STATE OF NEW HAMPSHIRE
DEPARTMENT OF STATE
BUREAU OF SECURITIES REGULATION

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

RESPONDENT MAURA CARROLL'S MOTION TO DISMISS ALL COUNTS OF THE AMENDED PETITION

INTRODUCTION

Respondent Maura Carroll, by and through her counsel, Shaheen & Gordon, P.A., hereby moves to dismiss all Counts of the Amended Petition.

This is an administrative proceeding to enforce RSA Ch. 5-B and RSA Ch. 421-B. The Bureau of Securities Regulation ("BSR") commenced this proceeding by filing a Staff Petition on September 2, 2011. It subsequently filed an Amended Petition on February 17, 2012. Counts I and II allege violations of RSA Ch. 5-B, Counts III, IV, and V allege violations of RSA Ch. 421-B, and Count VI alleges civil conspiracy.

Because these counts fail to state a claim against Respondent Maura Carroll, they should be dismissed as to her. Counts I and II should be dismissed for several reasons. First, since the Amended Petition does not allege any violations of RSA Ch. 5-B by Ms. Carroll individually, it should be dismissed as to her. Second, even if the Amended Petition did contain such allegations, RSA Ch. 5-B regulates risk pools, not individual employees of the pools, and does not make employees personally liable for violations of its provisions. Third, because the BSR was not given authority to enforce the statute until June 14, 2010, it is barred from remedying or enforcing alleged violations that took place before this time. Fourth, since the statute imposes only general standards on risk pools, Ms. Carroll had no notice that any of the alleged actions were violations of the statute. This lack of notice renders any liability for past actions inappropriate. Finally, the BSR's attempt to promulgate detailed, industry-wide rules under RSA Ch. 5-B though an enforcement proceeding and then to enforce those rules retrospectively violates the New Hampshire Administrative Procedure Act and Separation of Powers Clause.

Counts III, IV, and V also fail to state a claim and should be dismissed. All three rely on the faulty premise that membership interests in, and contracts with, the Local Government Center's risk management pools are "investment contracts" within the meaning of RSA 421-B:2, XX(a). That position flatly contradicts decades of United States Supreme Court precedent, and fundamentally misconstrues the purpose of the risk pool membership contracts and the nature of the Local Government Center. The Bureau's unprecedented interpretation of the term "investment contract" goes against firmly established legislative and regulatory policy, including its own. This reversal of their longstanding position legally prevents the Bureau from pursuing its claims against Ms. Carroll. That, coupled with numerous pleading deficiencies, compels dismissal of Counts III, IV, and V.

Finally, for the reasons stated in *Respondent John Andrews' Motion to Dismiss Count VI of the Amended Petition*, Count VI should be dismissed. In addition, Count VI fails to allege facts sufficient to state a claim against Ms. Carroll.

STANDARD OF REVIEW

When a defendant brings a "motion to dismiss for failure to state a claim upon which relief may be granted," the tribunal "assume[s] the truth of the facts alleged in the plaintiff's pleadings and construe[s] all reasonable inferences in the light most favorable to him." *Buckingham v. R.J. Reynolds Tobacco Co.*, 142 N.H. 822, 825 (1998). The tribunal must assess "whether the plaintiff's allegations are reasonably susceptible of a construction that would permit recovery." *Hobin v. Coldwell Banker*, 144 N.H. 626, 628 (2000) (internal citation omitted). "If the facts pled do not constitute a basis for legal relief," the motion to dismiss should be granted. *See Buckingham*, 142 N.H. at 825.

ARGUMENT

I. The BSR Has Not Stated a Claim that Ms. Carroll Violated RSA Ch. 5-B, and Counts I and II Must Therefore Be Dismissed.

A. The Amended Petition Does Not Specifically Allege Any Violations of RSA Ch. 5-B By Ms. Carroll, and Should Therefore Be Dismissed.

Counts I and II of the Amended Petition allege that LGC violated RSA Ch. 5-B in two principal ways: by maintaining an "improper corporate structure" that did not include separate boards for each 5-B pool (Count I), and by improperly retaining and failing to return member surplus (Count II). There are no allegations that Ms. Carroll herself violated RSA Ch. 5-B. Indeed, the factual allegations in support of these claims reference Ms. Carroll only twice, in the context of her allegedly giving suggestions or recommendations to the Board of Directors in her role as Executive Director. Neither mention of Ms. Carroll contains an allegation that she violated RSA Ch. 5-B. Where a count "does not indicate the theory of which the plaintiff [is] proceeding, it [is] properly dismissed." *Proctor v. Bank of New Hampshire, N.A.*, 123 N.H. 395, 400 (1983).

In the first mention of Ms. Carroll (aside from identifying her), the Amended Petition alleges that she "suggest[ed]" and "recommended" to the LGC Board that it characterize alleged past transfers from HealthTrust LLC to the Workers' Comp Trust as a "loan." *See* Am. Pet. ¶ 34 & n.1. The Amended Petition does not, however, allege that the Board's decision to make such a characterization was itself a violation of Ch. 5-B, let alone that Ms. Carroll's recommendation or suggestion would constitute a violation of the statute. Indeed, viewing the Petition in the light most favorable to the BSR, this factual allegation is offered in support of the BSR's allegation that the earlier creation of a holding company—an act that predated Ms. Carroll's tenure and in which Ms. Carroll is not alleged to have been involved—served to facilitate intra-company transfers. As noted in the Amended Petition, the corporate restructuring occurred in June 2003 at a time when Ms. Carroll was not the Executive Director. *Id.* ¶¶ 13, 75. Accordingly, this first mention of Ms. Carroll cannot be construed as an allegation that she violated RSA Ch. 5-B, as she had no authority to take any actions that would constitute a substantive violation of the statute, and the Amended Petition fails to specifically allege that her conduct did constitute a violation.

The second mention of Ms. Carroll is an allegation that LGC Board members relied upon her "direction," along with that of "Mr. Andrews," "legal counsel, and professional consultants when deciding how to manage Member funds held in the 5-B Pools," instead of "observing their duty to recuse themselves from interested transactions." Am. Pet. ¶ 84. This allegation merely provides that Ms. Carroll, presumably as Executive Director, advised the Board on the exercise of its duties. The Amended Petition does not allege that Ms. Carroll's alleged advice to the Board, which the Board had discretion to accept or reject, itself constituted a violation of Ch. 5-B. In the context of the Amended Petition, this factual allegation again appears in support of the BSR's contention that the BSR's corporate structure violated RSA Ch. 5-B. The Amended Petition does not allege that any specific advice provided by Ms. Carroll was a violation of Ch. 5-B and in the absence of any specific pleading cannot be construed to state a substantive violation of the chapter.

Counts I and II of the Amended Petition are therefore not "reasonably susceptible of a construction" that Ms. Carroll herself violated Ch. 5-B, whether by giving recommendations to the Board or otherwise. Given the lack of allegations against Ms. Carroll in Counts I and II, the Hearing Officer should dismiss those counts as to her.

B. RSA Ch. 5-B Does Not Provide For Personal Liability.

Even if the Amended Petition could be construed to allege that Ms. Carroll violated RSA Ch. 5-B, it must be dismissed for failure to state a claim, since RSA Ch. 5-B does not impose liability on individuals. RSA Ch. 5-B authorizes, affirms, and imposes obligations on "pooled risk management program[s]" created to facilitate the provision of coverage to municipalities. *See generally* RSA Ch. 5-B. It does not regulate the behavior of individual employees of the risk pools or make employees liable for actions taken by the risk pools themselves. Accordingly, individual respondents such as Ms. Carroll may not be held liable under RSA Ch. 5-B, and Counts I and II must be dismissed.

RSA Ch. 5-B contains several provisions authorizing risk pools and setting forth standards for them. The purpose of the chapter "is to provide for the establishment of pooled risk management programs and to affirm the status of such programs established for the benefit of political subdivisions of the state." RSA 5-B:1. It authorizes political subdivisions to establish and enter into agreements for insurance, to form associations or affirm existing associations to develop and administer risk management programs, and to provide certain coverages. RSA 5-B:3. It requires risk pools to make an annual informational filing with the Secretary of State. RSA 5-B:4. It sets forth "standards of organization and operation" for each "pooled risk management program." RSA 5-B:5. Lastly, it authorizes the Secretary of State to bring administrative actions to enforce the chapter or to investigate and impose penalties for violation of the chapter. RSA 5-B:4-a.

Because RSA Ch. 5-B imposes obligations only on risk pools, and not individual employees of the pools, it is only the risk pools themselves that can violate RSA Ch. 5-B. It would be illogical and incoherent to read the statute as imposing obligations on individual employees. For example, RSA 5-B:5, I requires, *inter alia*, that "[e]ach program shall:"

- "Be governed by a board the majority of which is composed of elected or appointed public officials, officers, or employees."
- "Return all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions."
- "Be governed by written bylaws which shall detail the terms of eligibility for participation by political subdivisions, the governance of the program and other matters necessary to the program's operation."

RSA 5-B:5, I(b), (c), (e). An individual person is not a "program," and unlike an entity, cannot be "governed" by a "board" or by "written bylaws." Similarly, only a risk pool itself can have earnings and surplus to return. An individual employee does not have earnings and surplus within the meaning of the statute, and therefore cannot return any, except, of course, as a ministerial act on behalf of the entity itself.

In other situations where the New Hampshire General Court has sought to impose individual liability on officers or agents for the failure to fulfill a corporate obligation, it has done so explicitly. The lack of a similar provision here makes individual liability unwarranted. For example, RSA Ch. 275:42-55, regulating the payment of wages, imposes certain obligations on employers. In defining employers, the statute provides that "[f]or the purposes of this subdivision the officers of a corporation and any agents having the management of such corporation who knowingly permit the corporation to violate the provisions of RSA 275:43, 44 shall be deemed to be the employers of the employees of the corporation." RSA 275:42, V. Accordingly, when a plaintiff seeks to hold individual officers liable under RSA 273:43 or 44, the courts have interpreted the statute to require a claim against the individual and a showing that the individual "knowingly permit[ted]" the violation at issue for individual liability to attach. *See, e.g.*, *Rosenzweig v. Morton*, 144 N.H. 9, 11-12 (1999). By contrast, Ch. 5-B contains no analogous provision imposing individual liability, and does not define individual officers or agents as risk pools for purposes of imposing obligations or liability on them. Under the statutory scheme in Chapter 5-B, obligations, and therefore the risk of liability, run only to the risk pools themselves. *See* RSA 5-B:5. In the absence of an explicit provision analogous to that found in RSA 275:42, V, there is no liability for individual employees here.

Finally, no New Hampshire court has ever imposed personal liability for a Ch. 5-B violation in the twenty-five years that the statute has been in effect. The lack of imposition of liability over an extended period of time strongly supports Ms. Carroll's reading that RSA Ch. 5-B does not impose personal liability. Moreover, even if the statutory text did permit individual enforcement, the lack of enforcement over an extended period of time would support the conclusion that enforcement is not warranted here. *Cf. Poe v. Ullman*, 367 U.S. 497, 501-02 (1961) ("Deeply embedded traditional ways of carrying out state policy—or not carrying it out—are often tougher and truer law than the dead words of the written text." (internal citation omitted)).

Accordingly, personal liability for violations of RSA Ch. 5-B may not be imposed against Ms. Carroll.

C. The BSR May Not Enforce the Statute as to Alleged Violations Arising Prior to the Grant of Enforcement Authority to the BSR in 2010.

Since the BSR had no authority to enforce the statute prior to June 14, 2010, and the statutory provision governing monetary remedies for violations was not in effect, the BSR may not enforce violations that took place prior to June 14, 2010.

