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

RESPONDENTS' MOTION FOR RECONSIDERATION OF FINAL ORDER

Respondents Local Government Center, Inc. and affiliated entities ("LGC") hereby move for reconsideration of the Hearing Officer's Final Order of August 16, 2012 (the "Order"). In the Order, the Hearing Officer errs numerous times by imposing specific requirements on LGC that are neither expressed in nor implied by RSA 5-B.

If the New Hampshire Secretary of State (the "Secretary"), who is charged with enforcing the statute, wished to mandate that pooled risk management programs such as LGC use a particular methodology to calculate their reserves; if he wished them not to exceed a fixed maximum reserve level; and if he wished them to structure themselves and conduct their operations in particular ways that are not spelled out (or even implicit) in the statute, then he should have gone to the legislature to seek an amendment to the statute to incorporate his preferred requirements. Alternatively, the Secretary could have engaged in rulemaking to provide LGC with fair notice of what the Secretary, as regulator, required of risk pools.

Instead, the Secretary improperly appointed a former state employee and paid him over $130,000, without the Governor's or the Executive Council's approval, to create requirements that are nowhere to be found in the statutory or regulatory landscape, but that instead surfaced

for the first time in the New Hampshire Bureau of Securities Regulation's (the "Bureau" or "BSR") Staff Petition to the Secretary, or in the Amended Petition submitted to the Hearing Officer months after the commencement of this proceeding. As LGC has argued in its dispositive motions (on some of which the Hearing Officer never ruled), such a procedure does not comport with basic notions of fundamental fairness and due process. While the Hearing Officer may disagree with certain decisions LGC has made, his legal assignment was *not* to offer his own assessment of the wisdom of LGC's actions or to second-guess the business judgment of its board of directors, but to rule on whether LGC violated the requirements of RSA 5-B. LGC respectfully requests that the Hearing Officer reconsider his decision to read into RSA 5-B, and impose on LGC, requirements that may reflect the Hearing Officer's own view of how a risk pool should be run, but that simply do not exist in the statute.

LGC argues in this motion that the Hearing Officer should reconsider (1) his decision not to withdraw from this case, despite the improper pecuniary incentives created by his financial arrangement with the Secretary; (2) his disregard for the violation of LGC's right to fair notice and due process caused by the Bureau's failure to publish their novel interpretations of the requirements of RSA 5-B prior to the issuance of the Staff Petition charging LGC with statutory violations; (3) his determination that LGC's reserve-setting methods or reserve levels violated RSA 5-B; (4) his disregard of the exercise by LGC's Board of Directors of its sound business judgment in setting reserves and operating the risk pools; (5) his determination that LGC's corporate structure or conduct violated RSA 5-B; (6) his violation of the New Hampshire Constitution's rule against retrospective legislation caused by the portion of the Order purporting to undo transfers between LGC entities executed before the Secretary obtained regulatory

authority in June 2010; and (7) other specific rulings and findings the Hearing Officer made that constitute errors of law, errors of reasoning, or erroneous conclusions, as detailed below.

I. The Hearing Officer, by failing to disqualify himself, violated LGC's constitutional right to a fair and impartial hearing.

The Fourteenth Amendment to the United States Constitution provides that a State shall not "deprive any person of life, liberty, or property, without due process of law." Part I, Article 35 of the New Hampshire Constitution sets out the right to due process in more detail:

> It is essential to the preservation of the rights of every individual, his life, liberty, property, and character, that there be an impartial interpretation of the laws, and administration of justice. It is the right of every citizen to be tried by judges as impartial as the lot of humanity will admit.

This essential right to an impartial decision-maker extends to quasi-judicial proceedings. *See In re Town of Bethlehem*, 154 N.H. 314, 330 (2006). Even the statute pursuant to which the Secretary of State hand-picked the Hearing Officer, without oversight, provides that:

> Each presiding officer may, at any stage of the hearing process, withdraw from a case . . . for any other reason that may interfere with the presiding officer's ability to remain impartial.

RSA 421-B:26-a,XI.

The *sine qua non* of judicial integrity and impartiality is that the judicial officer must have no pecuniary interest in the outcome of the matter. "'A *per se* rule of disqualification due to the probability of unfairness, applies when the trier has pecuniary interests in the outcome.'" *Appeal of Grimm*, 141 N.H. 719, 721 (1997) (quoting *Plaistow Bank & Trust Co. v. Webster*, 121 N.H. 751, 754 (1981)); *see also Haas v. County of San Bernardino*, 45 P.3d 280, 286 (2002) ("Of all the types of bias that can affect adjudication, pecuniary interest has long received the most unequivocal condemnation and the least forgiving scrutiny."). Schemes that create

impermissible pecuniary interests are not limited to those instances where a quasi-judicial or judicial officer's compensation is directly tied to the outcome of a case. *See Ward v. Village of Monroeville, Ohio*, 409 U.S. 57, 61 (1972).

While ostensibly less formal than judicial proceedings, administrative or quasi-judicial proceedings are no less governed by the United States Constitution, the New Hampshire Constitution, and New Hampshire statutes. These sources of authority, along with a common sense analysis of the circumstances, require the Hearing Officer to reconsider his decision not to withdraw from hearing this case.[1] Here, the undisputed facts are as follows[2]:

1. The Bureau submitted the Staff Petition to the Secretary of State, who issued an order to cease and desist and show cause.

2. The Secretary of State hand-picked the Hearing Officer without creating a record of the selection process or his conversations with his choice for the position.

3. The Secretary of State asked the Hearing Officer to conduct the proceedings for free. Transcript of Administrative Hearing [hereinafter, "Tr."] 2314. The Hearing Officer, who reported that he is "not a person of significant wealth," declined to do so. Tr. 2314-2315.

4. The Hearing Officer's contract contains a provision that exempts it from the usual Governor and Executive Council review.

5. While the contract states that the Hearing Officer shall be paid an amount equivalent to his last state compensation, the actual compensation is more than 40% greater than his former state salary.

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[1] When the issue concerns the pecuniary interest of a quasi-judicial officer pursuant to a particular compensation scheme the relevant inquiry may be framed as "whether the economic realities make the design of the fee system vulnerable to a 'possible temptation' to the 'average man' as judge." *See Brown v. Vance*, 637 F.2d 272, 284 (5th Cir. 1981) ("The 'average man as judge' concept was made the heart of the test to introduce a humble Everyman, prey to the vicissitudes of life, the need for bread on the table, and for small favors from the right people.")

[2] The facts taken from the record of the hearing are cited as such. The remaining facts are matters of public record (for example, the submissions of the Staff Petition and Amended Petition) or appear in documents obtained by LGC, pursuant to RSA 91-A requests, following its discovery that the Hearing Officer's compensation was tied to the duration of the proceeding and he was renegotiating his contract with the Secretary during the final hearing. The documents were submitted to the Hearing Officer with LGC's written motion for his withdrawal.

6. When LGC inquired about the Hearing Officer's contract with the Secretary of State, it was informed it was a "flat basis" or flat fee contract, even though the Hearing Officer is paid bi-weekly based on the duration of the matter, ostensibly up to a "not to exceed" amount.

7. At least twice during these proceedings, and after LGC had inquired about the Hearing Officer's contract, he renegotiated its terms with the Secretary of State. Each time, the renegotiation was done without creating a record. Each time, the Hearing Officer continued to be paid bi-weekly based on the duration of the matter, ostensibly up to a "not to exceed" amount. LGC was not informed of the renegotiations on either occasion.

8. On March 12, 2012, LGC and the other Respondents filed motions to dismiss the Amended Petition. On April 4, 2012, the Hearing Officer denied these motions. If the Hearing Officer had granted LGC's dispositive motions, he would have been paid at least $52,500 less than he has received so far pursuant to his contract with the Secretary of State.

9. On May 11, 2012, after LGC moved for his withdrawal, the Hearing Officer placed his comments on the record, including a recitation of his recollection of certain facts and events, and denied LGC's motion. (Tr. 2313-2317). The Hearing Officer precluded LGC from inquiring about, responding to, or presenting further argument based on his comments. (Tr. 2317-2318) (Counsel: "I would like to respond to your comments on the motion that is before you." . . . Presiding Officer: "[Y]ou have nothing to react to there. I'm the hearing officer, I've have made my ruling. And I am well aware that you would like me to say something to you and accept your representation, but sir, I don't accept your representation . . . I get to say that because I'm the hearing officer - -").

