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
	)	

ANSWER OF
LOCAL GOVERNMENT CENTER, INC., LOCAL GOVERNMENT CENTER REAL ESTATE, INC., LOCAL GOVERNMENT CENTER HEALTHTRUST, LLC, LOCAL GOVERNMENT CENTER PROPERTY-LIABILITY TRUST, LLC, HEALTHTRUST, INC., NEW HAMPSHIRE MUNICIPAL ASSOCIATION PROPERTY-LIABILITY TRUST, INC., LGC-HT, LLC, LOCAL GOVERNMENT CENTER WORKERS' COMPENSATION TRUST, LLC, AND MAURA CARROLL

The corporate and LLC Respondents and Maura Carroll (collectively, "LGC") answer the Amended Petition, as follows. LGC provides this Answer in narrative form, responding to the general claims made in the Petition rather than rebutting each sentence of that document, believing that to be more useful to the process. LGC can provide an answer in a sentence-by-sentence format, however, if preferred by the Hearing Officer.

I. Introduction

LGC is a non-profit organization, governed by an active Board of Directors made of up local, municipal, school, and county representatives, including elected and appointed officials, and employees. As a supportive resource for local governments, LGC provides programs and services that strengthen the ability of New Hampshire municipalities, schools, and county governments to serve the public. Legal support, legislative advocacy, training programs, and pooled risk management services are a few examples of LGC offerings.

The New Hampshire Bureau of Securities Regulation, a division of the New Hampshire Secretary of State's office, initiated an investigation of LGC in July 2009, in response to a complaint from the Professional Fire Fighters of Hampton, New Hampshire. The investigation

culminated in the Staff Petition of September 2, 2011. The Petition is an attack on organizations that have faithfully and successfully served the needs of local governments throughout this state. It asserts claims concerning actions that were taken long ago, consistent with industry practices, which were periodically reported to the Secretary of State and publicly disclosed, and never previously challenged. The motivations for such claims may be murky; but they are at least significantly wrong on the facts and the law, and a waste of taxpayer money and time.

LGC looks forward to disposing of the claims, either through dispositive motions, or following the hearing on the merits, currently scheduled to begin in April 2012. Through this Answer, LGC rebuts the specific factual and legal assertions made by the Bureau, and provides a summary of the defenses and affirmative defenses it intends to mount in advance of and during the merits hearing.

II. Response to Paragraphs 1-7 of the Petition

Paragraphs 1-7 of the Petition contain general, introductory material to which no response is required. LGC nevertheless supplements the Bureau's statements as follows:

A. The Respondents (¶s 4-5)

LGC (the term used throughout this pleading to describe all the corporate and LLC entities, collectively) provides various programs and services to its members, who are municipal governments and other political subdivisions within the State of New Hampshire. LGC serves its members as a catalyst for dialogue and action; an advocate on issues; a provider of benefits and risk management services, including education and training in skills; and a resource for information. Its Mission Statement calls for it "to strengthen the quality of its member governments and the ability of their officials and employees to serve the public."

Local Government Center, Inc. ("LGC, Inc.") has existed as a non-profit organization since 1941. Its members are New Hampshire municipalities, schools, and county governments. LGC oversees the operations of its wholly-owned subsidiaries: Local Government HealthTrust, LLC ("HealthTrust"); Local Government Center Property-Liability Trust, LLC ("Property-Liability Trust"); New Hampshire Municipal Association, LLC ("NHMA"); and Local Government Center Real Estate, Inc. ("Real Estate"). Prior to July 2003, LGC's name was New Hampshire Municipal Association.

HealthTrust, Inc. was established by the New Hampshire Municipal Association in 1984, during a crisis in pricing and availability of commercial insurance, in order to provide health coverage and other employee benefits to NHMA members. From its inception, the Board governing LGC, Inc. has appointed the board of HealthTrust, Inc. In July 2003, HealthTrust, Inc. ceased to provide coverage, after it believed it had merged into a newly formed entity, HealthTrust, LLC. Contrary to the Petition, HealthTrust, Inc. is not a "defunct" entity, but a New Hampshire non-profit corporation in good standing.

Local Government Center HealthTrust, LLC ("HealthTrust") was formed in June 2003 as a single-member New Hampshire Limited Liability Company. Its mission, in accordance with RSA 5-B, is to provide the highest quality employee benefit products and service, consistent with the lowest possible cost, for public employees and employers in New Hampshire. HealthTrust operates as a non-profit entity, with its income not subject to federal income taxation under Internal Revenue Code Section 115. HealthTrust believes that operating without profit-seeking contributes to its ability to deliver products to public sector employers and employees at lower charges than might otherwise be obtained for comparable products. It receives its operational, management, and administrative services from its parent, LGC, Inc.

HealthTrust has provided a full spectrum of employee benefits to LGC's members since July 2003.

New Hampshire Municipal Association Property-Liability Trust, Inc. ("PLT, Inc.") was established by the New Hampshire Municipal Association in 1986 in response to the lack of risk coverage available in the commercial insurance market. Its purpose was to provide property and liability coverage and risk management to NHMA members. From the inception of PLT, Inc. the Board governing LGC, Inc. has appointed the board of PLT, Inc. In July 2003, PLT, Inc. ceased to provide coverage after it believed it had merged into a newly formed entity, Property-Liability Trust, LLC. Contrary to the Petition, PLT, Inc. is not a "defunct" entity, but a New Hampshire non-profit corporation in good standing.

Local Government Center Property-Liability Trust, LLC ("Property-Liability Trust") provides property-liability, workers' compensation coverage, unemployment insurance, and risk management services to LGC's members, in accordance with RSA 5-B. In June 2003, LGC, Inc. formed Property-Liability Trust, LLC as a single-member New Hampshire Limited Liability Company. Property-Liability Trust's objectives are to formulate, develop, and administer, on behalf of LGC's members, a comprehensive risk management program, and to obtain lower costs for property-liability risk coverage. Property-Liability Trust also operates as a non-profit entity, with its income not subject to federal income taxation. The Trust receives operational, management, and administrative services from its parent organization, LGC, Inc. Property-Liability Trust has provided property and liability coverage and risk management to LGC's members since July 2003.

