in their own meeting setting. Likewise, we could gather facts. We could show them some numbers. We could help them understand some concepts. And -- but at the end of the day they have to decide what to do with that information.

So, for example, just on the issue of should we stay in the workers' comp. business or not, I can tell you that it was definitely not a done deal as to whether they would stay in the workers' compensation business or not, but by the end of the process they had very clearly reached the conclusion that it was in their members' best interest -- and when I say members, I don't mean the members of the comp. program, because there weren't that many at the time.

They had reached the conclusion that it was in LGC's members business and LGC's members participated in a variety of products and services. There were a couple hundred cities and schools and counties. That whether they were in workers' comp. or not, they had made it clear anecdotally and through the board input that they didn't want Primex to be the only carrier in the state. They wanted -- they liked the product that LGC had created. They liked the service and philosophy. They felt that the other products they offered were superior. And some of them even saw the benefits of integration, which was, again, the longer-term vision.

So they -- the board came to a very clear conclusion that they owed it to their members to not only stay in the workers' compensation business but embark on the right path to bring it to a point where it was -- it would no longer be sustaining operating losses. It could stand on its own.

Q. Did the board have a set of -- as part of your presentation did you present exhibits to the board with regards to the work and recommendations of the Long-Range Planning Committee?

A. Yes. There wasn't a lot of deep technical analysis. This was a lot of business judgment and observations and so forth. But we would bring that together. So a lot of it was my expertise and business judgment applying to their facts and situation to help them make their own conclusions.

Q. Let's look at some of the things that they considered during this retreat. LGC 77, please. Flip to the next page, please.

How did you use these materials in making the presentation to the board? What did you do with this sort of thing? What was the presentation they would have heard from you?

A. Well, I'm sure they got tired of Jenny and her PowerPoints, but the purpose of this was to lead the discussion. Issues would be brought up and this was -- and everybody was engaged in sharing their points of view and opinions.

Q. As part of this did you go over with

them the Long-Range Planning Committee's summary of the strengths and weaknesses of LGC's own offerings, product offerings?

A. You know, I did. I think there's probably a chart in here.

Q. Page 17, please. One more page, please, 18. Could you discuss this page?

MR. SATURLEY: This is actually page 17 of the written materials, Mr. Mitchell.

A. Yeah. This is -- in the consulting world we call this a moon chart. And, again, this is not -- I can't draw you to a quantitative analysis. These were the judgments that we had developed based upon the interviews and the data and the context that we had from working with pools throughout the country where we said, "Let's look at the key risk management product lines that you have right now, and how you're doing right now."

And the key attributes that most members are looking for from a risk management pool are, you know, a quality product. Does it have a lot of coverage? Does it pay the claims? Does it provide the risk management services we want? Are you easy to deal with? Everything about sort of, you know, that -- the product you're buying.

Q. And what was the assessment --

A. So the full circle means that the feedback was, consistently it's superior. Very strong quality products.

The second issue was market share, not because it's a commercial enterprise -- you know, this was clearly a not-for-profit business, but market share would speak to how many other members they are effectively reaching and being able to deliver their services to. And as you can see, at the time the HealthTrust had the -- had the dominant market share, Work Comp. had very little market share, and Property-Liability Trust had a pretty significant market share.

The other reason, by the way, that market share is important is that to make the economics of risk financing work, you really need enough critical mass to make it work. So, for example, at this stage in time the total annual contributions for workers' comp., the premiums that the members paid in had to go to fund the losses they had themselves, buy excess or reinsurance, pay the expenses. It -- there just wasn't -- if they had a bad year there wasn't anywhere near enough to go around.

Whereas if it was ten times as big as that, the economies of scales work better. The excess insurance becomes relatively cheaper. They can keep more of the risks themselves and manage the volatility. And there's sort of a tipping point at which it makes sense to pool or not, and they hadn't gotten there yet.

Q. With regards to the workers' compensation program?

A. The contribution level and adequacy, that refers to what we talked about in this instance, is their rates and the premiums in which they were charging. Pools tend to call it contributions, but they are not technically insurance companies.

And the adequacy means what is your actuary telling you about whether you're charging -- based on their predictions whether you're charging enough to cover the cost of doing business next year.

And of course, as I know you've heard, that's a moving target. When you're setting the price for an insurance product for the coming year, you don't know yet what your costs of goods sold is going to be. You don't know for sure what the losses are going to be. That's why you use actuaries. You know, you know your budget pretty well, you know your fixed costs, but that's going to be maybe 10, 15 percent of every dollar. All the rest of it is in play.

So while in any given year the premiums they collected for comp. might have been enough, it would have been -- they couldn't -- they had to go into it assuming that what they were charging -- they knew that what they were charging was not sufficient because they were incurring operating losses.

The actuary had told them that they -- in order to charge -- in order to charge a price that according to the actuary would be fully adequate for the coming year, it would have reduced a rate that would have been unable to meet the market rate that had been set in the market by Primex. In other words, Primex had set a market rate that was below what the cost of doing business was, and that's what was leading to the operating losses of workers' comp. And then finally --

Q. Let me pause there.

A. I'm sorry.

Q. In order to deal with that I take it a couple of things had to happen. Either the market pricing had to increase or, and I assume as well, or perhaps even independently, and I would like you to explain, the program had to get bigger?

A. Well, I would divide it into two buckets. On the program side the program had to get bigger.

Q. Or --

A. To become more economical.

Q. Or --

A. Or it had to shut down.

Q. Okay.

A. Plodding along was not an option. I mean, it's an option they could have taken, but it was never given any serious consideration. They either needed to make the right investments to grow this program to a successful program or they should get out of the business. And as I said, they clearly heard from their members, and that includes members who weren't buying the work comp. product at the time. The public entities in New Hampshire wanted them to be in the work comp. business. They didn't want Primex to be the only game in town.

In fact, I should mention, I did hear loud and clear from the board that competition was good. They didn't want Primex to be the only game in town, but they didn't want to be the only game in town either. That was made very clear by very -- by many board members.

Q. Why? Why would they say that?

A. They thought it was healthy to have -- you know, it keeps your game up a little bit if you've got some competition. They wanted to be able to make sure that they tested the waters periodically, and they just -- monopolies are scary things. You lose control. So it would be healthy to have at least a couple of options. And the commercial market had pretty much vacated New Hampshire, the commercial market for workers' compensation.

Q. And the last column?

A. So the last column, again, this was from the point of view of, "If I'm a buyer of your product what do I care about?" A lot of things were always done from the members' point of view. Surplus level and the adequacy of their surplus. The -- and as you can see, HealthTrust was a little below its target; Property-Liability was well capitalized at its target; and Workers' Comp. didn't have any surplus.

I would offer that on this issue of capital and surplus that's been talked about a lot, the reason the members care whether they know to call it capital or surplus is that the promise that's being made is: "We will be here to pay the claims. You're paying us a premium or contribution, and we will pay your claims, and we won't come back to you for more money for last year." And that was a promise that the board took very seriously. I remember many people saying, you know, "We don't" -- well, they were an assessable program. A lot of pools are assessable. But they take the position, "We don't ever want to have to go back and ask for more money for last year." That's not the deal that we cut with people. And especially in the absence of regulatory oversight, they couldn't say they had an A.M. Best rating.

Q. What's an A.M. Best rating?

A. In the commercial insurance industry there is sort of a -- we call it a small R regulator, not an official regulator, but an independent body like an S&P for bonds that puts ratings on the financial stability of an insurance company. And so an easy thing to do if somebody says, "Do you want to buy from Company A or Company B?" is to say, "Well, does one of them" -- and they look the same, "Does one of them have a better Best rating than the other?" And I'll go with the one with the better Best rating. But pools don't have that.

So pools very early on learn that they needed a different way to tell their members that, "You can trust that we'll be here." And they would do that by building surplus and adopting standards, target surplus as it's been called in this hearing, that would be insurance company-like in their -- they could say, "We may not be regulated like an insurance company but we hold ourselves to the highest standards." And so that surplus level and capital adequacy was critically important to members.

Q. Did the board more or less consider it, in essence, a promise to the members?

A. It's what it was. You're selling a promise. That's what insurance is. That's what risk financing is. I mean, again, it was more than that. It was also risk management and services, but at the end of the day the claims have to get paid.

Q. Let's go forward two pages in this exhibit, please. Does the exhibit and the presentation that you were making to the board conclude with the Long-Range Planning Committee's recommendations?

A. Yes.

Q. And what were they?

A. The recommendation from the committee was to commit to, build -- and build the Work Comp. program to a sufficient size so that it could ultimately stand on its own; to immediately consolidate the financial operations of the Property and Liability and Work Comp. program. In other words, they were already one -- the whole organization was one organization with one board, one government structure, but they had continued for management purposes to track the finances separately.

They decided to consolidate the finances of Property-Liability and Workers' Compensation, because there is -- there was leverage involved in that over the long run. The law of large numbers would come into play on their surplus and capital adequacy, if I dare say that. And to immediately coordinate all the pricing of the risk services program. To begin to price their products and make their services available to all of the membership as though they were one company rather than delivering them in separate products.

Q. Let's talk about that a little more. How did the board as you understood it following this retreat, how did they think of themselves in terms of their relationships with the members and the offerings that they were making?

A. They are one organization. They are one organization with one board, one set of bylaws, one formal participation agreement with a variety of different products and services that members could take advantage of at different times.

Q. And how did that compare with risk pools that you're familiar with from other parts of the country?

A. Well, it varies all over the place, but it -- but I do know pools that have one board and multiple product lines. The health, work comp., property-liability all under one board.

The -- and certainly, where that is the case the opportunity to create more value for the members by leveraging the total reach that you have, total asset base that you have, the total market influence that you have is that much more powerful.

Q. Did the board consider themselves to be somehow different or offering different things to the members than the commercial market or, indeed, some of the other pools?

A. Well, I think they understood that they were -- they understood that they were definitely different than a commercial insurer. They're not in the business to make money off of losses.

Q. What does that mean?

A. Well, that -- I've sort of half tongue-in-cheek often said, you know, the reality of the insurance industry is that they like losses. They don't like losses happening on their insurance, but they make their profit as a margin on the base. The base is losses. So as losses grow over time, insurer's profits grow. There's not really incentive to reduce risk. Any given individual entity there might be, but overall they make their money on the margin on losses.

That's not the business LGC or other pools are in. They are in the business of helping their members run local government more efficiently and effectively. They happen to have focused on the area of risk and risk management. And if they were successful in eliminating workers' compensation losses and the only thing they had to charge their members was a little bit of money to keep doing training programs, that would be hugely successful.