10. Later in the day on May 11, 2012, LGC renewed its motions to dismiss. If the Hearing Officer had withdrawn from the case or granted LGC's dispositive motions, he would have been paid at least $35,000 less than he has received so far pursuant to his contract with the Secretary of State.

11. The Hearing Officer did not issue the Final Order until August 16, 2012, more than three (3) months after evidence was submitted. That duration virtually ensures another contract extension will be necessary.[3]

[3] The most recent contract amendment of which LGC is aware has a "completion date" of August 31, 2012. Pursuant to RSA 421-B:26-a, XXVI, the parties have thirty days from issuance of the Final Order to submit motions for reconsideration. After his receipt of a motion for reconsideration, "[i]f the presiding officer believes further information or argument should be considered, the parties shall be provided with an appropriate notice and opportunity to be heard before any revision is made in the previous action." RSA 421-B:26-a, XXVII. Consequently, even without requesting further information or argument, by issuing the Final Order on August 16,

The Hearing Officer's erroneous conclusion that he was not required to withdraw from the matter is both an error in reasoning, and an error of law. The Hearing Officer had an impermissible pecuniary interest in the outcome of the proceeding, created by a compensation system that directly tied his compensation to the duration of the proceeding and the future good will of the Bureau. In a case that closely resembles this one, *Haas v. County of San Bernardino*, 45 P.3d 280, 283 (2002), the California Supreme Court held that "the practice of selecting temporary administrative hearing officers on an ad hoc basis and paying them according to the duration or amount of work performed" gave hearing officers an impermissible pecuniary interest in the cases before them, thus interfering with their ability to remain impartial and causing a violation of due process rights. *Id.* The California Supreme Court aptly framed the issue as follows:

> The question presented is whether a temporary administrative hearing officer has a pecuniary interest requiring disqualification when the government unilaterally selects and pays the officer on an ad hoc basis and the officer's income from future adjudicative work depends entirely on the government's goodwill. We conclude the answer is yes.

Id. at 285-86.

The California Supreme Court eschewed the notion that improper pecuniary arrangements were limited to cases where the judicial officer's compensation is dependent on the outcome of a particular case. The Court correctly reasoned that when a prosecutors' office is free to select its adjudicator, it is "presumed to favor its own rational self-interest by preferring those who tend to issue favorable rulings," and the adjudicators, in turn, will "have a 'possible

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2012, it appears likely that the Hearing Officer and the Secretary of State will again renegotiate the Hearing Officer's contract while the instant motion is pending (if they have not already done so).

temptation . . . not to hold the balance nice, clear and true.'" *Id.* at 288-89. The due process violation occurs because "[t]he 'possible temptation' . . . not to be scrupulously fair, alone and in itself, offends the Constitution." *Id.* (citing *Tumey v. Ohio*, 273 U.S. 510, 532 (1972)).

Here, as a quasi-judicial officer, paid by a "per diem fee to the state," the Hearing Officer's deal with the Secretary violates due process regardless of whether there is an actual *quid pro quo* arrangement. Consistent with his referenced "per diem fee to the state," the Hearing Officer often reminded counsel that he has served as a quasi-judicial officer for the State of New Hampshire in other instances. This fact, taken together with the Hearing Officer's acknowledgement that he is not a wealthy man, present the circumstances found to violate due process because of pecuniary interest. In short, the circumstances "offer a possible temptation to the average man . . . not to hold the balance nice, clear, and true." *Tumey*, 273 U.S. at 532; *see also Haas*, 45 P.3d at 288-289 ("The 'possible temptation' . . . not to be scrupulously fair, alone and in itself, offends the Constitution.").

The impropriety and, certainly, the appearance of impropriety, were never as clear as when: (1) the Hearing Officer and the Secretary were further negotiating the contract while this contested proceeding was ongoing; and (2) by the inaccurate information given to LGC suggesting that the Hearing Officer was being compensated on a flat-fee basis.

In addition to the pecuniary incentive created by the prospect of future employment as a hearing officer, payment based on the duration of a proceeding offends due process. It is inconceivable that in a state where "[i]t is the right of every citizen to be tried by judges as impartial as the lot of humanity will admit[,]" *Part I, Article 35 of the New Hampshire*

Constitution, a quasi-judicial officer can increase his compensation by at least $52,000 merely by denying a party's dispositive motions.

The Hearing Officer renegotiated his contract with the Bureau at least twice while the proceeding was pending, receiving a total of $100,000 more than was authorized by the original contract. The absence of notice to LGC that this was occurring, and the lack of any record of the process, highlights the disregard for due process. It is clear that such renegotiating while a proceeding is ongoing creates a situation where the Hearing Officer is "vulnerable to a 'possible temptation' to the 'average man' as judge." *See Vance*, 637 F.2d at 284. Accordingly, it was error for the Hearing Officer not to disqualify himself.

II. The Order violates LGC's right to fair notice and due process.

No language in the statute supports the reserve requirements the Hearing Officer announces in his Order. Instead, the statute leaves the setting of reserve levels to the sound business judgment of a risk pool's board of directors. *See* Section III, *infra*. While the Bureau could have acted via a formal rulemaking process if it believed the Legislature had merely omitted details related to the implementation of the statute, and then held LGC to those requirements going forward, it violates LGC's right to due process for the Hearing Officer in this adjudicative proceeding to sanction LGC for having violated standards that exist neither in the statute nor in a rule, and of whose existence LGC therefore could have no notice.

The New Hampshire Supreme Court has explained that "'promulgation of a rule pursuant to the [Administrative Procedures Act] . . . is not necessary to carry out what a statute demands on its face.'" *Appeal of Blizzard*, 163 N.H. 326, 330 (2012) (quoting *Nevins v. N.H. Dep't of Resources and Economic Dev.*, 147 N.H. 484, 487 (2002) (alterations in original). But "[i]f the

statute lacks sufficient detail on its face" to support an agency action, "then an agency must adopt rules supplying the necessary detail." *Id.* If the agency has not done so, the Court must "determine whether the result [of the agency's failure to adopt rules] was unfair by examining whether the complaining party 'suffered harm as a result of the lack of [required] rules." *Id.* (quoting *Nevins*, 147 N.H. at 488).

RSA 5-B:5,I(c) requires that pooled risk management programs "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions." The statute does not require that LGC set its reserves at fifteen percent (15%) of claims or adhere to an RBC of 3.0. The statute does not contain any reference to either of these standards, and in fact, RSA 5-B:5 provides no guidance whatsoever as to how or at what level reserves are to be set. *See Nevins*, 147 N.H. at 487 ("One purpose for requiring rules is to give persons fair warning as to what standards the agency will rely on when making a decision.") In imposing standards not included in or contemplated by RSA 5-B, and of which LGC had no notice, and in failing to grant—or even rule on—LGC's motion to dismiss, the Hearing Officer committed an error of law.[4]

Even the legislature has acknowledged that RSA 5-B:5 lacks sufficient detail to indicate what conduct is prohibited. Legislation enacted in 2010 directed the secretary of state to employ the services of an actuary and submit a report to the legislature containing specific

[4] This is not a case where LGC failed to calculate reserves. LGC adhered to the statutory requirements by selecting a means to calculate reserves and proceeding to calculate them accordingly. As required by the statute, LGC has "[p]rovide[d] for an annual actuarial evaluation of the pooled risk management program" that meets the requirements of 5-B:5, I(f). But after years of accepting LGC's filings without objection, and with no prior notice having been given to LGC that only certain (undefined) reserve levels and methods of calculating reserves were permitted, the Bureau suddenly declared that LGC's reserves violated the statute. The statute lacks sufficient detail on its face for the Bureau to "enforce" it in this fashion without first promulgating rules to provide LGC with notice of its interpretation of what exactly LGC is required to do. *See Blizzard*, 163 N.H. at 330.

recommendations concerning the limitation of reserves in pooled risk management programs and the limitation on administrative expenses as a percentage of claims of pooled risk management programs. Ch. 149:6, Laws of 2010. The requested report was submitted, but no action has been taken by the legislature. *See Recommendations Concerning the Limitation of Reserves and the Limitation on Administrative Expenses as a Percentage of Claims of Pooled Risk Management Programs*, submitted by BSR on December 30, 2010; Tr. 732. That the legislature deemed it necessary to engage an outside actuary to submit "recommendations concerning the limitation of reserves in pooled risk management programs"—that is, the purported statutory requirement LGC is alleged to have violated in Count II—is direct and substantial evidence that the statute, in its current form, lacks sufficient detail to support the very specific requirements the Hearing Officer has imposed on LGC. The Bureau acknowledged as much in the press release it issued with the submission of its report where it "emphasized that these are recommendations and the legislature will ultimately determine how to address the issue." LGC Ex. 361.