On June 14, 2010, the New Hampshire General Court amended RSA Ch. 5-B to give the Secretary of State authority to bring administrative actions to enforce, investigate, and impose penalties for violations of the chapter. *See* 2010 N.H. Laws 149:3; RSA 5-B:4-a. In response to violations, the amendment newly permitted the imposition of administrative fines and orders of rescission, restitution, or disgorgement. *Id.*

These provisions did not exist prior to June 14, 2010, so they cannot be applied to conduct that occurred prior to that date. The New Hampshire Constitution contains a broad prohibition on retroactive application of civil and criminal laws, providing that "[r]etrospective laws are highly injurious, oppressive, and unjust. No such laws, therefore, should be made, either for the decision of civil causes, or the punishment of offenses." N.H. Const. Pt. I, Art. 23. As Justice Story long ago elaborated, application of the retroactivity provision of the state constitution is not confined merely to statutes that are "enacted to take effect from a time anterior to their passage." *Society for the Propagation of the Gospel v. Wheeler*, 22 F. Cas. 756, 767 (C.C.D.N.H. 1814). Instead, "every statute, which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past, must be deemed retrospective." *Id.*; *see In re Goldman*, 151 N.H. 770, 772 (2005) (noting that New Hampshire adopted this interpretation in 1826). The New Hampshire Supreme Court has held that laws that "solely affect procedures or remedies" to enforce pre-existing rights are not subject to the prohibitions of the clause, but has cautioned against mechanical or formulaic application of that principle, and has held that "[i]f application of a new law would adversely affect an individual's substantive rights, it may not be applied retroactively." *Id.* at 772-73.

The 2010 amendments to RSA 5-B, and in particular the addition of RSA 5-B:4-a, go far beyond affecting solely "procedures or remedies." The amendment newly gave the Secretary of State exclusive authority and jurisdiction to bring administrative actions, to investigate, and to impose penalties, including fines, rescission, restitution, and disgorgement, where no such authority or potential of penalties existed before. *See* RSA 5-B:4-a. As discussed *supra*, it is Ms. Carroll's position that RSA 5-B imposes no obligations on employees of risk pools in their individual capacity. But if the Hearing Officer disagrees and holds that RSA 5-B:4-a provides the Secretary of State with the power to enforce Chapter 5-B against individual employees, any attempt to enforce the law for actions taking place prior to June 14, 2010 would run afoul of Article 23. Clearly, there was no contemplation of individual liability for violations of Chapter 5-B prior to June 14, 2010. As this action itself demonstrates, retroactive application of this law would adversely affect the substantive rights of Ms. Carroll by imposing liability for acts that preceded the enactment of the law. Therefore, permitting the BSR to proceed on Counts I and II against Ms. Carroll would violate Article 23.

Finally, even if the new authorities provided to the BSR by Ch. 5-B:4-a are held to be mere "procedures or remedies" outside the scope of Article 23's prohibition on retroactivity, there is a presumption that newly-enacted regulatory or remedial provisions do not apply to conduct that took place before the enactment of the provision in the absence of a specific direction to the contrary by the legislature. As the Supreme Court has explained:

> [T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know

> what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted. For that reason, the "principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal." In a free, dynamic society, creativity in both commercial and artistic endeavors is fostered by a rule of law that gives people confidence about the legal consequences of their actions.

Landgraf v. USI Film Products, 511 U.S. 244, 265-66 (1994) (internal citations omitted). For similar reasons, enforcing such legislation retroactively would also run afoul of the Due Process Clause's protection of "interests in fair notice and repose," since "a justification sufficient to validate a statute's prospective application under the Clause 'may not suffice' to warrant its retroactive application." *Id.* at 266.

Accordingly, under the anti-retroactivity provisions of the state and federal constitutions and because of the presumption against retroactivity in the absence of a clear statement by the legislature has not been rebutted, RSA Ch. 5-B may not be enforced as to conduct occurring prior to June 14, 2010.

D. Since The Statute Imposes Only General Standards, Ms. Carroll Had No Notice That Any of the Alleged Actions Were Violations of the Statute.

RSA Chapter 5-B imposes only general standards on risk pools, rather than more specific obligations. The existence only of these general standards provided Ms. Carroll with no notice that any of the alleged actions were violations of the statute. Assessing liability against Ms. Carroll for failure to adhere to these undefined standards would violate the Due Process Clauses of the New Hampshire and federal Constitutions. *See* N.H. Const. Pt. I, Art. 15; U.S. Const. Am. XIV.

The Due Process Clause protects "interests in fair notice and repose." *Landgraf*, 511 U.S. at 266. The imposition of liability in the absence of defined standards violates the principle "that no person should be held . . . responsible for conduct which he or she could not reasonably understand to be proscribed." *State v. Lamarche*, 157 N.H. 337, 340-41 (2008) (criminal law) (quoting *Palmer v. City of Euclid*, 402 U.S. 544, 546 (1971)).

Where a statute "fails to provide people of ordinary intelligence a reasonable opportunity to understand what conduct it prohibits," enforcing that statute would violate the constitutional right to due process. *N.H. Dep't of Envtl. Servs. v. Marino*, 155 N.H. 709, 716 (2007) (internal quotation marks omitted). Where the claim is that a particular application of the statute would run afoul of the Due Process Clause, known as an "as-applied" challenge, the tribunal must "examine whether the statute provided the respondents with a reasonable opportunity to know that their particular conduct was prohibited." *Id.*

RSA 5-B:5 provided Ms. Carroll with no opportunity to know that the particular conduct that the BSR has charged as a violation of the statute was prohibited. As discussed in greater detail in other filings, Chapter 5-B does not, by its terms, prohibit a parent-subsidiary structure for risk pools such as that maintained by LGC since 2003. It does not require a particular level of surplus. Nor does it require return of surplus funds by a particular manner or prohibit the rate stabilization method through which LGC has returned surplus in the past.

Therefore, Ms. Carroll had no reasonable opportunity to know that any act in which she engaged was a violation of RSA Chapter 5-B. As with all efforts to impose civil liability, the Due Process Clause requires that a finding of liability in an administrative adjudication be grounded in the violation of a known duty of which one has prior notice. *See Ford Motor v. FTC*, 673 F.2d 1008, 1010 (9th Cir. 1981) (overturning administrative adjudication order that announced new interpretation of law and then found that defendant was in violation of it, since "[o]ne of the basic characteristics of law is that potential violators have, or can obtain, notice of it”). Imposing liability on Ms. Carroll for violating RSA Chapter 5-B would therefore violate the Due Process Clauses of the state and federal constitutions. Counts I and II must be dismissed.

E. The BSR’s Attempt to Use an Enforcement Proceeding to Promulgate Industry-Wide Rules of General Application and To Enforce Those Rules Retrospectively Violates the New Hampshire Administrative Procedures Act and Separation of Powers Clause

The BSR’s attempt to promulgate industry-wide rules of general application under RSA Ch. 5-B through an enforcement proceeding, and to enforce those rules retrospectively, violates the New Hampshire Administrative Procedure Act and separation of powers. In this proceeding, the BSR has simultaneously asked the Administrative Hearing Officer to impose detailed, prospective rules and to enforce those rules retrospectively, all without providing notice and the opportunity of the public and the regulated entities to comment on the proposed rules. This practice is not permissible.

A fundamental value in our constitutional system of government is the separation of powers, the concept that liberty is preserved only through the placement of the legislative, executive, and judicial functions in distinct branches of government. Baron De Montesquieu wrote eloquently of the reasons for such separation some two and a half centuries ago:

> When the legislative and executive powers are united in the same person, or in the same body of magistracy, there can be then no liberty . . . . Again, there is no liberty, if the power of judging be not separated from the legislative and executive powers. Were it joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control; for the judge would be then the legislator. Were it joined to the executive power, the judge might behave with all the violence of an oppressor. There would be an end to everything, were the same man, or the same body, whether of the nobles or of the people, to exercise those three powers, that of enacting laws, that of executing the public resolutions, and of trying the causes of individuals.

Baron De Montesquieu, *The Spirit of the Laws* n. 39. In New Hampshire, Montesquieu's conception has found expression in the state constitution's separation of powers article, which provides that:

> In the government of this state, the three essential powers thereof, to wit, the legislative, executive, and judicial, ought to be kept as separate from, and independent of, each other, as the nature of a free government will admit, or as is consistent with that chain of connection that binds the whole fabric of the constitution in one indissoluble bond of union and amity.

N.H. Const. Pt. I, Art. 37.

In modern times, as a result of the needs of modern government and expedience, our system has evolved to permit a partial delegation of powers of the legislative and judicial branches to administrative agencies in the executive branch, and administrative agencies are thereby afforded limited discretion to engage in a quasi-legislative process—rulemaking—and a quasi-judicial process—administrative adjudication. *See McKay v. N.H. Compensation Appeals Bd.*, 143 N.H. 722, 726-27 (1999) (noting that separation of powers article "contemplates some overlapping and duality in the division as a matter of practical and essential expediency," and that the legislature may "empower[] an administrative body to resolve factual issues underlying a purely statutory right" (internal quotation marks omitted)). But in order to preserve the separation of powers and the animating principles behind it, rulemaking and adjudication are subject to essential—and distinct—limitations and safeguards.

An agency may engage in rulemaking only to the extent the General Court delegates it authority to do so, and rules may not "add to, detract from, or in any way modify statutory law." *See Kimball v. N.H. Bd. Of Accountancy*, 118 N.H. 567, 568-69 (1978). The General Court's authority to delegate rulemaking power to agencies is itself limited by the constitutional requirement that the discretion of the agency be constrained:

> Upon the separation of powers article of the New Hampshire Constitution, the General Court may not create and delegate duties to an administrative agency if its commands are in such broad terms as to leave the agency with unguided and unrestricted discretion in the assigned fields of its activity.

N.H. Dep't of Envtl. Servs. v. Marino, 155 N.H. 709, 715 (2007) (internal quotation marks omitted). Only under this double set of constraints is rulemaking permissible.

Exactly what the separation of powers article is intended to avoid would transpire in this case if the BSR is permitted to hold LGC and individual respondents liable. Relying upon a statute that contains standards phrased in general language, *see* RSA 5-B:5, and that affords the BSR general investigatory and enforcement authority, *see* RSA 5-B:4-a, the BSR has sought to use an administrative adjudication to reshape LGC according to a precise set of rules that has never found expression in the statute or regulations.

When an agency engages in rulemaking, it is engaging in the quasi-legislative process of establishing *future* rights and liabilities for regulated entities. Agencies are given the limited discretion to make rules consistent with the legislative will so that the legislature can take advantage of the agency's closer access to expertise and to the regulated entities. *See, e.g.*, *United States v. Johnson*, 632 F.3d 912, 932 (5th Cir. 2011) ("[T]he vast majority of agency rulemaking . . . produces nuanced and detailed regulations that greatly benefit from expert and regulated entity participation."). As *Marino* makes clear, with this authority comes limits. In addition to the requirements that the agency not alter a statute or have unguided and unrestricted discretion, under the New Hampshire Administrative Procedure Act ("APA"), RSA Ch. 541-A, agencies must follow specific procedures when enacting rules. These requirements include filing a notice of the proposed rule, filing the text of the proposed rule, and holding a public hearing and receiving comments. *See* RSA 541-A:3.

These procedures serve an essential purpose of giving the public the ability to participate in the rulemaking process. Under the process required by RSA 541-A, the public, particularly those expected to be affected by the rule, has the right to offer its views and information to the agency. Those views and information, together with studies, cost-benefit analyses, and other research conducted within and outside of the agency, inform and shape the final rules that result. When these strict procedures are followed, they result in prospective rules that are procedurally fair and that put all on notice of their standards and requirements.