So -- and there's evidence that pools have done that for their members. They have changed the risk profile. They have reduced the, what we'd say in technical terms but it's pretty commonsensical, the lost cost per unit of exposure. The amount that it costs for every body you employ has gone down under public sector pooling in ways that doesn't happen in the commercial enterprise. And that is to a large extent why they've been successful and why people believe in them.

Q. So did the board decide to proceed with the recommendations that were brought to it by the Long-Range Planning Committee?

A. They did. The entire second day was spent discussing and debating these recommendations. Lots of healthy dialogue from all of the board members.

I did want to mention the -- in this -- there was a particular dialogue with the members of the board that were employees. I had never seen this before, but the LGC board has employee representatives on it -- I don't know of any other pool in the country -- which was, again, part of their positioning. Their philosophy was: "We're trying to improve risks in the cities and schools. The employees should be engaged in this. Let's invite them to have a seat at the table." So their employees rest at the board as well.

So there was a concern in particular when the agreement was made that they should coordinate the pricing of the products, and, in fact, it developed during the second day, that they would create from the premiums that got paid in next year, they would set aside a small amount.

I don't remember whether the one percent came out at that meeting or after. The minutes would probably show it. But they would set aside a small amount of the new contributions coming in in what they called a strategic fund, and they were very careful to say -- and this would be the employee rep saying, "Let's make sure that the employee contribution portion of the benefits cost isn't included in that. That's not part of their deal."

So that was clearly laid out that the employer paid a portion of the benefits premiums and the property-liability premiums. A portion of that would be pulled out, a fund would be created that would be used to cover the expected operating losses that work comp. was going to continue to have as a group and to do other things related to the integrated vision: To cross-train employees; to get some more communications people; to do more outreach to the members.

And what the board said was to staff,

"Go away and figure out what that strategic fund is going to look like, how much money it is, and what your plans are to use it efficiently and effectively." And then I think they came back in September, management came back in September, October with a very comprehensive strategy that included packaged discounts for members across the board, multi-year programs, lots of new wellness and risk control safety programs, and, of course -- and rates for workers' comp that would allow them to attract new business and grow, because they would be market competitive that would likely produce operating losses, but those operating losses could get funded by the strategic fund.

Q. Do you consider this approach to these issues progressive?

A. Yes.

Q. Did you think that they were good decisions by the board?

A. I did. I thought they were very well thought out. They were -- the board was deliberate in saying, "We want to watch this closely. We've made a lot of assumptions when we developed this strategy. We believe that as we grow the workers' compensation program we will achieve the economies of scale that we want. We believe that as we start influencing the losses that the members have we'll beat the actuary."

Their projections -- the projections always start high from the actuary. If you actually manage risk better, then those projections start coming down. We believe that will happen. But we want to see every year how we're doing.

And they understood that these things take a long time to play out. And so they -- the understanding was it would be a five- to ten-year strategy, and then every year for the next several years I was invited back once a year to look at the data and review what was going on and have a dialogue with them about whether the strategy was working or not.

Q. One of the concepts you mentioned that you had been involved in outside of LGC was total health management or total integration.

A. Yes.
Q. Is that something that the board came to understand and embrace?
A. I would say that some of them understood it. They certainly understood -- everybody understood the efficiencies that could be achieved through one-stop shopping.
Q. What does that mean?
A. For any given town out there, to know that they could call one person at LGC who would know about all the products and services that they participated in, would know a lot about that town and could better serve them so they didn't have to call four different people. And that when you went out to do a training session on back injury prevention, you know, you might do that because they're in the work comp. program, but, "Oh, by the way, these things have total applicability to keeping yourself from wrecking your back on the weekend, too."
And those artificial walls that grew up as an accident of history in the insurance industry because of -- because workers' comp. was

a statutory benefit and health benefits were voluntary benefits, sort of shouldn't define how you work with your employees, so...

Q. Let's talk about a back injury for a minute.

A. Okay.

Q. Let's talk about the traditional approach to a back injury and treatment for the back injury and how this concept of total health management gets applied to a back injury.

A. Yeah. When I said the board, I think they all understood this sort of -- the practical part I was just talking about. More efficiency in the people and the touch points and the training programs. You take that one step further, and that's a concept that I'm not sure they all fully embrace. We saw the vision but didn't really -- I think a lot of people struggled with it.

And the example I always give, it's very simple, but there were -- we did some studies in the early '90s when I was very involved in this -- and there's an organization called the

Integrated Benefits Institute that continues to do these studies. We started to realize that the actual treatment employees get -- I have to slow down, right?

THE PRESIDING OFFICER: Absolutely.

THE WITNESS: I'm sorry.

MR. SATURLEY: I'd say she's passionate about her work.

THE PRESIDING OFFICER: She's certainly quick. Please proceed.

THE WITNESS: I'm sorry.

A. The -- it started to become recognized that the treatment that somebody would get for an injury were being influenced by whether it was a workers' comp. injury or a healthcare -- health benefits injury.

So the example that I give is: If you present with a -- you've hurt your back and the health insurer would say -- the doctor -- if it's covered by health insurance the doctor might be told if it's perfectly reasonable to take two aspirin every day, take an Advil and rest for a month, do that.

Q. In other words, if you did it on the weekend mowing the lawn --

A. Right. Because that will minimize the cost to the health program. If they were mowing the lawn at the city park on the job, the workers' comp. carrier would call the doctor and say, "Well, would it be helpful if we got him into physical therapy right away?"

"Oh, yeah. That might make sense."

"Well, let's get him into physical therapy for a week. Get him back to work right away."

Q. Why would the comp. carrier want to do that?

A. Because the comp. carrier is paying for both the medical costs and the lost wages. So the financial incentives of these two different product lines were influencing treatment protocols. Shouldn't the person and their doctor be figuring out what the right treatment protocol is regardless of which pocket the money is coming out of?

That's sort of -- that's the vision of

integrated care. Let's make sure it's the right care at the right time for that person to maximize their health and wellness and productivity. And what large self-insured employers have come to realize is that regardless of what you call it, it's pretty much all coming out of their pocket anyway.

Q. Why is that?

A. Because they're basically -- they're either self-insured or they're completely experience rated anyway. So it might look like insurance but it's all coming out of their pocket. And likewise for a pool, like LGC that had all the lines of coverage, all of their members, sooner or later they're paying for the health benefits, they're paying for the workers' comp. losses.

LGC was in a position to say, "We can break down those barriers. We can make sure that those anomalies created by the economics of the insurance business don't influence the care that an employee gets."

Q. Was that an opportunity and a vision

that the board embraced?

A. As I said, I -- we talked about it then. They -- some of them fully embraced it. I'm not sure everybody -- they certainly -- it sounded good knowing whether -- whether and how -- you know, it's not easy to do. It's still -- it's very forward-thinking and progressive even today -- even today and even in the private sector to get to that stage where everybody's comfortable with the fact that we're all in this together. Let's maximize health and productivity without regard to whether it happened on the job or off the job. That vision is still a work in progress. Not just at LGC but everywhere.

MR. SATURLEY: I'm looking for some guidance, Mr. Mitchell, on what you'd like to do.

THE PRESIDING OFFICER: How much do you have left, sir?

MR. SATURLEY: More than 15 minutes.

THE PRESIDING OFFICER: Why don't you continue.

MR. SATURLEY: Okay.

THE PRESIDING OFFICER: And let's see

how far we can get on direct.

MR. SATURLEY: Okay.

Q. You said that that was easier to do or that self-insured large employers could implement this idea with some ease and they had some enthusiasm for it.

A. Yes.

Q. How about insurers versus risk pools, how did this concept get applied as between the two -- those two models?

A. In the early '90s there were efforts to create what was known as 24-hour products. Some insurers were very interested in trying to create these kinds of products. But, you know, changing paradigms in the commercial world is very hard. The regulatory structures were different. It's just people don't like to -- a lot of people don't like change.

And so while the 24-hour products -- I'm sure you could go out and people will say, "Oh, 24-hour, we heard about that 20 years ago. It never happened." That's true when it comes to insurance products. When it comes to how -- how employers, how progressive, effective employers manage their employees' health and wellness, it has absolutely taken hold in how they manage their people, how they interact with their people.

A recent survey I saw said that in response to the Integrated Benefits Institute, about 20 percent of large employers say they now try to integrate their work comp. and health benefits program so that they're not working at odds with each other.

Q. Does this have an impact on productivity?

A. That's where the biggest impact has been, which is one reason it's hard, because a lot of productivity is hard to measure. People don't measure that. And it's hard to prove a negative. If someone came back after a week instead of after a month, well, how do you know that it would have been a month otherwise?

You know, that's always the problem with measuring the impact. But the -- but those that have embraced an integrated philosophy to managing employee health would tell you that they know it has improved the health and productivity of their population and they would never go back.

Q. At one point you talked about changing a risk profile and changing the culture of risk management. Is that consistent with what you're talking about now? Is that part of the same idea?

A. Sure. Changing -- beyond -- what pooling did first was it got rid of a bunch of their frictional costs.

Q. I'm sorry, the?

A. The frictional costs. The -- like in New Hampshire they're not paying agent's commissions anymore. They sell it directly. There's no premium tax. There's no profit and overhead going to the shareholders of the insurance company.

Q. You're saying in the pooling model?

A. The pooling model.

Q. Okay.

A. So depending on the line of coverage, right out of the gate a pool should expect to have a 5 to 10 percent advantage over the price of a commercial insurer. Now, at any given time that might not be true, because the insurer might underprice the product. But when it comes to real cost, the pool's cost of business is lower than the commercial insurer's cost of business.

But the real payoff is when you start to change the risk, when you impact the 80 or 90 cents of every dollar. And in the scheme of the different risks they face, our experience is that they've been able to have the most influence on workers' compensation through safety training and better alignment of employees with certain job positions and so forth, some influence on liability by teaching boards how not to get sued for planning and zoning. Less so on property, but some on property. With health benefits, pooling has definitely, definitively added the value of reducing the cost. With LGC, clearly, its costs of doing benefits, of doing HealthTrust is, I would say, 5 to 10 percent lower year in and year out than what a commercial insurer would charge.

But to get to the next place where you are, as they talk about, you know, when they talk about healthcare reform, bending the cost curve, you have to change behavior. And that means -- and LGC is doing a lot of that, but the -- it's a long process to reach out to the employees and say, "You have a role to play in this, too, whether it's healthy eating or smoking or doing your health risk assessment and all those things."