Unlike the situation in *Blizzard*, where the appellant never argued that the failure to promulgate rules harmed her (*see* 163 N.H. at 330), and *Nevins*, where the appellants could not "explain … any specific way in which they were prejudiced as a result of the lack of guidance" (147 N.H. at 488), the Bureau's failure to promulgate regulations has caused clear and substantial harm to LGC. LGC has, for years, operated its business in reliance on its reasonable determination that it was in compliance with the terms of RSA 5-B:5, I(c), which simply requires that LGC "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions." Moreover, for all of those years, LGC filed annual reports with the Secretary, who never

complained about LGC's methods of operation.[5] Now, based on the Bureau's pronouncement that LGC violated heretofore unidentified requirements purportedly imposed by RSA 5-B, LGC has been subjected to the enormous disruption and expense caused by BSR's enforcement action against it, culminating in the issuance of the Order requiring LGC to completely restructure its operations and its finances, including the payment of more than $50 million.

Federal law is consistent with New Hampshire precedent, in that it also prohibits the Bureau from announcing new requirements for the first time in an adjudicatory proceeding, and imposing them on LGC, without having given prior notice of their existence. In the absence of rules to put LGC on notice of the particular requirements the Bureau believes should be read into the very general statutory language about reserves, the Bureau cannot create such requirements after the fact and impose them on LGC. *See General Electric Co. v. EPA*, 53 F.3d 1324, 1328 (D.C. Cir. 1995)("In the absence of notice—for example, where the regulation is not sufficiently clear to warn a party about what is expected of it—an agency may not deprive a party of property by imposing civil or criminal liability."). "If a violation of a regulation subjects private parties to criminal or civil sanctions, a regulation cannot be construed to mean what an agency intended but did not adequately express . . . . [The agency] has the responsibility to state with ascertainable certainty what is meant by the standards [it] has promulgated." *Diamond Roofing Co. v. Occupational Safety and Health Review Commission*, 528 F.2d 645, 649 (5th Cir. 1976).

Because the text of RSA 5-B:5 did not provide LGC with notice of the standards to which the Bureau has sought to hold it, and because LGC was harmed by the Bureau's failure to

[5] Since the inception of RSA 5-B in 1987, the Secretary had the authority to "perform or cause to be performed the required audit or [actuarial] evaluation" and have the risk pool program pay the cost, if LGC failed to file an annual actuarial evaluation that complied with the statute. See RSA 5-B:5 II. However, the Secretary never exercised that authority.

promulgate rules that would have provided LGC with notice of those standards, the Bureau's failure to engage in rulemaking to supply the necessary detail violated LGC's constitutional rights to fair notice and due process. The Bureau should not be permitted to hold LGC to standards that are neither expressed nor implied in the statute, nor established via rulemaking. In so doing it has engaged in ad hoc rulemaking that neither state nor federal law permits.

III. The Hearing Officer erred in his statutory interpretation of RSA 5-B by imposing reserve requirements on LGC that are not contained in the statute.

A. LGC complied with the requirements of RSA 5-B.

RSA 5-B imposes the following specific requirements on pooled risk management programs related to reserves:

> 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.

RSA 5-b:5, I(c)

> Provide for an annual actuarial evaluation of the pooled risk management program. **The evaluation shall assess the adequacy of contributions required to fund any such program and the reserves necessary to be maintained to meet expenses of all incurred and incurred but not reported claims and other projected needs of the plan.** The annual actuarial evaluation shall be performed by a member of the American Academy of Actuaries qualified in the coverage area being evaluated, shall be filed with the department, and shall be distributed to participants of each pooled risk management program.

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

The uncontroverted evidence at the hearing established that LGC has consistently complied with the annual requirements to file an actuarial evaluation pursuant to RSA 5-B:5,I(f). *See*, e.g., LGC Ex. 306 at 45-55 and LGC Ex. 302 at 93-126. In fact, the Bureau's own actuary, Howard Atkinson, specifically acknowledged that HealthTrust has met these requirements; he

testified that LGC's actuary, Peter Reimer, is a member of the American Academy of Actuaries (Tr. 753); that HealthTrust conducted an annual actuarial evaluation (Tr. 753); and that the evaluation assessed the adequacy of contributions required to fund the program, the reserves necessary to meet expenses of all incurred and incurred but not reported claims, and other projected needs of the plan. Tr. 753-759.

RSA 5-B also provides that pooled risk management programs must "[r]eturn all earnings and surplus in excess of any amounts required for administration, claims, reserves, and purchase of excess insurance to the participating political subdivisions." RSA 5-B-5,I(c). The statute, however, does not establish a required method for calculating reserves—based on percentage of claims, RBC, or any other method. Nor does the statute establish a maximum amount of reserves a risk pool may hold.[6] In the absence of an established statutory directive or adopted rule related to the proper method or level of reserves, New Hampshire law charges the governing board in the exercise of its sound business judgment to determine the proper level of reserves to protect its participating members from future risks. This is precisely what LGC has done.

Rather than evaluate HealthTrust's reserves based on a business judgment rule analysis, the Hearing Officer declared that the statutory language of RSA 5-B:5 requires that LGC HealthTrust's reserves must be limited to "fifteen percent (15%) of claims or an RBC 3.0 as determined by the BSR, whichever is less." Order at 76, ¶9. The Hearing Officer erred as a

[6] The Hearing Officer acknowledges as much in his Order, stating: "The statute also does not expressly prescribe a particular method of computation to be used by a pooled risk management program to compute the amount of earnings and surplus." Order at 30.

matter of law in reading requirements into the statute that are nowhere to be found in its actual text.[7]

If—as the Hearing Officer appears to believe—the existing statute mandates a method for setting reserves and a specific level at which they must be set, passage of Chapter 149:6, Laws of 2010 would not have been necessary. The Legislature's request for guidance on the issue of reserve levels underscores the absence of any language in the statute to support the Hearing Officer's command that LGC set its reserves at the particular level he has specified.

B. The Hearing Officer erred in imposing his own judgment on the business and affairs of LGC, and ignoring the sound business judgment exercised by the Board.

In the absence of a specific statutory directive as to the proper method for calculating reserves or any specific reserve level ceiling, RSA 5-B:5 permits a risk pool's board of directors to exercise its sound business judgment in determining the proper level of reserves for its particular risk pool characteristics. Under New Hampshire law, the directors of a corporation

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[7] Reinforcing the point that RSA 5-B does not specify a maximum permitted reserve level is the fact that legislation was introduced in 2010 to require that reserves be set at ten percent (10%) of claims. Tr. at 737; House Bill 1393 (2010); LGC Ex. 253. Testifying at the Senate hearing on the proposed reserve limit in HB 1393, the Bureau's Attorney Kevin Moquin told the legislature that:

> We do support the concept of providing a specific benchmark for reserves. It doesn't seem unreasonable to us that the legislature should set a reserve level for a program the legislature authorized, and it would give us further guidance as to what the legislature considers a proper level of reserves.

HB 1393 Senate Commerce Committee Transcript at 2; LGC Ex. 253. The proposed legislation setting a specific reserve limit failed to pass. Tr. at 737; LGC Ex. 361 (BSR press release 12/30/10); HB 1393 (2010). Instead, the Legislature amended the bill and passed a law directing the Bureau to provide "recommendations concerning the limitation of reserves in pooled risk management programs and the limitation on administrative expenses as a percentage of claims of pooled risk management programs." Ch. 149:6, Laws of 2010 (emphasis added). In response, the Bureau submitted the report which studied HealthTrust only and made recommendation regarding possible reserve limits to adopt as part of RSA 5-B; its recommendations are still pending before the legislature. The Bureau's press release issued with submission of the report stated that "**The Bureau emphasized that these are recommendations and the legislature will ultimately determine how to address these issues."** (Emphasis added) LGC Ex. 361.

must discharge their duties (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner they reasonably believe to be in the best interests of the corporation. RSA 293-A:8.30(a).

Pursuant to the business judgment rule, there is "a powerful presumption in favor of actions taken by the directors in that a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be 'attributed to any rational business purpose.'" *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993); *see also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1373 (Del. 1995) ("The business judgment rule is a 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'").

The burden is on the party challenging an exercise of business judgment—here, the Bureau—to rebut the presumption in favor of directors who have acted in good faith and with ordinary care. *McMullin v. Beran*, 765 A.2d 910, 917 (Del. 2000). The business judgment rule thus "operates to preclude a court from imposing itself unreasonably on the business and affairs of a corporation." *Cede*, 634 A.2d at 360.