LGC, Inc. Property-Liability Trust, Inc. and HealthTrust, Inc. jointly began a Workers' Compensation program in 2000. Between 2003 and 2007, the Workers' Compensation program

was administered as a separate risk pool under RSA 5-B (**LGC Workers' Compensation Trust, LLC**). That program was merged back into Property-Liability Trust, effective May 31, 2007.

New Hampshire Municipal Association, LLC is a nonprofit, non-partisan membership organization of municipalities. It provides advocacy support for municipal governments as well as educational and training programs for local officials and employees. Advocacy activities are governed by a board comprising municipal officials from throughout New Hampshire, and represented at the State House by a staff dedicated to government affairs. NHMA's advocacy activities are funded in full by NHMA member dues.

Local Government Center Real Estate, Inc. is a New Hampshire non-profit corporation formed in 1989 to build and maintain an office building to house the operations of the LGC entities.

The Petition incorrectly identifies **Maura Carroll** as General Counsel of, variously, LGC, Inc., HealthTrust, and Property-Liability Trust, prior to her appointment as Interim Executive Director of LGC, Inc. in September 2009. Her actual role was as General Counsel for Legal Services and Government Affairs, overseeing the provision of legal services to municipal members of NHMA. The Petition also incorrectly identifies her as the Member of several of the Respondent LLCs. In each instance, LGC, Inc. is the sole member of the Respondent LLCs.

B. The Regulatory Framework (¶s 6-7)

Creation of the Pools pre-dates RSA 5-B. As described above, LGC created and operated health and property-liability risk pools prior to the adoption of RSA 5-B in 1987. No legislative action was necessary to permit the operation of these risk pools. Rather, in response to questions raised by the then-Commissioner of Insurance regarding whether these municipal risk pools were subject to Insurance Department regulation or taxation, the legislature adopted

RSA 5-B in order to exempt these risk pools from regulation and taxation if they comply with the statutory standards. Technically, RSA 5-B is not "enabling legislation" as to these risk pools, but rather a statute which affirmed their existence and provides an exemption from Department of Insurance regulation and state taxation. The operation of LGC's risk pools at the time the legislature promulgated RSA 5-B, in 1987, takes on particular significance due to the recognition granted them in the Purpose section of the statute (RSA 5-B:1): "[T]he 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." (Emphasis supplied.)

LGC makes annual filings with the Secretary of State. Since the adoption of the statute, the LGC risk pools have made an annual filing with the Department of State, for the purpose of providing public access to information concerning their nature and organization, including the following: a list of the risk pool's officers; a description of the coverages provided by the pools; an annual audit of financial transactions by an independent certified public accountant; a written plan of operation or bylaws; and an annual actuarial evaluation, assessing the adequacy of contributions required to fund the pooled risk management program, and the reserves necessary to meet expenses and other projected needs of the plan. That evaluation is performed by a member of the American Academy of Actuaries, qualified in the coverage area being evaluated.

The LGC pools have supplied this information to the Secretary of State each year since the adoption of the statute in 1987.

The Secretary lacked any regulatory authority until 2009, or any power to penalize until 2010. Prior to July 29, 2009, the Secretary of State had no regulatory or enforcement

authority over the RSA 5-B risk pools.[1] Through a 2009 amendment, the Secretary was provided limited regulatory and enforcement authority, but no authority to impose penalties or fines. To the extent the Bureau argues that the 2009 amendment granted it such authority, the Bureau's failure to adopt any rules or standards regarding the imposition of penalties bars it from imposing such penalties for actions that occurred prior to June 14, 2010.

The statutory authority to impose penalties and fines took effect June 14, 2010, with the adoption of RSA 5-B:4-a. Any attempt by the Bureau or the Secretary to regulate the activities of the pools in a way that penalizes them for actions taken prior to June 14, 2010 is improper and unfair, and would act as a retrospective application of a law, specifically prohibited by the federal and state constitutions as "highly injurious, oppressive, and unjust." (Part I, Article 23 of the State of New Hampshire Constitution.)

Further, LGC exists in a competitive marketplace with two other risk pools, PRIMEX and SchoolCare. The Secretary has ignored a similar complaint against the other risk pools, filed with him in June 2010. The Department of State is also aware that the other RSA 5-B risk pools have testified to the legislature regarding their RSA 5-B operating practices, which are the same as, or consistent with, many of the alleged violations raised in the Petition. In selectively enforcing the statute, and selectively applying his power against LGC only, the Secretary is violating the constitutional guarantee of equal protection and "free and fair competition in the trades and industries … [which] should be protected against all monopolies and conspiracies which tend to hinder or destroy it." Part I, Article 83 of the State of New Hampshire Constitution.

[1] The Bureau acknowledges in its Petition (¶ 7) that the State had no regulatory authority over the pools until the adoption of the amendment.

III. Response to Count I – Corporate Governance

A. Attempted Merger (¶s 8-15)

This section of the Petition concerns the 2003 reorganization of the LGC entities.

In response to the newly competitive environment, in 2003, the respective boards of NHMA, Property-Liability Trust, Inc., and HealthTrust, Inc. each determined that the welfare of their respective organizations, and their respective members, would benefit from a restructured organization represented by a single board of trustees. A plan to accomplish that was developed following long study, with input from a variety of sources, including consultants and legal counsel. The consolidation accomplished several critical goals:

- Ensured that LGC's programs remained stable and competitive for members, and maximized the efficiency of the programs by sharing resources;
- Modernized and integrated LGC's organization structure, to better adapt to the challenges faced by a public sector entity which needed to respond more quickly to member needs;
- Offered expanded service to members through packaged pricing and one-stop shopping;
- Developed a unified culture and brand; and
- Established a streamlined and more effective governance process to facilitate all of the foregoing goals.