It is only because of these strict safeguards that our constitutional order tolerates the deviation from the strict separation of powers that administrative rulemaking permits. It allows the deviation to go no further. In order to preserve the separation of powers, the law provides a harsh result when the strict rulemaking procedures have not been followed: the resulting rules are entirely invalid. As the New Hampshire Supreme Court has explained:

> [A]n agency may not undertake *ad hoc* rule-making: An unwritten, verbally promulgated regulation that was put into effect at some unknown time is without effect because there was no indication that the unwritten regulation on which the agency relies met any of the basic requirements of our Administrative Procedures Act. We stress that State agencies must comply with the Administrative Procedures Act if their 'rules' are to have effect.

Appeal of Nolan, 134 N.H. 723, 728 (1991) (quoting *Appeal of John Denman*, 120 N.H. 568, 573 (1980) (internal alterations and quotation marks omitted)).

It is undisputed that the BSR has not complied with RSA 541-A's rulemaking procedures here. Instead, it has sought to use adjudication against LGC to develop rules of general, industry-wide application regarding corporate structure of risk pools, appropriate levels of reserves, and the means of returning surplus. This practice is not permissible.

Administrative adjudication is procedurally and substantively quite different than rulemaking. *See, e.g.*, *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 221 (1988) (Scalia, J., concurring) ("Adjudication *deals* with what the law was; rulemaking deals with what the law will be."). When an agency engages in adjudication to enforce and impose penalties for violations of a statute, it is determining the rights and liabilities of a particular individual or entity based upon *past or present* facts, which must be measured against what the law was and is at the time of those acts to determine if a violation has occurred. *See, e.g.*, *San Juan Cable LLC v. Puerto Rico Tel. Co., Inc.*, 612 F.3d 25, 33 n.3 (1st Cir. 2010) ("Adjudication is party-specific and 'is concerned with the determination of past and present rights and liabilities.'" (quoting *Bowen*, 488 U.S. at 219). Because adjudications involve quasi-judicial determinations, due process requires a high measure of fairness, accountability, and procedures akin to the safeguards afforded a defendant in a court proceeding.

Just as a court may announce a new rule of law in a judicial decision, an agency may, in certain circumstances, announce new principles of law in an administrative adjudication. *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 290-95 (1974). But "agencies may not use adjudication to circumvent the Administrative Procedure Act's rulemaking procedures." *Cities v. FERC*, 723 F.2d 656, 659 (9th Cir. 1984) (interpreting federal law). Nor may they "impose undue hardship by suddenly changing direction, to the detriment of those who have relied on past policy." *Id.*

Where an agency seeks to impose new standards that apply to a widespread practice by regulated entities, as opposed to adjudicating the lawfulness of the unique or specialized behavior of an individual regulated entity, rulemaking is highly preferred, if not required. *See, e.g.*, *SEC v. Chenery Corp.*, 332 U.S. 194, 202 (1947) ("Since the Commission, unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon ad hoc adjudication to formulate new standards of conduct . . . . The function of filling in the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future."); *see also NLRB v. Wyman-Gordon Co.*, 394 U.S. 759, 764-65 (1969) (plurality opn.) (criticizing NLRB for using adjudication to promulgate new rules in the absence of rulemaking, since doing so fails to comply with the substance of the APA by not giving "interested parties" notice and the "opportunity to participate in the rule making"); *Ford Motor v. FTC*, 673 F.2d 1008, 1010 (9th Cir. 1981) (setting aside administrative order against a car dealer that addressed credit practice that was "widespread" in car dealership industry, on grounds that agency should have proceeded by rulemaking and not adjudication, because rather than remedying a discrete violation of a singular law, the adjudication "create[d] a national interpretation" of the relevant statute and "in effect enact[ed] the precise rule the F.T.C. has proposed, but not yet promulgated").

Given this preference for rulemaking as a means of fleshing out broad statutory mandates, when an agency seeks to adjudicate liability in the absence of rules, it is necessary for the tribunal to examine "whether the statute is 'sufficiently detailed to effectuate its purpose' without agency regulations. If the statute lacks sufficient detail on its face, then an agency *must adopt rules* supplying the necessary detail." *Appeal of Blizzard*, No. 2011-187 (N.H. Mar. 9, 2012), slip op. at 3 (internal citations and quotation marks omitted) (emphasis added). "Next, [the tribunal] determine[s] whether the result was unfair by examining whether the complaining party suffered harm as a result of the lack of required rules." *Id.* (internal citation, alteration, and quotation marks omitted).

These requirements cannot be satisfied in this case, and the BSR's effort to proceed by adjudication rather than rulemaking therefore violates the Administrative Procedure Act and separation of powers article. The BSR seeks to impose concrete, specific rules that would apply to risk pools across the industry, including the obligation that each risk pool have a separate and distinct board, that a specific level of surplus be set, and that a specific means of return of surplus be utilized. It simultaneously seeks to impose liability for past acts in violation of these not-yet-promulgated rules. The general standards provided in RSA Chapter 5-B that are at issue—that the risk pools be governed by a board "the majority of which is composed of elected or appointed public officials, officers, or employees," and that excess earnings and surplus be returned to "participating political subdivisions"—are not sufficiently detailed to trigger a finding of liability here. *See Appeal of Blizzard*, slip. op. at 3. Only through rulemaking could such detail be supplied. *See id.* Rulemaking has not, however, taken place.

Because the BSR seeks to use this adjudication to impose concrete, specific rules of general application that will govern the entire industry, relying on adjudication rather than rulemaking is an abuse of discretion. *See id.*; *see also Ford Motor*, 673 F.2d at 1010. In particular, permitting the BSR to impose liability in this action, in spite of the lack of rules, would cause LGC and the individual respondents "harm as a result of the lack of required rules." *Appeal of Blizzard*, slip. op. at 3. The historical and continuing lack of rules has denied LGC and individual respondents notice that its practices were or are in violation of the statute. *See Appeal of Blizzard*, slip. op. at 3; *see also id.* at 7 ("[Where] a party argues that a[n administrative action] was unjust or unreasonable, or contends that the absence of rules caused harm or prejudice, the lack of rules might prove dispositive. Adoption of rules could eliminate this risk."). Under *Blizzard*, this practice would violate the Administrative Procedures Act.

Furthermore, regardless of the means by which it proceeds, the BSR has no power—through either adjudication or rulemaking—to impose substantive requirements beyond those required by the text of RSA 5-B:5. *Kimball*, 118 N.H. at 568. The BSR's authority to conduct investigations into possible violations of RSA Chapter 5-B simply does not give it the authority to determine what constitutes a violation beyond the requirements stated in RSA 5-B:5. The legislature has not forbidden the practice of having a single board govern multiple risk pools. *See* RSA 5-B:5, I. The legislature has not legislated regarding the appropriate and proper amount of reserves, administrative costs, or costs to pay claims, let alone restricted such amounts in any way. *See id.* Nor has the legislature directed the manner in which any surplus arising after set-asides for these costs should be returned to the participating municipalities. *See id.* The BSR's attempt, through this proceeding, to set industry-wide standards for board structure, the proper amount of reserves and administrative costs, and the system for returning surplus, goes beyond the statutory and constitutional limitations on its power. Counts I and II should therefore be dismissed. *See Kimball*, 118 N.H. at 568 ("Rules adopted by State boards and agencies may not add to, detract from, or in any way modify statutory law. . . . If a board, in making a rule, acts beyond the limited discretion granted by a valid enactment, the rule is invalid." (internal citations omitted)).

II. The BSR Has Not Stated a Claim that Ms. Carroll Violated RSA Ch. 421-B, and Counts III, IV, and V Must Therefore Be Dismissed.

A. Participation Agreements in the 5-B Risk Pools Are Not Investment Contracts.

Agreements to participate in 5-B risk pool management programs between the LGC, its subsidiaries, and members are not investment contracts within the meaning of RSA 421-B:2, XX(a).[1] Application of the four-part test established by the United States Supreme Court, which New Hampshire courts and the Bureau recognize as the authoritative standard for interpreting the term "investment contract" as defined in federal and New Hampshire securities statutes, demonstrates that such contracts fail at least three of the four required elements. See Amended

[1] The Bureau appears to refer to such agreements as "risk pool contracts." Amended Petition, ¶107.

Petition, ¶107 ("The United States Securities and Exchange Commission and the Bureau have adopted the 'Howey' test."); *Manchester Bank v. Connecticut Bank and Trust Co.*, 497 F.Supp. 1304, 1313 (D.N.H. 1980) (applying Howey test to define "security" as used in the Securities Exchange Act of 1934 and RSA 421:2).

The Supreme Court created its four-part test for the definition of an "investment contract" in *SEC v. Howey*, 328 U.S. 293 (1946). Under *Howey*, a contract, transaction, or scheme is an "investment contract" for purposes of the 1934 Securities Act if a person: 1) makes an investment; 2) in a common enterprise; 3) with the expectation of profits; 4) to be generated solely from the efforts of the promoter or a third party. *Howey*, 328 U.S. at 298-299. Failing a single part of the *Howey* test means that the instrument is not a security. *SEC v. Life Partners, Inc.*, 87 F.3d 536, 548 (D.C. Cir. 1996). The alleged securities at issue here fail at least three of the four prongs.

1. Member Contributions Are Not "Investments."

The Bureau's bare-bones allegation that "member contributions" to the 5-B risk pools satisfy *Howey*'s "investment" element fails as a matter of law. Amended Petition, ¶¶109, 111. *Howey* and its progeny require courts to look beyond the mere payment of funds – a feature common to nearly all commercial dealings - to the "entire transaction," including the motives of those alleged to be making the "investment." *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 559–561 (1979). If what appears to be an investment is not made for traditional investment motives, it is not an investment for purposes of the *Howey* test. *Id.* To satisfy *Howey*'s investment criterion, the purported investor must "give up a specific consideration in return for a separable financial interest with the characteristics of a security." *Id.* at 559. In *Daniels*, the plaintiff-employee argued that his labor constituted an "investment" entitling him to pension benefits. *Id.* His remuneration consisted of a paycheck and possible pension benefits, "a compensation package" the Supreme Court considered "substantially devoid of aspects resembling a security." *Id.* at 560. "Looking at the economic realities," the Court held, the plaintiff's "decision to accept and retain covered employment may have only an attenuated relationship, if any, to perceived investment possibilities of a future pension." *Id.*

LGC member contributions are no more an "investment" under *Howey* than the *Daniels* plaintiff's labor contributions. As in *Daniels*, the insurance and risk management services that members receive in exchange for their contributions lack any "of the characteristics of a security." *Daniels*, 439 U.S. at 559. As the statutory framework establishing 5-B risk pools makes clear, members do not contribute for investment purposes, but to secure insurance and related administrative services for their employees:

> A political subdivision, by resolution of its governing body, may establish and enter into agreements **for obtaining or implementing insurance** by self-insurance; **for obtaining insurance** from any insurer authorized to transact business in this state as an admitted or surplus lines carrier; or **for obtaining insurance** secured in accordance with any method provided by law; or **for obtaining insurance** by any combination of the provisions of this paragraph.
>
> …
>
> To accomplish the purposes of this chapter, 2 or more political subdivisions may form an association under the laws of this state or affirm an existing association so formed to develop and administer a risk management program having as its purposes reducing the risk of its members; safety engineering; distributing, sharing, and pooling risks; **acquiring insurance**, excess loss insurance, or reinsurance…

RSA 5-B:3, I (emphasis added).