The Hearing Officer failed to analyze LGC's actions under the business judgment rule. Under RSA 5-B, it falls to the Board of Directors—exercising their sound business judgment—to establish an appropriate reserve level. Tr. 323:8-13. The Bureau's own insurance industry expert, Michael Coutu, testified that "[i]t's [the Board's] prerogative to set a [reserve] level they deem prudent." Tr. 323:3-4.

As documented in LGC's Post-Hearing Brief, there was voluminous evidence at the hearing that LGC's Board exercised its sound business judgment in selecting a method for setting reserves and holding a level of reserves. *See* LGC's Post-Hearing Brief Regarding Count II ("Post-Hearing Brief") at 4-16. In his Order, the Hearing Officer does not rule to the contrary, but instead simply disregards the business judgment rule. The Hearing Officer ignores the statutory language expressly identifying, as a criterion for evaluating pooled risk management programs, whether the plan held "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" (RSA 5-B:5,I(f)). He fails to explain how the phrase "other projected needs of the plan" could be interpreted other than to put substantial discretion in the hands of the Board of Directors to set reserve levels pursuant to its sound business judgment. In failing to analyze whether the Board acted within its discretion in exercising its reasonable business judgment to set LGC's reserves, the Hearing Officer committed an error of law.

C. The Hearing Officer erred in ignoring the contradiction between the Bureau's interpretation of the statute in this proceeding against LGC and its agreements with PRIMEX and SchoolCare on the same issues.

Contrary to the Order, RSA 5-B does not require pooled risk management programs to use a particular method for setting reserves or to maintain the specific reserve level the Hearing Officer has announced. This is clear from the Bureau's agreements with PRIMEX and SchoolCare, the two other pooled risk management programs, which were entered into just weeks before the hearing. Those agreements—drafted by the Bureau, the entity charged with enforcing RSA 5-B by the Secretary—do not subject PRIMEX or SchoolCare to the same requirements, purportedly found in RSA 5-B, that the Hearing Officer has imposed on LGC.

Indeed, those agreements do not impose a consistent methodology or limit on the other risk pools.

Instead, the Bureau has agreed that PRIMEX's and SchoolCare's boards of directors may set reserve levels based on their "sound business judgment," LGC Ex. 334, § 3.1; BSR Ex. 65, SchoolCare Agreement, § 3.2—which is precisely what the evidence revealed the LGC Board has done. The Bureau's agreements with PRIMEX and SchoolCare expressly permit their boards to set a reserve level above RBC 3.0 based upon their sound business judgment. *See* Tr. 1600-01; LGC Ex. 334 § 3.1; SchoolCare Agreement, § 3.2. The Hearing Officer committed an error of law in reading requirements into the statute in LGC's case that are flatly inconsistent with how the Bureau has interpreted the statute in its dealings with the other New Hampshire pooled risk management programs.

D. The Hearing Officer erred in ruling that fifteen percent (15%) of claims or RBC 3.0 is a sufficient level of reserves.

There was voluminous uncontroverted evidence at the hearing, summarized in LGC's Post-Hearing Brief, to support the Board's determination that LGC's reserve levels were necessary and appropriate. The Bureau's own expert, Howard Atkinson, testified that the work of LGC's actuary in setting reserves was "reasonable … [but] very conservative." Tr. at 693. Further, while the Hearing Officer appears to mock LGC's Chairman for thinking about possible future events such as pandemic disease and terrorist attacks, *see* Order at 48, the Bureau's own expert (Mr. Atkinson) indicated in his report that "reasons why claims might exceed expected levels" include "[p]andemics" and "[a]cts of terrorism." *See* BSR Ex. 68 at 108. Given this agreement by the Bureau's own expert that the possibilities weighed by LGC's Board were,

indeed, proper considerations for an insurer to weigh, the Hearing Officer's conclusion that this indicates the Board was too conservative in setting reserves is unwarranted.

Further, the record lacks any basis for the Hearing Officer to impose a capital adequacy limit on HealthTrust of the lesser of 15% of claims or an RBC of 3.0.[8] There was no actuarial evidence provided that either of these specific levels is the proper measure of capital adequacy the plan needs to ensure the solvency of HealthTrust in the face of unexpected future losses.[9]

The decision states that the 15% of claims methodology was chosen because it is a "straightforward method." Order at 75. "Straightforward" does not equate to "required by statute" or even "appropriate." As the Hearing Officer's findings and rulings on the issue of the adequacy of LGC's reserves were unreasonable and contrary to the evidence, they must be reconsidered.

[8] The Hearing Officer also erred in completely disregarding evidence introduced at the hearing that LGC's reserve levels and targets are in line with those maintained by like organizations in other states. *See* Order at 36-37; Tr. 324:17 (Blue Cross/Blue Shield has maintained an "RBC of 4 to 5, or in percentage speak, 400 to 500."); Tr. 776 (surplus levels have produced RBC ratios for Blue Cross/Blue Shield plans in the range of 500 to 900 percent); Tr. 325 (RBC ratios in Massachusetts are "600 to 700 percent."); Tr. 1290 (Pennsylvania looks for RBC ratios to be in the range of 5.0 to 7.0); Tr. 741-72 (RBC of 5.5 to 7.5 is appropriate for nonprofit organizations). While the Hearing Officer is no doubt correct that the programs LGC pointed to are not precisely identical to a New Hampshire pooled risk management program, that does not justify his decision to "eliminate their consideration" altogether. Order at 37. Nor does the fact that "[t]hese reports were undertaken for purposes other than this instant matter" (*id.* at 36) deprive them of evidentiary significance, as the Hearing Officer appears to believe. It was unreasonable for the Hearing Officer to disregard relevant evidence.

[9] While the PRIMEX agreement with the Secretary establishes an initial reserve limit of 3.0 RBC, that is not sufficient evidence to support a 3.0 RBC limit on HealthTrust. First, the PRIMEX agreement allows it to exceed a 3.0 RBC based on the Board's sound business judgment. Second, the limit in the PRIMEX agreement applies to non-health coverage lines of business, as PRIMEX has exited the health coverage business.

E. The Hearing Officer erred in setting a reserve level based on a percentage of the past year's claims rather than expected claims in the upcoming plan year.

The Hearing Officer limited capital reserves to the lesser of fifteen percent (15%) of claims or an RBC of 3.0 "based upon the year end audited financial statement."[10] Order at 76. Ordering a reserve limit based on the previous year's audited financial statement is an error of reasoning and shows a lack of understanding of the purpose for capital reserves.

A capital reserve is required to protect the risk pool from future unanticipated losses. That is why a risk pool, like any insurer, must establish a "target reserve level" for the upcoming year, based on the expected claim costs (rather than a number defined by past year's claims history).[11] The Bureau's own actuary acknowledged the routine use of developing "target reserve levels" for his clients, to protect a plan's solvency in the upcoming year from the risk that "the reserves at the beginning of the plan year plus the current year's premium and investment income will not be sufficient to cover the current year's claims administered expenses." BSR Ex. 68(e) at 108.

To protect the plan against such a risk, the plan must develop a reserve level based on expected future claims instead of the past year's claims history. As reserves are necessary to protect a plan from unexpected future claims it is unreasonable and an error of law to set reserves based on a prior year's claims figures.

[10] Similarly, the order requires HealthTrust to return net assets over 15% of claims as reported in its 2010 audited financial statements. Order at 76.

[11] Even the statute the Hearing Officer cites in support of his position utilizes reserves based on estimated annual claims, not the past year's incurred claims. See RSA 21-I:30-b.

F. The Hearing Officer erred in relying on RSA 21-I:30-b in support of his statutory interpretation that RSA 5-B prohibits reserves greater than fifteen percent (15%) of claims or an RBC of 3.0.

The Hearing Officer further erred in citing RSA 21-I:30-b in support of his determination that RSA 5-B somehow requires LGC's reserves to be limited to "fifteen percent (15%) of claims or an RBC 3.0 as determined by the BSR, whichever is less." Order at 76, ¶9; *see also* Order at 29. One problem with this line of reasoning is that RSA 21-I:30-b deals with a single employer self-insurance plan operated by the State of New Hampshire, which retains the coverage risks itself and has the option of tapping into the general fund if reserves prove to be insufficient. In contrast, LGC HealthTrust accepts the coverage risks of hundreds of employers and tens of thousands of individuals, and does not have the option under its contracts with its members to assess additional costs beyond the agreed-upon rates.