Upon the advice of legal counsel, the boards voted to restructure the existing entities into single-member, member-managed limited liability companies, with a common parent corporation. Because New Hampshire's non-profit statute (RSA Chapter 292) does not provide for merger of a Chapter 292 entity with an LLC, LGC used a previously employed technique to accomplish the desired end goal, which was to merge HeathTrust, Inc. and PLT, Inc. into the newly and validly established New Hampshire LLCs (HealthTrust and Property-Liability Trust).

The technique involved creating mirror image entities in Delaware, and merging them with the New Hampshire entities.

The Petition implies in this section that there are mandatory corporate forms for risk pools to take, and other forms that are forbidden. LGC disputes this. The only requirement in this regard is that each pool "exist as a legal New Hampshire entity." RSA 5-B:5, I(a). At all times, the entities which housed the LGC risk pools existed as legal New Hampshire entities. There is no requirement, for example, that the risk pool reside in a non-profit corporation, as suggested by the Bureau. Further, while the Petition correctly reports that, during the time of the investigation, neither HealthTrust nor Property-Liability Trust had LLC operating agreements, no such agreements were (or are) required by law, and in practice, such agreements are often considered extraneous when the LLC consists of a single member.[2] In this instance, LGC, Inc., as the single member, was expressly obligated in its By-Laws to manage the pools, and did so.

Unfortunately, LGC learned in August 2011 that the merger of the original New Hampshire corporations into the Delaware mirror LLCs was never effective because of a technical flaw in implementing the technique of simultaneous transactions.[3] Accordingly, with new legal counsel assisting, LGC filed Certificates of Revival to restore the historical entities, and each entity that participated in the reorganization of 2003 ratified the operation of the risk pools by the LLCs since 2003. This ratification took the form of a "Pooled Risk Management Agreement."

---

[2] Nevertheless, in order to eliminate any concerns, LGC has since adopted LLC Operating Agreements for both HealthTrust and Property-Liability Trust.

[3] The technique requires that a New Hampshire RSA 292 corporation must first merge with a Delaware non-profit corporation, which subsequently is merged into a Delaware LLC, before the Delaware LLC is ultimately merged into a New Hampshire LLC. In 2003, the first step was mistakenly omitted, so that the original RSA 292 entities attempted to merge straight into Delaware LLCs. As a result of this flaw, the New Hampshire corporate entities never effectively merged into the Delaware LLCs. This does not change the fact that the New Hampshire LLCs created by LGC in 2003 have always been, and continue to be, valid New Hampshire legal entities which own and operate their RSA 5-B risk pools.

Each of the steps taken in 2011 – filing of the Certificates of Revival and corrective documents with the Secretary of State's Corporate Division, entering into the Pooled Risk Management Agreement, and other ratifying acts – are well-recognized techniques for correcting such inadvertent and technical errors. LGC's corporate structure is legal and appropriate, and the Bureau's assertions otherwise are illogical, unnecessarily provocative, not grounded on any statutory violations of RSA 5-B, and generate unfortunate speculation and inefficiency.

B. Pooled Risk Management Program Statutory Requirements (¶s 16-20)

This section of the Petition starts with the false premise that the LGC entities are illegal due to the failed merger, and uses that as a platform to argue that RSA 5-B requirements have been violated, in that the pools did not exist as valid New Hampshire entities, and that they were not governed by Boards of Directors pursuant to written by-laws.

To the contrary: the Pools are properly owned and managed. Each of the pools are held by "a legal entity organized under New Hampshire law", as required by RSA 5-B:5, I(a). Valid New Hampshire LLCs were created in 2003, and they remain valid today, as attested to by Certificates of Good Standing issued for each of them by William Gardner, Secretary of State, obtained by LGC on November 8, 2011. Prior to July 2003, when respondent HealthTrust, Inc. and PLT, Inc. operated risk pools, they, too, were valid New Hampshire legal entities.[4]

In addition, the risk pools operated by the Respondents have always been governed by a board of directors pursuant to written bylaws. In the case of the single-member LLCs, the board of LGC, Inc. governs the pools pursuant to written bylaws which apply to the subsidiary risk pools.

[4] Indeed, the fact that the attempted mergers through Delaware were ineffective means that the corporations remained New Hampshire legal entities without ever becoming, even for an instant, Delaware entities.

The Bureau suggests that, because the LGC board that governs the risk pools is a board of directors as opposed to a board of trustees, the Respondents have violated some statutory requirement. RSA 5-B:5 I(b) merely requires, however, that a pool be governed by a board, without specifying that the board must be made up of trustees rather than directors. LGC's Board of Directors satisfies the statutory requirement.

As the Bureau points out, both trustees and directors have standards of behavior that they owe to the organization, be it the duties of good faith and fair dealing or even some higher standard. To the extent the Bureau charges them with these standards, however, the Bureau must also acknowledge that the board members, who are charged to take care with the members' assets, may act conservatively in setting reserve levels, in determining the level of risk they think appropriate for the organizations to accept, and in otherwise administering the affairs of the organizations. In later sections of the Petition, the Bureau appears unwilling to recognize the board members' right to exercise their business judgment, preferring instead to impose its own judgment as to acceptable risk levels and associated reserve amounts.

IV. Response to Count II – Financial Management

A. Requirement to Return Surplus (¶s 21-38)

This section of the Petition challenges the amounts LGC holds in its risk pool reserves. The Bureau's claims ignore history and the terms of RSA 5-B. The Bureau's attempt to impose through the administrative hearing process what the Secretary of State has refused to do by rule-making – set a method by which <u>all</u> risk pools would evaluate risk and establish reserve levels – is improper. The specific method it recommends is, furthermore, imprudent.