A review of the alleged "securities" reinforces the rather obvious conclusion that members join the LGC's risk pools to acquire insurance, not to make "investments."[2] For

[2] As discussed more fully below, the Bureau does not identify any specific document alleged to be a "security," instead using the general and somewhat ambiguous terms "participation contracts" and "risk pool contracts."

example, The Preamble to the Belmont Agreement states that the LGC and its members created the pools "for the management and provision of health and similar welfare benefits to their Employees." Exhibit A at 1. The contract makes clear that applicants, on behalf of their employees, seek membership, or renewal, "for the provision of" any of the following four purposes: 1) "health and other benefits"; 2) "protection against its property and liability risks"; 3) "workers compensation"; and 4) "unemployment benefits." *Id.* at 2.

In light of the plain language of the statutes establishing 5-B pools, the content of the participation contracts, and a common sense view of the economic realities animating each, it becomes clear that the fundamental purpose of joining the risk pools is the provision of insurance and related services, not investment making. See *Daniels*, 439 U.S. at 560 ("Looking at the economic realities, it seems clear that an employee is selling his labor primarily to obtain a livelihood, not making an investment."). The 5-B participation contracts fail this prong of the *Howey* test, therefore they are not "investment contracts" within the meaning of RSA 421-B:2, XX(a).

2. <u>Members Do Not Join the 5-B Risk Pools With a Reasonable "Expectation of Profit."</u>

The participation contracts also fail the third element of the *Howey* test, as members do not join the risk pools with a realistic expectation of profit. The Bureau's conclusory allegation that dividends, rate stabilization, and offsets to future contributions evidence "an expectation of

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Amended Petition, ¶107. For purposes of this Motion, Respondent uses the January 2008 Application and Participation Agreement between the Town of Belmont, HealthTrust, and PLT (the "Belmont Agreement"), attached hereto as Exhibit A, as an example of what it believes the Bureau refers to as a "participation contract." See *Venture Associates Corp. v. Zenith Data Systems Corp.*, 987 F.2d 429, 431 (7th Cir. 1993) (holding that "a defendant may introduce certain pertinent documents if the plaintiff failed to do so," especially when they are "central" to the parties' claims).

profit" reveals a fundamental misunderstanding of insurance and fails, as a matter of law, to satisfy the profit requirement as defined by *Howey* and dozens of subsequent cases. Amended Petition, ¶109.

The Bureau singles out Section of 8.2 of the LGC Bylaws, which grants directors authority "[t]o declare dividends for distribution to eligible members," and alleges, without a shred of evidence, that "LGC's predecessor entities touted the amount of dividends returned to members in marketing materials used to solicit continued participation in the 5-B Pools." Amended Petition, ¶60. As anyone with a rudimentary knowledge of insurance products knows, "[s]uch so-called dividends are, in reality, not dividends, but in a mutual insurance company are merely a return to policyholders of the unearned, that is, unused, portion of the premiums paid in." *Collins v. Baylor*, 302 F.Supp. 408, 411 (N.D. Ill. 1969). When read in the context of the entire participation contract, which includes the LGC Bylaws, i.e. the "economic realities" required by *Howey*, the potential for dividends does not transform the agreement from a contract for insurance and risk management into a profit-seeking venture. See *Waldo v. Central Indiana Lutheran Retirement Home*, No. IP 79-514-C, 1979 WL 1279, at *3 (S.D. Ind. Nov. 16, 1979) (applying Howey and refusing to draw "the entire transaction within the scope of the securities laws" because a single provision in a retirement home agreement granted members the option of receiving semi-annual interest payments).

The Bureau's misplaced emphasis of the term "dividend" contradicts *Howey*'s mandate to focus on the financial realities of a particular transaction, not the terms used. See *Tcherepnin v. Knight*, 389 U.S. 332, 336 ("in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality") (citing *Howey*). Potential dividend distribution does not materially impact the true and rather obvious reason why members join the LGC risk pools: to provide their employees with affordable insurance. See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849 ("Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto"). Like the stock certificates analyzed in *Forman*, the 5-B participation contracts "are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value." 421 U.S. at 851. In light of these limiting features, no member could have entered into these contracts with a reasonable expectation for profit. The only reason to join a 5-B risk pool is to obtain affordable insurance. See *Id.* ("In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit").

Like the dividends, the rate stabilization and contribution offsets that the Bureau claims constitute a "return of earnings" or "return on investment" are in reality returns of unused premiums, a common feature of insurance contracts. Amended Petition, ¶109. Similar to mutual insurance companies, the 5:B risk pools return excess premiums to members. These returns are hallmarks of both pooled risk management programs and mutual insurance companies, and can take the form of direct payments, limits on rate increases, or offsets to future contributions. Such financial benefits may make the 5:B risk pools more appealing, but they have no bearing on whether LGC membership agreements constitute "investment contracts." See *Forman*, 421 U.S. at 857 (the commercial facilities and the reduced rent their income may generate "[u]ndoubtedly…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 in *Howey*."). In the insurance context, courts consistently hold that a mutual insurance company's return of unused premiums does not satisfy *Howey*'s "expectation of profit" requirement.

In *Collins v. Baylor*, a federal district court applied *Howey*'s "economic reality" standard to hold that policies issued by mutual insurance companies "were not intended by Congress to be treated as securities under the Securities Exchange Act." 302 F.Supp. 408, 410 (N.D. Ill. 1969). The court rejected the plaintiff's argument that membership in the mutual insurance company constituted "an ownership interest, a share in the profits and losses, a security," holding that "so-called dividends are, in reality, not dividends, but in a mutual insurance company are merely a return to policyholders of the unearned, that is, unused portion of the premium paid in." *Id.* at 410-411. Declaring that there is nothing unique about mutual insurance policies that would render the insurance exemption of the 1933 Securities Act inapplicable, the *Collins* court went on to say that "[i]t is not the expectation of anyone buying these kinds of policies that they are going to be sharing the profits of a company." *Id.* at 411.

Twenty years later, in *Dryden v. Sun Life Assurance Company of Canada*, 737 F. Supp. 1058 (S.D. Ind. 1989), another federal district court rejected a similar argument by a policyholder claiming that his expectation in sharing in a mutual insurance company's profits rendered his policy a "security" subject to the federal securities laws. His expectation arose from a policy provision that entitled him to a pro-rata share of the premium surplus. *Id.* at 1063. The court disagreed, holding that the plaintiff "could not have reasonably expected to share in Sun Life's investment profits":

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

Id. at 1062-63 (internal citations and quotations omitted). The plaintiff, the court continued, "could not have expected to share in the profits generated by Sun Life's investment portfolio. All that he could have expected to receive was his pro rata share of the premium surplus." *Id.* at 1063.

The LGC's practice of returning excess premiums to members on a pro rata basis is the functional and legal equivalent to a mutual insurance policy provision that provides for the pro rata return of excess premiums to policyholders. As in *Dryden* and *Collins*, this practice cannot lead to a reasonable expectation that members are entitled to a share of the LGC's investment profits, as the Bureau alleges. The return of unused or excess premiums, whether in the form of dividends, reduced coverage rates, or offsets to future contributions, does not satisfy *Howey*'s expectation of profit requirement.[3]

Members naturally derive financial benefit from risk pool participation, primarily in the form of below-market insurance prices and rate stabilization, but these economic incentives do not constitute "profit" as *Howey* and its progeny define the term. See *Tanuggi v. Grolier, Inc.*, 471 F.Supp. 1209, 1215 (S.D.N.Y. 1979) (holding that the appeal of a defined benefit retirement plan to its participants "is its insurance-like 'stability and security' and not the prospect of growth," therefore it did not constitute an investment contract). The mere receipt of economic benefits – the motivation for any commercial transaction – cannot, by itself, transform these agreements into "securities":

> There is no doubt that purchasers in this housing cooperative sought to obtain a decent home at an attractive price. But that type of economic interest characterizes every form of commercial dealing. What distinguishes a security

[3] See also *Forman*, 421 U.S. at 854, in which the Supreme Court clarified that rebates, in that case the result of profits generated by rents exceeding co-op expenses, are not "the kinds of profits traditionally associated with securities."

> transaction—and what is absent here—is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for **personal consumption or…for personal use**.

Forman, 421 U.S. at 858 (emphasis added). Much like the apartment purchasing plaintiffs in *Forman*, but in stark contrast to the *Howey* investors, who had "no desire to occupy the land or to develop it themselves," and were "attracted solely by the prospects of a return on their investment," 328 U.S. at 300, the LGC members participate in the risk pools "to use or consume the item purchased," not for potential investment returns. *Forman*, 421 U.S. at 853. The fact that members derive certain financial benefits does not alter the "economic realities" of the transaction, and under *Howey* and *Forman*, financial incentives like dividends and offsets cannot be considered "the kinds of profits traditionally associated with securities." *Forman*, 421 U.S. at 854. For this reason alone, the "risk pool contracts" fail the *Howey* test and are not, as a matter of law, "investment contracts" within the meaning of RSA-B:2, XX(a).

Finally, it is worth noting the irony of the Bureau's allegation that a political subdivision would join the LGC, a non-profit entity, with "an expectation of a profit." Amended Petition, ¶109. Never in its twenty-five year existence has the LGC earned or maintained a profit. The "profit" alleged by the Bureau is actually surplus, which RSA 5-B:5, I(c) requires the LGC to return to its members. This surplus does not legally belong to the LGC, but to its participating political subdivisions. The LGC does not, as the Bureau alleges. "keep[] all the money," Amended Petition, ¶63, but rather returns it to its Members as required. That the Bureau disagrees with how and in what form the return of surplus occurs does not transform it into "profit."

3. <u>Any "Profits" Realized From the 5:B Participation Contracts Do Not Arise Solely From the Efforts of Others</u>.

Even if the alleged financial inducements created a reasonable expectation of "profit," such earnings do not arise solely from the efforts of others, thus failing *Howey*'s final requirement. The Bureau claims that "LGC and its professional agents unilaterally manage the investment of the member funds to achieve a return on investment." Amended Petition, ¶109. As with the prior *Howey* elements, indeed the entire Amended Petition, the Bureau provides no support for its assertion, as if merely reciting the allegation makes it true. A deeper look at the facts and the law belies the Bureau's claims.

As the Bureau concedes, the LGC's financial resources, and by extension its ability to distribute dividends, stabilize rates, and offer contribution offsets, is largely determined by its ability "to cover unexpected claim fluctuations." Amended Petition, ¶50. Common sense dictates that as with any insurer or risk manager, the LGC's ability to earn a surplus is primarily a function of its members' claims submissions. The more claims it pays out, the less it has to distribute to its members. Section 2 of the PLT "Multi Year Rate Guarantee Program," incorporated as part of the Belmont Agreement, illustrates this:

> The Program is not a guarantee of a freeze or cap on the total amount of contributions to be made to PLT by an enrolling member. If the underwriting exposures of a member remain the same from one fiscal year to another covered by this Agreement, then the actual amount of contribution to PLT for protection will increase no greater than nine percent (9%)…If the underwriting exposures of a member are reduced or increased during any fiscal year covered by this Agreement, then the amount of contributions will be commensurately adjusted.

Exhibit A at 25. See also *Id.* at pages 27 and 28 (allowing for deviations from the annual rate increase guarantee for "underwriting exposures added by the member.").

When confronted with similar facts, the Court of Appeals for the D.C. Circuit held that because the "insurance contract from which one's profit depends entirely upon the mortality of the insured," the viatical settlements at issue failed *Howey*'s final prong and thus did not constitute securities. *SEC v. Life Partners, Inc.*, 87 F.3d 536, 548 (D.C. Cir. 1996). In a viatical settlement arrangement, a third-party investor or group of investors induces a terminally ill person to purchase a generous life insurance policy, which the investors fund through premium financing, then sell the policy on the secondary life insurance market (usually after the two-year contestability period) to hedge funds, who, if all goes according to plan, eventually collect the death benefit. *Life Partners*, 87 F.3d at 537. Profit – the difference between the death benefit and the cost of premiums and administrative expenses - is predominately determined by a single factor: how soon the insured dies. *Id.* Despite their sinister nature, the LGC risk pool agreements share some of the same attributes, at least for securities law purposes.[4] Under both arrangements the amount of "profit" - or in the LGC's case, surplus - generated depends on the health and well-being of the underlying insureds.