More importantly, RSA 21-I:30-b is inapplicable because, unlike RSA 5-B, it establishes a minimum required reserve level, not a maximum. If anything, RSA 21-I:30-b supports LGC's position that RSA 5-B does *not* mandate any particular reserve level or method of calculating reserves, as it demonstrates that when the legislature wishes to impose such requirements, it does so via express statutory language of a type missing from RSA 5-B. *See* RSA 21-I:30-b ("five percent of estimated annual claims and administrative costs of the health plan").

G. The Hearing Officer erred by interpreting RSA 5-B to require the purchase of reinsurance.

The Hearing Officer erred as a matter of law in ordering that LGC immediately purchase reinsurance. *See* Order at 75, ¶7. RSA 5-B lists reinsurance (or "excess insurance") as a cost that *may* be incurred by (not one that is required of) a pooled risk management program (*see* RSA 5-B:5,I(c)) ("*any* amounts required . . .") (emphasis added). Moreover, the programs are

specifically authorized to self-insure. *See* RSA 5-B:3,I (authorizing political subdivisions to "establish and enter into agreements for obtaining or implementing insurance by *self-insurance*; for obtaining insurance from an insurer authorized…as an admitted or surplus lines carrier;…or for obtaining insurance by any combination of the provisions of this paragraph") (emphasis added).

Further, the Hearing Officer's remedies under RSA 5-B:4-a,VII are expressly limited to imposing fines and ordering rescission, restitution, or disgorgement. In affirmatively ordering that a New Hampshire pooled risk management program must purchase re-insurance, he has misconstrued the statute and exceeded his authority as a matter of law.

H. The Hearing Officer erred in relying on HealthTrust's "longer term investment vehicles" in determining that LGC retained excess surplus in violation of RSA 5-B.

According to the Hearing Officer, LGC's placement of certain funds in "longer term" investment vehicles "is another indication of the excess earnings and surplus available and retained by the LGC, Inc. health trust and is an improper retention that violates RSA 5-B:5,I(c)." Order at 53-54. Once again, the Hearing Officer committed an error of law by ruling that LGC violated the statute based on conduct—investments with a time horizon of greater than three years—RSA 5-B does not proscribe.[12]

Moreover, the point the Hearing Officer misses is that while it might make sense to hold *claims* reserves, which exist to cover known liabilities, in instruments with maturities that correspond to the time horizon on which the liabilities are expected to come due, *capital* reserves are held to ensure the overall financial soundness of the entity assuming the risk, and thus need

[12] RSA 5-B does not contain limits on the type or duration of risk pools investments.

not be invested in instruments that line up with estimated liabilities. The Bureau's insurance industry expert conceded as much at the hearing. *See* Tr. 301-303 ("Q. Would you agree with me that there isn't a linkage—there is no linkage necessary between the amount and the investment in capital, whether it's got to be invested in securities of some specific duration, would you agree with that statement? A. As relates to the capital piece, yes.").

I. The Hearing Officer erred in requiring annual return of excess reserves only in cash, and not permitting the return in rate credits or ways that would stabilize rates.

RSA 5-B requires risk pool programs to "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." RSA 5-B:5,I(c). In ordering that LGC annually return excess capital in cash, instead of via rate stabilization, *see* Order at 77-78, ¶¶10-11, the Hearing Officer erred, because the statute is silent as to the method and timing by which excess capital is to be returned.[13]

Indeed, rather than requiring the return of surplus through a particular means, the statute requires the program, as part of the rate setting process, to canvass its members for the desired means by which surplus is returned. Two public hearings must be held "to solicit comments from members regarding the return of surplus…." *See* RSA 5-B:5 I,(g).

The Board sought guidance from both its outside corporate counsel and its actuary before acceding to its members' wishes for rate stabilization instead of the vicissitudes of annual

[13] The Hearing Officer's presumption that rate stabilization is prohibited is also at odds with the evidence at the hearing, which revealed that when RSA 5-B was enacted, the purpose of pooled risk management programs was in fact to stabilize rates over time. S*ee generally* LGC Ex. 324 at 4, NH School Board's Insurance Trust RSA 5-B annual filing, 1987-1988 financial summary ("trust fund balance to be utilized for rate stabilization."); Testimony of John Andrews, Tr. Vol. 3 at 542, 590; SchoolCare Articles of Incorporation ("Purpose of stabilizing future benefit costs") LGC Ex. 315 at 39.

occurrences in rates. LGC's corporate counsel analyzed RSA 5-B and its legislative history, and opined in writing concerning the proper method of returning surplus/member balance; he testified that RSA 5-B is silent as to how and when surplus is to be returned, and that returning surplus via rate credits over multiple years was consistent with RSA 5-B, and risk pool practices around the country. Tr. 1616-1620; LGC Ex. 381; Tr. 2379. Based on the advice of its actuary, the Board adopted a policy of returning surplus in rate credits over a three-year period.

The Bureau's own actuary's report supports LGC's method of returning surplus. Tr. 793; *see also* Segal Report (commissioned by the Bureau), LGC Ex. 360 at 9 ("Prudent underwriting would call for trying to achieve the reduction over multiple (2-3) years during the rate revisit process."). Accordingly, the Hearing Officer erred in ordering a particular method to return capital where the statute directs programs to solicit the desired means from its members.

J. The Hearing Officer erred regarding the return of reserves of Property-Liability Trust.

The Hearing Officer's Order requires the Bureau and LGC to confer and establish a plan to return $3.1 million from Property-Liability Trust to its members, because "[t]he parties did not propose a means of calculating the required net assets for the Local Government Center's other [than HealthTrust] Risk pool management programs," and because LGC "also did not attest to the use of an actuarially based means of determining the required net assets for this risk pool management program." Order at 77. [14]

The Hearing Officer erred, as Property-Liability Trust submitted evidence showing an actuarial basis for calculating its required net assets. *See* LGC Ex. 305 at 11-12, 34; *see also*,

[14] The $3.1 million ordered to be repaid was held in a net asset fund designated for rate stabilization. LGC Ex. 169, 2010 Property-Liability Trust Financial Statement, Note 10. As explained in the immediately preceding section of this motion, such designated accounts are permissible.

LGC Ex. 302 at 93-126, actuarial evaluation and financial statements establishing the PLT reserve level at a 90% confidence level. The Hearing Officer improperly shifted the burden onto LGC to prove that its method of calculating net assets was proper and consistent with the requirements of RSA 5-B. Thus, it was clear error and warrants reconsideration.

K. The Hearing Officer erred in ruling that LGC improperly exceeded its RBC targets.

The Hearing Officer ruled that "setting a 'target figure' does not appear anywhere within the statute, as a 'target' is not a component of the standards of RSA 5-B:5,I(c)." Order at 56-57. He went on to rule that, by exceeding its target level, LGC acted improperly. *Id.* The Hearing Officer erred in determining that the use of a target reserve level is inappropriate for RSA 5-B entities and that LGC acted improperly by exceeding its target. *Id*. His rulings in this regard are unreasonable, and show a lack of understanding about the purpose and process associated with reserve setting.[15]

The nature of a "target reserve level" is that it will be exceeded in some years. As Peter Curro explained at the Hearing, "the concept of RBC" is "a moving target," one that fluctuates with membership levels and claims experience. Tr. 2366-67; *see also* Tr. 1286-8 (Riemer testimony). To expect an insurance provider to hit its RBC target with perfect accuracy every year is to misunderstand the nature of insurance. The Hearing Officer thus

[15] As previously discussed, capital reserve is needed to protect the risk pool from future unanticipated losses. *See* Section III, E, *supra*. That is why a risk pool, like any insurer, must predict and fund a "target reserve level" to protect itself from these future events. Establishing the proper level of reserves for the upcoming plan year necessitates establishing the reserve level based on the risk, and building any needed increases in those reserves into the projected rates for that upcoming year. Even the Bureau's own actuary acknowledges the routine use of developing "target reserve levels" for its clients, to protect a plan's solvency in the upcoming year from the risk that "the reserves at the beginning of the plan year plus the current year's premium and investment income will not be sufficient to cover the current year's claims administered expenses." BSR Ex. 68(e) at 108.

erred as a matter of law and reasoning in ruling that LGC "ignores its own target." *See* Order at 57.

L. The Hearing Officer erred in ruling that amounts invested in capital assets necessary for the operation of the risk pool are excess reserves which must be returned.