Again, the theory is that when the service provider, in this case LGC, has a good relationship, provides lots of services and lots of different touch points and is trusted by the employer and the employee, they will be better positioned to help influence positively those behaviors which will lead to better medical outcomes and lower healthcare costs.

Q. Are you generally aware of the offerings in training and education that LGC offers?

A. Generally.

Q. Is it -- are they along the lines of the things that you would expect to see in this sort of attempt and ongoing work towards changing the risk profile?

A. Oh, absolutely. They're very -- they're very comprehensive. They do -- you know, there are lots of discussions and debates about whether some of the investments being made are worth it. But the -- and that's an ongoing struggle, because there's no easy answer to that. But they -- there are places where there's no question that they have been successful.

One example is the public sector in general embraced managed care much later than the private sector. LGC through the HealthTrust helped move its members toward embracing managed care faster than they would have otherwise by creating products and promoting them that would get employers away from the pure paper service and into the managed care model that would help bend the cost curve a little bit.

Q. Does the fact that risk pools are member-owned, does that help in the sort of approach towards a total thought and a total attempt to manage a risk profile?

A. Oh, certainly.

Q. Why is -- tell me why.

A. If you buy insurance and do everything right the insurer makes more money, but when you're participating in a pool and it's your pool and it's your money -- not your money individually but your money collectively that you have -- that you have given the board the control of, you know that it's being sorted on your behalf. You start paying more attention. You have a vested interest, if I can use that term. A vested interest in managing your risk better.

And, in fact, I think my understanding from LGC is they've even got some employer bargaining groups that understand that, understand that if they can work together to manage costs, that's good for everybody.

Q. And so in contrast with insurance, if I signed up with a commercial insurance and I write a check, and what did you say, if I do well, then what happens?

A. If you don't have losses, they win. You don't get your money back.

Q. And contrast that with a risk pool.
A. If you don't have losses it's held onto by the risk pool. It builds capital and surplus, which provides comfort and security to you. It can -- that capital and surplus can help drive lower ongoing costs. You can negotiate better reinsurance terms because you can prove that you're a strong, healthy organization. You can avoid buying reinsurance, because we have enough capital and surplus to keep the risk yourself.
Q. So coming out of 2004, the board committed to a workers' compensation program?
A. They were -- they recommitted to the workers' compensation program and to a strategy for growing it to a more economical size and making it -- getting it to where it would not be suffering operating losses over a five- to ten-year period.
Q. Okay. With regards to the second topic, the integration of services, et cetera --
A. That was every bit -- the strategic fund was to support investments and administration and services that would begin to break down the walls

and move towards more integrated product offerings.

Q. And with regards to the competitive environment, where did the board come out?

A. That they should focus on running their business as well, and that -- that's what their focus should be on, on running their business as well and providing the best products and services to their members.

Q. With regards to the economies of scale, the law of large numbers that we've heard about --

A. Yes.

Q. -- how did that influence the board's thinking at that time to the extent that it came up?

A. The -- as I used it with them we explained that the -- the expected costs -- the losses are going to be what they are regardless of, you know, their line of business. Their expenses are going to be what they are. But the margin that you need, the capital that you need to protect yourself from volatility can be relatively smaller over the long term if you have a bigger base.

And so if you view all of your programs together -- they were one integrated organization. If you view the product lines together you could be -- you could be comfortable with a capital or surplus level that was relatively smaller than if you view them all individually and they each had to carry their own capital and surplus. That was one example.

That led to their conclusion to integrate Property-Liability and Work Comp. They weren't yet comfortable integrating the finances fully on HealthTrust just because of the scale of the organization, I think, because the scale of the organizations were still so different. But they did -- they understood that the goal in the long run was to take advantage of size and strength to benefit the members.

I'd add that the -- because I think it's relevant to some of the other conversation, you know, this works year by year, too. If you want to draw lines between product lines, you could also say, "And everybody who was in the program in 2006 should stand on their own, and everybody who's in the program in 2007 should stand on their own, because they might not be the same people." You might have different members one year to the next.

Well, if you don't let them pool their risk, now you're separating it by product line, you're separating it by year. Pretty soon you might as well let everybody's own experience stand on their own, and then you've completely undermine what pooling sets out to do.

MR. SATURLEY: Mr. Mitchell, may I ask for a break at this point?

THE PRESIDING OFFICER: How much further do you have?

MR. SATURLEY: I would say I was halfway through.

THE PRESIDING OFFICER: Halfway through?

MR. SATURLEY: Yes, sir.

THE PRESIDING OFFICER: All right. We'll break for lunch, but could I speak with lead counsel?

MR. SATURLEY: Certainly.

THE PRESIDING OFFICER: Thank you. We will return at 1:30. Thank you.

(At 12:30 to 1:35 p.m. lunch break taken.)

THE PRESIDING OFFICER: Good afternoon, Ladies and Gentlemen. We've returned from the lunch recess. Ms. Emery is still on the stand under direct examination by Attorney Satur -- Saturley, excuse me. Please proceed.

MR. SATURLEY: Thank you, Mr. Mitchell.

Q. BY MR. SATURLEY: Ms. Emery, let's jump from 2004 to 2009. In 2009 did you come back to the board to participate with them in an update of the goals and the activities that you had first discussed with them in 2004?

A. Yes. I went to their board retreat in 2009.

Q. Okay. I've sort of jumped over a series of years, but is it true that each and every year between 2004 and 2009 you would actually go back and re-engage with the board and with LGC on the topics that you had first engaged in in 2004?

A. Yes. That was part of the direction

that the board had given management when they adopted the strategic plan and appropriated the strategic fund was that they wanted an update on how it was playing out over -- at the board retreat each year.

Q. And so you would do that -- so you would reengage, and was that just for the two-day meeting or did you do a process each year?

A. I would engage a month or two in advance, gather information, talk to staff, look at data, talk to their actuary, and compile some information as the basis to, again, facilitate a discussion to see how they were doing versus their plan: How their membership had grown, whether the pricing was getting closer to adequate, and what kind of programs and services were being offered to all of the membership, and how were they being received by the membership.

Q. And so you would reengage each year. Did you find the board engaged on these topics each and every year?

A. Oh, absolutely. I wouldn't say the question was back on the table, "Should it be in comp. or not?" They made the commitment, but they definitely wanted to make sure things were moving in the right direction, that it made sense. And basically, kind of take the temperature of all of the programs and products and services and make sure that they were all improving and everybody was benefitting across the board.

Q. What did you understand the board's principal mission to be in its own mind?

A. The board's mission was the stated mission of LGC, which was to -- I don't have the exact words, but it was to help their members be better at local government.

Q. And did you watch them grapple with that topic in ways to accomplish that?

A. Always. I would say that all of my work with them has always been premised on how can we make our member governments better at doing what they do for the taxpayer, whether it's through our insurance products or the training programs we have.

Q. Okay. Let's look at Exhibit 131,

please. Is Exhibit 131 another sample of a presentation that -- and a process you went through with the board at the 2009 retreat?

A. Right. Yes.

Q. Turn to page 2, please. As part of this did you actually revisit the moon chart, or whatever you called it, moon diagrams that had been presented in 2004?

A. Yes.

Q. And turn to page 3. Did you revisit them?

A. It's very hard to see here, but the point was to, again, look at the totality of LGC and its various programs and take their temperature in the four areas that I discussed this morning.

It's hard to see here, but I think in the original where the moons got bigger it was colored slightly differently, but the -- the basic takeaway is that you could quickly see that there was -- as you fill in the moons you're getting closer and closer to the optimal goal, and the moons are more full after five years than before.

I would note that, you know, the HealthTrust had gotten stronger during this period of time, the PLT had gotten stronger, and Workers' Comp. got stronger. Obviously, the most opportunity was in Workers' Comp. They had grown dramatically in the number of members, and the expense rate had -- expense ratio was going down and the loss costs were improving. So that's where the most improvement was. But other product lines were improving, too.

So that was very reassuring to the board that was concerned about making sure that the rising tide floats all boats, so to speak.

Q. Could and did the board conclude that the support and the growth and the progress in the Workers' Compensation program was good for all the members of LGC, whether or not they were particularly purchasing workers' comp.?

A. Absolutely. They -- they concluded that, in part, because they were told that by members who were not members of Work Comp. The preponderance of input from members were: "We like your products and services and we want you as an option in all of these areas."

Q. Is that the only data they had from which they could make their decision or did they have other reasons?

A. Well, they had -- they certainly had other things we talked about earlier, which was that they potentially needed to have a comp. program for defensive reasons, they -- but the real vision of integrated products was out there, too.

But the other thing I would say that we realized as the years went on is the investment that was being made, the strategic fund, it's very hard to track exactly where the benefit is flowing, but all of the programs were getting stronger, so something was working.

Q. Okay.

A. And they concluded to stay the course with the strategic funding. It was -- in my mind it was no different than a decision to, for example, engage in a wellness program. The cost benefit analysis is a judgment, and you spend a lot of money and you hope that it'll pay off in the long run. And you can't measure it real closely. But that's exactly the kind of judgment that the board is in place to do.

Q. And so in watching and participating in the board go through this process to make this judgment on a year-to-year basis, did you observe the board acting in good faith?

A. Absolutely.

Q. Did you believe them to be exercising their ordinary prudence with regards to the decisions they were making?

A. There was no question about it.

Q. Did you believe that they were making the decisions in the best interest of the organization and the members?

A. Yes, I did.

Q. I'd like to jump to 2010. Were you a participant in something called an SMO process?

A. Yes.

Q. What was your role? By the way, do you remember what the initials --

A. It was -- I think it was strategy

management and organization.

Q. Okay.

A. The organization had recently -- John Andrews had retired so there was a new at the time interim executive director, soon to be full-time executive director. And certainly, after 30-something years, plus the fact that we hadn't -- the strategy had been put together in 2004 hadn't -- had been reviewed but hadn't really been updated. There were -- I think the board decided it was time to have a more comprehensive outside review of their strategy, management, and operations.

I have to say that I'm sure that in part it was also motivated by the external environment, which included the firefighter litigation that was going on. And I'm not sure whether the -- whether this -- whether the Secretary of State issues had become obvious yet at that stage or not, but certainly the firefighter litigation. But they wanted an outside view.