It was this "X" factor – entirely outside anyone's control - that led then Circuit Judge Ginsburg to conclude that despite their significant pre and post entrepreneurial efforts, and the undeniably investment oriented nature of the policies, the defendant promoters could not materially impact the enterprises' profits, therefore the viatical settlement interests were not securities. *Id.* at 545-548. The same can be said about the LGC. While it promotes health and wellness through a variety of programs and outreach, it cannot control who gets sick or injured, or which municipal buildings burn to the ground. It is factors like these, completely outside of LGC's control, that determine whether there will be any surplus to allocate. Just as "the only variable affecting profits"

[4] Indeed, one of the LGC's key missions, to promote health and wellness, could not be more diametrically opposed with the goals of a viatical settlement promoter, whose livelihood depends on the early demise of strangers.

in *Life Partners* was "the timing of the insured's death," 87 F.3d at 545, so too is the health and safety of the LGC's 75,000 insureds and countless covered properties that ultimately determines the organization's financial wellbeing.

Howey's final element is formidable: the efforts of others must be "undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476, 482 (9th Cir. 1973). Try as it might, but the LGC's efforts ultimately have little bearing on the surplus of the enterprise. The Bureau's conclusory allegation that the LGC's "unilateral" management of "the investment of the member funds" determines its "profits" fail as a matter of law and common sense. Amended Petition, ¶109. The participation contracts fail yet another *Howey* element, proving for a third time that they are not "investment contracts."[5]

4. Participation Contracts in the 5-B Pools Are Not Investment Contracts Under the Risk Capital Test.

After declaring *Howey* the definitive test in New Hampshire, Amended Petition, ¶107, the Bureau supplies an alternative, the seldom used and often criticized Risk Capital Test, to conclude that the 5:B participation agreements are "investment contracts."[6] Under the Risk Capital approach, "virtually every conceivable investment…would qualify as securities.

[5] The Bureau peppers its Amended Petition with a variety of unsupported claims that the LGC invests member contributions inappropriately, even "adventurously." Amended Petition, ¶71, 72, 98, 102, 127c, and 131. Setting aside the Bureau's somewhat contradictory claim that such investments resulted in "substantial investment income," even if true, these allegations are irrelevant to the Howey analysis. As the *Life Partners* court made clear, even theft of investor funds or complete abdication of any post-contractual services, both of which would affect investor "profits," "provides no basis upon which to distinguish securities from non-securities." 87 F.3d at 545.

[6] The Bureau's superfluous application of this alternative, wholly inapplicable methodology may be a result of its former interim Director, Joseph Long, who played a leading role in the early stages of the Bureau's investigation of LGC and is a longtime proponent of the Risk Capital approach. See Long, Joseph C., *An Attempt to Return 'Investment Contracts' to the Mainstream of Securities Regulation*, 24 Okla.L.Rev. 135 (1971).

However, no federal court has adopted the 'risk capital' test." *Hirsch v. duPont*, 396 F. Supp. 1214, 1222 (S.D.N.Y. 1975). The Bureau's second attempt to pin the "investment contract" label on the participation contracts, even under this far more expansive test, fails for the same reasons as the first.

The Risk Capital Test, despite its numerous variations, always requires that "the valuable benefit of some kind" must, Amended Petition, ¶110, just as in *Howey*, derive from the managerial efforts of others. See *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 477 n.7 (5th Cir. 1974) ("the element of managerial control is implicit in the risk capital test"); *United California Bank v. THC Financial Corp.*, 557 F.2d 1351, 1358 (9th Cir. 1977) ("The combination of 'economic realities' standard plus the [Supreme] Court's emphasis on an expectation of profits from the entrepreneurial efforts of others are encompassed in this circuit's 'risk capital' test."). For the same reasons that the participation contracts fail *Howey*'s third element, that profits arise predominately from the efforts of others, so too do they fail the Risk Capital Test's final, and essentially equivalent element. As discussed above, the LGC's work has a minimal impact on the surplus of the enterprise, whose financial condition predominately depends on its members' claims histories. Regardless of the Bureau's sudden infatuation with the Risk Capital Test, the result remains the same. Under *Howey* or Risk Capital, the 5:B participation agreements are not "investment contracts" within the meaning of RSA 421-B:2, XX(a), and Counts III, IV, and V must be dismissed.[7]

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[7] A review of the Bureau's Statements of Policy, No-Action Letters, Administrative Orders, and other official agency documents revealed nine instances since 1996 wherein the Bureau applied *Howey* in deciding whether a given instrument constituted a "security" within the meaning of RSA 421-B:2, XX(a). The most recent, its November 16, 2010 Statement of Policy: *When Are 'Notes' Securities Under the New Hampshire Uniform Securities Act*, contains the following *Howey* endorsements: "If further analysis is necessary, the Bureau will use the *Howey* test for investment contracts, which it believes is the proper definition for *all securities*" (emphasis in original); and "The Bureau believes that the *Howey* test for investment contracts identifies the true elements of a

B. 5-B Risk Pool Membership Agreements Are Contracts For Insurance.

Not only do the 5-B participation contracts fall outside the definition of "investment contract," New Hampshire statutes specifically exempt them from the definition of "security," because they are fundamentally contracts for insurance. RSA 421-B:2, XX(a) ("'Security' does not include any insurance or endowment policy or annuity contract under which an insurance company promises to pay money either in a lump sum or periodically for life or for some other specified period."). Even a cursory reading of the LGC participation agreements demonstrates that they are contracts for various forms of insurance, the purpose of which is the spreading of risk, not the expectation of profits.

Almost every paragraph of the Belmont Agreement relates in some way to the provision of insurance and related administrative services. For example, the application portion asks members or prospective members to select up to four different insurance policies for their employees: health, property and liability, workers compensation, and unemployment. Exhibit A at 2; see also *Id.* at 40 ("Certificate of Authorizing Resolution" wherein political subdivisions enroll, via governing board resolutions, in the various insurance trusts). Three pages later, applicants choose up to seven insurance-related administrative services, including those related to the Public Health Service Act ("COBRA"), retiree billing, and various rate guarantee programs designed to lower the cost of the four insurance products offered. *Id.* at 5-6. The subsequent addendums detail these services and obligations, ranging from delivery of COBRA notifications and associated information, the treatment of confidential patient health information, to bill collection. *Id.* at 8-18. The incorporated PLT and WCT "Multi Year Rate Guarantee

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security." See Nov. 16, 2010 Statement of Policy, pages 5 and 12, n.18, respectively. Prior to the LGC case, no official Bureau documents referenced the Risk Capital Test.

Program(s)" explain that the respective trusts operate "a pooled-risk" program for the management and provision of: "(a) protection against property and liability risks of its members…and (b) workers compensation and unemployment benefits to members' employees." *Id.* at 24, 29; see also *Id.* at 34 (same, with respect to the "Municipal Total Risk Management ('TRiM') Agreement."). Article II, Section 2.1 of the LGC Bylaws, incorporated into each participation agreement, reinforces that each contract is for the provision of insurance and insurance services:

> (a) The mission of the LGC is to provide programs and services…by being…a provider of benefits and risk-management services…;
> (b) The mission of HealthTrust is to provide health and other benefits to Participants for their employees and to facilitate joint cooperation of the Participants…relating to the provision of such health and other benefits;
> (c) The mission of PLT is to provide property-liability and workers' compensation coverage benefits to Participants for their employees and to facilitate joint cooperation of the Participants…relating to the provision of such benefits.

Id. at LGC-AH003280. Finally, Section 8 of the Bylaws empowers the Board and Executive Director to perform functions essential to the proper administration of an insurance program, including:

> 8.1(a): Create a reserve for the payment of benefits and claims;
> 8.1(b): Pay or provide for the payment on behalf of members to the insurer of all premiums as they become due on any policy of insurance;
> 8.4(b): Pay benefits and claims to or on behalf of members or Employees in accordance with the purpose of the Trusts;
> 8.4(d): To purchase contracts of insurance and to hold all insurance policies issued by Insurers and to deal with Insurers on behalf of the members;
> 8.4(e): To administer risk management pools, collect Contributions and pay authorized losses on behalf of members;
> 8.4(g): To provide risk management services including defense of and settlement of claims…;
> 8.4(h): To purchase reinsurance or excess insurance as necessary to protect the interests of the members and the Trusts.

Id. at LGC-AH003292-95. The substance of the Belmont Agreement makes clear that it is above all else a contract for insurance, not a security purchased with the expectation of profits.

The statutes that gave rise to the LGC risk pools further reinforce that members enter into 5:B participation agreements for the overriding purpose of securing insurance for their employees. RSA 5-B:1 explains that the legislature authorized the creation of pooled risk management programs to fill the void left by typical insurance companies, whose high rates jeopardized coverage for thousands of public employees: "…the resources of political subdivisions are presently burdened by the securing of insurance protection through standard carriers." RSA 5-B created a much needed insurance alternative:

> The purpose of this chapter is to provide for the establishment of pooled risk management programs and to affirm the status of such programs established for the benefit of political subdivisions of the state. The legislature finds and determines that insurance and risk management is essential to the proper functioning of political subdivisions; that risk management can be achieved through purchase of traditional insurance or by participation in pooled risk management programs established for the benefit of political subdivisions…

RSA 5-B:1.

The plain language of the participation agreements, the economic realities underlying their execution, and the statutes that gave rise to their creation confirm that the trusts' primary function is to pool and spread risk, the quintessential function of insurance. See *New Hampshire Motor Transport Association Employee Benefit Trust v. New Hampshire Insurance Guaranty Association*, 154 N.H. 618, 621 (2006), in which the New Hampshire Supreme Court defined the term "insurance" to mean "the action or process of insuring…against loss or damage by a contingent event (such as death, fire, accident, or sickness), and a device for the elimination or reduction of an economic risk common to all members of a large group and employing a system of equitable contributions out of which losses are paid."[8]

It is this universal, common sense recognition that the purpose of an insurance contract is the distribution of risk from the insured to the insurer, not the expectation of investment returns, which led Congress to specifically exempt insurance contracts from the definition of "security" in the federal securities laws. While the drafters rightfully assumed that no regulator would consider such agreements "securities," the legislative history of the 1933 Securities Act reveals that they explicitly excluded insurance contracts, *and related agreements*, from the definition of "security" so as to remove any doubt:

> Paragraph (8) makes clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the provisions of the act. The insurance policy ***and like contracts*** are not regarded in the commercial world as investment securities offered to the public for investment purposes. The entire tenor of the act would lead, even without this specific exemption, to the exclusion of insurance policies from the provisions of the act, but the specific exemption is included to make misinterpretation impossible.

H.R. Rep. No. 85, p.15, 73rd Congress, 1st Sess. 1933 (emphasis added).[9]

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[8] The United States Supreme Court provided a similar definition in *Group Life and Health Insurance Co. v. Royal Drug Co., Inc.*, 440 U.S. 205, 211 (1979) ("The primary elements of an insurance contract are the spreading and underwriting of a policyholder's risk. . . [i]t is characteristic of insurance that a number of risks are accepted, some of which involve losses, and that such losses are spread over all the risks so as to enable the insurer to accept each risk at a slight fraction of the possible liability upon it.").