The Need, and Authority, for Adequate Reserves. Pooled risk management programs must maintain sufficient reserves (1) to protect against adverse claims experience; (2) to avoid

escalations in cost; (3) to minimize underwriting cycle changes; and (4) to provide for competitive, regulatory, and service requirements. RSA 5-B risk pools, whose members are political subdivisions which can only raise additional funds through taxation, lack ready access to additional capital should their reserves prove to be inadequate. New Hampshire risk pools are further constrained to only operate within the state, and cannot spread risk across multiple markets. Providing health care and other coverages to New Hampshire political subdivisions is therefore a volatile business, and adequate reserves are vital to ensure the continuing availability of promised benefits and rate stability to members, even in the event of catastrophic claims.

RSA 5-B:5, I(f) provides that a risk pool's management, in consultation with a qualified actuary, shall determine the contributions required to fund its program; the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims; and other projected needs of the plan. The statute imposes no specific reserve level – either minimum or maximum – but relies upon the risk pool boards, in consultation with qualified experts, to determine the appropriate level of reserves for their pools, based on their experience and informed judgment.

New Hampshire courts have also recognized that a non-profit health service provider must maintain an adequate contingency reserve fund:

> [A] contingency reserve fund is the only protection a non-profit health service has against temporary insolvency due to large claims arising from "catastrophe, epidemic, or serious economic dislocation." Thus, a contingency reserve fund is important to a corporation's economic well-being.

NH-VT Health Serv.v Comm'n of Ins., 122 N.H. 268, 275 (1982) (quoting N.H.-Vermont Hosp. Serv.v.Whaland, 114 N.H. 92, 94 (1974)).

How LGC Sets Its Reserves. The National Association of Insurance Commissioners (NAIC), together with the American Academy of Actuaries, designed the "Risk Based Capital"

(RBC) formula to determine how much reserve capital an insurance company should maintain to assure solvency. This methodology is used by both insurance companies and risk pools across the nation. Regulatory intervention can be triggered when an insurer's RBC falls below a certain level. Many insurance companies maintain reserve levels higher than LGC and other New Hampshire risk pools.

LGC's consulting actuary annually recommends that LGC's risk pools utilize this industry standard for determining the size of their reserves. Based on this advice, HealthTrust has chosen an RBC target ratio of 4.2 (equivalent to approximately 20% of member contributions), since 2002. This level of RBC is above the minimum reserve level that would require intervention by various insurance regulators, though below that maintained by some not-for-profit Blue Cross Blue Shield Plans (RBC of 5.5-9.5), and below levels that other experts consider justifiable (RBC of 5.5-9.0).[5]

Actuarial prediction of rates necessary to cover a year's worth of claims can never be 100% accurate. In 2009, for example, HealthTrust paid out $353 million in claims and sustained an operating loss of $14 million, which was covered by its existing reserves and surplus. Even a short string of consecutive years of such adverse experience could (1) deplete a risk pool's reserves below minimum industry standards; (2) render the pool unable to pay the health care claims of its covered individuals; (3) result in dramatic rate increases; and (4) eventually result in insolvency. Reserves necessary to cover these contingencies are vital to risk pools.

The LGC board spends a considerable amount of time reviewing reserve levels each year, with the advice of qualified actuaries. There are differing opinions about the right level of

[5] The Massachusetts Division of Healthcare Finance and Policy prepared a *Study of Reserves and Surpluses of Health Insurers in Massachusetts*, discussing the appropriate maximum level of reserves. The study found that the appropriate maximum level is more than twice as high as LGC's target reserve levels, and four times as high as that recommended by the Secretary of State's actuary.

reserves, yet LGC's reserves have remained well within the range of reserves established by similar risk-management programs. A regulated health insurance program in New Hampshire with reserves at the level recommended by the Secretary of State's actuary would likely prompt regulatory concerns about the solvency of that program.

LGC has annually filed with the Secretary of State the actuarial evaluation of its pooled risk management programs, as required by RSA 5-B:5, I(f). The evaluation assesses the adequacy of contributions required to fund the program, and the reserves necessary to be maintained to meet expenses of all incurred, and incurred but not reported claims, and other projected needs of the plan, all as permitted by the statute. This is the first time the Secretary has taken issue with the content of the annual evaluations.

The Key Issue on Reserves: The Absence of Statutory Requirements or Rule-Making Guidance. Though there are potentially many ways to set reserves and evaluate risks – among them RBC, chosen by LGC since 2002, and the Stochastic Method, recommended to the Legislature by the Bureau in 2011 – the key legal question for this hearing is whether LGC's Board violated some known law, rule, or applicable standard in choosing the method it did. No statute historically set the method; no rule was ever promulgated, determining the means by which those reserves should be set; the Secretary has never previously questioned LGC's method; and even to this day the New Hampshire Legislature continues to evaluate the report and recommendations of the Bureau on this topic, *but has yet to set a method that must be followed*. LGC has complied with the only standard governing the setting of reserves: the requirement of an annual actuarial evaluation by a qualified actuary. The various Respondents have therefore violated no actionable standard in setting reserves in the conservative and prudent manner that they did.

B. Additional RSA 5-B Analysis (¶s 39-43)

Reserves are necessary to defray administrative expenses, and those expenses are consistent with industry levels. RSA 5-B:5, I(f) allows reserves for other projected needs of the plan. LGC has set aside reserves to manage yearly fluctuations in administrative costs, including necessary equipment, furnishings, and system upgrades. Administrative reserves help cushion the impact of capital expenses that arise during the year, without requiring an adjustment to the rates charged to its members.