The approach to the process -- they

asked me to be involved, and we agreed to sort of build a little consortium of experts with different areas of expertise and that we would work together collectively. So that included myself. And I was kind of the general contractor of the process and services. A woman named Chris Becker, who was retired and had formally been the deputy director of the National League of Cities. So she had experience working with state leagues and the pools they operated for many years, but stronger on the league side, and I was stronger on the pooling side. A person named Jeff, whose last name escapes me, but he was a real expert in team interaction and mentoring because they had a new executive, meaning a leadership team.

And the four of us took on different roles, and a subcommittee called the SMO Committee was formed, a subcommittee to the board. It was similar to the 2004 in terms of the consultants playing a facilitative role to a board committee process that led to recommendations to the board. It was broader in scope than that. It was a comprehensive look at the organization and operations.

Q. Did the topic of the integration of the operations, which have been worked on as a yearly -- on a yearly basis, was that part of the SMO review?

A. I -- yes, it was. Most -- most importantly, right from the beginning I think in our very first discussion the -- of the scope of inquiry, one of the issues being discussed was the integrated government file, the decision they made in 2003, and did it make sense or should that be questioned or second-guessed because of what was going on in the external environment.

And through deliberation and discussion the board reached a very -- reached the conclusion that they did not see any reason to question the integrated government structure that they had adopted. They felt it was working well. It was paying benefits to the members just as it was supposed to and was fully consistent with their -- with the 5-B statutory requirements.

Q. As part of this process was there a survey done of members?

A. Yeah. We did feel that more than just observations and so forth we should also -- especially given what had been in the press, we should reach out to the membership. So a survey was put together. This was not a statistically significant sort of scientific survey, but a membership satisfaction survey.

It was done electronically. I don't have all the details, but I'm sure it went to some probably 1,500 or 2,000 public officials on their mailing list, multiple people in each organization, maybe, you know, a city manager and a mayor. So elected and appointed officials. And it addressed their perceptions and satisfaction with LGC overall and its individual products.

Q. I'll call up Exhibit 181. This is the LGC fact book. Would you turn to page 15, please, 15 of the -- it's page 13 in the written materials. Page 15 of the actual -- of the -- yes. Is that some of the charts that came out of the membership survey?

A. Yes.

Q. Okay. Is this all of the charts and all of the questions that were asked during the survey or is this just some of the material?

A. No. It was multiple pages. I think this is representative of the feedback. It was analyzed in different ways. We looked at whether the answers were different if you were an elected or appointed official -- elected official versus an appointed official, city versus a school, in one program or not in another program to see how the -- see what we could learn about the different perceptions.

I guess the overall takeaway, which, frankly -- Chris Becker and I took the lead on this, and we were, frankly, surprised with the results given the amount of vigil that had been in the press. Member satisfaction was very high. Member support for the integrated organization was very high. I think the lowest score they got on anything was their satisfaction with the cost of healthcare was only 72 percent.

Q. In favor? Favorable?

A. Favorable. So it was kind of like,

where do you -- how do you ever get 72 percent of people -- nobody's happy with the cost of healthcare. And that was kind of the worst score they got. Which, you know, the -- and then there were lots of written comments and so forth.

But the very clear message from the membership -- there was good feedback about: "Your organizational structure is kind of confusing, the labels of LGC." And different members have different touch points with the organization. So that did lead to some of the out -- some of the conclusions about trying to clarify the brand, clarify the organization structure, do more communications and outreach, which is always hard, because you can go to them a lot and they may or may not want to pay attention at that particular time. But it was clear that they were satisfied with their services.

Q. Was the evolving regulatory structure one of the topics that was discussed during the SMO process?

A. During the SMO process -- I'm not sure what the -- I don't know what you mean by evolving regulatory structure. The reality of 5-B and what the board's role was in light of 5-B was certainly discussed.

Q. Okay. How would you compare the 5-B status and the 5-B environment which LGC operates to other pooling states across the country with which you're familiar?

A. Well, the range of regulatory environments goes from, you know, no regulation to a couple states where you've got to be a licensed regulator of an insurance company where you can't do pooling without that, and everything in between.

New Hampshire's 5-B falls closer to the -- to this end of the scale. It is an enabling statute is how I would characterize it. Even less -- the vast majority of pools by number fall into the even less regulated category.

Specifically, they were the earliest, in California, which has -- they call them JPAs, Joint Powers of Authority, and there is, I don't know, 150 of them there in California and maybe

15 or 20 in Texas. Those pools are formed under long-existing statutes that were already on the books that said any two public entities can band together to do jointly what they can do individually.

I think it was originally intended to allow for joint purchasing. It's been used to -- as the basis for these interlocal pools without much of any other regulation put to it, and then they are -- it is incumbent upon those boards and those organizations to set policy and basically to self-regulate, and they've done an excellent job of it. And then all the way up the continuum, as I say, to those that are very heavily regulated.

Q. Somewhat out of sequence, but nevertheless, a topic that's come up a fair amount in the past few days is a two-year lockout provision --

A. Uh-huh.

Q. -- with regards to how LGC or HealthTrust treat its members. Could you just give from a -- from the perspective of somebody familiar with pool operations a comment on the two-year lockout?

A. The -- I don't know where the label two-year lockout comes from, but the policy standard in a membership organization like LGC that -- that requires some commitment when you join. Sometimes it's if you join you have to be in for at least a few years, or if you leave you have to stay out for at least a few years. It's not only very common but it's the best practice.

These aren't commercial insurance enterprises. They are membership organizations. And I would use the old, you know, adage: Membership has its benefits but it's got its obligations, too. And if you allowed members to come and go as they pleased, it would be a disservice to the other members, because one member might come one year, have an outsized amount of loss and decide to leave and leave the other members responsible for their losses, because that's the way pooling works.

So actually, a -- a one-year hiatus from coming -- if you decide to leave, a rule that says, "You can leave, but then you can't come back for at least another year," that's actually on the more limited end in my experience from a lot of pools.

Q. And that's your understanding of LGC's rules?

A. Yes.

Q. Reinsurance has been a fairly common topic. Are you familiar with reinsurance?

A. Yes.

Q. And can you describe how it works with regards to pools and specifically with regards to LGC?

A. Reinsurance or excess insurance is the transfer of risk above the level that a pool can comfortably keep on its own books.

Q. Okay.

A. So from the beginning of pooling, typically when they don't have much capital and surplus, they pool a small amount of risk, maybe 50,000 per loss, maybe 100,000 per loss, and then use the rest of their contributions to buy insurance.

They slowly build surplus and capital and wean themselves off of reliance on excess insurance or reinsurance, because to the extent that they can aggregate the risk and increase the level of predictability of that risk and to the extent that they have the capital necessary to deal with variances from that, then they don't have to pay premiums to commercial reinsurers.

As a practical matter most pools still buy some level of excess or reinsurance up at -- they've gotten to higher levels, but they get to a stage where it's worth buying it. It's still worth buying it. It's still remote. But if it does happen, I'd rather pay a little money in case city hall burns down.

In the case of -- health insurance, actually, works -- the dynamics, the economics are a little different, but what's relevant here is in the case of HealthTrust. It has reached the stage now where it's large enough, the base of predictable claims is large enough that they -- that the question of the value of buying external stop loss became a very real one over the last four or five years.

And, in fact, our firm had become their broker. And when we first came in they were buying reinsurance. They were spending, I've got to say, maybe 5,000,000 a year in premiums on reinsurance. I could have the numbers wrong, but whatever it was, they were maybe collecting back if they hit a couple times $1,000,000.

So reinsurers, they're not in the business to lose money, but every year when they price the product they have to -- they have to price it as though you might hit them that year and then you might leave.

Q. "They" meaning the commercial insurer?

A. "They" meaning the commercial insurer.

Q. All right.

A. Whereas if you retain that risk yourself, put it on your balance sheet, if you don't have the losses that year then you can roll it forward and you don't have to pay it each and every year. And then you slowly incrementally grow it to keep up with your size.

Q. Let me make sure I understand that. If you're a pool and you're paying, let's use your example, $5,000,000 for reinsurance and you hit a little, so maybe you get $1,000,000 back, what -- what's the net effect on your financial statement for that particular year's transactions regarding reinsurance?

A. Well, you have an expense of 5,000,000 offset by 1,000,000 coming back, and you move on.

Q. That's $4,000,000 gone?

A. Right.

Q. Not to be recovered?

A. Right.

Q. For that year?

A. Right.

Q. And they were doing this year after year?

A. Yes.

Q. And was it your assessment, or yours or your company's assessment that they needed to do that?

A. No. Our assessment was that -- again, while one year out of ten, it might have been a good bet, but they were a going concern. They were going to stay in business. So over the long run they could manage those fluctuations and not spend the money on the reinsurance. They had already made that decision long before we got involved in the case of -- in the case of aggregate excess insurance.

And I do want to explain this, because it's relevant to their capital requirements. Aggregate stop loss, or excess insurance, comes into play if all of the losses you have in that year exceed a certain amount; whereas individual stop loss relates to one claim, one large claim.

I believe that when the HealthTrust first started they had aggregate stop loss at 120 percent of expected loss. So if the actuary said, "I think we're going to have $4,000,000 of medical payments this year," I should say -- I'll use a round number, 10,000,000 of medical claims, this insurer would say, "Okay, if it gets to 12,000,000, 20 percent more than you planned for, we will kick in." I believe that's probably where that 20 percent capital margin came in. They said, "Let's fund the difference in case we hit it, then buy the excess."

That type of reinsurance, aggregate stop loss for health plans is very expensive relative to the chance that you're going to hit it. And as you get bigger, like the HealthTrust got bigger, the market's appetite to write that kind of coverage for you gets smaller and smaller, because they know that you have the wherewithal to keep the risk yourself. So if you're trying to send it to them, they're thinking there might be a reason.

So I wouldn't tell you it -- aggregate reinsurance for the HealthTrust is unavailable, but it's not feasible. It's unavailable commercial -- it's -- it wouldn't be commercially practical for them of their size to buy that. So they had stopped buying that, but they still bought the individual stop loss. So the individual claim that went to 1,000,000, if it got over 500,000, it would go to the reinsurance. If it went over 750, it would go to the reinsurance.

What we did is took the loss each year,

did some modeling. The actuaries did their Monte Carlo simulations and said, "Okay, how -- over a ten-year period how often might we be hitting it?" And it was clear that what they were spending on the individual stop loss was -- they were not going to see that return. In fact, if they did have the losses such that they -- it was worth buying it, all that was going to happen is that their premium was going to go up next year, and they had the capital to manage the volatility.