[9] New Hampshire's statutory definition of "security" is nearly identical to those adopted in the federal securities laws. While the Bureau will likely argue that they are not obligated to follow federal law or policy, the state's securities statutes say otherwise. See RSA 421-B:32 ("This chapter shall be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation of this chapter with the related federal regulation."). The Bureau cites to this provision in its November 16, 2010 Statement of Policy to support the proposition that the interpretation and application of New Hampshire's Uniform Securities Act should be reconciled with other states that adopted the Uniform Act, but they omit the phrase "with the related federal regulation." See November 16, 2010 Statement of Policy at 9. See also *Manchester Mfg. Acquisitions, Inc. v. Sears, Roebuck & Co.*, 909 F.Supp. 47, 54 (D.N.H. 1995) ("The court further finds and rules that since 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") (citing RSA 421-B:32).

As shown above, it is clear that the alleged securities are akin to insurance contracts. That they are not technically agreements between insureds and insurance companies is a function of the economic realities – LGC member employees obtain insurance through their employers, who in turn contract with the LGC and its trusts. To hold that this structure renders the participation agreements something other than contracts for insurance is to place form over substance and ignore the economic realities, thereby disregarding the mandates of *Howey* and *Forman*. The lack of privity of contract between the insurer and the ultimate insured employee does not mean that the participation agreements do not "constitute the business of insurance." See *American Mutual Reinsurance Co., v. Calvert Fire Insurance Co.*, 367 N.E.2d 104, 109 (Ill. App. Ct. 1977) ("Although it has been held that a reinsurance contract between two insurance companies does not involve the policyholder in that he lacks privity of contract with the reinsurer and has no right of action against it…the ultimate purpose of the agreement is to provide reliable insurance to policyholders. Consequently, the agreement between Amreco and Calvert constitutes the 'business of insurance.'") (internal citations omitted).

The fact that members benefit financially from such arrangements, even in the form of dividends or rate reductions, does not transform them into "investment contracts." If anything, such benefits show that the LGC and its Trusts are satisfying the goals of RSA 5-B – providing efficient pooled risk management programs, "an essential governmental function." RSA 5-B:1. As for the specific benefits the Bureau alleges are evidence of "investment contracts," they are as common place to insurance contracts as names and addresses. Such benefits reinforce what the participation agreements clearly are: contracts for insurance. As such, New Hampshire's securities laws expressly exclude them from the statutory definition of "security," and Counts III, IV, and V must be dismissed.

C. The Bureau's Attempt to Treat Participation Contracts in the 5-B Risk Pools as Investment Contracts Contradicts Decades of Unanimous Regulatory History.

The Bureau's attempt to treat LGC participation agreements as "investment contracts" goes against at least 92 years of state and federal precedent. See *Howey*, 328 U.S. at 298 n.4 (citing state court decisions pre-dating the 1933 Securities Act concerning the meaning of "investment contract"). No other jurisdiction or regulatory agency has ever held or considered participation contracts in pooled risk management programs to be "investment contracts."[10] Of the approximately 480 intergovernmental risk and benefit pools operating in the United States, none have ever been considered "securities" by any court, legislature, or state or federal agency. HealthTrust and PLT are the only such pools regulated by a securities agency. In every other state the Insurance Commissioner, Risk Management Division, Audit Department, or their equivalents regulate such programs. This is hardly surprising in light of the insurance and risk management services such programs provide. With respect to securities agencies, however, regulatory inaction should not be mistaken for regulatory silence.

The SEC has never taken the position that participation agreements such as those at issue here constitute "investment contracts." In fact, it has expressly declined to do so on at least 50 occasions since 1972 alone.[11] For example, when applying *Howey* to mutual insurance

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[10] Respondents are aware of the pending federal, civil action, *Naylor v. Indiana State Teachers Association*, in which the Indiana Securities Commissioner asserts that certain "commingled long-term disability…and health arrangements with a promise of a return on funds" constitute "securities." Naylor Complaint, ¶1.a. While the Bureau will make much of this pending action, three observations regarding the *Naylor* matter are worth noting: 1) the actions of one other similarly misguided, overzealous state securities regulator are hardly determinative of this case, particularly in light of the prolonged, unanimous history of not regulating public risk pools as securities; 2) there are fundamental differences between the *Naylor* instruments and the LGC risk pool agreements; and 3) the Naylor case has yet to be decided. It remains true that a ruling in this case that the LGC participation agreements are "investment contracts" would be entirely unprecedented.

[11] See, e.g., *Global Van Lines, Inc.*, SEC No-Action Letter (October 2, 1979); *Medical Device Mutual Assurance and Reinsurance Co.*, SEC No-Action Letter (August 31, 1979); *Norcal Bowling Proprietors Mutual Insurance Co.*,

companies and their holding entities, the SEC has repeatedly held that membership interests therein failed the "investment" and "expectation of profit" elements, therefore they did not constitute "investment contracts" within the meaning of the federal securities laws. See Note 11. The SEC has repeatedly taken the position that funds advanced by members or policyholders were not investments made for the purpose of generating profit, but premiums paid with the intent of obtaining insurance coverage. *Id.* The agency has also unanimously and consistently concurred that members of mutual insurance companies or their holding companies fail *Howey*'s "profit" requirement, because members are motivated by a desire to purchase an insurance policy, and under *Forman* the attendant membership interest falls outside the 1933 Securities Act's definition of "security." *Id.*

Neither Congress nor any state legislature has taken a contrary view. In fact, the most recent version of New Hampshire proposed Senate Bill 212, scheduled to become law on July 1, amends RSA 5-B:5 to clarify that contributions "provided to a pooled risk management program established under this chapter by the state or member political subdivisions ***shall not be considered securities under RSA 421-B***" (emphasis added). As the Bureau itself proclaimed, "*Legislative* creation of *exclusions* from the statutory definition or *exemptions* from one or more parts of the regulatory scheme is a practical decision, based upon public policy and political

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SEC No-Action Letter (December 5, 1983); *Podiatric Assurance Co.*, SEC No-Action Letter (February 19, 1985); *Medmarc Insurance Company Risk Retention Group*, SEC No-Action Letter (October 2, 1987); *National Transport Assurance Alliance, Inc.*, SEC No-Action Letter (February 22, 1989); *Construction Trade Purchasing Group, Inc., and Construction Trades Insurance Company*, SEC No-Action Letter (October 1, 1993); *East Isle Reinsurance Ltd.*, SEC No-Action Letter (April 1, 2009); *American Re Corporation*, SEC No-Action Letter (May 15, 1998); *Construction Trades Purchasing Group, Inc.*, SEC No-Action Letter (October 1, 1993); *Martin R. Hochman and William M. Shelton*, SEC No-Action Letter (April 3, 1978); *The Woodmen Accident and Life Company*, SEC No-Action Letter (December 28, 1999); *National Travelers Life Company*, SEC No-Action Letter (December 29, 1999); *The Baltimore Life Insurance Company*, SEC No-Action Letter (December 11, 2000); *Milwaukee Mutual Insurance Company*, SEC No-Action Letter (January 30, 2003).

factors." November 16, 2010 Statement of Policy: *When Are "Notes" Securities Under the New Hampshire Uniform Securities Act*, at 12 (emphasis in original).

In the face of this overwhelming and contrary regulatory precedent and its own legislature, the Bureau, in lieu of satisfying its mandate to draft rules regarding risk pool management programs, attempts to reverse longstanding law and policy by investigation, subpoena, and now, administrative action. This regulatory overreaching is compounded by the fact that their nearly three-year investigation uncovered no evidence that the LGC, its subsidiaries, officers, and directors have done anything other than faithfully serve this state's town governments, school districts, and other municipalities, and by extension, tens of thousands of hardworking New Hampshire employees whose public service might not be possible without the affordable insurance the LGC provides.

D. The Bureau's Attempt to Treat Participation Contracts in the 5-B Risk Pools as Investment Contracts Contradicts Its Own Longstanding Policies.

The Bureau's pursuit of the LGC flies in the face of not just the official policy of the SEC and state securities regulators, Congress, and the New Hampshire Legislature, but even its own firmly rooted policies. A review of the agency's files, both online and onsite, reveal that since 1997 the Bureau, uniformly and exclusively applying the *Howey* test, has concluded on at least seven occasions that membership interests in various New Hampshire limited liability companies, corporations, and condominium associations did not constitute "securities":

- On November 29, 2001, the Bureau issued an Order concluding that membership interests in The South Beech Street Homeowners' Association, LLC were not securities within the meaning of the New Hampshire Uniform Securities Act (*In the Matter of: The South Beech Street Homeowners' Association, LLC*).

- On January 17, 2002, the Bureau issued an Order concluding that membership interests in the GRQ Investment Club, LLC were not securities within the meaning of the New

Hampshire Uniform Securities Act (*In the Matter of: GRQ Investment Club, LLC*). GRQ's Certificate of Formation, on which the Bureau relied in issuing its Order, explains that its primary business purpose is "[t]o invest the assets of the company in stocks, bonds and other securities for the education and benefit of the members."

- On February 20, 2002, the Bureau issued an Order concluding that membership interests in The Village at Noble Farm, LLC were not securities within the meaning of the New Hampshire Uniform Securities Act (*In the Matter of: The Village at Noble Farm, LLC*).

- On October 5, 2005, the Bureau issued an Order concluding that membership interests in the Colliston Yard Condominium Unit Owner's Association were not securities within the meaning of the New Hampshire Uniform Securities Act (*In the Matter of: Colliston Yard Condominium Unit Owner's Association*).[12]

Two of the Bureau's prior decisions merit further discussion. First, on October 28, 2002, in response to a request for a no-action letter by Associated Pharmacies, Inc. ("API") seeking a determination that "APA [sic] Certificates of membership and Participation" were not "securities," then Staff Attorney Jeffrey Spill wrote that the Bureau "will not recommend any enforcement action if API" continued to offer such certificates for sale. Spill premised his conclusion on several factors:

1) API members have "the right to receive a Patronage Dividend from API based upon the amount of purchases such member has made during the calendar year relative to the purchases made by all other members, and that profits are not paid on a pro rata basis, nor are they paid in proportion to the amount of money a member has invested in his Certificate;
2) the Certificates are non-negotiable and non-transferable…"
3) API members "do not have the right to pledge or hypothecate their respective Certificate;
4) each member is allowed only one Certificate, and each Certificate confers the right to one vote;
5) there is no potential for appreciation of the Certificates…"

[12] The only three occasions on which the Bureau concluded that certain instruments constituted "securities" occurred either immediately after it issued a Cease and Desist Order to the issuer of the same securities, see March 1996 letter to the Attorney General's Office concerning Flexible Mortgage Corporation, or in the viatical settlement context. See *In re Gary Arthur Gahan*, COMO5-028 (N.H. Cur. Sec. Reg., Dec. 30, 2008); *In re Viatical Investments, Status As Securities*, Into4-003 (N.H. Bur. Sec. Reg., Oct. 10, 2004). None of the three concerned membership interests.

While Staff Attorney Spill did not cite to *Howey* or any other decision, the factors he enumerated are nearly identical to the criteria applied by the *Forman* court to find that the "stock" issued to apartment purchasers in that case did not constitute securities. 421 U.S. at 851. In stark contrast to the LGC matter, however, Staff Attorney Spill appears to distinguish dividends from profits. Amended Petition, ¶109. In the LGC matter the two are linked, and more importantly, deemed critical to the Bureau's conclusion that LGC participation contracts are "securities." *Id.* Ten years ago, in the API matter, the Bureau considered dividends separate and apart from profits, and their presence did not prevent the Bureau from finding that the certificates at issue were *not* "securities." The Bureau's decision in the Associated Pharmacies matter is consistent with *Howey*, *Forman*, *Collins*, and *Dryden*, but it is remarkably inconsistent with its position in the LGC matter. Contradictory regulation, especially in the form of enforcement, results in serious consequences for the men, women, and entities doing business in New Hampshire. "Businessmen and issuers need to have stability in order to intelligently decide whether the instruments they sell are securities, subject to the securities acts, or non-securities, which are not." November 16, 2010 Statement of Policy: *When Are "Notes" Securities Under the New Hampshire Uniform Securities Act*, at 14.