Members come and go. Together with the other RSA 5-B New Hampshire risk pools, LGC does not provide return of surplus to members who have left the pool. The statute only requires return of surplus to "participating political subdivisions," not formerly participating members who have left the pool. This is consistent with the practice of not charging members their share of the needed surplus (i.e., reserves) when they enter the pool. This practice facilitates political subdivisions shopping for the most competitive price, annually, without having to pay a large up-front "reserve payment."

Public Entity Risk Pools May Take on the Characteristics of an Insurer. LGC is exempt from regulation as an insurer, by statute. The Bureau, however, then erroneously and irresponsibly argues that insurance concepts and methods of evaluating risk are "irrelevant."

In fact, the cost and expense structure of a RSA 5-B pooled risk management program can be quite similar to that of an insurer. A November 1, 2011 report from the New Hampshire House of Representatives Committee Services Office, prepared for the House Select Committee to Study Issues Regarding the New Hampshire Local Government Center, quotes an excerpt from a text regarding Government Accounting Standards Board treatment of public entity risk pools, as follows:

> State and local governments encounter essentially the same accounting and reporting issues as commercial enterprises that provide insurance coverage (insurer) and that purchase insurance coverage (insured). … When a governmental entity is organized as a public entity risk pool, it may take on many of the characteristics of an insurer.[6]

This observation is unsurprising, for a public entity risk pool that failed to act like an insurer – setting sufficient reserves, paying claims, covering its administrative expenses – would soon fail.

How LGC Invests. The Board of LGC, Inc. is a prudent and responsible manager of the assets of the risk pool programs. It periodically reviews its investment policy, the objectives of which include preservation of principal, prudent diversification, and availability of projected cash flow. The policy limits the permissible investments to meet the adopted objectives. LGC utilizes a professional investment manager and investment advisor to ensure the appropriateness of and compliance with the investment policy.

While the Bureau acknowledges it is appropriate for LGC to invest its capital, the Bureau criticizes certain investment vehicles and the use of investments with a maturity of more than one year. Yet the practices utilized by LGC related to its investment decisions are consistent with the standard of care that apply to trustees, as set forth in the Uniform Prudent Investor Act, RSA 564-B:9-902, which requires evaluation of individual assets not in isolation, but in the context of the portfolio and strategy as a whole. The nature of the risks covered by LGC can extend further than the current year. That fact affects the calculation of risk reserve. It also makes it appropriate to invest in assets that extend further than the current year. In addition, while the investments made by LGC may contain a term longer than the current year, each of them is relatively liquid.

LGC has annually reported to the Secretary of State its investment policy, its chosen investment manager, its practice of bi-annual evaluations of the performance of the investment

[6] *Governmental GAAP Guide 2009*, by Michael A. Crawford and D. Scot Lloyd.

manager, and the nature and terms of its investments, since at least 2001. This is the first time the Secretary has taken issue with anything disclosed in the annual reports.

It is common, and permitted, to return surplus through rate reduction. The Bureau contends there is "no support for this practice in the statute." Actually, the statute is silent on how surplus should be returned. Accordingly, the LGC Board looks to the advice of its consultants, and the preferences of its members, to determine the best means of returning excess funds. The practices of other, similar risk public risk pools are also considered.

Risk pools have to determine rates months in advance of the periods they cover, and then commit to those rates. Similarly, LGC's members consistently report a preference to receive excess surplus in the form of rate stabilization rather than as a lump sum payment, as more predictable rates allow for greater certainty in budgeting and administration. Indeed, returning surplus through rate stabilization is the general practice of RSA 5-B risk pools in New Hampshire. Even the Segal Report commissioned by the Bureau endorses returning amounts above that needed for reserves through rate subsidization over multiple years: "Prudent underwriting would call for trying to achieve the reduction over multiple (2-3) years during the rate revisit process."[7]

The return of surplus through rate reduction was addressed in an opinion letter from LGC's attorney on April 20, 2007, which concluded as follows:

> A reduction in rating resulting from the consideration of these additional funds which reduction results in lower contributions by Members, achieves the same economic result as the dividend return to Members who then in turn must pay proportionately higher contributions. In essence, a return of additional funds to the Members has been achieved. In the absence of contrary legislative or judicial clarity on the meaning of "return" of surplus and the lack of an express legal mandate that a "return" be accomplished only by a declaration of a dividend, this method should constitute a return of additional funds to the Members within the meaning of RSA 5-B.

[7] Segal Report, page 9.

In that same opinion, LGC's legal counsel concluded that the return of additional funds to Members through an adjustment in the ratings process, spread over a number of years to address additional unexpected contingencies, and to seek to achieve rate stabilization, was legal.

C. Other Improper Spending (¶s 44-57)

In this section, the Petition criticizes LGC's support of its workers' compensation pool, and other spending which the Bureau terms "improper."

Strategic support of the workers' compensation pool was a business judgment of the LGC Board. Following the 2003 reorganization, LGC's Board decided to fund certain strategic priorities. The decision reflects the Board's determination how to best offer several lines of coverage, and to coordinate activities related to these coverages in a cost-efficient manner, to better serve LGC's members. The activities funded as a part of that strategy include training; wellness; loss prevention across all lines of coverage; as well as assisting the workers' compensation program's competitive position in the marketplace. The decision to do so was made following extensive due diligence and deliberation, with the advice of counsel. The decision reflected the Board's prudent business judgment that such support allowed better administration and management of the members' long-term, total claims liability, and preserved the long-term financial sustainability of all lines of coverage in a changing marketplace.

The strategic support of the workers' compensation pool – both the policy and the amount – has been publicly disclosed in the pools' annual filings with the Secretary of State, starting in 2004 and continuing through the 2010 fiscal year filings. Strategic funding ended with the calendar year 2010.