In ordering the return of $33.2 million from HealthTrust as excess reserves, the Hearing Officer included $2,237,390 "invested in capital assets."[16] LGC Ex. 159. Such capital assets include computer systems, furniture, and other equipment needed for the operation of HealthTrust. These capital assets are necessary for the ongoing operation of the risk pool program. In declaring these capital assets "excess surplus" to be returned, the Hearing Officer committed an error of law.

IV. The Hearing Officer erred as a matter of law in holding that LGC's corporate structure violated RSA 5-B.

A. The Hearing Officer erred in ruling that RSA 5-B prohibits a single board of directors and a single set of bylaws from governing multiple risk pools.

It is well understood that "LGC is a single organization that owns and manages" multiple subsidiaries that "operate pooled risk management programs under chapter 5-B," and that "LGC manages its subsidiaries through a single board of directors . . . ." *Professional Firefighters of New Hampshire v. Local Government Center, Inc*., 159 N.H. 699, 700 (2010). The Hearing Officer has now ordered LGC to "organize its two pooled management programs into a form that provides each program with an independent board and its own set of written bylaws." Order at 73, ¶1. In so doing, the Hearing Officer committed an error of law, as nothing in the statute

[16] The $33.2 million ordered by the Hearing Officer is calculated by subtracting 15% of claims from the total net asset amount of $86,781,781 reported in the 2010 audited financial statement. However, this total net asset amount includes $2,237,390 invested in capital assets. See LGC Ex. 159, HealthTrust's 2010 Financial Statement, at 19, "Liabilities and Net Assets."

requires that LGC's risk pools be governed by independent boards of directors or their own independent sets of bylaws.

RSA 5-B provides that "[e]ach pooled risk management program shall . . . [b]e governed by a board . . . ." RSA 5-B:5,I. This is a clear, unambiguous requirement with which LGC has complied. It is undisputed that LGC's pooled risk management program is "governed by a board," as the statute requires. Nowhere in the statute does it say that two or more risk pools cannot be governed by a single board.

The statute further requires that "[e]ach pooled risk management program shall . . . (e) [b]e 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. It is undisputed that LGC's pooled risk management programs are "governed by written bylaws," as the statute requires. The statute does not say that two or more risk pools may not share a set of bylaws. *See* Dispositive Motion regarding Count I, dated March 12, 2012; Post-Hearing Brief dated June 4, 2012. If the legislature had intended to require that each risk pool have its own independent board and its own bylaws, it would have said so. It is error for the Hearing Officer to impose these requirements.

The Hearing Officer's rationale for his decision regarding what is permitted under the statute highlights his errors in reasoning and of law. After comparing LGC's current corporate structure to that which existed in 1987, Order at 8-11, the Hearing Officer regards the earlier organizational structure as if it were adopted by the legislature in the statute as the only permissible governance structure. ("Therefore, the legislature knew of the existing structure of the health trust and the property liability trust programs and affirmed them and the other

programs, unrelated to LGC, Inc. (then NHMA, Inc.) in existence at the time of passage as each met the requirements of RSA 5-B:5, I (b) and (e)." Order at 20.) However, the statute did not enact such requirements.

While the Hearing Officer recognizes that there were other then-existing risk pools affirmed by the passage of RSA 5-B (Order at 9, FN 4), he ignores the uncontroverted evidence that these other risk pools, which were likewise affirmed by the adoption of RSA 5-B, had organizational structures that are inconsistent with his interpretation of the statute. For example, the NH School Boards Insurance Trust had one board and one set of bylaws that governed three separate risk pools with different sets of members in each. *See* LGC Ex.323 (NHSBIT's Annual RSA 5-B filing covering 1987). The legislature was aware of this alternative risk pool structure when adopting RSA 5-B, as the New Hampshire School Board's Insurance Trust's executive director testified to the legislative committee considering the bill and informed them that it was a single entity that operated multiple risk pool programs. *See* LGC Ex.232. Consequently, interpreting RSA 5-B to require LGC's risk pools to maintain their 1987 corporate structure is unreasonable and not supported by the statute, the legislative history, or the record.

B. The Hearing Officer erred in ruling that two separate Boards are required to prevent the dilution of the powers of the respective members of each pool.

The Hearing Officer erroneously ruled that:

> By abolishing each program's respective board and substituting the LGC, Inc. board of directors, the political subdivision members of each pooled risk management program were deprived of the governance previously maintained for their benefit. **There can now be reasonable dispute that such an action dilutes the power of the respective members of each program**, the health trust and the property liability trust, to control operation and expenditures.

Order at 19 (emphasis added).

Contrary to the Hearing Officer's implication, the statute does not require that these board members be representatives of the political subdivisions that specifically participate in a particular risk pool program. While the LGC Board of Directors is elected by a vote of LGC's members at the annual meeting, *see* LGC Ex. 223, LGC Bylaws § 3.8, RSA 5-B does not require an election by the participating risk pool members or that the board members be representatives of the participating risk pool members. This interpretation is consistent with the Hearing Officer's finding that, pursuant to RSA 5-B:1 "the beneficiaries of this statute are intended to be our state's political subdivisions as representative of the public benefit." Order at 19. [17]

Finding there is a "reasonable dispute" that an action dilutes the power of respective members is not finding that any action actually violates a statutory requirement, and, consequently, is an error of law and reasoning.

C. The Hearing Officer erred as a matter of law in ruling that the LGC, Inc. Board of Directors took "complete control and dominion, *by fiat,*" over what had been separately governed RSA 5-B risk pools.

In the Hearing Officer's formulation, the LGC Board of Directors "install[ed] itself as parent" over its subsidiary risk pool entities in a maneuver that (according to the Hearing Officer) amounted to "tak[ing] away the independence" of the risk pools. Order at 21; *see also* Order at 15 (the LGC Board assumed control over the risk pools "*by fiat*"). In fact, the merger

[17]The Hearing Officer also erred in finding that HealthTrust and Property-Liability Trust's respective risk pool participating members' control over operations and expenditures were diluted by transitioning in 2003 to a single board of directors. No evidence of such dilution was submitted at the hearing. Rather, all the evidence shows that, prior to the passage of RSA 5-B in 1987, through the 2003 reorganization, the participating risk pool members of HealthTrust, Inc. and NHMA Property Liability Inc. did not appoint or elect the Board of Directors of these respective entities. Instead, the Bylaws for both HealthTrust, Inc. and for NHMA Property-Liability Trust Inc. provided that their respective Boards of Trustees were appointed by the NHMA Executive Committee (the predecessor name for the LGC, Inc. Board of Directors) and could be removed at any time and for any reason by the same. *See* LGC Ex. 220, §§ 3.3 and 3.8.; and Ex. 221, §§ 4.3 and 4.7. Thus, it is unreasonable to conclude that a dilution of control occurred or that the statute requires separate boards to protect against such dilution.

was accomplished pursuant to votes taken by the then-separate boards of the Health Trust and Property-Liability Trust entities. *See* LGC Ex. 45, 54. The joint resolution separately adopted by each of the risk pool boards specifically acknowledges as much:

> That the respective Boards of Trustees or Executive Committee, as the case may be, of the New Hampshire Municipal Association, Inc., the New Hampshire Municipal Association Property Liability Trust, Inc. and HealthTrust, Inc. (together the "Companies"), each separately and jointly, deem it advisable and generally to the welfare and advantage of each Company and all of their respective members and the employees of members, that the Companies be consolidated into an organization represented by a single board of trustees.

LGC Ex. 54, Joint Resolution.

As there is no evidence that LGC installed itself over the risk pools, took away the risk pool's independence, or assumed control of the risk pools *by fiat*, such a finding by the Hearing Officer is unreasonable and should be reconsidered.[18]

V. The Hearing Officer erred in barring LGC from setting its own membership requirements.

The Hearing Officer erred as a matter of law in barring LGC from requiring membership and/or the payment of dues. *See* Order at 74, ¶4.[19] Although this issue was raised in the

[18] The Hearing Officer also erred in ruling LGC's members are not the intended beneficiaries under RSA 5-B. Order at 19. The express purpose of the statute 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. Thus, the Hearing Officer erroneously concluded that the members of LGC are not intended to be the beneficiaries of RSA 5-B. Furthermore, this error is apparent throughout the decision. The Hearing Officer consistently characterizes LGC as if it were separate from the political subdivisions that were intended beneficiaries under 5-B, and that LGC's actions were foisted upon the political subdivisions. For example, the Hearing Officer differentiates the needs of the member political subdivisions envisioned under the statute and "the needs of a controlling third party conglomerate." Order at 18.
In contrast with the Hearing Officer's erroneous conclusion, the political subdivisions that are the members of LGC voluntarily participate in the risk pools and elect the Board of Directors at the annual meeting (LGC Ex. 222, § 3.8). The LGC Board, in turn, represents the members and governs the organization in the best interest of the members who elected them. In fact, to insure broad representation of the different types of political subdivisions in the state, the LGC bylaws divide the seats on the board so that the Board of Directors is comprised of twelve (12) Municipal Public Officials, twelve (12) School Public Officials, six (6) Employee Officials and one (1) County Public Official. (LGC Ex. 222, § 6.1). The Directors are expressly charged with the duty to "set policy, oversee and administer LGC, NHMA, HealthTrust, PLT, and LGC Real Estate." (LGC Ex. 222, § 8.1).