So over several years running, and this was an example of -- I think management got comfortable that they really didn't need the reinsurance anymore, but it took several years for the board to get comfortable. They're very conservative financially, and they wanted to fully understand it. And we slowly moved that attachment point up from 500,000 to 750 until finally -- to 1,000,000 to finally a couple years ago it became very clear that, "Why are we going to spend -- why are we to spend money on commercial reinsurance when we don't really need it, because we have our own capital that we can rely on? And that way we save the money."

So they reduced their expenses by not buying the reinsurance, and they know that they've got the capital in the bank where it belongs. It still belongs to the members but it's there to benefit them to keep their expenses down.

Q. Do you consider this to be a well-reasoned decision by the board?

A. Absolutely.

Q. Taken in good faith?

A. There is nothing more valuable for a pool to achieve than the status where their negotiation with a reinsurer is not -- is not which reinsurance to buy but whether I need to buy it at all, because I can afford to keep the risk myself. That gives you real negotiating power. If a reinsurer came and said, "We'll take the risk real cheap," they could still buy it. They're now in the driver's seat on behalf of their members as to whether to make the purchase or retain the risk.

Q. And you had watched the board exercise prudence in going through this process --

A. Yes.

Q. -- and arriving at this decision? You believe it was taken in the best interest of the organization?

A. Yes.

Q. And the members?

A. Every time.

Q. And believed that it saved the members money?

A. I know that it saved the members money. It's saving the members money today.

Q. This is one way in which the board was managing the reserves of the organization, the capital of the organization?

A. The capital, yeah.

Q. The members' balance or net assets, as it's been called throughout this process?

A. Yes.

Q. Why is capital strength important to the members of LGC in addition to this reason you've just discussed?

A. It gives you -- that negotiating power, it gives you negotiating power and leverage with the other counterparts you deal with. The -- I know that vendors -- I don't know this about Anthem in particular, but I know in other cases a vendor like an Anthem will -- they want to be affiliated with financially strong organizations, and you can drive a better contract price with them because they know that you're a strong, well-managed organization.

And you do that by presenting yourself as having the same kind of capital and surplus and financial mechanisms that a well-run insurance company would have, which is why you benchmark yourself against other insurance companies and you say, "We're not an insurance company. We do much more than what an insurance company does, but when it comes to the numbers we run ourselves like a well-run insurance company." It also gives the members -- I mentioned this earlier, gives the members confidence.

Q. That their promise is going to be met?

A. They can take it to the bank that once they've paid their premium, once they've paid that year's contributions, nobody's going to come back and ask them for more money. "Sorry, we undershot." I know pools that have gone out and assessed. A lot of pools have had to go out and assess.

Q. What does that mean, pools that have to go out and assess?

A. A lot of pools have in their participation agreements the ability to assess their members. When they first started and they had very little capital, they needed that --

Q. I'm still not sure what assess means. What does that mean?

A. To go out and ask for more money after the fact.

Q. Okay.

A. So when they first started they had very little capital, and you needed a fail-safe to -- if the money you collected isn't enough for the claims, two things can happen. You can close your doors and you default, and the assessment provision gives you the ability to sort of default by design.

Q. Is assessment available in risk pools, for LGC, for instance?

A. I don't believe the LGC pools are assessable. As far as I know they could be. I think it's a governance policy whether to be assessable or not. I'm not positive, but I haven't seen anything in 5 -- I'm not aware of anything in 5-B that precludes them from being assessable.

Q. What is the problem of undercapitalization?

A. The risk that you're not going to have enough money and you're going to have to go out -- you're either not going to make good on the promises you make or go back to members and ask for more money.

Q. Does more capital allow you to offer broader coverages?

A. Yeah. The other -- one of the other things that members want from their pools is for some of the tough risks that insurers don't like to cover to be covered. There are risks that insurers have decided almost never happen, but if they did, it would be too big, so they don't want to cover it. And generally, the pool's coverage documents are broader in the personal industry documents.

If they say to their actuary, "Well, my coverage here is broader than normal, how much more should I add to my rate?" the actuary says, "Well, you have no experience, so it's either zero, or if it happens it's going to be a lot." Those are the kind of coverages that you feel much more comfortable offering to your members if you know you've got a good sound capital foundation.

Q. Does a sound capital foundation enable a board to make investments in more efficient products and operations?

A. Oh, certainly. And that's -- the general theme of pooling has been as they've grown and become successful and build their capital bases rather than just give it back to the members, they have generally reinvested -- well, they have stabilized rates and then reinvested it by getting into other lines of business or offering new products and services.

Q. One of the comparisons that the Bureau has pushed is the State of New Hampshire employee health plan, which has a 5 percent reserve. Are you familiar with that?

A. Only from reading one of the expert's reports.

Q. Okay. What would you think if that were -- what do you think of that plan or how -- what do you think of that comparison in regards to LGC?

A. My -- based on my understanding of the comparison, which is to the state's own self-insured employee benefit plan, employee health plan, it's a complete apples-and-oranges comparison. The state's program would be an example of an individual employer, the state, in control of all of its employees and the benefits they offer, self-funding them and deciding to include a 5 percent margin to soften the blow of a bad year.

The LGC is a collection of, I think, a

couple hundred completely separate entities with completely separate governing structures who have made a deal with the LGC. "We'll pay you our money and you'll provide us these products and services, and we don't expect you to go away and not be able to do it, and we don't expect you to come back with more money."

You can't compare an individual employer program to a large -- to a multi-employer organization.

Q. Did you express your opinions in a written report?

A. Yes, I did.

MR. SATURLEY: Okay. Ms. Emery's report is Exhibit LGC 271. I would move to strike the ID and have it accepted as a full exhibit at this time.

THE PRESIDING OFFICER: Any objection?

MR. VOLINSKY: No.

THE PRESIDING OFFICER: With no objection, 271 is a full exhibit.

(LGC 271 was entered into evidence.)

MR. SATURLEY: Thank you.

Q. BY MR. SATURLEY: Ms. Emery, in conclusion, is it fair to say that you think that pooling in this area is unique and powerful?

A. Absolutely.

Q. Different than insurance in many ways, like it in some with regards to the contracts that it takes on to provide payment for risk?

A. Defining it as insurance is necessary, but it is not sufficient. It is much more than insurance.

Q. Ultimately, has it saved public employers money?

A. There's no question that it has saved millions and millions of taxpayer dollars.

Q. With regards to LGC, do you have any similar observations?

A. I have no question that LGC through its products and services has saved the taxpayers of New Hampshire millions of dollars.

MR. SATURLEY: No further questions for Ms. Emery.

THE PRESIDING OFFICER: Thank you, Mr. Saturley. Mr. Gordon, any?

MR. GORDON: No.

THE PRESIDING OFFICER: Mr. Howard?

MR. HOWARD: No. Thank you, Mr. Mitchell.

THE PRESIDING OFFICER: Mr. Volinsky on cross-examination. You doing all right over there, Ms. Emery?

THE WITNESS: I'm fine. Thank you.

CROSS-EXAMINATION

BY MR. VOLINSKY:

Q. Need more water?

A. I'm good.

Q. Ms. Emery, I'm going to try and keep us on just a couple of issues and maybe even complete this in 20 minutes or so.

A. All right.

Q. So let's see if we can stay focused. And I'll jump from point to point and try and let you know that I'm switching topics.

A. All right.

Q. First topic is: You were explaining to Mr. Saturley that the Local Government Center and risk pools in general can offer a broader array of products because, in essence, they can take on products without a history of claims to measure the cost against; do you remember that topic?

A. Yes.

Q. I just want to ask you straight-up. In your opinion does the Local Government Center HealthTrust offer products for which Mr. Riemer is unable to project claims and associated costs?

A. I think that they -- by their nature they offer a product where the projections of the actuary are insufficient to assure solvency.

Q. So there are products that they offer for which Mr. Riemer cannot project claims and associated costs?

A. Mr. Riemer would tell you an actuary cannot sufficiently project the costs such that it can operate without a substantial margin in case of variation.

Q. In your opinion is it prudent to offer products to HealthTrust members for which the consulting actuary is unable to project costs and claims?

A. I didn't say they were unable to

project -- I didn't intend to say he was unable to project costs and claims. I said that -- I intended to say that no actuary would purport to be able to project definitively the cost of claims, and therefore, would always recommend and require that sufficient capital and surplus be carried.

Q. Thank you. Switch topics. I want to ask you about the 2004 series of meetings that ultimately led to the summertime retreat. You started working with either committees or the board beginning in April and met with them essentially monthly through July, correct?

A. Yeah. I don't know the exact time frame, but it started in the spring, ended in July, and we had a number of meetings.

Q. Okay. And Mr. Saturley went through with you the minutes for all of those meetings?

A. Yes.

Q. And so whatever the dates are they're on the minutes, right?

A. Okay. Right.

Q. And if you would just take a quick look at the front page of the minutes that Mr. Saturley went over with you. They're all sealed minutes, aren't they?

A. Yes.

Q. So none of these minutes describing the plan to make strategic payments to benefit Workers' Comp., none of these were available to members as this decision-making was ongoing, right?

A. This was strategic planning. This was strategic planning in a competitive environment, and they made the determination to do it as a board in executive session.

Q. Which means that none of this was available to the members, correct?

A. The board is the representative of the members, so I consider the board the representative of the members.

Q. When -- do you know when these became unsealed?

A. No.

Q. If I were to suggest to you it was in the context of this case, would that ring a bell?

A. It would ring a bell. I just don't think it's relevant.

Q. Okay. Let's stay with that same time period, springtime to July, whether it's April or some other time in the spring. When you got to the July retreat, do you agree or disagree that one of the reasons a decision was made to subsidize Workers' Comp. was because Primex's strongest program was workers' comp.?

A. I never -- no, I didn't hear that.

Q. Okay.

A. No.

Q. Didn't hear that topic -- maybe not those exact words --

A. The topic --

THE PRESIDING OFFICER: Just hold on. Wait for the question.

THE WITNESS: Okay.

THE PRESIDING OFFICER: Go ahead, Mr. Volinsky.

Q. Maybe not those exact words, but did you hear that concept expressed, which is: "We should subsidize our Workers' Comp. program because Primex's strongest program is their workers' comp. program"?

A. No. What -- what we -- what they discussed was that the reason there were operating losses in Workers' Comp. and the reason it wasn't growing the way it needed to was because Primex was setting the market rate below an adequate level. And if they wanted to be in the market, grow the product and have a product, they were going to have to find a way to absorb those operating losses until they grew to a sufficient size so that they could have the influence they wanted to have.

Q. Did you hear at that retreat discussion about a perceived threat that Primex was going into the health insurance business?