The funding of strategic priorities by the Board was consistent with RSA 5-B. RSA 5-B:3, III permits pooled risk management programs to provide "any or all" of a multitude of

coverages, including casualty, health, and workers' compensation, for the purpose of "distributing, sharing, and pooling risks." Those terms are undefined (as are the statutory permissions to retain "any amounts for administration," RSA 5-B:5, I(c), or funds which may be necessary for "other projected needs of the plan," RSA 5-B:5, I(f)). The strategic support of the workers' compensation pool complied with these statutory provisions, for in determining what coverages to offer, how to distribute and pool the risk for those coverages, what other needs the plan might face, and what amounts might be needed to administer the programs, the LGC Board exercised its best business judgment. In doing so, the Board selected the best and most efficient method of accomplishing these purposes. Taking action against Board members now, years after the actions were taken and publicly disclosed, and with no rules or guidance on the subject *to this date*, would be a severe violation of fairness and due process.

Only employer funds were used. LGC's contract to provide health coverage is entered into with each employer-political subdivision, and all payments due LGC for such coverage are the responsibility of the participating political subdivision. Nevertheless, LGC recognized that employers, at times, require their employees and retirees to defray a portion of the employers' payments to LGC for health coverage. In making the strategic contributions, LGC took the extra step of segregating, to the degree possible, funds attributable to the share employees and retirees were required by their employer to contribute. Such amounts were not included in calculating HealthTrust's share of strategic funding.

To further eliminate any concerns regarding the amounts contributed by HealthTrust toward strategic support for the workers' compensation program, LGC has specifically identified the amount of the support and recognized such amount as a loan, by executing a note for the workers' compensation pool to repay over time.

Other expenditures, criticized by the Bureau, were equally proper. RSA 5-B:5, I(c) permits the pools to retain "any amounts required for administration," without defining "administration." The Bureau criticizes *any* charitable giving by LGC as improper and unjustified, despite the broad scope of the term "required for administration."

The amounts are relatively small, and the Board considered them appropriate business expenditures to support the purposes of the pools and their members. The sponsorships were provided to groups that have a direct connection with the mission of the organization "to strengthen the quality of its member governments and the ability of their officials and employees to serve the public," and included events for the Professional Firefighters of New Hampshire, the New Hampshire School Administrators Association for educational conferences, and the New Hampshire Citizens Health Initiative, established by Governor Lynch to improve the systems that provide and finance health care in New Hampshire. LGC's board reasonably concluded that supporting these groups, and other initiatives including health and safety awareness, wellness and risk prevention, positively impacts the pools and their members. This is achieved by the favorable long term impact on claims experience for the pools, and by building goodwill, which increases the size and quality of the pools' membership, thereby further reducing overall pool costs.

The establishment of the Defined Benefit Plan was an appropriate act by the LGC Board. LGC voted to establish the LGC Defined Benefit pension plan in July 2006.[8] At the time, the Board saw a need to adopt the plan for recruitment and retention of personnel. It noted that PRIMEX, a competitor, had instituted a similar plan. It also noted that LGC competes in the labor market with state, federal, and local governments, all of whom offer defined benefit plans.

[8] The Defined Benefit Plan replaced a defined contribution retirement plan funded by both employer and employee contributions.

The Board limited the cost to the organization by declining to adopt a cost of living increase or any retiree medical coverage subsidy. As a result of this and other decisions, the final pension offered under the LGC plan is more modest than the state retirement plan.

In adopting the plan in 2006, the Board also voted to budget a sum sufficient to purchase a share of employees' past service liability. LGC's share of the past service funding, as employer, amounted to 54%, while the employer share of the current service liability in 2007 through 2010 amounted to 59%. Paying for past service liability to establish a defined benefit plan is consistent with a practice followed by others in the industry.

Providing employees with a defined benefit plan is consistent with industry practice for both municipal leagues and municipal league risk pools. In light of the broad availability of such plans to employees of municipal leagues, and similar availability of defined benefit plans to most employees of public bodies and public agencies in this state, it was reasonable for LGC's Board to adopt such a plan. The decision enhanced LGC's competitiveness in the labor market, for the long term benefit of LGC, its risk pools, and its members.

D. Improper Tying Arrangement (¶s 58-61)

RSA 5-B:5, I(e) permits pools to establish the terms of eligibility for participation. This statutory construct recognized the history and practice of the risk pool organizations. Many state municipal leagues created risk pools specifically to provide coverage options for their members, at a time when their members were either unable to get insurance coverage at all or were unable to get coverage at a reasonable price. The private market had abandoned local government. In acknowledgement of the fact that the state leagues created the pools to address this lack of access to coverage for local governments, it was, and to this day remains, common in many states to require membership in the league to access the pools.

When the New Hampshire Municipal Association established risk pools in 1984 and 1986, eligibility to participate was limited to NHMA members. The establishment of the pools pre-dates the passage of RSA Chapter 5-B. (See the 1985 Articles of Agreement for HealthTrust, Inc., and the 1986 Bylaws for Property-Liability Trust, Inc.) At the time legislators were considering adoption of RSA 5-B, they were aware that the pools were established to serve the members of NHMA. In passing RSA 5-B, the legislation not only specifically permitted pools to establish eligibility criteria, it affirmed the existing pools' use of their current eligibility criteria. The continued use of that criteria does not violate the statute.

Currently, city and town members of LGC have access to the legislative advocacy services that are offered directly by NHMA. Those members pay a membership fee that is based on population and equalized value for such access. By contrast, school district and county members pay a nominal fee to be a member of NHMA, which acknowledges and recognizes the continuing value offered by the creator of the pools to all members that participate in the risk programs.