Bureau's original petition, it was dropped from the Amended Petition. Therefore, the Hearing Officer has ruled on an issue which was not presented or argued by the Bureau in the Amended Petition or at the hearing, and in so doing, he made an error of law, and violated LGC's state and federal constitutional rights to due process.[20]

Even if the Bureau had raised this issue, RSA 5-B does not prohibit pooled risk management entities from setting requirements for members. The statute describes the voluntary participants in a pooled risk management program as "members of [an] association," RSA 5-B:3, I, and declares that a pooled risk management program shall "be governed by written bylaws which shall detail the terms of eligibility." RSA 5-B:5,I(e).

The statute specifically permits LGC's membership requirements.[21] In ruling as he did, the Hearing Officer committed an error of law.

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[19] The Hearing Officer further erred as a matter of law in prohibiting LCG from charging its risk pool members for services not specifically identified and approved by RSA 5-B. Order at 74, ¶4. RSA 5-B permits pooled risk management programs to engage in a wide array of administrative and risk management services that are expressly not intended to be limited by those specifically identified in the statute. *See* e.g. RSA 5-B:2 IV ("the provision of loss prevention services including, but not limited to…")

[20] The Hearing Officer's Order prohibiting LGC's Risk Pools from requiring membership in another organization also contradicts his own findings and rulings in the decision. The Hearing Officer lists "*mandatory membership in another of its entities, the NHMA, LLC*" as being one of the numerous other administrative practices that are maintained by LGC… *that may not directly violate the statutory provisions addressed by this decision* but should, in light of this decision and accompanying order, be considered in any discussions regarding changes in governance and financial management." Order at 70 (emphasis added). In spite of finding that this practice may not directly violate the statute, the Hearing Officer nevertheless prohibits LGC from continuing the practice.

[21] In fact, when the statute was enacted in 1987 and affirmed the then-existing risk pools, several pooled risk management programs had membership requirements. New Hampshire School Board Insurance Trust ("NHSBIT") required that members also be New Hampshire School Board Association members, and PLT, Inc. required membership in the New Hampshire Municipal Association. *See* LGC Ex. 323, NHSBIT 1987 Bylaws at 7; LGC Ex. 221, PLT, Inc. Bylaws § 2.5.3).

VI. The Hearing Officer erred as a matter of law in ruling that strategic support for the Workers' Compensation program violated RSA 5-B.

A. The statute permits a risk management program to financially support a new coverage line.

RSA 5-B:3,I provides that:

> 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; and processing, paying and defending claims against the members of such association.

(Emphasis added.)

The separate Boards of HealthTrust and Property-Liability Trust established exactly such a risk management program in 1999 when they jointly created a workers' compensation risk pool. In doing so, they determined that it would be in the best interests of their respective members to establish and financially support such a pool. The Boards reasonably believed that offering and providing integrated health benefits (including workers' compensation coverage and accompanying health management) to employees of the political subdivisions would result in reduced losses and long-term cost savings to each of the three risk pools. LGC Ex. 2 – 6, Minutes of Board Meetings from 1999.

After the reorganization of the entities into its current structure, the LGC Board also found that it would be in the best interest of its members to continue such strategic support as part of its risk management program. *See* LGC Ex. 67 and Ex. 68 (Minutes of Board Meetings from 2004).

The Board developed a strategy, adopted in 2004, which was a long-term vision of integrated risk management and health management for employees. Through a combination of Workers' Compensation programs, short and long-term disability benefits, and health benefits, LGC's members (counties, cities, towns, school districts, school administrative units) essentially are financially responsible for the total health of the people they employ and their families. While traditional commercial insurance products are often segregated, LGC recognized that it was in the unique position to help its members take an integrated approach to the funding, claims management, and risk management related to total employee health.

For example, the Board concluded that training on proper lifting techniques or safe driving which might result in the direct reduction of Workers' Compensation claims also will help people avoid back injuries and car accidents off the job, thereby reducing health and disability claims and lost work. In sum, LGC envisioned a strong, viable Workers' Compensation program to be an integral complement to the HealthTrust coverage, with a resulting benefit to the health and welfare of employees and their families and to the finances of LGC members and their taxpayers. *See* LGC Ex. 425.

The Hearing Officer committed an error of law in ruling that the strategic support to the workers compensation pool violated RSA 5-B.

B. The Hearing Officer erred in overruling the Board's business judgment.

RSA 5-B:5 permits a risk pool's board of directors to exercise its sound business judgment in determining the specific actions to take to reduce long-term costs and risks. As previously discussed, the directors of a corporation must discharge their duties (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar

circumstances; and (3) in a manner they reasonably believe to be in the best interests of the corporation. RSA 293-A:8.30(a); *see* Section III, B, *supra*.

As explained in LGC's Post-Hearing Brief, the evidence at the Hearing established that LGC's Board exercised its sound business judgment to determine that strategic support for the workers' compensation program was in the best interests of all of its members, including the members of HealthTrust. *See* LGC Post-Hearing Brief at 20-23. Moreover, the strategic support for the workers' compensation program started in 2000, when the two risk pools in question each had its own independent board—which establishes that the initiative was *not* something that was foisted upon the HealthTrust pool by its corporate parent. For these reasons, the Hearing Officer erred as a matter of law in ruling that the strategic support for the workers' compensation program was improper. *See* Order at 78, ¶13.

C. The Hearing Officer erred in ordering that the Property-Liability Risk Pool is responsible to reimburse monies contributed by the HealthTrust pool to support the Workers' Compensation pool.

The Hearing Officer erred in ordering that "the Local Government Center Property Liability Trust, LLC, however it may be organized in the future, shall re-pay the $17.1 million subsidy to the Local Government Center Health Trust risk pool management program." Order at 78. This is an unjust and unreasonable liability being placed on the Property-Liability program.

If the Workers' Compensation strategic support is indeed an impermissible subsidy, any order to repay the subsidy should be by the Workers Compensation program. To shift that responsibility to the Property-Liability coverage program is error.[22]

[22] The note executed by the LGC board for the repayment of $17.1 million to HealthTrust specifically limits this obligation to the workers' compensation program. *See* LGC Ex. 279. The Hearing Officer implies that the note is unreasonable because it is interest-free, without a date certain for repayment, and is to be paid out of surplus

D. The Hearing Officer erred as a matter of law in holding that he could undo transfers executed before the Bureau obtained regulatory authority in June 2010.

Should LGC's strategic support for its workers' compensation program somehow violate RSA 5-B, the Hearing Officer cannot legally undo transfers executed before the Bureau obtained its regulatory authority over LGC.[23] The Hearing Officer committed an error of law in ordering that "Local Government Center Property Liability Trust, LLC, . . . shall re-pay the $17.1 million subsidy to the Local Government Center Health Trust risk pool management program" (Order at 78, ¶13), because application of the new statutory enforcement provision to retroactively invalidate transfers that were made prior to the Bureau having the power "to exercise any rulemaking, regulatory or enforcement authority over any pooled risk management program" is a retroactive application of the new enforcement provision, in violation of Part I, Article 23 of the New Hampshire Constitution.

The Hearing Officer found that, of the money contributed by HealthTrust, all but $3.8 million was transferred prior to calendar year 2010. Order at 41. However, the Hearing Officer did not make any ruling as to how much of this $3.8 million was transferred after the Secretary of State was provided his regulatory powers in June of 2010. Furthermore, the Hearing Officer

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funds. In contrast, the Board found that to be reasonable because the source of funds was similarly out of net capital, not operating revenue, the funds were provided over many years, and repayment should follow suit. The Board likewise found that since the transfers were not initially meant to be a loan, but an investment into lowering the long-term costs for each of the pools, while reclassifying the transfer to a loan (in order to respond to member requests), it was reasonable not to charge interest on the repayment. *See* LGC Ex. 281. The Board has the authority to enter such notes pursuant to RSA 5-B:6,II and to the extent the Hearing Officer ruled that the Note was unreasonable it was an error of law in not applying the business judgment rule to the execution of the Note.