A. Yes.

Q. And did part of the decision-making to subsidize Workers' Comp. revolve around the perceived threat that Primex would go into health insurance?

A. Yes. I'm not sure if it was perceived. I think they had launched the health program. I could be wrong, but the -- let me just put the puzzle pieces together.

Q. Whatever you need.

A. If LGC was not in workers' comp., Primex would be the only game in town. There would be a monopoly. They could charge what they wanted. And as we sat there at that time, they had something like four or five dollars of surplus for every dollar of premium in their comp. program already. So there was real concern that without competition Primex could use their work comp. program to charge lower than market rates in healthcare and begin to destabilize that market as well, which wouldn't be good for anybody.

Q. So at the time you were a risk pool practice group manager, right?

A. Yes.

Q. For a national consulting firm, correct?

A. Yes.

Q. You had already completed your MBA by then, correct?

A. Yes.

Q. You had financial analysts on the staff at your consulting firm, correct?

A. Yes.

Q. Yet, prior to, in preparation for, or during this July retreat, you completed no financial analysis as to what it would cost Primex to successfully enter the health market, correct?

A. Correct.

Q. And so all of this -- well, you also didn't consider or determine or figure the cost of Primex reaching what we call a tipping point in the health market such that they could become -- they could transition from a start-up to an ongoing program? Didn't do that either?

A. Well, let me --

Q. You can explain, but please answer.

A. No. No. No, we didn't.

Q. Okay.

A. Let me explain what we could do. Primex was not filing any of the required financial filings with the Secretary of State's office, so we didn't have access to information that would have been helpful through the process, so we pieced it together.

What we did understand was that there -- they had developed a relationship with Harvard Pilgrim. And one of the critical factors in terms of how strong they could get and how long it would take them to get there was -- we didn't know how much risk -- and I think it was Harvard Pilgrim. Maybe it was somebody else, but whoever their partner was, we didn't know how much risk Primex was retaining or how much risk the insurer was retaining. If, in fact, the insurer was taking most of the risk, a commercial insurer can lose money for a long time and destabilize the market.

So Primex could have used its market share and a partner who was willing to lose money for a long time to destabilize the market, but we had no way of knowing exactly what their arrangements were.

Q. And so you facilitated the discussions that led to decision-making by the board without knowing how financially large or small the investment was on Primex's part to get into health insurance, correct?

A. Primex getting into health insurance was not the driving factor relating to the strategy. It was a consideration.

Q. It was -- I'm sorry?

A. It was a consideration.

Q. A consideration? You made no effort during this spring to summer time frame to financially analyze the numbers related to SchoolCare, did you?

A. No.

Q. And SchoolCare was the other-than active healthcare risk pool in New Hampshire, right?

A. Yes.

Q. That's a question. Did you know that?

A. Yes. My understanding was that they were another HealthTrust that -- that LGC had respect for in terms of their ability -- that they were out offering good products at responsible prices.

Q. You mentioned in your testimony that LGC was innovative because they had a couple of employee representatives on their board of directors, right?

A. Yes. I said in my experience that's the only time I had seen that.

Q. Did you know that SchoolCare by terms of their bylaws has to have equal number of employee and management members on their board?

A. No. Never worked for SchoolCare.

Q. At the time that you were meeting with the board in 2004, am I correct to understand that you did not understand the process to have resulted in the payment of a subsidy by HealthTrust to benefit Workers' Comp.?

A. I don't understand the question.

Q. Did you know that the board was voting a subsidy as part of this strategic planning payments as you were meeting with them that summer? Did you understand that?

A. On the second day the board took action to create a strategic fund comprised of one percent of employer-paid premiums from all the programs in the coming year; that fund was to be used to support the Workers' Compensation program and to develop products and services and make administrative expenses to increase the integrated product activity that they wanted to make happen. They made a choice to make an investment. It included the strategic fund, a portion of which would be used to cover any operating losses in Workers' Compensation.

Q. So as of today, would you agree with me that some 17 or $18,000,000 in subsidization has been paid by Health to Workers' Comp.?

A. I would agree that Workers' Compensation has continued to sustain operating losses that have been covered through other LGC sources. LGC is one organization.

Q. And so you disagree that they paid a subsidy to the tune of 17, 18,000,000?

A. I'm saying -- sorry. I'm saying LGC is the only program and it has used resources from one product line to cover operating losses for another product line.

Q. Do you not know that there was a note signed last summer by Workers' Comp. to repay 17.1 million to --

A. I do know that.
Q. What's your understanding of why that note was signed?
A. My understanding of why that note was signed is that because of -- that some members -- because of lots of communication, some members got uncomfortable with -- and started to question whether -- started to question the decisions that the board had made.
And so the board reassessed their decision and said -- while they did not -- at the time they made the decision there was an investment across the board. They made a determination in a year or two ago to make a commitment that if and when the Workers' Compensation program starts generating surplus, they will use that to replay -- repay the other lines of business.
Q. Other lines or just HealthTrust?
A. I'm not sure.
Q. Fair enough. I think you said in response to one of Mr. Saturley's questions that it's very hard to measure exactly where or what

the benefit was to HealthTrust in making this strategic planning, which you call investment; is that a fair statement?

A. Yes, I said that, but HealthTrust isn't -- I don't think of HealthTrust as an entity. HealthTrust is a product line.

Q. Do you know that there's something called the HealthTrust, LLC?

A. Yes. I understand that to be a legal mechanism they put in place to try to create some special liability protection. It's a single member LLC, but the HealthTrust is not a separate organization. It has no separate bylaws. No separate board. It did at one time. That board made the decision on its members' behalf to create an integrated board. And there's not one organization with members across the gamut of all their product lines.

Q. So I take it you could not tell me whether HealthTrust received a $17,000,000 benefit for its $17,000,000 investment in Workers' Comp.?

A. Well, again, I don't see HealthTrust as a separate entity. I would submit to you that the HealthTrust line of business got stronger during the same period of time that the Workers' Compensation program got stronger. For all I know there were people happy with Workers' Compensation that, therefore, started buying health insurance. I don't know.

Q. Did you tell me at deposition that one way to think about this issue of quantification of the benefit to HealthTrust was to look at the size of the program; do you remember that? I can show you your deposition.

A. I think that's consistent with what I just said, that they grew during this period of time.

Q. Okay. That's all I'm just trying to make sure I understand.

A. Yeah.

Q. Let me -- if I can do this quickly with everyone's indulgence. In Exhibit 69 I want to show you two pages from our financial statements, because the financial statements include the size of HealthTrust in the management discussion.

So for '04 -- and it may be easier just to look at it on the screen because it's just one number. In '04, if I send you to page 494 of Exhibit 69, right down here there's a discussion of membership changes and then the size. At the end of '04 for HealthTrust is -- call it 60,000 health members --

A. Yes.

Q. -- in the health product, right? See where I am?

A. Yes.

Q. Actual members refers to all their different products, dental and short and long term. Okay? So I want you to look at this 59,769 in 2004.

And then I'm going to switch you to page 805 of Exhibit 69. And if you look at the 2010 figure for the number of lives insured, it's now dropped to 57,000 from 2004 when it was -- I'll put them both together on the same screen -- 59,000 in '04, 57,000, '10. And the '10 happens to have a schedule of years from '04. So it went from '04, 59, it went up a hair to 60, then down, then down, then up, then up, and then down again.

So if you're using size of the health program as a measure to quantify the benefit to health of having Workers' Comp., would you agree with me that the results in terms of medical lives doesn't support a conclusion like that?

A. Yes, I would.

Q. Thank you. Let me give you Exhibit -- Exhibit Book 1. I'll ask you to turn to number 24. You were an expert in the firefighters' case in 2010, were you not?

A. I -- I submitted this affidavit.

Q. Okay. Fair enough. I'll take that. You submitted a -- an affidavit in the firefighters' case in 2010?

A. Yes.

Q. Is this the affidavit?

A. Yes.

Q. A couple of points, I just want to ask you very quickly if you still subscribe to them. Turn to paragraph 18 for me, which is on page 4. I'll let you just read that to yourself. Just let me know when you've done that.

A. (Witness peruses document.) Yes.
Q. You indicate in paragraph 18, "Given the influence of private health insurers, it's hard. It's very difficult to form a large and successful health insurance pool in New Hampshire at this point in time," 2010, correct?
A. Yes.
Q. Was it less hard in 2004 to start a risk pool in health?
A. I don't know.
Q. Turn the page. Let me ask you to read 22.
A. (Witness peruses document.) Yes.
Q. Fair to say that one of the stated purposes of the 2003 reorganization was to allow less siloing of activities with the different lines and more coordination between the different programs?
A. Yes.
Q. When you got to the 2004, a year later, retreat process, that had not yet happened?
A. The governance structure had been integrated. The operations had not yet been

fully integrated.

Q. Okay. Let me ask you the flip side of that. As a consultant who works in this field and who's worked in it for many, many years, LGC could have effectuated the operational cooperation that you tried to help them achieve in '04 without creating separate entities and putting them under a parent organization; they could have cooperated in the legal format that they were in prior to the reorganization?

A. I think it's fair to say that in theory they could, but in practice if their goal -- if their goals were the integration goals that we've talked about, one of the recommendations would be you should align your governance structure and your operating practices with those goals. They had already done it before I came in, but it's certainly -- if they hadn't, that would have been a recommendation. It's very hard to break down walls and silos when organizations are separate.

Q. In fact, when you came back in 2010 for the SMO process --

A. Yes.

Q. -- there were still operational differences that indicated that operationally the individual lines still were not cooperating as fully as had been hoped?

A. I don't think we concluded that. In fact, I think they made -- I think we concluded that they had made a lot of progress. And that project was the impetus for, actually, a staff reduction that Ms. Carroll testified to the other day. They were able to downsize some of the people because of how the operations were flowing.

Q. They were able to downsize in 2010 based on matters that you discussed in the retreat in '04?

A. Well, I'm not saying that there's a direct line. It's not as though we identified bodies in 2004, but there had definitely been operational changes, organization of activity such that when a fresh look was taken in 2010 they found some redundancies and were able to release those people.

Q. Okay. Turn to paragraph 41. Read it

and then look up when you're done, please. 41.

A. (Witness peruses document.) Okay.

Q. In 41 you're describing the development of the strategic plan where the one percent is contributed up to the parent, correct?

A. Right.

Q. And by distributing money up to the parent, in effect, you were discussing with the board the idea of intermingling funds from the different pools, correct?