V. Response to Count III – Violations of the New Hampshire Securities Act (Paragraphs 62-108)

In this section, the Bureau contends that LGC has violated RSA 421-B by selling two types of securities: membership interests in NHMA, and risk pool contracts. LGC denies the underlying premise to Count III; that is, that the products and services offered by LGC are investment contracts or securities, as contended by the Bureau. Accordingly, each and every allegation made by the Bureau in this section is denied, and each has no application to LGC.[9]

[9] LGC admits that ¶s 84 and 87 must be true: they allege LGC has never registered as a broker-dealer of securities, and none of its employees are registered as agents for the sale of securities.

The Bureau's novel take on what constitutes securities has potential application to the other New Hampshire risk pools as well. On information and belief, neither of them has registered under the Securities Act provisions.

Further, a number of changes have been proposed to RSA 5-B for consideration by the legislature in the upcoming session, by LGC and others. On information and belief, the draft bill that will come out of the Legislative Oversight Committee considering these issues will contain language clarifying that RSA 5-B pool activity is not subject to the securities laws.

LGC will raise a number of technical defenses to these claims, as well. The Membership interests and Risk Pool Contracts are not securities under the Howey test adopted by the Bureau, as they lack the features of a security: there is no "investment" of money, but rather a purchase of services, and there is no expectation of profit. Even if the return of surplus is mischaracterized as profit, any return largely results from the claims experience of the members themselves.

The Risk Capital test is not the standard for determining an investment contract in New Hampshire.[10] Even if it were, the Membership interests and Risk Pool Contracts are also not securities under that test. The municipalities pay LGC for coverage and services; their payments are not 'an initial value, subject to the risk of the enterprise', as defined by this test. Nor is there an expectation of a benefit, over and above the initial value provided, which is the touchstone of this analysis; nor is any value provided by the activities of others, compared to the members' own claims experience.

To the extent the Membership interests or Risk Pool Contracts are found to constitute securities, there are a number of exemptions that appear to apply, found under RSA 421-B:17,

[10] The Bureau has adopted the Howey test in all other instances of which LGC is aware, and that test applies in all State court cases which LGC has found. The applicability of the Risk-Capital test to this matter is therefore unclear.

I(a) (issued by a political subdivision); (j) (sold only to members); or (m) (issued by a trade or professional association).

VI. Response to Count IV – Additional Issues Regarding Limited Liability Company Formation and Management (Paragraphs 109-141)

This section repeats some of the claims made in Count I. The Bureau goes on, however, to make misleading claims about the members of the LLCs, and to assign inappropriate significance to those false claims.

Neither Mr. Andrews nor Ms. Carroll was ever the member of the LLCs. The 2003 resolution commencing the reorganization process, for example, made clear that Mr. Andrews's capacity in signing documents to effect that transaction was a representative one:

> FURTHER RESOLVED: That … John B. Andrews as Fund Administrator or Executive Director, as the case may be, of the Companies,… [is] hereby authorized and directed to execute and deliver any and all documents, certificates or affidavits or take any action … necessary or advisable in order to carry out the transactions authorized by the foregoing resolutions.

(Emphasis supplied.)

LGC admits, and has throughout this process, that inadvertent errors were made in some of its annual filings. For example, the signature blocks on certain annual filing forms, completed at various times for the signature of John Andrews or Maura Carroll, incorrectly referred to them as *the* member of the LLC, rather than *on behalf of* the member of the LLC.

Inadvertent errors are common in corporate filings.[11] They are easily corrected. In the instance of LGC, they have been corrected, in filings made with the Secretary of State's Office since the Bureau's investigation began. The Bureau's obsession with the now-historical

[11] Mistakes can also be made by the Secretary of State, even in corporate documents made by him specifically for purposes of this case. Note, for example, the dates of the Certificates issued by William Gardner, Secretary of State, as Exhibits 7 and 8 in Support of the Bureau's Motion to Determine Status of Counsel and Request for Findings of Fact and Rulings of Law, made part of the record in this case: August 23 and 26, 2011, respectively. Yet, on those dates, the Secretary purported to certify certain recordings made on August 31, 2011, five to eight days *in the future*. Either the Secretary made a mistake, or he is clairvoyant.

technical filing errors, and the incorrect legal conclusions the Bureau reaches over their meaning, says more about the Bureau's motives than it does the legal significance of the errors themselves.

The assets of the risk pools are held by the LLCs, and have been since 2003. Each of the entities involved has recently ratified the course of conduct since 2003. The Bureau's game of "Gotcha!" should be rejected by the Hearing Officer.

A. Limited Liability Companies (¶s 109-114)

The transfer of HealthTrust, Inc.'s and PLT, Inc.'s assets from the Chapter 292 entities to the LLCs in 2003 was legal, appropriate, and consistent with the votes and actions taken by the Boards of those entities, despite the concerns expressed by the Bureau regarding the effect of the technical failure of the 2003 mergers. Pursuant to the Pooled Risk Management Agreements, the Chapter 292 corporations ratified and approved the transfer to and subsequent use of those assets by the LLCs, and the operation of the pooled risk management programs owned and operated by the LLCs since 2003, under the direction of the LGC Board. Accordingly, those LLCs legally and appropriately hold the assets, if any, that remain from the 2003 transfers, together with all the assets the LLCs have accumulated in the administration of the pools they have owned and operated since 2003.

LGC denies the Bureau's contentions to the contrary, largely found in Paragraph 114 of this section.

B. Mechanisms for Management of HealthTrust, LLC and Property-Liability Trust, LLC (¶s 115-124)

LGC disputes the Bureau's factual allegations and conclusory statements about the law in this section.

LGC contests the requirements the Bureau argues apply to LLC management, such as whether a formal LLC agreement is required for its operation. LGC agrees, however, that

management authority over each pool is lodged in the sole member of each risk pool (LGC, Inc.). Accordingly, LGC contests the conclusions the Bureau reaches concerning any flaws or failure of the management structure.

C. Annual Reports (¶s 125-135)

The Bureau lists a number of inadvertent, ministerial errors in the annual corporate filings by LGC with the corporations division of the Secretary of State's Office. LGC admits there were occasional errors in the filing block identification of the person signing the documents.