[23] On June 14, 2010, RSA 5-B was amended to give the Secretary of State "the power to investigate pooled risk management programs, issue cease and desist orders, initiate adjudicatory proceedings, impose administrative fines, and order rescission, restitution, or disgorgement." (Amended Petition ¶22.) Until 2009, RSA 5-B:4 had expressly provided that "[n]othing contained in this chapter shall be construed as enabling the department to exercise any rulemaking, regulatory or enforcement authority over any pooled risk management program formed or affirmed in accordance with this chapter."

found that "the exact amount of these funds directed to subsidize the workers' compensation program from the health trust through December 31, 2010 are difficult to ferret out from the state of the financial statements entered into evidence." Order at 41.[24] Thus, an undetermined portion of the ordered $17.1 million, but no more than $3.8 million, was transferred after the change in the law took effect.

As applied by the Hearing Officer, RSA 5-B:4-a affects substantive rights and liabilities, as it would reverse the transfer of millions of dollars that had been lawfully in the possession of the Workers' Compensation pool, and expended by that pool, prior to the Secretary having any regulatory or enforcement authority pursuant to RSA 5-B:4-a. There can be no doubt that a requirement that millions of dollars be transferred from Property-Liability Trust to HealthTrust "enlarge[s] or diminish[es] the parties' rights and obligations" of LGC and its risk pools. *Workplace Systems*, 143 N.H. 322, 324 (1999). Because this portion of the Order applies RSA 5-B:4-a in a constitutionally impermissible manner, the Hearing Officer's Order on this issue should be reconsidered.

VII. The Hearing Officer erred in ruling that payment of certain administrative expenses violated RSA 5-B.

The Hearing Officer erred in ruling that LGC violated RSA 5-B by establishing and funding an employee retirement plan, and in executing an employment contract with its former executive director which contained a post-employment non-compete provision.

[24] As an illustration, the amount of funds to be repaid would have to be reduced by the value of the corresponding benefit derived by the political subdivisions participating in HealthTrust who were also workers' compensation risk pool participants at the time any transfer was made.

RSA 5-B:5,I(c) expressly permits the use of funds for the "administration" of the risk pools.[25] The statute also authorizes that these programs, "whether or not a body corporate, may sue or be sued; make contracts; hold and dispose of real property; and borrow money, contract debts, and pledge assets in its name." RSA 5-B:6,II. Thus, programs under RSA 5-B have broad authority to expend funds to administer the complex and multifaceted operations of a Pooled Risk Management Program.

Notwithstanding these statutory provisions, the Hearing Officer ruled that certain specific administrative expenditures violated the statute, specifically the establishment and funding of an employee defined benefit plan, and payments under a non-compete/consulting contract with the former executive director. Order at 43-44. This is directly contrary to the statutory provisions permitting expenditures to run a risk pool.[26] Accordingly, the Hearing Officer erred as a matter of law in ruling that LGC's expenses violated RSA 5-B:5,I(c).

VIII. The Hearing Officer erred in ruling that real estate transfers violated RSA 5-B.

The Hearing Officer ruled that the 2003 real estate transfers among the LGC entities violated RSA 5-B. *See* Order at 79, ¶15. The Order, however, does not specify a section of the

[25] While administration is undefined, the statute expressly authorizes RSA 5-B programs to "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; and processing, paying and defending claims against the members of such association." RSA 5-B:3 I. "Risk management" is further defined as "the defense of claims and indemnification for losses arising out of the ownership, maintenance, and operation of real or personal property and the acts or omissions of officials, employees, and agents; the provision of loss prevention services including, but not limited to, inspections of property and the training of personnel; and the investigation, evaluation, and settlement of claims by and against political subdivisions." RSA 5-B:2 IV.

[26] In assessing the overall administrative costs of LGC's program, the Hearing Officer found that the BSR expert witness "conceded that the LGC, Inc. reporting of the cost of administration at 7.7% of claims was reasonable." Order at 46. The Hearing Officer concluded "that no further discussion in this decision is attributed to such other administrative costs or the extent such were necessary to the operation of the pooled risk management program entities, particularly the health trust." Order at 47. This finding is directly contrary to his ruling that certain other administrative expenses violate RSA 5-B.

statute the real estate transfers violated, because it cannot. To the contrary, RSA 5-B:6,II, provides that "any such program operated under this chapter, whether or not a body corporate, may … hold and dispose of real property."

Administration of a pooled risk management program, like that of any business which has a physical location, requires a real property location to base its operations. LGC is no different. As LGC's ownership of LGC Real Estate, Inc. is expressly permitted by RSA 5-B:6,II, the Hearing Officer's ruling that the real estate transfers somehow violated RSA 5-B is erroneous.

The ruling that the transfer was without compensation is in error. Order at 41-2. The risk pools only pay their proportional operating costs for the building. *See* e.g. LGC Ex. 161 at 7; Tr. Vol. 9 at 2296; Tr. Vol. 7 at 1530-1. The uncontroverted testimony established – indeed, the parties jointly stipulated – that the "rent" payments charged to the risk pools are substantially below market rates. *Id. See*, also, Joint Ex. 3.

The Bylaws specifically note that upon dissolution, assets held by LGC. Inc. shall be liquidated and the proceeds shall be "distributed equitably to the Members in accordance with their participation in NHMA and/or the Trusts from which assets to be distributed are generated." LGC Ex. 222, Section 10.1. Thus, the value of the real estate will revert to HealthTrust and Property-Liability Trust, should the use of the building to house the operations ever cease to be needed. Nothing in RSA 5-B prohibits this ownership arrangement.

Moreover, all of the real estate transfers occurred prior to the Bureau obtaining regulatory authority on June 14, 2010. Accordingly, as set forth above in Section VI, D, *supra*, the Hearing Officer's Order invalidating the transfers is prohibited as a retrospective law.

IX. The Hearing Officer erred in ordering LGC, which prevailed on three of the five counts of the Amended Petition, to pay all of the Bureau's costs.

The Order requires LGC to pay "the costs of the investigation in this matter, and all related proceedings," pursuant to RSA 5-B:4-a,V, which authorizes the shifting of costs "upon the secretary of state's prevailing at hearing . . . ." Order at 80, ¶18. In this case, however, the Bureau prevailed on just two of the five counts, and the Bureau effectively withdrew substantial portions of the original and the Amended Petition against LGC. Any award of costs against LGC should therefore be reduced to reflect the fact that LGC prevailed on the majority of the Bureau's claims.

X. The Hearing Officer Exceeded His Authority and Erred as a Matter of Law in the Additional Relief that He Ordered.

RSA 5-B:4-a provides the following specified set of limited remedies that may be ordered in a proceeding enforcing RSA 5-B: an order to cease and desist, fines, and the following identified forms of relief: rescission, restitution, or disgorgement. A hearing officer lacks broad equity powers, and is limited to the specific authority granted by the statute.

Accordingly, the Hearing Officer erred as a matter of law in ordering the following relief:

1) Enabling the Bureau to "impose a higher limit or different methodology for calculating required net assets" on LGC HealthTrust. Order at 77, paragraph 10.

2) Providing the Bureau the authority to pre-approve loan terms before LGC Property-Liability Trust can borrow funds from a third party. Order at 78, paragraph 13.

3) Authorizing the Bureau to pre-approve the generally accepted actuarial analysis LGC Property-Liability Trust wishes to use to determine its required net assets in the future. Order at 78, paragraph 12.

4) Penalizing LGC's risk pools with forfeiture of the statutory exemption from the State's insurance laws, and from state taxation, granted pursuant to RSA 5-B:6. Order at 73, paragraph 2.

5) Ordering, without any statutory basis, how the management of LGC Real Estate, Inc. must be structured. Order at 79, paragraph 15.

XI. Conclusion.

For the foregoing reasons, after the Hearing Officer's reconsideration, the Final Order should be vacated.

Respectfully submitted,
LOCAL GOVERNMENT CENTER, INC., *et al*

By Their Attorneys:

Dated: September 14, 2012

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CERTIFICATE OF SERVICE

I certify that on the 14th day of September, 2012, I filed two printed copies with the Office of the Secretary of State, and forwarded copies of this pleading *via* e-mail to all counsel of record.

_____/s/ William C. Saturley_____