A. Yes. I just want to -- we never talked about it as distributing money to a parent. I didn't spend a lot of time thinking about the legal structure as -- the way the organization operated was -- was LGC. The fact that they had put the product lines in separate single-member LLCs for liability protection purposes was a legal artifice that had nothing to do with what we were talking about. So I just want to --

Q. Okay.

A. It was let's take one percent of next year's incoming employer contributions and create an investment fund, a strategic fund, that will allow us to start doing some of the things that we promised our members we'll do.

Q. Okay. Let me pursue what you've just said just a little bit. You said you didn't pay attention to the different legal entities in the discussions, right?

A. It's a nonissue at -- for the board.

Q. I understand.

A. Yes.

Q. I understand.

A. Yeah.

Q. But health insurance charged a premium for health insurance coverage, correct?

A. Well, the health -- I don't know what you mean when you say, "Health insurance charged a premium."

Q. HealthTrust. Let me make it clear --

A. The product line called HealthTrust has a premium charge attached to it. The product line HealthTrust is one of the product lines of LGC ever since 2003.

Q. Right. And Workers' Comp. had a separate premium?

A. Yes.

Q. And Property-Liability had a third premium?

A. Yeah.

Q. And each of those premiums were calculated based on the cost of those particular lines?

A. That's right.

Q. Except that an extra increment, which happened to be one percent, was added to each set of premiums to create this strategic bucket of money, correct?

A. Yeah. I think that's fair to say.

Q. And in describing it that way, which you say is fair, that extra bucket was mingled from the premiums from one program to the premiums to the second and the premiums of the third, forgetting the legal artifice of corporate entity --

A. Right.

Q. -- correct?

A. Yes.

Q. And no one in this time frame of '04

raised any question whether the integration of the product line funding from different pools was authorized by enabling legislation. So you don't think I'm cheating, I'm reading from the middle sentence in your paragraph 41. No one raised that legal issue?

A. At the time this plan was developed, I do not recall that there was any questions raised. That would be the emphasis. There was no question. It was obvious and clear that the integration of the product line funding was authorized by, namely, legislation.

I don't mean that the -- the implication here was it was obvious upon its face given that it was -- that the integration had already happened.

Q. Okay. Glad I asked you to clarify that. So there's some legal opinion to this effect as indicated in 41, your sentence in 41?

A. Well, there were lawyers involved in the integration of the governance structure, which effectively broke down the silos. There were lawyers attendance at this retreat. And as I said here, the normal -- it would not at all be unusual for pools to operate this way.

Q. Okay. Just to make sure I understand, I want to focus you on the '04 retreat, because that's where the strategic plan money was voted, right?

A. Yes. Yeah.

Q. And you know that the LGC had the advantage of a note taker who was capable of doing shorthand, right?

A. Right.

Q. And she produced minutes, and those minutes were reviewed by the staff, correct, and then approved by the board?

A. I've heard that.

Q. Do you know that?

A. I've heard that, yes.

Q. Okay. Let me ask you to assume that. There's been other testimony about it.

A. Okay.

Q. So if this issue of the legality of mixing the funds was raised and discussed at that retreat, likely, it would be in the board

minutes, in the retreat board minutes, correct?
A. I don't -- I can't -- I don't know how -- you know, I never read her minutes, so I don't know what she captured and what she didn't.
Q. Fair enough. Let's move to another topic. Go to paragraph 43. Read it to yourself and then look up when you're done.
A. (Witness peruses document.) Okay.
Q. Here you use the word "subsidy" yourself.
A. Yeah.
Q. And that's the 17,000,000-odd dollars paid over time from Health to Workers' Comp., correct?
A. As I understand it's been calculated.
Q. Well, this -- okay.
A. That is the amount -- --
Q. You're guessing on the number?
A. Apparently, that's the amount of the accumulative operating loss for Workers' Compensation line that has been covered by the other lines of business.
Q. Okay. Let's just accept the 17,000,000

for purposes of argument. You agree that without that sum Workers' Comp. would have failed?

A. Without a way to cover the operating losses that were going to be incurred in order to price the product in a way that could meet the market price that Primex had set, their alternative was to exit the business.

Q. Or fail?

A. Well --

Q. Intentionally exit or unintentionally, it would exit?

A. Yes. I think as I've said --

Q. Thank you.

A. -- it was pretty clear in their minds that sitting and doing nothing and wasting members' money was not something that they were going to do.

Q. Thank you. Switching topics. Go to paragraph 53 for me. You'll see 53 goes on to the very next page.

A. (Witness peruses document.) Yeah.

Q. You still agree that health insurance coverage is a very short-tail line of coverage?

A. Yes.

Q. Thank you.

A. Can I expand on that?

Q. If you feel the need, you may. I promised 15 minutes, but go ahead.

A. And the point is that when it comes to health insurance it is not the length of the liability tail that drives its need for surplus. It is the volatility and pricing.

Q. Anything else you need to add on that point?

A. No.

Q. I don't want to stop you.

A. I'm good.

Q. Thank you. Would you agree with me that you are not an expert in setting appropriate net asset levels, because that's an actuary's job and you are not an actuary?

A. I would agree with you that I'm not an actuary. I would not agree with you that it's an actuary's job to set appropriate net assets.

Q. Do you think you're an expert in setting appropriate levels of assets for say HealthTrust?

A. I think I am an expert in working with boards to set net asset policy, and I think it is the board's purview to set the net asset policy.

Q. So you're an expert in the process?

A. I'm an expert in working with boards to guide them to set policies that are appropriate for the risk appetite and risk characteristics of their organization.

Q. Can you tell me whether LGC's HealthTrust currently has too much or too little or the right amount in net assets?

A. I -- my understanding of the process that they have been through to set the target that has relied on benchmarks for other similar organizations appears very appropriate. The number seems reasonable -- the target number seems reasonable to me in comparison to others. Exactly where they are relative to it one year to the next can vary a lot, but it has seemed like very sound policy to me.

Q. If I gave you access to any number that you wanted, any bit of data that you wanted in a calculator, could you tell me how much the appropriate amount of net assets for HealthTrust should be based on your own calculation?

A. It's not relative to my calculation. It's a board policy.

Q. Could you answer the question, please? Can you do that calculation --

MR. SATURLEY: Objection to the question.

THE PRESIDING OFFICER: Okay. I didn't hear her answer the question. Repeat the question, Mr. Volinsky.

Q. If I gave you access to whatever data you said you needed and a calculator, could you personally figure out how much in your opinion should be held in net assets in HealthTrust?

THE PRESIDING OFFICER: If you would answer --

A. I would have an opinion, yes.

Q. So your answer is you can calculate --

A. I could have an opinion. It's not -- it's a board's job, but I could have an opinion based on --

Q. And would you consider your opinion

through that process reliable?

A. Yes.

THE PRESIDING OFFICER: Am I going to hear how much? Okay.

MR. VOLINSKY: Can I have just one moment, please?

THE PRESIDING OFFICER: Certainly.

MR. VOLINSKY: Almost done.

(Brief pause.)

Q. Switching topics. The one percent amount that was contributed to the strategic plan --

A. Yes.

Q. -- that one percent, was that the result of some calculation that you or someone in your organization performed?

A. No.

Q. Did anyone perform a financial calculation that resulted in that one percent number?

A. No. As I think we discussed at the deposition, the deliberation was around creating a pool of funds that could be invested in a variety of ways including covering the operating loss of Workers' Compensation that could be done without in any way undermining or destabilizing the value of the other products to the members.

And, again, I don't remember whether it was at that meeting or subsequently that the one percent came up, but management was tasked with going and -- coming back with a plan for using that pool of money in the best interest of all the LGC members, and that's what they did.

Q. So as far as you know no one assisted the board in choosing the one percent number by doing any kind of actual financial calculation, correct?

A. I don't know what financial calculation would get done. No -- I mean, yes, correct.

Q. Thank you. The total amount to be contributed to Workers' Comp. through the subsidy program, other than concluding it might be a five- to ten-year process at the time of the July board meeting, did anyone quantify how much Workers' Comp. was likely to need in terms of a number?

A. The -- well, not then, but there was a sense because their actuary -- there was some sense, although, the numbers always change, but the difference between what the actuary said they needed for a full rate versus what the market would bear was a known number and it would keep changing, but they would keep their eye on that number.

So maybe it was -- maybe there was a 30 percent differential when they were first starting, and a year or two later they were down to only a 20 percent differential because the size of the pool had grown, and then they were down to a 15 percent differential. So the issue that they had their eye on was are our rates getting more and more adequate? And in the meantime they were subsidizing the operating losses.

Q. Do you ever work with clients on putting together business plans?

A. Yes.

Q. I note that you're mostly retired now. When you were practicing, business plans?

A. Yes.
Q. And are you aware of the process in a business plan where a business or a pool or an insurance carrier goes through the effort to figure out the costs, to understand the market and projects, plus or minus, a particular cost of getting stable, how many dollars and cents? Are you familiar with that?
A. Sure.
Q. Have you done that?
A. I personally haven't, but we would do pro forma analysis, and they were done on the Workers' Compensation program.
Q. So in July of '04 when the commitment was made to contribute one percent -- contribute something to strategic plans, whatever the percentage was, are you telling me that someone for the board's benefit actually did a pro forma that projected from July to stability what the cost was likely going to be?
A. I don't know that it was done at July. I know that before the board approved the final plan for how to use the strategic fund they had

the Workers' Comp. actuary do -- and then they would do five-year projections, and then we would update them every year. They would have different assumptions. If it grows this much -- if it grows this much, if the loss -- obviously, there's about 20 different levers in trying to project insurance product cost, but that was definitely done on an ongoing basis.

Q. If -- I wasn't asking ongoing. I'm asking --

A. I don't recall that we had done that -- that kind of pro forma analysis to see how long for sure it would take or how much it would take when the decision was made to set up the strategic fund. Again, the strategic fund was for more than just that. So then they probably went away then and figured out, "How much is going to be eaten up by Work Comp. subsidy versus how much can we spend on other things?"

Q. Just so we have a clear record on this point. In July when the board retreat occurred did someone do for the board's benefit, even though it's an estimate, a precise pro forma that said if you start today until stability it will likely cost a certain amount of money?

A. We did not do rigorous actuarial pro formas at that stage. We did rough estimates of how big the pool was going to need to be to reach the efficient -- the economies of scale that needs to be reached, which was determined to be about 5,000,000 in contributions. But the more rigorous work came after the strategic retreat.

Q. How long after?

A. I believe sometime between the retreat and when the final operating plan for how to spend the money was delivered to get back to the board.