Even more at odds with its stance in the LGC case is the Bureau's April 8, 1997 Order in *In the Matter of: Good Health Medical Services of New Hampshire, LLC, et. al.* As in the previous orders, the Bureau applied *Howey* to conclude that membership interests in the five LLCs were not securities within the meaning of the New Hampshire Uniform Securities Act.[13] According to its corporate filings, the primary business purpose of all five entities was "to

[13] The other four named LLCs are Good Health Medical Services of Franklin, Good Health Medical Services of Laconia, Speare Health Network, and Huggins Good Health Network.

develop an organization to contract with insurers and other sponsors of health insurance plans under which the organization will accept financial risk, to manage the delivery of medical services through its participating providers, and to arrange to provide coordinated medical services in the community." The shared business purpose of the five LLCs substantially overlaps with the mission of the LGC and its subsidiaries, i.e. to contract with insurers, manage and deliver medical services, while taking on substantial financial risk. The Bureau concluded that membership interests in Good Health Medical Services of New Hampshire, LLC and its four sister organizations were not "securities." It adopts the polar opposite approach with the LGC and its related entities. As the Bureau recently declared, the consequences of such inconsistent regulation can be dire: "all instruments of the same type need to be treated alike, either as being securities or not being securities. If these basic concepts are violated, chaos results." November 16, 2010 Statement of Policy: *When Are "Notes" Securities Under the New Hampshire Uniform Securities Act*, at 13.

E. The Administrative Gloss Doctrine Prevents the Bureau From Regulating the 5-B Risk Pool Membership Contracts as Securities.

The Bureau's inconsistent, if not selective, approach to its determination of what membership interests do and do not constitute "securities" does far more than paint a mischievous picture of its pursuit of the LGC: it legally prevents it. As the Bureau recently recognized, in a thorough Statement of Policy regarding whether secured promissory notes constitute securities, the doctrine of administrative gloss legally precludes it from changing its position, as articulated in the above-cited Orders and its interim silence.

The Bureau leaned heavily on the administrative gloss doctrine in its November 16, 2010 Statement of Policy: *When Are "Notes" Securities Under the New Hampshire Uniform*

Securities Act ("SOP"), citing the doctrine no less than 24 times to explain why its longstanding policy of not considering certain promissory notes "securities" obligated it to maintain this position absent legislative action.[14] After scrubbing its records, the Bureau concluded:

> [N]o enforcement action has ever been taken by the Bureau for non-registration of, or fraud in connection with the offer or sale of, a *secured* promissory note. Further, these records reveal that the Bureau has never registered such secured notes or persons selling them. Finally, the Bureau has never taken the position through a Statement of Policy or No-Action Letter that such notes or the persons selling them *must* be registered.

SOP at 17 (emphasis in original). "With the passage of time," the Bureau concluded, "this position became administrative gloss. As administrative gloss, it became part of the legislative history." *Id.*

The Bureau's history of not treating membership interests in 5:B risk pools as securities satisfies all three requirements of the administrative gloss doctrine, as set forth by the Bureau. See SOP at 24. First, the statutory clause must be ambiguous, and as the Bureau admits, "(c)ertainly, the definition of 'securities' in Section 421-B:2(XX)(a) meets this criteria." *Id.* See also *Id.* at 3 (noting that the statutory definition of "security" "is nothing more than a laundry list of items to be considered to be securities," and commenting that "no guidance can be obtained from Rules or Regulations under the Act as there are no such Rules or Regulations"). "Second, the informal *de facto* interpretation must actually exist and be of longstanding." *Id.* at 24. The legislature created 5-B risk pools twenty-five years ago. The LGC, its predecessor, and subsidiaries, have been filing corporate documents with the Secretary of State, which encompasses the Bureau, since at least 1985. Yet the Bureau has never considered whether

[14] The Bureau drafted the SOP in response to a report issued by the New Hampshire Attorney General's Office, which apportioned blame for the regulatory failings regarding Financial Resources Mortgage, Inc. across three agencies, including the Bureau. See, e.g., SOP at n.4 ("the Attorney General has no authority to second guess the Bureau's interpretation of the" New Hampshire Uniform Securities Act.)

membership interests in 5-B risk pools constitute securities. Just as the Bureau's regulatory inaction with respect to secured promissory notes satisfied this second element of the administrative gloss doctrine, so too does its silence regarding membership interests in 5:B risk pools. "Finally, the Legislature must not have indicated disagreement with the Bureau's informal *de facto* policy." *Id.* Not only has the legislature not indicated its disagreement with the Bureau's *de facto* policy of not considering membership in 5-B risk pools securities, once the Bureau indicated a reversal of that policy, the legislature took steps to overturn that reversal with SB 212, the current version of which expressly states that contributions "provided to a pooled risk management program…shall not be considered securities under RSA 421-B."

All three elements of the administrative gloss doctrine are met, and there is no principled reason why the Bureau's application of it to secured promissory notes in the SOP should not apply here. While the instruments differ, the issue – interpretation of the term "security" as defined in RSA 421-B:2, XX(a) – is identical. Not only has the Bureau not addressed the issue of membership interests in 5:B risk pools, they have consistently, as shown above, *every time the issue has arisen*, concluded that similar membership interests are not "securities" within the meaning of the New Hampshire Uniform Securities Act. Such longstanding, consistent application, combined with no response from the legislature, means, by the Bureau's analysis, that they have applied an administrative gloss over the issue. See *Anderson v. Motorsports Holdings*, LLC, 155 N.H. 491, 502 (2007) ("An administrative gloss is placed on an ambiguous clause of a [statute] when those responsible for its implementation interpret the clause in a consistent manner and apply it to similarly situated applicants over a period of years without legislative interference.").

The Bureau has never brought an enforcement action regarding the registration, offer, or sale of 5-B membership interests or contracts. No records exist showing that the Bureau has ever registered such membership interests or contracts, or persons selling them. Nor has the Bureau ever taken the position through a Statement of Policy or No-Action Letter that such membership interests or contracts, or the persons selling them must be registered. By its own admission, the Bureau's prolonged refusal to consider membership interests in or participation agreements with 5-B risk pools as securities supports the proposition that they are not. The Bureau's refusal to do so is not evidence of their incompetence or inattention. As the preceding sections explain, just the opposite is true: with the potential exception of the Indiana Securities Commissioner, no other regulator, court, or legislative body, state or federal, has ever taken the position that membership interests in or participation agreements with public risk pools are securities. The Bureau's prolonged silence in this arena coheres with the regulatory universe and the legislature's subsequent acquiescence is hardly surprising. See *New Hampshire Retail Grocers Association v. State Tax Commission*, 113 N.H. 511, 514 (N.H. 1973) ("It is a well established principle of statutory construction that a longstanding practical and plausible interpretation given a statute of doubtful meaning by those responsible for its implementation without any interference by the legislature is evidence that such a construction conforms to the legislative intent.").

The administrative gloss doctrine compels dismissal of the Amended Petition. After reviewing their application of the doctrine, even the Bureau must admit that its impact is fatal to their claims. See SOP at 23 ("Since the Bureau's determination is based, at least in part, upon the application of the administrative gloss doctrine, based upon a long-standing *informal interpretation by the Bureau and acquiescence by the Legislature*, the effect of the application is far reaching.") (emphasis in original). The Bureau lacks the authority to unilaterally change its position. "Only the Legislature can change the Bureau's interpretation, and only *prospectively*. The Bureau, itself, lacks the authority to alter its interpretation once established. Administrative gloss, once established, becomes part of the legislative intent behind the statute." *Id.* While the Bureau is likely to disregard or minimize its *de facto* policy of not bestowing security status on 5:B participation agreements and membership interests, its selective memory will not save it. As the Bureau concedes, "an agency cannot change an interpretation created by administrative gloss by merely ignoring past policies." *Id.* (citing *Tessier v. Town of Hudson*, 135 N.H. 168 (1991)). Just as they were in the realm of secured promissory notes, "the Bureau's hands are tied," and their Amended Petition must be dismissed.

F. Counts III, IV, and V Must be Dismissed Because the Bureau Fails to State a Claim on Which Relief Can be Granted.

1. <u>The Bureau Fails to Adequately Allege that NHMA Membership "Interests" or "Risk Pool Contracts" are Securities.</u>

First, and most remarkably, the Bureau charges Ms. Carroll with violating various provisions of the New Hampshire Uniform Securities Act without specifically identifying which instruments constitute the alleged securities. That the Amended Petition is the culmination of a nearly three year investigation, during which the LGC produced tens of thousands of documents, renders this omission even more astonishing. The closest the Bureau comes to identifying with any particularity just what documents, instruments, or transactions constitute the alleged "securities" is Paragraph 107, in which they assert that "membership interests in NHMA, LLC and participation contracts for participation in each of the 5-B pools" are "investment contracts." Without specifically identifying an example of either, Respondents are left to speculate.

In addition to the 5-B participation agreements, the Bureau alleges, without explanation, let alone identification, that "membership interests in NHMA, LLC" are also securities under RSA 421-B, XX(a). Amended Petition, ¶107.[15] Aside from alleging that such NHMA membership "interests" exist and constitute securities, they provide no additional supporting facts. The Bureau does not even bother applying *Howey* or its suddenly captivating Risk Capital Test to this alleged interest to show that it is an "investment contract."

Because Counts III, IV, and V fail to adequately allege that the NHMA membership "interests" meet the elements of a security, they must be dismissed to the extent they are based on allegations that NHMA membership "interests" or "contracts" are securities. See *Proctor v. Bank of New Hampshire*, 123 N.H. 395, 400 (1983) (trial court properly dismissed negligence count where "[t]he basis of the parties' dispute is incomprehensible…because this count fails to adequately allege the defendant's duty, breach, and the resulting harm to the plaintiff.") (internal citation omitted).

The Bureau's half-hearted attempts to apply the *Howey* and Risk Capital tests to the 5:B participation contracts are equally deficient and fall short of even the most forgiving pleading standards. The Bureau does not so much apply the tests as they do recite their respective elements and then allege, without citations to the law or record, that the risk pool contracts satisfy each. Amended Petition, ¶¶109-111. This feeble attempt to shoehorn the participation agreements into the state's securities statutes is woefully insufficient to survive dismissal. See *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) ("a formulaic recitation of the elements of a cause of action will not do.").

[15] The Bureau later refers to an "NHMA membership contract[]," which may or may not be the same instrument. Amended Petition, ¶125.

2. The Bureau Fails to Adequately Allege Ms. Carroll's Role in the Claimed Violations of New Hampshire's Securities Statutes.

i. The Bureau Fails to Allege How Ms. Carroll is an "Agent" of LGC Within the Meaning of RSA 421-B:2, II.