LGC notes, however, that it made each annual filing. To the extent the signature block varied from other publicly-available information, detailing who should have signed on behalf of the LLC, no person – including the regulator, the Secretary of State – ever complained of the discrepancy. No harm has ever been alleged to have resulted from such inadvertent errors.

LGC notes, further, that any discrepancies have since been corrected.

Finally, LGC specifically disputes the legal significance the Bureau attributes to these errors: a scrivener's error in an annual filing does not lead to "a lack of lawful membership and thus a lack of lawful management authority," as contended by the Bureau in ¶ 135.

D. Judicial Dissolution (¶s 136-141)

Neither RSA 5-B nor RSA 421-B provide dissolution of a legal New Hampshire entity as a permitted remedy. The Bureau nevertheless seems committed to using some inadvertent errors as a basis to seek dominion over LGC's assets, either through this hearing process or through some resort to the Superior Court. Such a power grab would amount to theft by the sovereign – something rejected by the people of New Hampshire since the 1770s.

VII. Statement of the Law

A. Count I (¶s 1-11)

LGC assumes the Bureau has properly quoted the statutes. LGC disputes the application of many of the statutes to the events at issue in this proceeding, including those cited in Paragraphs 2-6 and 8-9.

LGC also disputes the conclusions and applications to the circumstances that the Bureau reaches within this section of the Petition, including, for example those contained in Paragraph 3.

Further, the Bureau's references to several statutes seem out of place in this proceeding, especially those concerning the superior court (e.g., Paragraphs 7 and 10), since this is an administrative proceeding begun by the Bureau itself, under RSA 5-B and RSA 421-B:26-a.

B. Count II (¶s 12-25)

LGC assumes the Bureau has properly quoted the statutes. LGC disputes the application of many of them to the events at issue in this proceeding, including those cited in Paragraphs 13-14.

LGC also disputes the conclusions and applications to the circumstances that the Bureau reaches within this section of the Petition, including, for example, those contained in Paragraphs 15 - 18.

C. Count III (¶s 26-41)

LGC assumes the Bureau has properly quoted the statutes. LGC disputes the application of any of them to the events at issue in this proceeding, for the reasons described earlier.

VIII. Affirmative and Other Defenses

LGC may raise any or all of the following affirmative and other defenses in this matter:

A. The Secretary lacks the authority to regulate any activities of any RSA 5-B risk pool prior to June 29, 2009, the effective date of the amendment of RSA 5-B:4.

B. The Secretary lacks the authority to impose penalties related to the activities of any RSA 5-B risk pool which occurred prior to June 14, 2010, the effective date of RSA 5-B:4-a.

C. The Secretary's attempt to regulate LGC only, rather than the RSA 5-B pools as a group, is a selective prosecution, barred by the Bill of Rights and the Constitutions of the State of New Hampshire and the United States.

D. The Secretary's selective prosecution of LGC only, rather than the other RSA 5-B pools for which similar complaints have been received by the Secretary, is barred by the Bill of Rights and the Constitutions of the State of New Hampshire and the United States.

E. The selective prosecution of LGC only, rather than the other RSA 5-B pools for which the Bureau of Securities knows similar violations exist, is barred by the Bill of Rights and the Constitutions of the State of New Hampshire and the United States.

F. The Secretary's lack of prior complaint concerning LGC's actions, plainly reported in LGC's annual filings constitutes a waiver of any claims on those topics.

G. The Secretary's lack of prior complaint concerning LGC's actions, reported in LGC's annual filings, administratively estops the Secretary from making claims on those topics.

H. The Secretary's lack of prior complaint concerning LGC's actions, reported in LGC's annual filings, constitutes laches, barring any claims on those topics.

I. The lack of rule-making on any of the topics described in the Petition is a bar to any attempt to penalize LGC by administrative or judicial fiat.

J. The lack of rule-making, on the regulatory standards being applied in the Petition to claim a violation of RSA 5-B and RSA 421-B, is a bar to any attempt to penalize LGC by administrative or judicial fiat.

K. The vagueness of the statutes (both RSA 5-B and RSA 421-B) bars any attempt to penalize LGC by administrative or judicial fiat.

L. Deference to the judgment of the Respondents is warranted, as the actions taken by LGC and its pools were taken pursuant to the best business judgment exercised by its Boards, at the time, given the available information, and with the advice of consultants and legal counsel, and were similar to those taken by other pools, both within and without New Hampshire.

M. The actions by LGC do not fall within the definitions of actions regulated by the Securities Act; if they fall within the definitions, the actions fall within an exemption granted under the Act.

N. The Bureau's fanciful concoction of the risk pool Member Agreements as 'investment contracts' fails, because political subdivisions of New Hampshire are limited by statute to the type of investments in which they may legitimately invest, and such investment contracts are not permitted.

O. To the extent the Petition contains fraud allegations, they are insufficiently described in any meaningful detail.

P. All the Counts of the Petition fail to state a cause of action for which relief may be granted.

LGC reserves the right to amend this list of Affirmative Defenses, supplementing it with additional defenses that may appear during the discovery in this matter, and removing those that prove to have no application to the case.

Respectfully submitted,

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

By Their Attorneys:
PRETI FLAHERTY BELIVEAU & PACHIOS, PLLP

Dated: January 6, 2012

By: /s/ William C. Saturley
William C. Saturley, NHBA #2256
Brian M. Quirk, NHBA #12526
PO Box 1318
Concord, NH 03302-1318
Tel.: 603-410-1500
Fax: 603-410-1501
wsaturley@preti.com

CERTIFICATE OF SERVICE

I certify that on the 6th day of January, 2012, I forwarded copies of this pleading *via* E-mail to counsel of record.

/s/ William C. Saturley