Q. If we were going to look -- if we were gonna look for this document that you say was completed sometime after July, what would be the name or description of that document?

A. They would have had then -- they would have had their work comp. actuaries. In the process of developing the future work comp. rates, also do the projections. So it might have been part of the rate study or the reserve study, but it would have been a work comp. actuarial process.

Q. That would have predicted likely cost to stability?

A. Yes.

MR. VOLINSKY: Okay. Thank you. I have nothing further.

THE PRESIDING OFFICER: Thank you, Mr. Volinsky. Absolutely, Mr. Saturley. You would generally apply the multiplier of two and three --

THE WITNESS: To the estimate?

THE PRESIDING OFFICER: -- to the estimates.

THE WITNESS: Just like an actuary. That's why you need capital and surplus.

THE PRESIDING OFFICER: We'll go off the record for now.

(Recess taken.)

THE PRESIDING OFFICER: Continuing from a short recess, Mr. Saturley, do you have any further questions?

MR. SATURLEY: No, thank you.

THE PRESIDING OFFICER: Thank you. Mr. Gordon?

MR. GORDON: No.

THE PRESIDING OFFICER: Thank you. Mr. Howard?

MR. HOWARD: No.

THE PRESIDING OFFICER: All right. I have a couple, Ms. Emery. You've been in these proceedings --

THE WITNESS: I'd be disappointed.

THE PRESIDING OFFICER: Okay. I wouldn't want you to be disappointed, but you understand the nature of mine is somewhat different than you have in the --

THE WITNESS: Yes.

THE PRESIDING OFFICER: The first one I have is when you started to describe in 2010 the SMO, strategy management organization committee, and you had put together, if you will, a team to work with them, you listed yourself and Chris Becker and a gentleman named Jeff something.

THE WITNESS: Right.

THE PRESIDING OFFICER: And then -- does

that name come to your mind at all? It's okay. It's not a test, because here's my question. My question was: Then your next statement I believe was, "the four of us."

THE WITNESS: Oh, the fourth person was Mark McCue.

THE PRESIDING OFFICER: Okay.

THE WITNESS: General counsel.

THE PRESIDING OFFICER: Okay. So there was an attorney on that team?

THE WITNESS: Oh, yes.

THE PRESIDING OFFICER: All right. That fills in a few holes for me. With respect to the so-called moon charts --

THE WITNESS: Yeah.

THE PRESIDING OFFICER: -- the -- did I understand correctly that the data that supports that came from a member survey?

THE WITNESS: No, not the moon charts.

THE PRESIDING OFFICER: Okay. That came from some type of feedback that was passed on to you?

THE WITNESS: Yes. That's our expert

analysis of their standing relative to their environment.

THE PRESIDING OFFICER: Okay.

THE WITNESS: I'm sorry, can I correct that?

THE PRESIDING OFFICER: Absolutely. That's what I'm just trying to do.

THE WITNESS: The very first column was product quality, so that's -- and that -- that came from both anecdotal and I think some old member surveys that they had already done that showed member satisfaction.

THE PRESIDING OFFICER: Okay.

THE WITNESS: Whereas the other columns had more to do with us looking at numbers and so forth.

THE PRESIDING OFFICER: Thank you. I was just looking for clarification. I don't intend to ask you to know everything about LGC, notwithstanding your long involvement with them.

THE WITNESS: Okay.

THE PRESIDING OFFICER: I do want to use your expertise and experience, however. When you make reference to these pools, risk pools, 150 in California, there's just a whole lot of them out there, yes?

THE WITNESS: Yes.

THE PRESIDING OFFICER: Okay. And these pools, of the pools, is there -- can you give me an indication of your familiarity or the -- or the percentage delineation between private risk pools and public risk pools, public member risk pools?

THE WITNESS: Well, these pools that I'm talking about are all public sector -- pools of public sector entities. All of them. None of these are private pools.

THE PRESIDING OFFICER: Okay.

THE WITNESS: And they are -- the estimates are that there are probably 80 percent of the public agencies and entities in the country, not by size but by number, are in these pools for one or more of their insurance coverages and that there's some 15 to $20,000,000,000 of annual contributions flowing through these pools, these nonprofit, largely unregulated pools.

THE PRESIDING OFFICER: So your general references when you said, for instance, that you've worked with, you know, at least 50 of them, would that percentage apply to those 50, that is, you worked with both private and public?

THE WITNESS: No. These are all public sector pools.

THE PRESIDING OFFICER: You've worked only with public?

THE WITNESS: Yes. There is no private sector entities that want to do this kind of thing.

THE PRESIDING OFFICER: Okay.

THE WITNESS: Have to do it -- there's no legislation to allow them to do it. I mean, there is but not the same kind.

THE PRESIDING OFFICER: I was unsure when Mr. Volinsky was asking questions about minutes and such. I thought I heard your response as being that you had not read those minutes?

THE WITNESS: I have not read those

minutes.

THE PRESIDING OFFICER: Okay. And I had missed the reference in terms of those, but let me ask you this question: Have you read or reviewed the minutes of meetings in which you participated in preparation for today?

THE WITNESS: Very little.

THE PRESIDING OFFICER: Okay. But you reviewed them?

THE WITNESS: Just the snippets that he had shown me. I have not reviewed the minutes.

THE PRESIDING OFFICER: All right. Let me ask it this way: Did Mr. Saturley tell you what was in the minutes?

THE WITNESS: He told me that --

THE PRESIDING OFFICER: Can you answer of your own accord, please?

THE WITNESS: Yeah. He told me that they were very comprehensive and that they demonstrated a consultant facilitating lots of process through the board and I wouldn't be surprised by anything in them.

THE PRESIDING OFFICER: All right. You

don't have any reason to doubt the accuracy of the minutes, do you?

THE WITNESS: No.

THE PRESIDING OFFICER: Okay. We need to find out the name of this woman who was taking these minutes and see if she's still in the business.

That's it for me, gentlemen. If I stirred anything up, feel free to go around again.

Mr. Volinsky on cross? Mr. Saturley?

MR. SATURLEY: No, sir.

THE PRESIDING OFFICER: Mr. Gordon and Mr. Howard? I believe we're done with this witness. Ms. Emery, thank you very much --

THE WITNESS: Thank you.

THE PRESIDING OFFICER: -- for providing information to us this afternoon. You're excused. All right. At this time we have a couple housecleaning or administrative issues. Mr. Ramsdell.

MR. RAMSDELL: We have one stipulation.

THE PRESIDING OFFICER: Fine. Would you

please come to the microphone, sir.

MR. RAMSDELL: Before we close the record for the day we have a stipulation regarding real estate, and I'll read it and then submit it, if that's your preference.

THE PRESIDING OFFICER: That would be fine.

MR. RAMSDELL: Okay. "HealthTrust and Property-Liability Trust both pay below fair market value rent for the space they occupy at the Local Government Center building at 25 Triangle Park Drive in Concord. HealthTrust and PLT pay their respective pro rata share of the operating costs of the building. The amount is $6.80 per square foot, gross rent. If the entities paid fair market value for gross rent, the cost would be closer to $16.25 per square foot. HealthTrust occupies 29,653 square feet of the building and PLT occupies 17,753 square feet."

THE PRESIDING OFFICER: And that's signed by?

MR. RAMSDELL: I beg your pardon?

THE PRESIDING OFFICER: Is that signed by anyone?

MR. RAMSDELL: No, it's not.

THE PRESIDING OFFICER: Okay. Then I have to go around. Mr. Volinsky, do you stipulate so?

MR. VOLINSKY: I do, yes.

THE PRESIDING OFFICER: And Mr. Howard?

MR. HOWARD: Yes.

THE PRESIDING OFFICER: And Mr. Gordon?

MR. GORDON: Yes.

THE PRESIDING OFFICER: Thank you.

MR. RAMSDELL: Would you like to give it to the stenographer?

THE PRESIDING OFFICER: Give it to the stenographer. And could you determine a number for us? How about Joint 3?

MR. VOLINSKY: Yeah, make it a Joint.

THE PRESIDING OFFICER: All right. Joint 3.

(Joint Exhibit 3 was marked for identification.)

THE PRESIDING OFFICER: Any other housekeeping? Mr. Siracusa Hillman?

MR. SIRACUSA HILLMAN: Yes. Yesterday during the examination of Ms. Carroll, I believe you requested a full copy of the recruitment brochure, which had been marked as LGC Exhibit 450. We have obtained a full copy, and the exhibit, I believe, has been replaced in the hearing officer's file. And I've given a copy to counsel for the BSR.

THE PRESIDING OFFICER: Thank you very much. I'm presuming you have no objection, Mr. Volinsky?

MR. VOLINSKY: I don't think so, but I haven't seen this.

THE PRESIDING OFFICER: I understand. By all means. Why is it that people don't want me to get full documents?

MR. VOLINSKY: We do not have an objection.

THE PRESIDING OFFICER: Excellent. And that's replacement number...

MR. VOLINSKY: 450.

THE PRESIDING OFFICER: 450 LGC. Are there any other administrative items?

Mr. Ramsdell?

MR. RAMSDELL: There are a couple of items we'd like to take up that we don't need a record for. They don't have to do with pending exhibits or --

THE PRESIDING OFFICER: Wonderful. Then I think that we're in recess until tomorrow morning at 9:00 a.m. Thank you very much for your attention and cooperation.

* * *

(Whereupon, at 3:14 p.m., the proceedings were recessed, to reconvene on Friday, May 11, 2012, at 9:00 a.m.)

C E R T I F I C A T E

I, Michele M. Allison, Licensed Shorthand Reporter, Registered Professional Reporter, and Certified Realtime Reporter, do hereby certify that I reported in machine shorthand the proceedings had at the taking of the above entitled hearing, held on the 10th day of May 2012, and that the foregoing is a true, complete, and accurate transcript of said proceedings as appears from my stenographic notes so taken to the best of my ability, and transcribed under my personal direction.

I further certify that I am a disinterested person in the event or outcome of this cause of action.

THE FOREGOING CERTIFICATION OF THIS TRANSCRIPT DOES NOT APPLY TO ANY REPRODUCTION OF THE SAME BY ANY MEANS UNLESS UNDER THE DIRECT CONTROL AND/OR DIRECTION OF THE CERTIFYING COURT REPORTER.

IN WITNESS WHEREOF, I subscribe my hand and affix my Certified Shorthand Reporter seal this 24th day of May, 2012.

____

MICHELE M. ALLISON, LCR, RPR, CRR