The Bureau completely fails to show, or even attempt to show, how Ms. Carroll is an "agent" pursuant to RSA 421-B:2, II. Amended Petition, ¶116. The Bureau simply cuts and pastes a portion of the statutory definition of the term "agent," then baldy asserts that she meets the definition merely because she is an LGC "officer and employee." Id. The Bureau does not allege how Ms. Carroll "represents" the LGC "in effecting or attempting to effect purchases or sales of securities," they merely recite these basic elements of the statutory definition. *Id.* A pleading that offers only "labels and conclusions…will not do." *Bell Atlantic Corp*, 550 U.S. at 555. "Nor does a complaint suffice if it tenders naked assertion[s] devoid of further factual enhancement." *Id.* at 557. This is a prime example of how the Amended Petition, which mentions Ms. Carroll a grand total of six times (once in the list of Parties, another in a superfluous footnote) over the course of 135 paragraphs, fails to explain her role in the alleged violations. Because the Bureau utterly fails to explain, let alone in any detail, Ms. Carroll's role "in effecting or attempting to effect purchases or sales of securities," Count III must be dismissed. See *Batchelder v. Northern Fire Lites, Inc.*, 630 F.Supp. 1115, 1122 (D.N.H. 1986) (dismissing complaint alleging violation of RSA 421-B:3 "devoid of any alleged facts indicating that defendants…had any involvement" in the claimed transaction).

ii. Count IV Fails to Allege How Ms. Carroll Knowingly or Negligently Aided the LGC in the Sale of Unregistered Securities.

The Bureau continues its failure to link Ms. Carroll with any of the alleged securities violations in Count IV, providing no evidence that she "either knowingly or negligently aided

LGC in selling unregistered securities in violation of R.S.A. 421-B:11." Amended Petition, ¶120. The Bureau's lone companion allegation is that "the Individual Respondents participated in, or approved, the marketing of 'risk pool contracts' to Members and potential Members with a purpose of inducing investment in the 5-B Pools by Members by creating an expectation of value and/or a return on investment." Id. at ¶121. This conclusory statement, largely a paraphrasing of the elements of the *Howey* and Risk Capital tests, says nothing about Ms. Carroll's claimed role in the marketing of "risk pool contracts," let alone how such efforts created any "expectations of value and/or a return on investment." Assuming for the sake of argument that Ms. Carroll played some part in the LGC's marketing efforts, it defies logic that she, or anyone else, would promote the actual contract, as the Bureau claims. That would be no different from a gym owner or country club promoter trumpeting the actual, legal instrument by which prospective members join as a means of increasing patronage.

Aside from the nonsensical nature of the Bureau's allegation, it cannot survive dismissal because it fails to specify, or even generalize, Ms. Carroll's role in the alleged marketing. In this multiparty case, in which the Amended Petition originally charged five individuals in six counts in a scheme which the Bureau alleges has lasted for at least thirteen years, the Bureau must explain each individual's role. See *Manchester Mfg. Acquisitions, Inc. v. Sears, Roebuck & Co.*, 802 F. Supp. 595, 602 (D.N.H. 1992) (dismissing claims brought under RSA 421-B:3 where "in this multi-defendant case, plaintiffs fail to particularize the role of each defendant…thus failing to place each on notice of what role he is alleged to have played.").

The Bureau's most far-fetched allegations with respect to Count IV concern what the "Individual Respondents knew, or should have know [sic] through the exercise of reasonable care," namely that "'risk pool contracts' and NHMA membership contracts are securities under

New Hampshire law and must be registered for sale." Amended Petition, ¶ 120. This allegation is nothing short of breathtaking. Prior to mid-2009, when it began its investigation of the LGC, not even *the Bureau* knew that such instruments were securities under New Hampshire law. In light of the universal, and on-going non-security treatment of membership interests in and participation contracts with pooled risk management programs, no one could have known, whether through the exercise of reasonable care or otherwise, that such instruments would be considered securities under New Hampshire law. For the Bureau to prove the allegations against Ms. Carroll, it will have to show that she knew, or should have known, after twenty-five years of regulatory silence, contrary federal and state policy, legislative inaction, contradictory policy statements by the Bureau, all while the LGC, its predecessors, and subsidiaries submitted corporate filings with the Secretary of State, that the very same agency, through the Bureau, would one day claim that "'risk pool contracts' and NHMA membership contracts" are securities under state law. In other words, the Bureau must prove that Ms. Carroll is clairvoyant. For that reason, Count IV must be dismissed.

iii. Count V Fails to Plead Securities Fraud With Particularity.

Count V, which charges Ms. Carroll with committing securities fraud, suffers from equally fatal pleading deficiencies. The Bureau alleges that "Respondents," without identifying who, failed to disclose the following material facts "to Members and potential Members":

> a. NHMA membership contracts and "risk pool contracts" are unregistered securities;
> b. LGC Parent and its subsidiaries are not licensed as broker-dealers or issuer-dealers as required by law to offer or sell securities; and
> c. LGC Parent's officers and employees are not licensed as agents as required by law to offer or sell securities.

Amended Petition, ¶125. The Bureau also accuses unnamed "Respondents" with engaging "in actions that operate a fraud or deceit on their Members as defined by" RSA 421-B:3, I(c). *Id.* at ¶127. The unnamed Respondents, the Bureau continues, "have used Member funds held in trust in the 5-B pools for non-pool purposes without the knowledge or written authorization of Members." Id. This alleged misuse of funds included:

> a. Diverting Member funds from the HealthTrust and Prop. Liab. Trust pools to LGC Parent for use to subsidize the Workers Comp Pool;
> b. Diverting Member funds from the HealthTrust and Prop. Liab. Trust pools to LGC Parent for the benefit of LGC Parent's non-pool administration activities; and
> c. Investing Member funds in risky investment vehicles not authorized by Municipal Budget laws.

Id.

The Bureau's material omissions claim fails for the same reason that its Claim IV aiding and abetting claims fall flat: it premises them on the same registration and licensing claims, which in turn rely on the status of "NHMA membership contracts" and "risk pool contracts" as securities, which necessarily requires extraordinary divination powers in order to be actionable. See *In re Open Joint Stock Co. Vimpel-Communications*, No. 04 Civ. 9742 (NRB), 2006 WL 647981, at *6 ("defendant's lack of clairvoyance simply does not constitute securities fraud.").

Because Count V accuses Ms. Carroll of fraud, it must be plead with particularity, and its abject failure to do so must result in its dismissal. Not only does the Bureau fail to identify any of the Respondents who committed the allegedly material omissions or misrepresentations, it does not say when they were made or in what context. This deficiency alone compels dismissal. See *Manchester Mfg.*, 802 F.Supp. at 602 (dismissing RSA 421-B:3 claims because "plaintiffs simply do not sufficiently specify facts regarding time, place, and content of the alleged false or fraudulent representations.”). Nor does the Bureau “supply any detail about where the relevant misrepresentations took place.” *Id.* In order to state a claim of securities fraud, the Bureau must plead “in detail…the who, what, when, where, and how of the alleged fraud.” *Id.* (citing *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990)). This is particularly true here, where the Bureau alleges that the Respondents’ violations began “[a]t least as early as 1999.” Amended Petition, ¶30. To claim that Respondents’ allegedly illegal conduct began at least thirteen years ago, and then specify no time period, not even a range of years, when the allegedly fraudulent conduct occurred, fails any pleading standard, and certainly fails as a matter of law when pleading fraud. See *Manchester Mfg.*, 802 F.Supp. at 602 (dismissing New Hampshire securities fraud claim in part because plaintiffs claimed the fraud occurred “sometime” between “winter/spring of 1988” and December 1988). The Bureau’s timeframe, or lack thereof, is Jurassic by comparison.

Just as fatal is the Bureau’s failure to connect Ms. Carroll in any way to any of the alleged omissions or misrepresentations. The Bureau makes no attempt to plead what Ms. Carroll said, where she said it, when she said it, and to whom she said it. See *Proctor*, 123 N.H. at 399 (“in order to withstand a motion to dismiss, the plaintiff must specify the essential details of the fraud, and specifically allege the facts of the defendant's fraudulent actions.... It is not sufficient for the plaintiff merely to allege fraud in general terms.”). While courts normally must accept the truth of the allegations at the motion to dismiss stage, New Hampshire courts “will not, however, assume the truth or accuracy of any allegations which are not well-pleaded, including the statement of conclusions of fact and principles of law.” *Snierson v. Scruton*, 145 N.H. 73, 76 (2000). It is black-letter law that “[t]o establish fraud, a plaintiff must prove that the defendant made a representation with knowledge of its falsity or with conscious indifference to its truth with the intention to cause another to rely upon it." *Id.* at 77. Not only has the Bureau failed to allege that Ms. Carroll made any representations "with knowledge of its falsity or with conscious indifference to its truth," they have not plead that she made any statements at all. Id.

Again, as with Count IV, the Bureau fails to distinguish the roles played by the various Respondents, this time not even distinguishing amongst the individual and corporate Respondents. Such poor pleading was sufficiently deficient to warrant dismissal of the prior counts, but the Bureau compounds its shortcomings by repeating them in the context of a fraud allegation. See *Manchester Mfg.*, 802 F. Supp. at 602 (dismissing RSA 421-B:3 claims where plaintiffs "fail to particularize the role of each defendant…thus failing to place each on notice of what role he is alleged to have played in the fraud."). If there were any doubt that the Bureau's filing an Amended Petition that totally fails to connect Ms. Carroll to any misconduct represents grounds for dismissal, the fact that they did so after nearly three years of investigation and access to tens of thousands of LGC documents removes that doubt entirely.

III. Count VI Should Be Dismissed Because this Hearing Officer Has No Jurisdiction Over Claims of Civil Conspiracy, and Count VI Fails to State a Claim That Ms. Carroll Engaged in a Civil Conspiracy.

Ms. Carroll joins in *Respondent John Andrews' Motion to Dismiss Count VI of the Amended Petition*. For the reasons stated in that motion, Count VI must be dismissed as to Ms. Carroll.

In addition, Count VI fails to allege facts sufficient to state a claim against Ms. Carroll. New Hampshire defines civil conspiracy as follows:

> A civil conspiracy is a combination of two or more persons by concerted action to accomplish an unlawful purpose, or to accomplish some purpose not in itself unlawful by unlawful means. Its essential elements are: (1) two or more persons (including corporations); (2) an object to be accomplished (i.e. an unlawful object to be achieved by lawful or unlawful means or a lawful object to be achieved by unlawful means); (3) an

> agreement on the object or course of action; (4) one or more unlawful overt acts; and (5) damages as the proximate result thereof.

Jay Edwards, Inc. v. Baker, 130 N.H. 41, 47 (1987) (internal citations and quotation marks omitted). The Amended Petition has not sufficiently alleged these elements. In addition to its failure to state a claim as to the first and fifth elements as discussed in Respondent Andrews' Motion, the Amended Petition refers only collectively to the actions of "Individual Respondents." *See* Am. Pet. ¶¶ 129-135. It does not allege that Ms. Carroll joined the conspiracies alleged in the Amended Petition, or what statements she uttered, or decisions she made, that reflected an intent to join them.

In addition, there is no allegation that Ms. Carroll took an overt act in furtherance of the conspiracy, whether by statements she uttered or decisions she made. As discussed in greater detail in Ms. Carroll's motion for summary judgment, unlike other Individual Respondents, Ms. Carroll was neither a board member nor Executive Director when the alleged conspiracies commenced. With regard to acts while serving as Executive Director, the BSR has failed to identify any particular act other than a suggestion she made at a Board Meeting in response to a request by certain members. As discussed in detail in Ms. Carroll's motion for summary judgment, this suggestion cannot form the basis for liability.

In the absence of specific allegations as to the means by which Ms. Carroll conspired with the other Individual Respondents, Count VI must be dismissed.

CONCLUSION

For the foregoing reasons, this tribunal should dismiss all counts as to Maura Carroll.

Respectfully submitted,

MAURA CARROLL

By Her Attorneys:
SHAHEEN & GORDON, P.A.

Dated: March 12, 2012

/s/ Steven M. Gordon

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CERTIFICATE OF SERVICE

I hereby certify that I have, this 12th day of March 2012, forwarded copies of this pleading *via* E-mail to counsel of record.

/s/ Steven M. Gordon